

**UCC UPDATE:
2013 CASE LAW UPDATES AND
EXAMPLES OF HOW YOUR BANK MAY BE
ABLE TO REDUCE EXPOSURE ON
POTENTIAL FUTURE LOSSES**

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INTRODUCTION

I handle UCC Section 3, 4, 4A claims and various other claims for various banking clients. I have been asked to revise many deposit agreements to better protect banks from claims made by customers and to provide an update in the development of UCC case law. The following article is not intended to be specific legal advice. Plus, it is not intended to address all issues that could arise with UCC issues. Rather, this paper is intended to identify particular issues I have recently noticed in some UCC cases I have handled. This paper is also intended to provide a spotlight on several of the issues I believe will be raised in the future regarding such issues.

There are several cases I think that you might find of interest regarding Articles 3, 4, and 4A. However, I also think there will be other future issues that develop that have not yet been fully discussed by the courts as new issues and banking products arise.

A. CASES I THOUGHT YOU MIGHT FIND OF INTEREST

In updating this paper, I wanted provide additional cases that have been decided over the last year or so. I also wanted to provide some specific case updates on UCC § 4A issues. It is my opinion that more and more plaintiffs will begin filing claims under UCC § 4A as people may start using paper checks and traditional banking methods even less.

1. Various cases you might find of interest regarding UCC issues and other banking issues.

- a. Recent case you might find of interest regarding a court ruling against plaintiffs trying to avoid a home equity loan.

In *Priester*, Plaintiffs obtained a home equity loan secured by a first lien on their house, and Plaintiffs alleged that the closing of the loan occurred at their home rather than at the offices of an attorney, the lender or a title company as required by the Texas Constitution. See *Priester v. JP Morgan Chase Bank, N.A.*, ___ F.3d ___, 2013 WL 539048 (5th Cir. 2013). Plaintiffs sued various defendants and sought a declaratory judgment that under the Texas Constitution, the loan and the lien were void. Plaintiffs sought the forfeiture of all principal and interest and sought actual and exemplary damages and attorneys' fees. Chase removed the case to federal court. The Fifth Circuit Court of Appeals confirmed that a four year statute of limitations applies to even the constitutional claims raised by Plaintiffs. The court also concluded that the legal injury rule applies and that the statute of limitations began to run when the lender made the original loan purportedly violating the Texas Constitution.

Plaintiffs also alleged that because the loan was a non-recourse loan, publishing information on credit reports about Plaintiffs being delinquent on their loan payments was defamatory. However, the court disagreed and held that the defamation claims were also rightly dismissed.

- b. Recent case you might find of interest regarding a holding that a foreclosure action can be considered a debt collection action.

The Sixth Circuit Court of Appeals has held that foreclosure is a debt collection, potentially liable under the FDCPA. See *Glazer v. Chase Home Finance, LLC*, ___ F.3d ___, 2013 WL 141699 (6th Cir. 2013). There were complicated facts, including the death of the original borrower, and there were issues with regard to what entity allegedly owned the note. Plaintiff sued the servicer and a law firm. Some claims were dismissed. However, the Sixth Circuit ultimately held that the actions undertaken in the foreclosure process constituted debt collections under the FDCPA. The Court also held the servicer that obtained the servicing rights before the loan became in default was not subject to the FDCPA.

- c. Recent case you might find of interest regarding partnership issues.

In the *Rojas v. Duarte* matter, Plaintiff sued Defendant Rojas alleging that they had formed a partnership for the purposes of acquiring and operating ATMs. *Rojas v. Duarte*, ___ S.W.3d ___, 2012 WL5987548 (Tex.App.–El Paso 2012, no pet.). Both Plaintiff and Defendant had grown up together and Plaintiff learned how to repair, maintain and program ATM machines. Defendant allegedly took Plaintiff under his wing. At different times, he helped him find work. They then began acquiring, selling and operating ATMs together. At one point, the parties agreed to separate. The division of assets never properly occurred.

The court analyzed the issue under the Texas Revised Partnership Act. The court analyzed the Act under the Texas Supreme Court opinion of *Ingram v. Deere*, 288 S.W.3d 886 (Tex 2009). Pursuant to the TRPA, the five factors that indicate the creation of a partnership are the following: (1) receipt or right to receive a share of the profits of the business; (2) expression of an intent to be partners in the business; (3) participation in or right to participate in control of the business; (4) sharing or agreeing to share losses or liability; and (5) contributing or agreeing to contribute money or property to the business. The court ultimately found that there were enough facts to justify the existence of a partnership.

Consequently, even if you do not have a formal partnership, you want to be mindful of such factors if you form business relationships with other people.

- d. Recent case you might find of interest regarding issues pertaining to indemnification claims.

A not uncommon issue arises in some litigation. Your company is sued. You deny plaintiff's claims. You might have a claim for indemnification against a third party via a breach of contract claim, a common law claim and/or through other means. One issue that arises is whether or not you should file a third-party petition and join the party that may owe you an indemnification in the original lawsuit.

This issue arose in a case where a defendant tried to obtain additional time to allow the joinder of a third party. The trial court denied the request, and the defendant filed a mandamus proceeding. The appellate court agreed with the trial court and denied the mandamus petition. The appellate court explained that an indemnity claim would only accrue upon a finding of liability, and the defendant would, therefore, have an adequate remedy at law to sue the third party in the future if plaintiff was successful in the original lawsuit against defendant. *In re State Line Fireworks, Inc.*, ___S.W.3d ___, 2012 WL 5499955 (Tex.App.-Texarkana 2012 no pet.) (This Opinion has not been released for publication in the permanent law reports. Until released, it is subject to revision or withdrawal). I know there is another argument to the contrary as some courts do not want to have two different trials over the same set of facts. Notwithstanding this issue, I wanted you to have a copy of this opinion.

- e. Recent case you might find of interest regarding establishing damages and the difference between lost revenue and lost net profits.

Many plaintiffs try to establish damages by showing lost revenue. However, in many cases, plaintiffs fail to take into consideration various costs that may be incurred in obtaining such revenue. Consequently, courts have explained that lost revenue is not the correct measure of damages for lost profits. Rather, lost net profits is the correct measure of damages. *See Superior Broadcast Products v. Doud Media Group, LLC*, -S.W.3d---; 2012 WL 5951980 (Tex. App. – Eastland, 2012, no pet. h.). In this case, the expert opined as to estimated lost revenues but because the expert did not opine as to costs and net lost profits, the court had to reverse and remand the jury award.

- f. Recent case you might find of interest regarding internal policies.

In the enclosed case interpreting Mississippi law, an employee alleged that another employee had raped her. *See Keen v. Miller Environmental Group, Inc.*, ---F.3d---, 2012 WL 6098355 (5th Cir. 2012). The alleged victim sued the employer and claimed that the employer negligently failed to run a background check. On the application, the employee claimed that he did not have a criminal history. However, he did have a significant criminal history, and the employer did not do a background check to confirm same.

Importantly, plaintiff argued that the employer had an internal policy of doing background checks and failed to comply with same. The employee argued that failing to comply with their own internal policy was a breach of a duty. The court disagreed, and explained that, “Noncompliance with an internal corporate policy or custody is evidence merely suggestive of a breach of duty, not evidence dispositive of it.” This is yet another case that has confirmed that courts appear to want to encourage companies to have internal policies and procedures and that a breach of same should not necessarily expose the company to liability.

- g. Recent case you might find of interest – garnishment with a zero balance account.

In the enclosed Opinion, a court was asked to decide whether or not certain funds were subject to a writ of garnishment. *See Art & Frame Direct, Inc. v. Dallas Market Center Operating L.P.*, ___ S.W.3d ___, 2012 WL 4077507 (Tex.App.-Dallas 2012, n.p.h.) The writ of garnishment named a judgment debtor. There was a zero balance account at the garnishee bank styled in the name of the debtor. The zero balance account was linked to another account and the second account was styled in the name of another entity. The garnishing creditor claimed that because the zero balance accounts were linked, and even though there were no funds in the debtor’s account, because the accounts were linked, the garnishment captured the funds in the second account. The garnishing creditor claimed that the funds made the subject of the garnishment should be tendered to the judgment creditor. After analyzing the issues, the Texas appellate court ultimately decided that funds purportedly linked by a zero balance account would not be subject to the writ of garnishment. The court ultimately ruled that the summary judgment evidence did not establish that the debtor’s ownership of the funds could be based on the zero balance account agreement. In reaching its decision, the court also analyzed several case specific facts concerning zero balance account agreement and regarding the way in which the account was handled prior to the un-linking of the accounts from the master account, and the court analyzed to the level of access the debtor had over the account. Thus, the court reversed the previously granted summary judgment and did not allow the garnishing creditor to obtain the funds at this time. Unfortunately, I am uncertain how a future court may handle zero balance account issues in the future under different facts.

- h. Recent case you might find of interest regarding whether a sale of a vehicle was a commercially reasonable sale.

In *Foley*, a creditor had a bench trial and tendered a business records affidavit to show that a sale of an automobile was commercially reasonable and that the bank should be allowed to pursue a deficiency judgment. *See Foley v. Capital One Bank, N.A.*, ___ S.W.3d ___, 2012 WL 3860445 (Tex.App.-Houston [14 Dist.] no. pet.) (until released, it is subject to revision or withdrawal.) The Court examined the case law and UCC Article 9 statutory language in ultimately ruling that the creditor had not established that the sale was a commercially reasonable sale. The court explained the case law as follows:

Under the common law, a creditor seeking a deficiency judgment has the burden of pleading that disposition of the collateral was commercially reasonable. *Greathouse v. Charter Nat’l Bank-Sw.*, 851 S.W.2d 173, 177 (Tex.1992). A creditor can meet this burden by pleading specifically that disposition was reasonable, or by pleading generally that “all conditions precedent have been

performed or have occurred.” *Id.* If the debtor responds to a general pleading with a specific denial, the burden shifts back to the creditor to prove reasonableness at trial. *Id.* For non-consumer transactions, this burden has been further developed in Article 9. *See Tex. Bus & Com.Code Ann § 9.626(a).* For consumer transactions, however, the statute provides that it “is intended to leave to the court the determination of the proper rules,” and that the court “may continue to apply established approaches.” *Id.* §9.626(b).

Lastly, in an final effort to avoid losing, the creditor asked for a new trial so that it could be allowed to present additional evidence, and the court refused. The court stated that, “justice does not require that the creditor receive a new trial to prove what it had the burden and the opportunity to prove at the first trial.” This is a difficult decision for creditors. However, it is good to learn from other people’s mistakes, and if you are in this situation, creditors need to remember to present evidence of a commercial reasonable sale.

- i. Recent case you might find of interest about a law firm disclosing confidential documents in violation of a protective order.

In some discovery disputes, one side may want to keep certain documents confidential. The other side usually argues that they will agree to enter into a Agreed Protective Order and they will agree to keep documents confidential. Unfortunately, some parties may intentionally “leak” various documents and/or sometimes mistakes happen causing the inadvertent disclosure of such documents. In the enclosed opinion, a plaintiff’s law firm allegedly inadvertently released confidential documents during a seminar. Understandably, the defendant was upset, and asked for various sanctions. In the enclosed opinion, the Court confirmed that courts do have the authority to impose discovery sanctions for even alleged inadvertent violations of a protective order and the court confirmed the amount of attorneys’ fees that was justified to be awarded as discovery sanction. *See Smith and Fuller, P.A. v. Cooper Tire and Rubber Co.*, --- F.3d ----, 2012 WL2345024 (5th Cir. 2012). Ultimately, the Appellate Court upheld the Court Order that plaintiff’s counsel’s firm had to pay defendant \$29,667.71 in fees and expenses.

- j. Recent case you might find of interest about a court choosing to not exercise jurisdiction over a non-resident bank.

Enclosed please find a case wherein a court did not exercise jurisdiction over a non-resident bank for accepting various checks for deposit and/or negotiation. *See Concord Servicing Corporation v. JPMorgan Chase Bank*, 2012 WL 2913282 (D. Ariz. 2012). I know that many of my Texas banking clients get sued in other jurisdictions. This case might be helpful in trying to defend against such claims and in trying to get such cases dismissed. With the advent of the internet, far more plaintiffs try to sue a bank and/or other businesses outside of their normal “home”

jurisdiction. I previously sent a blurb about case law interpreting banks acquiring customers via the internet and whether or not the internet allowed a plaintiff to exercise jurisdiction over an entity that purportedly solicited clients in other jurisdictions via the internet.

- k. Recent case I thought you might find of interest about borrowers unsuccessfully trying to avoid a foreclosure sale.

Attached is a case I thought you might find of interest. Many borrowers are trying to argue technicalities to avoid a foreclosure after they are unable to make the required loan payments. In a recent Texas case, the Court ruled against such borrowers for various reasons. See *Martin v. New Century Mortgage Co.*, --- S.W.3d ---, 2002 WL 34720270 (Tex. App. – Houston [1st Dist.] 2012, no pet. hist.) (Notice: This opinion has not been released for publication in the permanent law reports. Until released, it is subject to revision or withdrawal.). In *Martin*, the borrowers argued that since New Century had assigned the deed of trust and the underlying debt to Wells Fargo in its capacity as trustee, and because Carrington Mortgage acted as the servicer on behalf of Wells Fargo, Plaintiff argued that Carrington and Wells Fargo could not enforce the note, deed of trust and the rights via contractual assignment of the note. Plaintiffs filed the enclosed lawsuit on the day before a scheduled foreclosure sale. The Court reviewed the issues and concluded that Wells Fargo did have standing to enforce the note. The Court also concluded that the homeowners failed to raise a fact issue on their other federal and state claims against the lenders. The Court also noted that the deed of trust provided that the note together with the deed of trust could be sold one or more times without prior notice to the borrower.

- l. Case you might find of interest about electronic discovery issues.

Technology keeps changing the rules in the discovery process during litigation. More and more people are trying to have courts order production of an opposing party's computer hard drive and/or email accounts. In the *Jordan* matter, the court confirmed that when a party seeks production of another party's computer hard drives, both the parties and the trial court must follow the procedures set forth in the *Weekly Homes* matter. See, *In re Jordan*, --- S.W.3d ----, 2012 WL 1098275 (Tex. App. – Dallas 2012, no pet.) (NOTICE: THIS OPINION HAS NOT BEEN RELEASED FOR PUBLICATION IN THE PERMANENT LAW REPORTS. UNTIL RELEASED, IT IS SUBJECT TO REVISION OR WITHDRAWAL). I am attaching a copy of the recent *Jordan* Opinion, as well as the *Weekly Homes* matter. As electronic discovery issues continue to develop, I wanted you to have examples of how courts may analyze certain computer issues.

- m. Recent case I thought you might find of interest about a credit card account.

I am enclosing an opinion confirming a judgment in favor of a bank on a credit card debt claim based on an "account stated" cause of action. See *Compton v. Citibank*, --- S.W.3d---, 2012 WL 1066301 (Tex. App. – Dallas 2012, n.p.h.) (NOTICE: THIS

OPINION HAS NOT BEEN RELEASED FOR PUBLICATION IN THE PERMANENT LAW REPORTS. UNTIL RELEASED, IT IS SUBJECT TO REVISION OR WITHDRAWAL.). Citibank had brought causes of action for breach of contract for an “account stated” claim. The Court explained that, to recover under “account stated” claim, Citibank had to prove (1) transactions between it and Compton gave rise to the indebtedness, (2) an agreement, express or implied, between the parties that fixed the amount due, and (3) Compton made an express or implied promise to pay the indebtedness. *Dulong v. Citibank, (S.D.), N.A.*, 261 S.W.3d 890, 893 (Tex. App. – Dallas 2008, no pet.). Defendant argued that it was not liable for the amounts for various reasons. However, the Court held that Defendant agreed to pay the full amount on the statement and that various fees were periodically assessed without objection, and Defendant, therefore, was liable for the amounts due and owing. Plus, the Court explained that the Defendant did not present proper evidence that Defendant objected to or disputed the fees and charges. It was nice to see another good victory for a bank.

- n. Recent case I thought you might find of interest about note ownership issues, standing issues and holder of note issues.

Attached is a case I thought you might find of interest. Many borrowers are trying to argue technicalities to avoid a foreclosure after they are unable to make the required loan payments. In a recent Texas case, the Court ruled against such borrowers for various reasons. *See Martin v. New Century Mortgage Co.*, --- S.W.3d ---, 2002 WL 34720270 (Tex. App. – Houston [1st Dist.] 2012, no pet. hist.) (Notice: This opinion has not been released for publication in the permanent law reports. Until released, it is subject to revision or withdrawal.). In *Martin*, the borrowers argued that since New Century had assigned the deed of trust and the underlying debt to Wells Fargo in its capacity as trustee, and because Carrington Mortgage acted as the servicer on behalf of Wells Fargo, Plaintiff argued that Carrington and Wells Fargo could not enforce the note, deed of trust and the rights via contractual assignment of the note. Plaintiffs filed the enclosed lawsuit on the day before a scheduled foreclosure sale. The Court reviewed the issues and concluded that Wells Fargo did have standing to enforce the note. The Court also concluded that the homeowners failed to raise a fact issue on their other federal and state claims against the lenders. The Court also noted that the deed of trust provided that the note together with the deed of trust could be sold one or more times without prior notice to the borrower.

2. Case update on UCC § 4A issues.

As more and more customers use electronic transaction as opposed to paper checks, there will be more and more cases interpreting UCC § 4A. Banks may see more issues regarding incorrect descriptions in wire transfer instructions, on line fraud, identity theft and various other issues. There are so many new ways to get information on banking information. Banks will need to keep up with the types of methods and continue to increase preventative measures.

I wanted to provide blurbs from a few recent different cases on UCC § 4A issues. As seen below, there is a good Texas case that ruled in favor of the bank on its commercial reasonable security procedures.

a. *All American Siding & Windows v. Bank of America*, 367 S.W.3d 490 (Tex. App.-Texarkana, 2012, pet. denied) – this is the first Texas case interpreting section UCC § 4A reasonable security procedure requirements.

In this case, a bank customer was a victim of electronic banking fraud and filed a lawsuit against the bank claiming breach of contract, violation of the DTPA, fraud, fraudulent inducement, negligence, and negligent misrepresentation. A representative of the bank signed an affidavit stating that the customer refused additional security options that were offered by the bank. The affidavit also stated that the bank had no knowledge of fraudulent transactions being conducted by someone other than the customer.

According to the court, the bank did not breach its deposit or any other banking agreements with the customer by failing to protect the customer's business accounts from fraudulent checks electronically drawn on the accounts via an ACH. The fraudulent transactions were completed through a security procedure in place for customers for ACH transactions, i.e., through use of company identification and password with confirmation through a digital certificate. Because the bank had no knowledge that the transactions were conducted by someone other than the customer, according to the security procedures set in place, the bank accepted the payment in good faith. V.C.T.A., Bus. & C. §§ 1.201(b)(20), 4A.201.

This is a good case for Texas banks as it contains quite a bit of specific language that a court will find acceptable to include in a wire transfer agreement and/or treasury management services agreement.

Practice tip -- Banks should look at the specific provisions cited in the opinion and make sure that similar provisions are included in their respective wire transfer agreements and/or treasury management service agreements.

b. *Patco Construction Co. v. People's United Bank*, 684 F.3d 197 (1st Cir. 2012)

In this case, a commercial customer filed a lawsuit against the bank claiming negligence, breach of contract, breach of fiduciary duty unjust enrichment, conversion, and that the bank's security system was not commercially reasonable.

The bank had lowered the dollar amount limitation from \$100,000 to \$1 and by doing so, it allegedly substantially increased the risk of fraud by asking for security answers for every \$1 transaction. This allegedly allowed cyber criminals equipped with keyloggers to capture all the information necessary to compromise an account every time the customer initiated an ACH transaction. In the event a customer's computer became infected with a keylogger, the Court thought that it was likely that the customer would be prompted to answer its challenge questions before the malware was discovered and removed from the customer's computer.

The bank's decision to set the dollar amount rule at \$1 for all of its customers ignored Article 4A's mandate that security procedures take into account "the circumstances of the customer" known to the bank. Article 4A directs banks to consider such circumstances as "the size, type and frequency of payment order normally issued by the customer to the bank. In this case the Court thought that these characteristics were regular and predictable. The bank did not assert it ever offered to adjust the threshold amount for particular customers. Instead, the bank adopted a "one-size-fits-all" dollar amount rule of \$1 for its customers. therefore increasing the risk of cyber criminals gaining access to customer information. This is a good case that other banks can learn from.

- c. *Experi-Metal v. Comerica Bank*, 74 UCC Rep. Serv. 2d 899 (E.D. Mich. 2011)

In this case, an employee of Experi-Metal was the victim of a phishing email which lead him to provide his confidential identification information to hackers. The hackers used this information to log into Experi-Metal's bank accounts and initiate \$1.9 million in wire transfer orders to accounts overseas. A portion of this was not recovered and Experi-Metal filed a lawsuit, seeking to hold the bank liable for this amount, alleging that the risk of loss for the unauthorized wire transfer falls upon the bank.

The Court found that the fraudulent wire transfer orders would not be effective as orders of Experi-Metal if the bank did not accept the orders in "good faith," as that term, is defined in the UCC. Plaintiff agreed that the burden fell upon the bank to prove that it accepted the payment orders in good faith, and plaintiff argued that the bank failed to present evidence sufficient to satisfy its burden. There were some bad facts in this case as the bank shut down the login access but did not stop ongoing fraud as the fraudster had already logged in.

- d. *Chavez v. Mercantil Commercebank.*, 701 F.3d 896 (11th Cir. 2012)

In this case, a customer sued the bank, seeking to recover \$329,500 that was transferred from his account as a result of an allegedly fraudulent payment.

The Court of Appeals held that a procedure requiring that payment orders delivered in person be delivered by customer was not a "security procedure" within meaning of Florida UCC safe-harbor provision. The bank asserted an affirmative defense premised upon Fla. Stat. § 670.202(2), which relieves a bank of liability for fraudulent payment orders in certain situations. The bank also argued that its third affirmative defense, premised upon the safe-harbor provision in § 202, shifted the risk of loss to Chavez.

The security procedures selected by Chavez required only that payment orders delivered in person be in writing and delivered and signed by Chavez. The court explained that the agreed-upon security procedure did not require a signature comparison, and that it only imposed requirements upon Chavez before he could present a payment order to the bank. The court explained that because the agreed-upon procedure did not specify what the bank would do to verify a payment order, it could not satisfy the UCC requirements.

- e. *Insoftvision, LLC v. MB Financial Bank*, 2011 WL 4036134 (N.D. Ill. Sep 12, 2011)

In this case, an employee of Insoftvision denied ordering a wire transfer of \$1+ million of Insoftvisions's funds from its account at the bank. Insoftvision claimed that the bank was liable to it for making an unauthorized wire transfer of Insoftvision's funds.

The bank claims it used a commercially reasonable security procedure to verify the order and that the procedure should be treated as such because the bank offered Insoftvision a procedure which they refused. The court concluded that the way in which the bank "offered" the procedure was not done in a reasonable matter. The bank used none of the types of security procedures listed in § 4A-201 to verify the authenticity of the wire transfer order nor do the factors listed in § 4A-202(c) support a finding that the bank's procedure of accepting an email from the employee's account amounted to a commercially reasonable security procedure.

As John Krahrmer stated in his recent UCC update speech on UCC § 4A issues, banks may want to review the 2005 FFIEC Guidelines regarding these issues. The 2005 FFIEC Guidelines are available at

http://www.FFIEC.gov/pdf/authentication_guidance.pdf

A supplement to these guidelines is available at:

http://ithandbook.ffiec.gov/media/153051/04-27-12_fdic_combined_fil-6-28-11-auth.pdf.¹

B. RECENT UCC CASE OPINIONS I THOUGHT YOU MIGHT FIND OF INTEREST ON "REPORTING ISSUES" UNDER THE UCC.

Creative plaintiffs' attorneys are getting more and more clever with how to try to avoid existing case law and/or statutory analysis under the UCC. I wanted to provide some examples of some of these new arguments. For example, Texas has a unique provision under 4.406(a).

A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment. If the bank does not return the items, it shall provide in the statement of account the telephone number that the customer may call to request an item or legible copy of the items pursuant to Subsection (b).

One of my banking clients had a customer who utilized an employee to do all of the bookkeeping. The employee began writing checks to herself and/or third parties. Since the

¹ The author wants to acknowledge this good practice tip learned from John Krahrmer.

bookkeeper was reviewing the monthly statements (as opposed to the owner of plaintiff), no one timely reported the alleged unauthorized disbursements.

To try to avoid the reporting requirements section in the bank deposit agreement and/or Section 4.406(a) of the UCC, plaintiff's counsel argued that the bank had not properly included a telephone number for the account holder to contact if there are questions about the monthly bank statement. I had not been able to find a Texas appellate court that had analyzed the unique section under the Texas version of the Section 4.406 of the UCC. As seen by Tab A, the court ultimately ruled that the bank had properly complied with the section, and the court granted summary judgment for the bank.

The court agreed with the bank's Motion for Summary Judgment when the bank argued as follows:

1. Plaintiff's claims are barred, because it did not timely and/or properly report the alleged improper transactions.

Plaintiff is precluded from asserting the alleged unauthorized transactions against the bank, because plaintiff failed to timely and/or properly report the alleged improper transactions and/or unauthorized disbursements. Under the Texas Business and Commerce Code § 4.406(f), without regard to care or lack of care, a customer must discover and report to the drawee bank within one (1) year or else the customer is precluded from recovering from the bank for the unauthorized transactions.

As the Comments to the UCC explain: "Section 4-406 evidence[s] a public policy in favor of imposing on customers the duty of prompt examination of their bank statements and the notifications of banks of forgeries . . . and in favor of reasonable time limitations on the responsibility of banks for payment of forged . . . items." *Id.* § 4.406 cmt. 7. A recent Texas Supreme Court case governs this dispute. *See American Airlines Employees Federal Credit Union v. Martin*, 29 S.W.3d 86 (Tex. 2000). In *Martin*, an unauthorized person made fourteen (14) transfers that were allegedly unauthorized. *Id.* at 90. The alleged unauthorized person made twelve (12) transfers by telephone and two in person. These transactions would show up on quarterly statements that were mailed to the owner of the account. The accountholder denied receiving the statements. However, the accountholder did not contact the bank to request the quarterly statements. *Id.* at 90. The accountholder claimed that the alleged wrongdoer had no authority to make the transactions in dispute.

The Texas Supreme Court held that the purpose of Section 4.406 of the UCC is to place the burden on those best to be able to detect unauthorized transactions so that further unauthorized transactions can be prevented. *Id.* at 93. The Texas Supreme Court also stated that the burden included the risk of non-receipt of account statements. *Id.* at 93. The Texas Supreme Court held that the burden must fall on the customer, the one most familiar with the underlying transactions. In this case, as in *Martin*, plaintiff is claiming that an unauthorized person should not have been allowed to make various withdrawals from plaintiff's accounts. In *Martin*, the plaintiff claimed his girlfriend should not have done it, and in this case, plaintiff is making the same claims against an employee. Just like *Martin*, plaintiff failed to timely report the alleged unauthorized disbursements and/or transactions. In this case, plaintiff claims to have "reported"

the forgeries on March 16, 2009, but plaintiff does not specify what transactions were reported and/or claim that such “reporting” was timely. At a minimum, plaintiff has presented no evidence as to when plaintiff timely and properly reported the various specific alleged unauthorized disbursements.

In *Martin*, the Texas Supreme Court went further than simply enforcing the one year preclusion period of § 4.406(d). In fact, the Texas Supreme Court held that a 60-day notice provision in the banking deposit contract would be enforced as written and further limited the time Martin had to report the unauthorized transactions. *Id.* at 97-98. The Texas Supreme Court held that because the plaintiff in *Martin* did not report the alleged unauthorized signatures until more than 60 days after the bank statements were mailed, the plaintiff was barred from recovering against the bank. *Id.* at 98. Under the banking deposit agreement in effect between the parties in this case, it was incumbent upon plaintiff to deliver timely (within 30 days of the bank mailing plaintiff a statement showing the unauthorized disbursement) notice of the unauthorized transactions to the bank.² Plaintiff did not do so. More specifically, the banking deposit agreement required specific reporting of unauthorized transactions.³

Deposit agreements that shorten the time period to notify the bank of unauthorized account activity, such as the deposit agreements at issue in this lawsuit, are enforceable in the State of Texas. *See Martin*, 29 S.W.3d at 97-98; *Tumlinson v. First Victoria National Bank*, 865 S.W.2d 176 (Tex. App. — Corpus Christi 1994, no writ). At issue in *Tumlinson* was a deposit agreement that provided:

We lose these protections if we fail to exercise ordinary care in paying an item with an unauthorized signature unless you do not notify us of the problem within 30 days of when we send or make available to you the statement and items.

In *Tumlinson*, the depositor, Mr. Tumlinson, filed suit against First Victoria National Bank (“**First Victoria**”) for wrongfully paying forty-five checks between September 1989, and September 1990. *Id.* at 177. Mr. Tumlinson first complained to First Victoria on September 26, 1990. *Id.* In *Tumlinson*, the trial court entered judgment for the bank for any items paid more than sixty days prior to the customer’s complaint.⁴ *Id.* The Thirteenth Court of Appeals affirmed the trial court’s ruling and noted that “[t]he trial court’s grant of judgment barring these items was proper, and the bank’s negligence, if any, was irrelevant”. *Id.* The *Tumlinson* Court further held that the bank’s negligence was only relevant to the most recent items (i.e. those within the last sixty days) and remanded only that portion of the case to the trial court for a new trial. *Id.* at 178.⁵

² To recover for a breach of contract, Plaintiff must identify the contract and provide facts supporting an alleged breach. In Plaintiff’s live Complaint, Plaintiff wholly fails to identify what contract was allegedly breached.

³ Plaintiff has argued that the statements did not have a phone number, but the statements all have a phone number Plaintiff could have called to contact Bank. Plus, if Plaintiff truly needed more information or alleges Plaintiff did not get a statement or information, certainly Plaintiff knew how to contact its own bank.

⁴ In *American Airlines Employees Federal Credit Union v. Martin*, 29 S.W.3d 86 (Tex. 2000), the Texas Supreme Court upheld a sixty day notice requirement.

⁵ The Texas Supreme Court in *Martin* favorably acknowledged that other courts have upheld reporting requirements limiting the time to as little as fourteen (14) days.

Plaintiff may try to claim that some sort of general notice was given. **However, in Texas, the customer must identify the unauthorized transaction, instead of merely making a vague reference to some unauthorized transactions.** See *Hatcher Cleaning Co. v. Comerica Bank-Texas*, 995 S.W.2d 933 (Tex. App. — Fort Worth 1999, no pet.). Plaintiff may try to explain why it waited so long to report the alleged improper transactions to the bank. However, excuses do not matter. Without a timely report, plaintiff cannot recover.⁶ The monthly statements were sent to plaintiff and/or made available to plaintiff. Plus, if plaintiff truly did not get its statements and expected to get them, why didn't plaintiff call the bank to request copies of same?

In *Wetherill*, an employee was given more and more responsibilities with regard to a bank account. See *Wetherill v. Putnam Investments*, 122 F.3d 554 (8th Cir. 1997). The bank employee began writing improper checks out of the bank account. The owner of the company became suspicious in late 1992, or early 1993. The owner sent a letter in May 1993 to the bank asking for account related documents to further investigate the embezzlement, and he even stated in the letter that he thought that the business had been subject to embezzlement by the alleged wrongdoer. However, it was not until a subsequent letter dated November 1, 1994, that Mr. Wetherill identified the checks at issue and then stated in that subsequent letter that the checks were signed and/or endorsed by an unauthorized person. See *Id.* at 556. The court held that due to the delay in specifically identifying the alleged unauthorized disbursements, the UCC Section 4.406 barred the claims. The court reasoned that the first letter was insufficient notice as it did not specifically identify the disputed checks. The court also found that all of plaintiff's claims, which were common law causes of action, were barred regardless of how the claims were brought due to Section 4.406 of the UCC. See *Id.* at 558.

Regardless of plaintiff's excuses as to why plaintiff did not timely report the alleged improper transactions, the case law is clear that plaintiff is barred from trying to recover such alleged improper disbursements from the bank. **The Texas Supreme Court has held that risk of non-receipt should be borne by the customer.** See *Martin*, 29 S.W.3d at 90 and 92. Plaintiff's duty to examine and notify arises from the sending of each of these statements — a point even clearer in the revisions to Section 4.406 that took effect on January 1, 1996, which specifically placed a duty on plaintiff to examine "the statement or the items." See TEX. BUS. & COM. CODE ANN. § 4.406(c) (Vernon Supp. 1997) (emphasis added); *Id.* § 4.406(a), (d) & cmt. 1. Similarly, as the Texas Supreme Court did in *Martin*, this Court should bar all of plaintiff's claims against the bank, because plaintiff completely failed to timely identify the alleged unauthorized transactions and plaintiff failed to provide facts that any such transactions were timely reported to the bank. The bank asserts that plaintiff may have claims against the alleged wrongdoer for improperly managing and/or administering the accounts and/or doing alleged unauthorized transactions. However, summary judgment is warranted for the bank.

⁶ As seen by the recent *Berry* opinion, courts have continued to not allow plaintiffs to sue banks when the plaintiffs failed to timely report the alleged unauthorized transactions. See *In re Estate of Berry*, 280 S.W.3d 478 (Tex. App. — Dallas 2009, no pet.). In *Berry*, the plaintiff tried to use the excuse that her husband handled the filing activities and reviewing the banking statements when he filed same. Consequently, she said she did not notice the alleged unauthorized transactions for quite some time as her husband had those duties. The court stated that such excuses should not matter and that the *Berry* plaintiff would still be bound by the requirement that she timely give notice of the alleged unauthorized disbursements. See *Id.*

2. Plaintiff's argument is wrong in that there is no "good faith" element in 4.406(f).

In plaintiff's Response, plaintiff may again try to get around plaintiff's failure to timely report the alleged unauthorized disbursements by claiming that there is a good faith requirement that the bank must prove that it acted in good faith. However, in the *Cantrell* case cited by plaintiff for this argument, the court was opining that a "good faith" requirement existed under the repeat wrongdoer rule in a repeat wrongdoer situation. While the bank has raised a repeat wrongdoer issue under UCC § 4.406(d), plaintiff ignores the entirely separate defense raised by the bank — i.e., 4.406(f). There are two separate hurdles for a plaintiff to overcome with regard to UCC Section 4.406. The repeat wrongdoer is simply one issue plaintiff must address. Plaintiff continues to ignore that UCC Section 4.406(f) says, "Without regard to care and/or lack of care" 4.406(f) expressly states as follows:

(f) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (Subsection (a)) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under Section 4.208 with respect to the unauthorized signature or alteration to which the preclusion applies.

There is no "good faith" element in the second 4.406 defense. The *American Airlines v. Martin* case confirmed that there were two separate, distinct defenses under UCC § 4.406. More specifically, the *Martin* court explained both UCC 4.406 defenses as follows:

Section 4.406 also provides the bank with certain defenses when the customer fails to comply with this obligation. **The Credit Union here relied on two of these defenses.** First, the customer cannot assert his unauthorized signature against the bank when one wrongdoer makes a series of unauthorized transactions on the same account if the customer fails to discover and report the first unauthorized transaction within fourteen days. This defense is not available when the bank has failed to exercise ordinary care in paying the items.

Second, and the defense on which the Credit Union places the most emphasis, the customer is absolutely precluded from asserting his unauthorized signature on an item against the bank if the customer fails to discover and report the unauthorized signature within a year after the bank makes available the item and the account statement showing the transaction:

Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer . . . discover and report his unauthorized signature or any alteration on the face or back of the item . . . is precluded from asserting against the bank such unauthorized signature or . . . such alteration.⁷

⁷ 4.406 changed slightly with the 1996 revisions to the UCC, but both defenses remained in § 4.406.

This statutory scheme reflects an underlying policy decision that furthers the UCC's "objective of promoting certainty and predictability in commercial transactions." The UCC facilitates financial transactions, benefitting both consumers and financial institutions, by allocating responsibility among the parties according to whoever is best able to prevent a loss. Because the customer is more familiar with his own signature, and should know whether or not he authorized a particular withdrawal or check, he can prevent further unauthorized activity better than a financial institution, which may process thousands of transactions in a single day. Section 4.406 acknowledges that the customer is best situated to detect unauthorized transactions on his own account by placing the burden on the customer to exercise reasonable care to discover and report such transactions. The customer's duty to exercise this care is triggered when the bank satisfies its burden to provide sufficient information to the customer. As a result, if the bank provides sufficient information, the customer bears the loss when he fails to detect and notify the bank about unauthorized transactions.

See *American Airlines v. Martin*, 29 S.W.3d 86, 91-92 (Tex. 2000).

The Martin court also confirmed that a deposit agreement could lower the reporting deadline from one year to 60 days, 30 days, or even 15 days. The court held as follows:

The Deposit Agreement required Martin to give notice within sixty days after the account statements showing Blair's transfers were mailed. Pursuant to section 4.406(d), Martin cannot assert his unauthorized signature against the Credit Union as to any transfers for which he did not give timely notice. . . . Because his claims are all premised on unauthorized signatures, section 4.406 bars recovery for all of Blair's transfers that appear on the two statements.

See *Id.* at 98. Thus, since plaintiff failed to timely and specifically identify and report the alleged unauthorized disbursements, summary judgment is warranted.⁸

3. Even if the bank's conduct was negligent, which the bank denies, plaintiff's claims are barred, because such negligence or other improper actions are legally irrelevant under UCC § 4.406.

UCC § 4.406(f) contains an absolute notice provision based solely upon a depositor's duty to discover and report irregularities. The only prerequisite is that the depository institution makes available the information from which the irregularity could be deduced. In fact, the statute precludes any consideration of breach or negligence in its operation. The statute itself emphasizes at its beginning, "without regard to care or lack of care of either the customer of the bank" See TEX. BUS. & COM. CODE ANN. § 4.406(d) (Vernon 1994), now § 4.406(f). Concerning the unauthorized withdrawals not reported within the 30-day notice provision of the deposit agreement in *Tumlinson*, the Court noted: "**the bank's negligence, if any, was irrelevant.**" See *Tumlinson*, 865 S.W.2d at 178 (emphasis added). Similarly, plaintiff's

⁸ Again, Plaintiff has failed to identify a single specific check that was timely reported. At a minimum, Plaintiff should have stated when and what specific transactions were allegedly timely and specifically reported.

attempts to plead a vague cause of action under the Texas Business and Commerce Code should not be allowed as UCC § 4.406 bars plaintiff's claims.

The provision is intended to set a limit to claims arising from unauthorized payments. Since it operates only when an unauthorized payment has been made, it cannot logically be defeated by the very same event that allows it to be invoked, *i.e.*, an unauthorized payment. Even if the bank breached its agreement with plaintiff or was negligent in processing the allegedly unauthorized transactions, which the bank denies, it would be legally irrelevant under UCC § 4.406(f). Even when plaintiff proceeds outside the UCC to assert breach of contract or negligence, courts have held that Section 4.406 still applies. *See, e.g., Siecinski v. First State Bank of East Detroit*, 26 UCC Rep. Serv. 2d 666, 669-70 (Mich. App. Ct. 1995). Consequently, this Court should not allow plaintiff to avoid the reporting rule by asserting various claims for alleged breach of the Texas Business and Commerce Code or similar claims.

Another case with a very similar fact situation, is *Watseka First National Bank v. Horney*, 686 N.E.2d 1175, 35 UCC Rep. Serv. 2d 582 (Ill. App. Ct. 1997). In *Horney*, the Court held that UCC Section 4.406 barred plaintiff's claims because plaintiff did not timely report the unauthorized transactions. The *Horney* Court reasoned that the committee comments to the UCC emphasized the onus placed on the customer to discover and report unauthorized signatures and authorizations when it stated that "one of the best ways to keep down losses is for the customer to promptly examine his statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items." *Id.* at 585-86. The *Horney* plaintiff argued that other causes of action, including breach of contract, should control and not limit the plaintiff's damages. *Id.* at 586. In *Horney*, the plaintiff also argued that the bank could not use 4.406 as a defense, because the bank did not exercise reasonable care when it honored the forged checks. The *Horney* Court expressly disagreed. *Id.* The Court stated that the plain language of the statute states that the preclusion period applies without regard to care or lack of care to either the bank or the customer. *Id.* at 586-87. Consequently, the Court held that any discussion of care or lack of care would be superfluous. *Id.* at 587.

In *Wetherill*, the Court held that regardless of the theory on which a plaintiff is relying, UCC § 4.406 will preclude the claim if the customer does not timely report the unauthorized transaction.⁹ *Wetherill v. Putnam Investments*, 122 F.3d 554, 558 (8th Cir. 1997). The *Wetherill* Court reasoned that the generality of the language of UCC § 4.406(d), now § 4.406(f), suggests that it bars the bank's liability no matter how the customer brings the claim. *Id.* Consequently, all of plaintiff's claims against the bank are barred as a matter of law.

C. THERE ARE A LOT OF NEW CASES DECIDING ISSUES UNDER UCC PERTAINING TO PROVISIONAL CREDITS, TIMELY PAYMENT OF ITEMS AND/OR ALLEGED REPRESENTATIONS MADE BY BANK EMPLOYEES WHEN DEPOSITS ARE MADE ONLY TO BE LATER RETURNED.

As many of you are aware, there have been several law firms that appear to get a putative new client and then end up receiving a counterfeit cashier's check that is then deposited into an IOLTA account. The law firm is then tricked into wire transferring the money overseas to a

⁹ Similarly, this Court should find that § 4.406 applies and bars Plaintiff's two remaining causes of action.

putative client. The check is later returned as a counterfeit check. The law firm then tries to avoid the loss by suing the bank.

There are many different appellate opinions that discuss these issues. I wanted to provide some briefing in case this issue arises at your bank.

1. The rights and duties as between plaintiff and the bank are governed by the Texas UCC and the Deposit Agreement, and plaintiff’s creative attempts to avoid the UCC should not be allowed by the Court.

A. The Texas UCC

The Texas UCC — codified in the negotiable instrument chapters of the Texas Business and Commerce Code — contains a “comprehensive and carefully considered allocation of responsibility among parties to banking relationships.” *Southwest Bank v. Information Support Concepts, Inc.*, 149 S.W.3d 104, 107 (Tex. 2004). The mandate of the courts is to construe it as “carefully integrated and intended as a uniform codification of permanent character covering an entire ‘field’ of law.” *See Southwest Bank*, 149 S.W.3d at 109 (quoting TEX. BUS. & COM. CODE § 1.104 cmt. 1) (emphasis added). As a uniform act, it must be “liberally construed and applied to promote its underlying purposes and policies”. *Id* at 110 (quoting TEX. BUS. & COM. CODE § 1.103(a)) (emphasis added). Those purposes and policies include: (1) to simplify, clarify and modernize the law governing commercial transactions; (2) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties; and, (3) to make uniform the law among the various UCC jurisdictions. *Id.* (also citing TEX. GOV’T CODE § 311.028).

Article 4 of the “revised UCC”, which was adopted in Texas effective January 1, 1996, “establishes the rights and duties between banks and their customers regarding deposits and collections”. *American Airlines Employees Fed. Credit Union v. Martin*, 29 S.W.3d 86, 91 (Tex. 2000).¹⁰ Under Article 4, a “collecting bank” is defined as a bank handling an item for collection except the payor bank. TEX. BUS. & COM. CODE § 4.105. Sections 4.201 and 4.210 identify the status of a collecting bank as agent and address the provisional status of credits provided to a collecting bank’s customers - such as the credit provided in the case at bar - as follows:

Unless a contrary intent clearly appears and before the time that a settlement given by a collecting bank for an item is or becomes final, the bank, with respect to the item, is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank, such as those resulting from outstanding advances on the item and rights of recoupment or setoff.

TEX. BUS. & COM. CODE § 4.201(a) (emphasis added).

¹⁰ The *Martin* case applied the pre-1996 version of the Texas UCC.

Further, § 4.210 sets forth a collecting bank's security interest in an item as a holder in due course and any accompanying documents or the proceeds of either:

- (1) in case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;
- (2) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or
- (3) if it makes an advance on or against the item.

TEX. BUS. & COM. CODE § 4.210(a). Plus, UCC § 4.214 states as follows:

Tex. Bus. & Com. Code § 4.214.
RIGHT OF CHARGE-BACK OR REFUND;
LIABILITY OF COLLECTING BANK; RETURN OF ITEM

(a) If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive settlement for the item that is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customers, but it is liable for any loss resulting from the delay. These rights to revoke, charge-back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

(b) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(c) A depositary bank that is also the payor may charge-back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (Section 4.301).

(d) The right to charge-back is not affected by:

- (1) previous use of a credit given for the item; or
- (2) failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(e) A failure to charge-back or claim refund does not affect other rights of the bank against the customer or any other party.

(f) If credit is given in dollars as the equivalent of value of an item payable in foreign money, the dollar amount of any charge-back or refund must be calculated on the basis of the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in the ordinary course.

The bank is a collecting bank; plaintiff received a provisional credit in the amount of the counterfeit check; and, the counterfeit check was later returned. Under §§ 4.201, 4.210 and 4.214 of the Texas UCC, the bank was entitled to charge back or obtain a refund from plaintiff in the amount of the credit given to the customer account for the amount of the counterfeit check deposited by plaintiff. TEX. BUS. & COM. CODE §§ 4.201 and 4.210; *see also Bill Hart Auto Sales, Inc. v. Comerica Bank-Texas*, 893 S.W.2d 705, 708 (Tex. App. — Eastland, 1995, no writ) (the court held the bank has the right to charge back the account for the provisional credit when the bank failed to receive a settlement for the item from the drawee bank and that this right was not affected by the customer's prior use of the funds). Thus, under the UCC, summary judgment is warranted.

B. The Deposit Agreement

Moreover, Article 4 of the Texas UCC permits parties to vary the effect of its provisions by agreement. *See Canfield v. Bank One, Texas, N.A.*, 51 S.W.3d 828, 835 (Tex. App. — Texarkana, 2001 no pet) (citing *Martin*, 29 S.W.3d at 95). The bank-customer relationship itself arises from the depositary contract, and is contractual in nature. *Id.* “Contractual precedents” are “in accord with public policy by limiting disputes in a society where millions of bank transactions occur every day”. *Id.*

The signature card for the customer account, signed and agreed to by plaintiff, expressly incorporates the terms of the bank's Deposit Agreement. (See signature card, Tab 1 to Exhibit A hereto.) Moreover, the Deposit Agreement was, during all times relevant, made available to the customers in the lobbies at bank banking centers, free of charge. The Deposit Agreement in effect during the relevant time frame expressly provided as follows:¹¹

3. DEPOSITS AND COLLECTIONS

. . . We may accept an item for deposit to your account from anyone and without questioning or verifying the authority of the person making the deposit. **Any item that we cash or accept for deposit may be subject to later verification and final payment. We may deduct funds from your account if an item is lost, stolen or destroyed in the collection process, if it is returned to us unpaid, or if it was improperly paid, even if you have already used the funds. Cash deposits are also subject to later verification. Credit for any item we accept for deposit to your account, including funds that are deposited by electronic funds transfer, is provisional and may be revoked if the item is not finally**

¹¹ I suggest that you check your bank's deposit agreement to make sure it has similar language.

paid, for any reason, in cash or its equivalent. We may give cash back to any authorized account signer(s) or agent(s) in connection with items payable to any owner, whether or not the items have been endorsed by the owner. If you make a deposit or payment that is not accompanied by instructions indicating how or where it is to be credited, we may apply it at our discretion to any loan or deposit account you maintain with us. We may endorse and/or collect items deposited to your account without your endorsement, but may require your personal endorsement prior to accepting an item for deposit.

Chargebacks. In the event a deposited or cashed item drawn on us (an “on us” item) is determined by us not to be payable for any reason or a deposited or cashed item drawn on any other payor is returned to us for any reason, without regard to whether the other payor returned the item to us before its deadline to do so, we may charge the item (a “chargeback item”) to your account or to any account of which you are an owner. We may debit all or part of a chargeback item to your account even if doing so results in or causes an overdraft of your account and regardless of whether the item can be physically returned to you. You waive notice of dishonor in connection with any item that is not finally paid in full and that we charge back to your account. We may recover from you any amount withdrawn by you against a chargeback item. In the event that our debit of all or part of a chargeback item results in or causes an overdraft of your account, we may obtain and retain possession of the item, if it is available, until we recover from you the amount of any overdraft of your account and for a reasonable time thereafter. If our debit of all or part of a chargeback item that is an “on us” item does not result in or cause an overdraft of your account; our deadline for return to you of the item, if it is available, shall be six business days after we make such determination. If we are notified that any item for which you received payment or credit to your account is not properly payable, you agree that, without notice to you, we may authorize the drawee bank to hold the item and try to obtain payment. We will not initially decide whether a deposited item has been improperly returned; if you believe that a deposited item has been improperly returned, you should contact us immediately. We will not be responsible for failing to pay any item presented against your account before a deposit becomes available for withdrawal, as set forth herein, unless there is a sufficient available balance in your account to pay the item without regard to such deposit.

Clearly, under the Deposit Agreement’s plain terms, the bank was entitled to reverse the provisional credit and plaintiff was responsible for the overdraft balance, if any, as well as any the returned-item fees and the attorney’s fees and costs associated with the collection of the overdraft balance and/or incurred in the above-captioned litigation. *See Rodriguez v. NBC Bank*, 5 S.W.3d 756, 765 (Tex. App. — San Antonio 1999, no pet.) (bank acted within its depository agreement with customer in debiting customer’s account upon notice of dishonor of check she deposited). Therefore, summary judgment is warranted against plaintiff’s claims.

2. Plaintiff is ignoring the fact that plaintiff deposited the counterfeit check and made various UCC warranties to the bank, and summary judgment is warranted on those grounds as well.

When plaintiff deposited a counterfeit check and the bank provided a provisional credit to plaintiff, it was plaintiff (not the bank) that made various warranties regarding the check. Pursuant to § 4.207 of the Texas UCC, the bank is entitled to summary judgment as a matter of law against plaintiff for a breach of a transfer and/or presentment warranty. Section 4.207 states as follows:

(a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that: (1) the warrantor is a person entitled to enforce the item; (2) all signatures on the item are authentic and authorized; (3) the item has not been altered; (4) the item is not subject to a defense or claim in recoupment (Section 3.305(a)) of any party that can be asserted against the warrantor; (5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and (6) with respect to a remotely-created item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (i) according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an incomplete item, according to its terms when completed as stated in Sections 3.115 and 3.407. The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subsection by an indorsement stating that it is made “without recourse” or otherwise disclaiming liability.

(c) A person to whom the warranties under Subsection (a) are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

TEX. BUS. & COM. CODE § 4.207 (emphasis added).¹²

Plaintiff warranted to the bank when plaintiff deposited the counterfeit check in the Account that all signatures on the counterfeit check were authentic and authorized and/or that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item was drawn. The counterfeit check was later returned and the transferor, plaintiff, is obligated to pay the amount equal to the loss suffered as a result of the breach of warranty plus

¹² Plaintiff also breached warranties under UCC Sections 4.208, 3.416 and 3.417.

expenses and loss of interest incurred as a result of the breach as set forth in the Texas UCC. *See e.g., San Jacinto Sav. Ass'n v. MBank Greenway, N.A.*, 1988 WL 3981, *1 (Tex. App. — Houston [1st Dist.], 1988, writ denied) (affidavit stating there was a forgery, admissions and answers to interrogatories and a copy of the forged check itself were sufficient evidence to prove as a matter of law that transferor breached warranty under 4.207(b)). Because plaintiff breached these UCC warranties, summary judgment is warranted on this ground as well.

3. The doctrines of unclean hands, estoppel, contributory negligence, economic loss rule, waiver, failure to mitigate and/or similar doctrines should bar plaintiff's claims against the bank as it was plaintiff's own actions that truly caused the damages.

A party in Texas is presumed to know the laws in the state of Texas. *See Morris v. Reaves*, 580 S.W.2d 891 (Tex. Civ. App. — Houston [14th Dist.] 1979, no writ) (every person is conclusively presumed to know the law). This plaintiff is not an ordinary plaintiff. Instead, this plaintiff is a lawyer. This particular plaintiff, more than any other plaintiff, should be well aware of the laws in the state of Texas.

Even though plaintiff had represented clients in fraud cases, plaintiff apparently did the banking transactions notwithstanding several suspicious facts.¹³ Plaintiff was then asked by his purported client to deposit the check and immediately wire transfer money to a bank outside of the United States. Plaintiff then did as requested and instructed the bank to wire transfer the amount of \$70,000.00.¹⁴ Later, the bank was informed that the check was counterfeit. Consequently, the provisional credit that had been provided to plaintiff was reversed.

Estoppel and/or quasi estoppel precludes a party from asserting, to another's disadvantage, a right inconsistent with a position previously taken by him. The doctrine applies when it would be unconscionable to allow a person to maintain a position inconsistent with one in which he acquiesced, or of which he accepted a benefit. Quasi estoppel forbids a party from accepting the benefits of transaction or statute and then subsequently taking an inconsistent position to avoid corresponding obligations or effects. The doctrine essentially requires (1) a previous action and (2) a subsequent inconsistent action which is thereby sought to be estopped. *Mulvey v. Mobil Producing Texas and New Mexico Inc.*, 147 S.W.3d 594, 607 (Tex. App. — Corpus Christi 2004, pet. denied). In this case, plaintiff deposited the check and plaintiff got the benefit of the provisional credit provided to plaintiff's account. See Exhibit A.

Waiver is an intentional relinquishment of a known right or intentional conduct inconsistent with that right. *Jernigan v. Langley*, 111 S.W.3d 153, 156 (Tex. 2003) (per curiam); *U.S. Fid. & Guar. Co. v. Bimco Iron & Metal Corp.*, 464 S.W.2d 353, 357 (Tex. 1971). The elements of ratification are: (1) approval by act, word, or conduct; (2) with full knowledge of the facts of the earlier act; and (3) with the intention of giving validity to the earlier act. *Motel Enterprises, Inc. v. Nobani*, 784 S.W.2d 545, 547 (Tex. App. — Houston [1st Dist.] 1990, no writ); *see also Gibson v. Bostick Roofing and Sheet Metal Co.*, 148 S.W.3d 482 (Tex. App. — El Paso 2004, n.p.h.).

¹³ For example, Plaintiff got the "client" through email, and Plaintiff was allegedly retained and swindled in less than three weeks.

¹⁴ Plaintiff did so even though Plaintiff argues he was never truly hired by his putative client.

Laches is an equitable doctrine similar to estoppel. It is invoked when a claimant unreasonably delays asserting available legal remedies, resulting in the potential defendant's good faith change of position to its detriment. *See Jamail v. Stoneledge Condominium Owner's Ass'n*, 970 S.W.2d 673 (Tex. App. — Austin 1998, no writ). Laches is recognized as a defense in an action at law for damages. *See Regent International Hotels, Ltd., v. Las Colinas Hotels Corp.*, 704 S.W.2d 101 (Tex. App. — Dallas 1985, no writ).

Moreover, the economic loss rule precludes recovery of economic losses in tort cases when the loss is the subject matter of the contract between the parties. *See Tarrant County Hosp. Dist. v. GE Auto*, 156 S.W.3d 885 (Tex. App. — Fort Worth 2005, n.p.h.). When a plaintiff asserts a tort claim arising from a contract the courts must look to the substance to the cause of action, not the manner in which it was pleaded, to determine the type of action that is brought. *See Id.* at 895. When the injury is only the economic loss to the subject to the contract itself, the action sounds in contract alone. *See Id.*

Plaintiff was well aware of and/or should have been aware of very suspicious facts. Indeed, it appears that plaintiff was first contacted by his "client" via email on or about January 30, 2010. Plaintiff got the check on or about February 11, 2010, and plaintiff was asked to do the wire transfer and did so on February 16, 2010. For whatever reason, plaintiff allowed himself to be defrauded by his own purported customer. Thus, plaintiff's own actions in failing to protect himself should be grounds to grant a summary judgment in favor of the bank.

As a lawyer, plaintiff should know that under the UCC, a party has up to three years to complain about an allegedly improperly deposited check. Plaintiff, as a lawyer, should know these Texas laws. Additionally, plaintiff had full knowledge of background facts that should have made plaintiff very suspicious of the Check. Plaintiff has handled various fraud cases for various clients. Plaintiff, more than the normal plaintiff, should have been well aware that fraud occurs and that people need to take steps to protect themselves.

If plaintiff is allowed to recover against the bank, it would run contrary to the whole checking system in the United States. The bank, as a depository bank, would have absolutely no knowledge as to whether or not a check would ultimately get paid. Common sense surely should preclude plaintiff from trying to recover any damages against the bank.

Indeed, if plaintiff is successful in trying to recover against the bank, this would change the entire banking system. Anybody depositing a check would then ask the bank whether or not the check would be paid and/or try to argue that a hold should be placed on a check. Again, there are hundreds of reasons why a check may not ultimately get paid.

Plaintiff may try to blame the purported maker's bank, the depository bank and/or others. However, the UCC provides a comprehensive scheme of how checks are collected, presented, and paid, making plaintiff's claim meritless. For example, if three different people have checks in the amount of \$5,000.00 and there is only \$6,000.00 in the account, only one of those checks would be paid, and the two would not be payable and would be returned NSF. If those three people went to three different bank branches and asked a bank teller if there were sufficient funds in the maker's account to cover the check they were holding, the teller could say that there was money in the account, but the teller would not know whether or not the check would

ultimately be paid. The checks would be routed through the federal banking system and the debits and credits would be calculated at a set point in time. Checks are paid by a midnight deadline or are returned—in the case of plaintiff, the Check was returned because the Check was counterfeit. Plaintiff’s attempts to try to blame others when plaintiff himself may have prevented this loss should not be allowed by the Court. For these additional reasons, summary judgment is warranted.

Other court opinions have discussed these issues. For example, in the *Chase v. Morgan* case, the plaintiff was alleging that the bank misled him into believing that the check would clear. In this case, plaintiff is claiming that the bank did the exact same thing — *i.e.*, that the bad check would clear.¹⁵ Plaintiff also claims that the other cases are inapplicable because they involve plaintiffs trying to shift the risk of loss to banks who allegedly “misinform the customers” of the status of the checks after they have been deposited. Again, these are the exact same issues in dispute in this case. Plaintiff is claiming that but for the bank’s alleged misrepresentations regarding that a cashier’s check was the “same as cash,” plaintiff would not have suffered a loss (plus, again, plaintiff continues to ignore that plaintiff wholly failed to provide any facts that may have raised any suspicions on behalf of the bank and only asked a vague and general question). In other words, plaintiff is now trying to shift the risk of loss to the bank based on alleged representations made by the bank. These are the exact same fact patterns in the other cases.

Furthermore, in the *Chase v. Morgan* matter, this case goes to the exact issue being raised by plaintiff with regard to the IOLTA account. In the *Chase v. Morgan* matter, the attorney said that the bank should not reverse the provisional credit because there were attorney-client funds in the account into which the check had been deposited. These are the exact same facts plaintiff is claiming in this case. The court rejected such an argument and found that judgment was proper for the bank.

In *TCF National Bank*, plaintiff retired from a private company and received an email purportedly from a Chinese corporation. See *TCF National Bank v. Adobe Liquidations, LLC*, 2009 WL 4143818 (Mich. App. 2009). The email asked plaintiff to help with getting funds and receivables and wanted plaintiff to receive checks, deposit the checks into the bank account, and then forward a portion of the funds to other individuals. That plaintiff did as requested and ultimately deposited quite a bit of funds and wire transferred large sums of money to various entities. Checks were returned as fraudulent. That plaintiff alleged that a Wells Fargo employee indicated the checks had cleared and that no stop payments were associated with it. Consequently, that plaintiff sued the bank based on said alleged misrepresentations. When the checks were returned, the bank sued to recover the shortfall. The court analyzed similar provisions in the Michigan UCC as exist in the Texas version of the UCC and ultimately concluded that the bank should prevail. The court analyzed provisional credit issues under the UCC as well as contractual warranties agreed by the bank’s customer in the deposit agreement that governed the parties’ relationship. The court concluded that the ultimate risk of such a forged and/or counterfeit item should be borne by the customer notwithstanding any comments made by the bank.

¹⁵ In this case, Plaintiff is bringing a negligent misrepresentation claim and common law fraud and misrepresentation claims.

In *Chase*, an attorney deposited a check in his law firm's escrow account. See *Chase v. Morgan Guarantee Trust Co.*, 590 F. Supp. 1137 (S.D.N.Y. 1984). When the check was subsequently returned, the bank charged it back against the account. The attorney personally reimbursed the account for the shortfall and then brought a lawsuit against the bank. This face pattern is extremely similar to the facts in existence in the case at bar.

The *Chase* court was also faced with a motion for summary judgment. The court analyzed UCC § 4-201, just as the Court is being asked to do in this particular matter. The court explained that UCC § 4-201 states that prior to final settlement, the collecting bank is merely the agent for collection of the check deposited by the owner and any settlement is provisional. The court explained that under UCC § 4-212, if the collecting bank has credited a customer's account for an item and even if the customer makes a provisional withdrawal, but fails to receive a final settlement for that item, the bank may charge back the customer's account. In *Chase*, the reversal of the provisional credit caused a shortfall in the account. In *Chase*, the plaintiff also claimed that he had been misled into believing that the check had apparently cleared. However, the court ruled against plaintiff and granted a summary judgment. See *Id.* at 1139.

The *Chase* court explained that a bank may not be able to charge back only if the bank's negligence causes ***the dishonor that requires the charge-back***. Plus, the court analyzed the official comments to the UCC and explained that any alleged failure to exercise ordinary care must be in *handling* the item or otherwise there was no valid claim against the bank. See *Id.* The court even explained that such an interpretation was not unfair to customers. Customers should know that a provisional credit by definition is one that can be charged back. The court cited many other cases that confirm such law. Consequently, the court explained because the law was so clear, summary judgment was warranted.¹⁶

Additionally, there are other cases that also seem to be applicable. For example, in the *Allen v. Carver Federal Savings and Loan Association* matter, the court ruled against the customer and held that the bank was entitled to recover pursuant to its counterclaim to allow recovery on the reversal of the provisional credit. See, 477 N.Y.S.2d 537 (Supreme Court, New York 1984). The *Allen* court also analyzed provisional credit issues and analyzed risk of loss regarding similar facts. The court explained that a customer cannot shift the risk of loss to the bank by relying upon a statement of the teller that the check had "cleared" and/or the fact that she believes she was permitted to withdraw the funds from her account. In this case, the facts are even better for the bank because plaintiff is not even alleging that anyone at the bank ever told plaintiff that the check had, in fact, "cleared." Again, the court analyzed the UCC provisions and ruled against the customer as the court did in the *Chase* matter. See *Id.* at 706.¹⁷

If this issue arises at your bank, I have additional arguments and/or briefing on these issues. For example, I have drafted other arguments sections as follows:

¹⁶ The *Chase* plaintiff even argued that a material fact issue existed regarding what was allegedly said by the teller, but the court disagreed.

¹⁷ Another New York Supreme Court similarly ruled in *Call v. Ellenville National Bank* matter. See, 774 N.Y.S.2d 76 (New York Supreme Court 2004).

- I. **There is no conversion claim as plaintiff deposited funds into plaintiff's account that were later returned uncollected. Consequently, the funds truly never belonged to plaintiff and plaintiff wire transferred funds from this same account at plaintiff's own risk.**
- II. **As seen by the bank's original Counterclaim and/or Amended Counterclaim, even if plaintiff is successful in recovering under some sort of conversion claim and/or other claim, plaintiff would still owe the exact same amount of said funds to the bank due to the check not being paid and returned to the bank. Thus, under such a judicial offset theory, plaintiff cannot recover an affirmative judgment against the bank.**
- III. **Plaintiff's cause of action for conversion fails as a matter of law for other reasons.**
- IV. **This plaintiff cannot bring a conversion claim. Plus, plaintiff has wholly failed to prove up any damages even if this Court is somehow convinced that a conversion claim brought by this particular plaintiff is somehow appropriate.**
- V. **Plaintiff is in essence trying to bring a wrongful dishonor claim as a conversion claim and only a maker of a check can bring a wrongful dishonor claim against a bank if a check is improperly not paid.**

I have other arguments a bank can make as well regarding such situations.

D. BANKS CAN ALSO TRY TO AVOID FUTURE RISK BY HAVING GOOD DEPOSIT AGREEMENTS THAT SUPPLEMENT THE GOOD DEFENSES PROVIDED UNDER THE UCC.

I have previously given speeches on how and why bank deposit agreements can be amended to better protect banks from future liability. Please contact me if you want a copy of a paper I have done to support such a speech. I wanted to provide a brief overview on such issues.

More specifically, the Texas Finance Code specifically allows a deposit agreement to be a binding contract between a bank and a depositor. *See* Texas Finance Code Sections 34.301 and 34.302. More specifically, Section 34.301 states as follows:

(a) A deposit contract between a bank and an account holder is considered a contract in writing for all purposes and may be evidenced by one or more agreements, deposit tickets, signature cards, or notices as provided by Section 34.302, or by other documentation as provided by law.

(b) A cause of action for denial of deposit liability on a deposit contract without a maturity date does not accrue until the bank has denied liability and given notice of the denial to the account holder. A bank that provides an account statement or passbook to the account holder is considered to have denied liability and given the notice as to any amount not shown on the statement or passbook.

(c) To the extent provided by Section 4.102(c), Business & Commerce Code, the laws of this state govern a deposit contract between a bank and a consumer

account holder if the branch or separate office of the bank that accepts the deposit contract is located in this state.

Plus, Section 34.302 states as follows:

(a) A bank and its account holder may amend the deposit contract by agreement or as permitted by Subsection (b) or other law.

(b) A bank may amend a deposit contract by mailing a written notice of the amendment to the account holder, separately or as an enclosure with or part of the account holder's statement of account or passbook. The notice must include the text and effective date of the amendment. The bank is required to deliver the notice to only one of the account holders of a deposit account that has more than one account holder. The effective date may not be earlier than the 30th day after the date of mailing the notice unless the amendment:

(1) is made to comply with a statute or rule that authorizes an earlier effective date;

(2) does not reduce the interest rate on the account or otherwise adversely affect the account holder; or

(3) is made for a reason relating to security of an account.

(c) Except for a disclosure required to be made under Section 34.303 or the Truth in Savings Act (12 U.S.C. Section 4301 et seq.) or other federal law, before renewal of an account a notice of amendment is not required under Subsection (b) for:

(1) a change in the interest rate on a variable-rate account, including a money market or negotiable order of withdrawal account;

(2) a change in a term for a time account with a maturity of one month or less if the deposit contract authorizes the change in the term; or

(3) a change contemplated and permitted by the original contract.

(d) An amendment under Subsection (b) may reduce the rate of interest or eliminate interest on an account without a maturity date.

(e) Amendment of a deposit contract made in compliance with this section is not a violation of the Deceptive Trade Practices-Consumer Protection Act (Section 17.41 et seq., Business & Commerce Code).

Thus, the Texas Finance Code specifically allows a deposit agreement to be a binding contract. Most deposit contracts become binding by having a customer sign a signature card. The signature card generally refers to a deposit agreement that is amended from time to time. In the vast majority of the cases, the actual deposit agreement is not signed by the customer.

There have been several court cases that held that when a customer signs a signature card, the customer becomes bound by a deposit agreement. The Texas Supreme Court has held that an unsigned paper may be incorporated by reference in the paper signed by the person sought to be charged. *In re Prudential Ins. Co. of America*, 148 S.W.3d 124 (Tex. 2004). The Texas Supreme Court has reached the same conclusion in other cases. For example, the Texas Supreme Court has held that the exact language used to incorporate by reference is not important provided that the document signed plainly refers to another writing. *Id.* See also *Owen v. Hendricks*, 433 S.W.2d 164, 166 (Tex. 1968). Moreover, the agreements executed at the same time, with the same purpose and part of the same transaction or construed together. See *Jim Walter Homes, Inc. v. Schuenemann*, 668 S.W.2d 324, 327 (Tex. 1984). In the *Prudential* case, the Court held that the guarantee agreement incorporated the jury waiver clause in the lease that had not been signed by the guarantors. Thus, in most cases, a bank's signature card should plainly reference the fact that the customer agreed to be bound by the deposit agreement and that the customer has been provided a copy of the deposit agreement. Therefore, the deposit agreement in effect should govern the parties' relationship.

Additionally, the Texas Supreme Court has held that a customer's continued use of a bank account constitutes an agreement by the customer to be bound by the deposit agreement. More specifically, the Texas Supreme Court in *Martin* was faced with a plaintiff's argument that he should not be found to have agreed to be bound by a deposit agreement, and the court overruled the argument as follows:

In May 1994, the Credit Union adopted the Deposit Agreement containing the sixty-day notice provision, notified all its members, including Martin, made the agreement available, although Martin did not attempt to obtain a copy at the time, and sent account statements specifying the critical sixty-day time frame. Thereafter, Martin continued to maintain his account at the Credit Union. These actions are, as a matter of law, sufficient to demonstrate that the parties agreed to be bound by the terms of the Deposit Agreement. Consequently, the sixty-day notice provision in the Deposit Agreement is enforceable.

See *American Airlines Employees Credit Union v. Martin*, 29 S.W.3d 86 (2000). There are other court cases that hold that deposit agreements are binding by and between a bank and its customer. Generally speaking, courts will enforce deposit agreements as the contract by and between a bank and its customer.¹⁸

E. OTHER MISCELLANEOUS NEW CASES I THOUGHT YOU MIGHT FIND OF INTEREST ON UCC ISSUES

In *½ Price Checks Cash v. United Automobile Insurance Co.*, 344 S.W.3d 378 (Tex. 2011), the case concerned a holder's claim against a drawer of a dishonored check under the Texas version of the UCC Section 3.414. Unfortunately, the Texas Supreme Court ultimately ruled that the plaintiff would be allowed to recover and the plaintiff was allowed to recover

¹⁸ Courts are still analyzing issues regarding enforceability of jury trial waiver provisions. A recent opinion, attached as Tab B, discusses the purported enforceability of clauses requiring arbitration of class actions and/or related issues.

attorneys' fees. This is a case to be leery of as it might allow future plaintiffs to try to argue that attorneys' fees are recoverable.

However, please keep in mind that, for example, in a UCC 3.420 check conversion case, a Texas appellate court has ruled that plaintiffs cannot recover their attorneys' fees. In other words, there has been a fairly recent Texas appellate decision that has held that in a check conversion case, a plaintiff is not able to recover its attorneys' fees, costs and expenses against the depository bank. See *AMX Enterprises, Inc. v. Bank One, N.A.*, 196 S.W.3d 202 (Tex. App. — Houston [1st Dist.] 2006, no pet.). My law firm handled this case for Bank One.

F. MORE AND MORE PLAINTIFFS ARE SEEKING TO TRY TO HOLD BANKS RESPONSIBLE FOR PURPORTEDLY IMPROPERLY ACCEPTING CHECKS FOR DEPOSIT WITH FORGED ENDORSEMENTS.

I wanted to provide you with some briefing on such issues. For example, here are sections from a motion for summary judgment I have filed on these issues:

1. Plaintiff's conversion claims fail as a matter of law.

The Code Construction Act provides that "a uniform act included in a code shall be construed to effect its general purpose to make uniform the law of those states that enact it." Tex. Gov't. Code Ann. § 311.028 (Vernon 1998). The Texas Business and Commerce Code ("TBCC") is that type of uniform act to which the Code Construction Act applies. By its own terms, the TBCC promotes the laudable goal of making "uniform law among the various jurisdictions." See, TEX. BUS. & COMM. CODE § 1.102 (Vernon 1998). Thus, this Court can look to other jurisdictions in determining and applying the TBCC.

a. Because the check is ambiguous as to whether one payee or two or more were needed to endorse the check, third-party defendant's endorsement was sufficient to properly endorse the check.

Effective January 1, 1996, the TBCC changed the rule on how many payees must endorse checks payable to multiple payees. The check in dispute was written after January 1, 1996. Specifically, § 3.110(d) states:

(d) If an instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If an instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.

This changed the rule on whether a bank is liable if it accepts a check with only one person endorsing the check. Under previous law, if the check was ambiguous as to whether it was payable alternatively or jointly, all payees were required to endorse the instrument. Now, if there is any ambiguity, any payee on the check has the authority to endorse and negotiate the instrument. Indeed, § 3.110(d) now states that if the instrument is ambiguous as to whether it is

jointly payable or alternatively payable, then it is payable alternatively and the endorsement of only one payee is needed to transfer the instrument.

There is a fairly recent Dallas Court of Appeals Opinion that, although factually distinguishable, is directly relevant to the present case. This is the first Texas Appellate Court to analyze Texas law interpreting the current version of § 3.110(d). See, *Allied Capital Partners, L.P. v. Bank One*, 68 S.W.3d 51, 52 (Tex. App. — Dallas 2001 pet. denied). The *Allied Capital* Court held that where a check was issued that was made payable to payees that were listed vertically on the check with no word “and” separating the names that either payee could endorse the check and negotiate the instrument. The Dallas Court of Appeals specifically held that both parties did not need to endorse the check in order to negotiate the instrument. See, *Id.* Importantly, the clear holding of the case is that in a case of ambiguity as to whether the check is jointly payable, “persons dealing with the instrument should be able to rely on the endorsement of a single payee.” *Id.* at 52.

In that case, the court reasoned as follows:

We conclude that Bank One’s policy correctly followed the provision of the business and commerce code regarding instruments with multiple payees. See *Id.* § 3.110(d). The plain language of section 3.110(d) and the comments that follow indicate an instrument bearing multiple payees linked by “or” is payable to any of the payees individually, and an instrument linking payees by “and” is payable only to all of the payees jointly. See *Id.* Where an instrument does not use the word “or” or “and” between multiple payees, the instrument is ambiguous and, therefore, payable to any of the payees individually. See *Id.* Thus, without resort to testimony concerning the custom and usage of the banking industry in Dallas, the business and commerce code clearly indicates that “or” means “or,” “and” means “and,” and the absence of such words between listed multiple payees results in the instrument being payable to any of the payees individually. See *Id.* We overrule *Allied* and *American*’s first issue.

See *Allied Capital Partners v. Bank One*, 68 S.W.3d 51, 53 (Tex. App. — Dallas 2001, no pet.).

In this case, there is no dispute that one of the payees, Third-Party Defendant, endorsed the check and negotiated the check. It is also undisputed that the word “and” does not appear between the various purported payees. Although there appears to be some type of symbols between the various words on the check, the symbols are, at best, ambiguous, which rendered the check negotiable with the endorsement of either payee. Consequently, in this case, because one of the named payees endorsed and/or deposited the check, the check was properly accepted by the bank for negotiation. Moreover, if plaintiff is truly entitled to a large percentage of the proceeds represented by the check, as plaintiff alleges, the maker of the check should never have made the check payable as it was, and the maker certainly should not have provided the check to Third-Party Defendant. Plaintiff’s recourse, if any, is against the maker of the check and/or Third-Party Defendant, if Third-Party Defendant should have never gotten the proceeds represented by the check. Defendant expects plaintiff to argue that at least one of the four symbols should be treated as an “and.”

In *Danco, Inc. v. Commerce Bank*, 675 A.2d 663, 29 UCC Rep. Serv.2d 513 (N.J. Super. Ct. App. Div. 1996), the New Jersey Court held that no conversion occurred where one endorsement of a co-payee was valid and another endorsement was allegedly forged because the check had an ambiguous co-payee designation. The *Danco* Court held that no conversion occurred because even if the endorsement of payee had been forged, the bank would not be liable because the second endorsement was not needed for negotiation of the check once a proper endorsement had been placed on the check. See, *Id.* The *Danco* Court focused on UCC § 3.110(d) in holding that “in the case of ambiguity, persons dealing with the instrument should be able to rely on the endorsement of a single payee.” See, *Id.* The *Danco* Court reasoned that it is the objective intent of the maker, as shown on the face of the check, that is controlling as to the endorsements required. See, *Id.*

The Court stated that unless the maker makes it clear on the face of the check that endorsement by a single payee is unacceptable, persons dealing with the instrument should be able to rely on the single endorsement without suffering the risk of incurring liability. See, *Id.* The maker is in the best position to guard against the ambiguity and that is where the duty should be. See, *Id.* In *Danco*, the New Jersey Court reasoned that no conversion had occurred because even assuming that one endorsement was a forgery, it was not required. The *Danco* Court explained that only one valid signature was required because the checks were payable to the two parties alternatively and not jointly. See also, *Kinzig v. First Fidelity Bank*, 277 N.J. Super. 255, 260, 25 UCC Rep. Serv.2d 125 (N.J. Super. Ct. Law Div. 1994) (where the Court held that one valid signature, even where the other is a forgery, is sufficient to properly pay a check made payable to two payees in the alternative).

In *L.B. Smith*, a check in the names of two payees was deposited with two endorsements, one valid and the other unauthorized. See, *L.B. Smith, Inc. v. Bankers Trust Co. of W. New York*, 439 N.Y.S.2d 543, 31 UCC Rep. Serv. 596 (N.Y. App. 1981). The *L.B. Smith* Court held that the check had been validly negotiated by the defendant bank. Although the signature of one payee was unauthorized, the Court held that the check had been properly negotiated with one valid endorsement. See, *Id.* at 544. The New Jersey and New York cases make sense under the UCC. Plaintiff’s loss, if any, should be the responsibility of the maker of the check **who could have prevented the alleged loss by either inserting an unambiguous “and,” issuing separate checks to separate payees, or by sending the check(s) to plaintiff.**

In *New Wave*, a Texas court recently continued the trend in deciding if there was any possible ambiguity, any payee could endorse and negotiate the check, and the court granted a summary judgment for the bank. See *New Wave Technologies, Inc. v. Legacy Bank of Texas*, 281 S.W.3d 99 (Tex. App. — El Paso 2008, pet. denied).

In *New Wave*, the checks were made payable to “Maxim Solutions Group/New Wave Techn” in the amount of \$134,656.16 and \$52,558.73 respectively. The back of each check stated “Each Payee Must Endorse Exactly as Drawn.” Notwithstanding such specific language, the court found that having a virgule between the two purported payees meant that the check was ambiguous as to whether or not the check was alternatively and/or jointly payable. Consequently, the bank moved for summary judgment asserting that it did not convert the check as a matter of law because the payees were alternative payees as a matter of law. The court agreed notwithstanding the language on the back of the check that stated “Each Payee Must

Endorse Exactly as Drawn.” The court analyzed that if there is any reason to believe that the check could be made alternatively payable, only one payee needed to endorse the check. Indeed, the court looked at other jurisdictions and found that other courts have found virgules to mean “or.”

The *New Wave* court also explained that makers could insert the words “or” and/or “and” to make it clear if the maker intended two or more payees to endorse checks, and if these words are not used on the check, the check is not clear. Consequently, the court found that the check on its face, was ambiguous as to whether or not it was payable to persons alternatively or jointly, and as such the instrument was payable alternatively under the Texas version of the UCC. Consequently, the court upheld a summary judgment granted in favor of the bank.

Under the revised UCC, the drafters clearly intended that if there is any ambiguity, one signature is all that is needed to validly endorse the check. Once Third-Party Defendant signed the check and its signature constituted a proper endorsement, the check was properly payable. Various Texas Courts of Appeals have recently confirmed that such is the law in Texas. The UCC was changed so that banks would no longer be “insurers” of checks. Care needs to be done so that checks are properly drafted and delivered. For all of these reasons, summary judgment is warranted for Defendant.

- b. Defendants are entitled to summary judgment because plaintiff never got possession of the check or voluntarily gave up possession of the check in dispute, and Defendants did not owe any duty or breach any duty owed to the plaintiff.**

There is no allegation or evidence of the fact that plaintiff ever had possession of the subject check. In *Miller-Rogaska*, the Dallas Court of Appeals held that without possession, a payee cannot maintain a conversion cause of action. See, *Miller-Rogaska v. Bank One, Texas*, 931 S.W.2d 655 (Tex. App. — Dallas 1996, no writ). The Court held that essential to a cause of action for conversion is a party’s status as a holder. See, *Id.* at 660. The Court reasoned that in order to establish a cause of action for conversion, a party must be a holder, and one cannot be a holder without possession. See, *Id.* Plaintiff admitted that plaintiff did not have physical possession of the check when the alleged conversion occurred.

In *Miller-Rogaska*, the drawer of the check made the check and inadvertently mailed the check to a different entity who mistakenly cashed it. The *Miller-Rogaska* plaintiff argued that because it was the named payee and the check was placed in the mail system, that this constituted possession. However, the Court held that at any time prior to actual delivery, the drawer could have destroyed the check, decided not to pay the plaintiff, or placed a stop payment on the check even after it was mailed. Consequently, the Court stated that until the payee had possession of the check, no cause of action for conversion would lie.

If a check is never delivered to the named payee, there is no basis for a conversion action. See, *City Nat’l Bank of Miami v. Wernick*, 368 So.2d 934 (Fla. Dist. Ct. App.), cert. denied, 378 So.2d 350 (1979). In *Wernick*, a corporation issued a check payable to the order of plaintiff. However, instead of delivering the check to plaintiff, the corporation forged the plaintiff’s endorsement and deposited the item into the corporation’s own bank account. This seemingly

illogical transaction supposedly created increased financial confidence in the corporation. In fact, plaintiff did not even know of the bogus check until long after the wash transaction took place. However, being owed substantial money by the defunct corporation, plaintiff later sued the depository-drawee bank for conversion by arguing that the bank paid the check over a forged endorsement. The *Wernick* Court examined the UCC and held that, “conversion will not lie unless the named payee has taken delivery of the check.” See, *Id.* See also, *Lincoln Nat’l Bank and Trust Co. v. Bank of Commerce*, 764 F.2d 392 (5th Cir. 1985).

In *Lincoln Nat’l Bank*, an insurance agent forged the signature of a policyholder on loan documents. As a result, checks were issued payable to the policy holder and sent to the agent, who forged the endorsements of the policy holder, added his own endorsement, and deposited the checks into his personal account. The intended payee sued the depository bank, alleging conversion. The Fifth Circuit concluded that possession was a necessary predicate of any conversion action brought by the intended payee. See, *Id.* In *Lincoln Nat’l Bank*, the policyholder never received possession of the checks because they were diverted by the dishonest agent to a different address. Therefore, the Court rejected the intended payee’s conversion action. The Court suggested that the intended payee had a right to sue the insurance company as drawer.

Other courts have precluded payees who were not in possession from bringing conversion claims against the depository bank. See, *Florida Nat’l Bank v. Isaac Indus., Inc.*, 560 So.2d 1203 (Fla. Dist. Ct. App. 1990). The *Florida Nat’l Bank* Court gave three reasons for denying a conversion claim to a payee that has never received possession:

- (a) Without delivery, the intended payee cannot assume the status of a holder;
- (b) Even though the payee cannot recover from the collecting bank, he or she retains the right to sue the drawer on the underlying obligation; and
- (c) When the payee does not receive the check, the forged endorsement is probably the result of the drawer’s negligence, an issue not easily litigated in a suit between the payee and the collecting bank.

In this case, because plaintiff never got possession and/or voluntarily gave up possession of the allegedly converted check, plaintiff is unable to recover against the depository bank. Nothing prohibits plaintiff from trying to recover from the maker of the check and/or the Third-Party Defendant.

Under the plain language of TEX. BUS. & COMM. CODE § 3.420, in order to bring a claim for conversion, the party must have possession of the instrument. Thus, plaintiff’s claims for conversion and/or any similar claims are barred as a matter of law. Alternatively, to the extent required, Defendant moves for a no-evidence summary judgment on the requisite elements of delivery, causation and damages as to plaintiff’s conversion claim.

G. MANY PLAINTIFFS' ATTORNEYS ARE TRYING TO AVOID VARIOUS UCC PROVISIONS AND ARE BRINGING CREATIVELY PLED COMMON LAW CAUSES OF ACTION AND/OR OTHER CAUSES OF ACTION TO TRY TO AVOID THE UCC AND/OR OTHER STATUTES.

Here are some examples of briefing on such issues:

1. Plaintiff's common law claims are preempted by the UCC.

The Texas Legislature made a deliberate decision, by enacting Chapters 3 and 4 of the UCC, to remove the confusion and uncertainty concerning such "run of the mill" check conversion cases, and to resolve such disputes by means of the precise and detailed rules for check conversion cases developed by the American Law Institute and the National Conference of Commissions on Uniform State Laws and embodied in the UCC. *See Pacific Products v. Great W. Plywood Ltd.*, 528 S.W.2d 286, 291 (Tex. App. — Fort Worth 1975, no writ). On this point, the UCC explicitly assigns responsibility, defines behavioral norms, allocates risks and establishes limits on liability among and between the various parties to check fraud and/or unauthorized disbursement cases. *See Union Bank of Benton, Ark. v. First Nat. Bank of Mt. Vernon*, 792, 621 F.2d 790 (5th Cir. 1980). To permit common law or competing statutory schemes to creep into this well-considered regime would defeat entirely the very purpose of having a uniform statute that clearly was intended to govern transactions that by their very nature are national in scope.

In drafting Chapter 3 and Chapter 4 of the UCC, the competing interests of banks, Texas bank customers, as well as the public interest were carefully considered. These competing interests were represented in the drafting process and were thoroughly weighed by the Legislature. *See e.g.*, Texas UCC, Section 3.404, "State Bar Comments." The rules that emerged represent a careful and deliberate balancing of these interests, and should be considered the exclusive means of determining rights, duties and liabilities in those situations covered by the particular provisions of Chapter 3 and Chapter 4. Consequently, resorting to principles of law or equity outside of Chapters 3 or 4 is discouraged and is certainly not appropriate to create rights, duties and liabilities inconsistent with Chapter 3 or Chapter 4. Where the legislature has embraced a statutory scheme that is so precise and so carefully considered, there is no need to import common law or nonspecific competing statutory regimes to resolve unauthorized withdrawal cases. *See Union Bank, supra* at 792.

Here, plaintiff raised this exact issue by pleading an alleged improper check conversion case, and then asking that the dispute be resolved under negligence and/or possibly other common law principles. As discussed above, by enacting the UCC, the Texas Legislature adopted a comprehensive set of rules governing the transactions to which it applies and including specifically transactions involving unauthorized checks and other deposit account transactions. A leading Texas decision construing the UCC and explaining the concept of displacement noted quite convincingly:

The objective of the Uniform Commercial Code, or any code, is to displace scattered legislation or decisional law, and to state as fully as practicable a comprehensive and workable set of rules and principles for the governing of all

aspects of transactions in the field to which it applies. Of course prior law is applicable in so far as it is not displaced by specific provisions of the Code.

See *Pacific Prods.*, *supra* at 291 (Tex. Civ. App. — Fort Worth 1975, no writ).

Likewise, in *Southwest Bank v. Information Support Concepts*, 85 S.W.3d 462 (Tex. App. — Fort Worth 2002, writ granted), the Court of Appeals, in holding that Chapter 33 of the CRPC was displaced by the UCC, observed:

Recent amendments to the UCC demonstrate a discrete legislative fault scheme uniquely applicable to banks. See TEX. BUS. & COM. CODE ANN. §§ 3.405. (Vernon 2002). Although, traditionally, contributory negligence by a plaintiff was not a defense to a bank's liability for conversion under section 3.420, recently, articles 3 and 4 of the UCC have been amended to permit some defenses by banks when an employer's negligence substantially contributes to the alteration of an instrument or to the making of a forged signature on an instrument. See TEX. BUS. & COM. CODE ANN. §§ 3.405 - .406 (Vernon 2002); see also Donald J. Rapson, Loss Allocation in Forgery and Fraud Cases: Significant Changes Under Revised Articles 3 and 4, 42 Ala. L.Rev. 435, 457-64 (1991); cf. *DoAll Dallas Co. v. Trinity Nat. Bank*, 498 S.W.2d 396, 402 (Tex. Civ. App. — Texarkana 1973, writ ref'd n.r.e.) (holding plaintiff's contributory negligence not a defense to a section 3.420 conversion claim); *Rosenthal v. Mfrs. Hanover Trust Co.*, 30 A.D.2d 650, 291 N.Y.S.2d 19, 20 (N.Y. App. Div. 1968) (same).

It is evident, therefore, that the Legislature intended to establish a balanced allocation of rights and obligations to govern the type of commercial transaction here in issue, and any effort to import other statutory or common law schemes is discouraged. The Fifth Circuit Court of Appeals echoed this same theme when it noted:

The UCC is found (by the Court) to be a finely tuned statutory mechanism containing interlocking provisions designed to provide certainty in commercial transactions. Once the pieces of this puzzle are correctly aligned, the UCC furnishes an answer to almost any question involving the rights and liabilities of the parties to a covered transaction.

Union Bank, *supra*, at 750.

For those circumstances where the UCC does not provide the answer, the Legislature recognized that the UCC could not possibly address every single factual permutation that might occur in the countless transactions to which it applies. The Legislature therefore provided that “[u]nless displaced by the particular provisions of this title, the principles of law and equity . . . shall supplement its provisions.” TEX. BUS. & COM. CODE § 1.103 (Vernon 1994).¹⁹

As for the displacement itself, however, the following rule of thumb applies – when the fact pattern of a particular transaction comes within the scope of the UCC, the common law

¹⁹ This provision applies to the entirety of the UCC articles, e.g., sale of goods, leases, secured transactions, etc.

claims and remedies that might also apply are “displaced”. *See, e.g., Miller-Rogaska, Inc. v. Bank One, N.A.*, 931 S.W.2d 655, 662 (Tex. App. — Dallas 1996, no writ) (holding that claim for common law conversion was displaced by UCC § 3.419 n/k/a § 3.420); *see also New Ulm State Bank v. Brown*, 558 S.W.2d 20, 28 (Tex. Civ. App. — Houston [1st Dist.] 1977, no writ) (since the UCC provided a remedy for conversion of documentary drafts and breach of presentment warranty, there was “no basis” for additional “bad faith” damage award). Thus, Defendant’s Motion for Summary Judgment seeks to apply this principle of displacement to the non-UCC assertions made by plaintiff.

(a) Plaintiff’s common law claims should be displaced.

When the UCC applies, it displaces common law claims, including negligence. *See Halifax Corp. v. First Union National Bank*, 546 S.E.2d 696, 704 (Va. 2001) (rejecting common law claims and holding that [common law principles] have been displaced by the [UCC], which was enacted to promote uniformity, predictability and finality in certain types of commercial transactions.”) As is discussed above, the facts alleged by plaintiff are governed in all respects by Chapters 3 and 4 of the Texas UCC.

The heart of this case is plaintiff contends that the bank converted the check and that Defendant is liable for that activity. As a case governed by the UCC, plaintiff’s allegations that Defendant was negligent or that Defendant “failed to do this” or “failed to do that” all are reduced to the question of whether plaintiff has a claim under the UCC and whether Defendant has any such defenses to the claim.

(b) The displacement rule controls this case.

The Dallas County Court of Appeals’ decision in *TSC v. Sav of America* reflects the majority rule on the question of displacement. Indeed, other courts around the country have also found that common law negligence claims are displaced when, in cases like this, the UCC provides a comprehensive remedy to the plaintiffs. *See Moody National Bank v. Texas City Development*, 46 S.W.3d 373 (Tex. App. — Houston [1st Dist.] 2001, pet. denied) (holding the Texas UCC preempts any negligence claim that “falls squarely within the parameters” of a specific UCC provision); *Grain Traders, Inc. v. Citibank, N.A.*, 160 F.3d 97 (2d Cir. 1998) (holding common law claims precluded “when such claims would impose liability inconsistent with the rights and liabilities expressly created” by the UCC); *Lee Newman, M.D., Inc. v. Wells Fargo Bank, N.A.*, 87 Cal. App. 4th 73 (Cal. App. — 2d Dist., Div. 3 2001) (holding “the Commercial Code precludes a common law negligence action against banks taking checks fraudulently indorsed by dishonest employees”); *Sebastian v. D & S Express, Inc.*, 61 F. Supp.2d 386 (D.N.J. 1999) (holding, in a check fraud case, that the plaintiff’s common law negligence claim was barred because “common law negligence and the UCC cause of action would necessitate the same legal analysis”); *Equitable Life Assurance Soc’y of the United States v. Okey*, 812 F.2d 906, 911 (4th Cir. 1987) (holding common law negligence claim displaced, and noting “[t]he cumbersomeness of dealing simultaneously with two causes of action that incorporate the same elements under varying burdens, when the only conceptual reason for considering both still viable is their somewhat different measures of damages”). For these additional reasons, summary judgment is warranted.

2. Plaintiff should not be allowed to recouch its various claims into different causes of action to avoid the terms of the UCC.

Plaintiff has sued Defendant for, among other things, negligence, conversion and possibly other claims. However, all of these claims involve the same set of facts. Specifically, plaintiff is claiming that Defendant improperly allowed the alleged wrongdoer to negotiate the check in dispute. Plaintiff claims that as a result of this alleged act, it was damaged because Defendant improperly allowed the wrongdoer to get the proceeds of the check.

However, plaintiff may not recast its claim in the language of another cause of action to avoid limitations or compliance with mandatory statutes or to circumvent existing case law contrary to their position. *See Hodge v. Northern Trust Bank*, 54 S.W.3d 518 (Tex. App. — Eastland 2001, writ denied). In *Hodge*, the Court held that the plaintiff was only allowed to bring a conversion claim (and not plead other claims) because the money being held at the bank was a special deposit. *Id.* Other Courts have held that a plaintiff is not allowed to recast claims into various other causes of action. *See Earl v. Ratliff*, 998 S.W.2d 882, 893 (Tex. 1999) (essence of plaintiff's claim was that defendant was negligent by not conforming to the applicable standard of care despite labeling claims as DTPA causes of actions); *In re Kimball Hill Homes Texas, Inc.*, 969 S.W.2d 522, 526 (Tex. App. — Houston [14th Dist.] 1998, orig. proceeding) (nature of claim controls and plaintiff cannot, by artful pleading, recast claim to avoid adverse effect of statute); *Martz v. Weyerhaeuser Co.*, 965 S.W.2d 584, 589 (Tex. App. — Eastland 1998, no pet.).

Indeed, other Courts have held that where a plaintiff tries to recharacterize a legal malpractice claim into fraud and other torts, all of the claims (including fraud) would be time-barred as a matter of law because the crux of all of the claims is that the law firm did not provide adequate representation. *See Kimleco Petroleum, Inc. v. Morison and Shelton*, 91 S.W.3d 921 (Tex. App. — Fort Worth 2002, pet. denied). In *Kimleco Petroleum*, the court held that the alleged professional failures could only be characterized as legal malpractice and barred all of the plaintiff's claims. *Id.*

In this case, the UCC bars plaintiff's claims, and plaintiff should not be allowed to try to creatively plead to avoid the terms of the UCC. Plaintiff should not be allowed to recouch its claims into other causes of action. *See Jureczki v. Banc One Texas*, 252 F. Supp.2d 368 (S.D. Tex. 2003). Therefore, summary judgment is appropriate on all of plaintiff's causes of action.

H. OTHER CREATIVE PLAINTIFFS ARE TRYING TO SUE BANKS EVEN WHEN THERE IS ABSOLUTELY NO RELATIONSHIP WITH THE BANK. COURTS CONTINUE TO BE RELUCTANT TO ENFORCE SUCH CAUSES OF ACTION.

Here are sections I have included in motions for summary judgment on such issues:

1. Plaintiff has provided no evidence to support its possible negligence claims.

In order to establish a cause of action for common law conversion, a plaintiff must prove: (1) plaintiff owned, had legal possession of, or was entitled to possession of property; (2) defendant assumed and exercised dominion and control in an unlawful and unauthorized manner, to the exclusion of and inconsistent with plaintiff's rights; and (3) defendant refused plaintiff's

demand for the return of property. See *Ojeda v. Wal-Mart Stores, Inc.*, 956 S.W.2d 704, 707 (Tex. App. — San Antonio 1997, pet. denied). Although somewhat unclear, plaintiff purportedly alleged that Defendant has somehow converted its property. But, even if plaintiff establishes elements for conversion, plaintiff cannot recover as a matter of law.

An action for conversion will lie when the money is specifically identified. An action for conversion must be supported by title by the plaintiff, and there must be a means of identification of it as a specific chattel for it to constitute the subject of conversion. See *Houston Nat'l Bank v. Biber*, 613 S.W.2d 771, 774 (Tex. Civ. App. — Houston [14th Dist.] 1981, writ ref'd n.r.e.). A suit for conversion will not lie where a debtor/creditor relationship merely exists. *Id.* The making and acceptance of an ordinary deposit because the money deposited into a bank account becomes represented by a general debt of the bank and creates a debtor/creditor relationship between the bank and its depositor. *Id.* See also *Upper Valley Aviation v. Mercantile Nat'l Bank*, 656 S.W.2d 952, 955 (Tex. App. — Dallas 1983, writ ref'd n.r.e.) citing *First Nat'l Bank of Bellaire v. Hubbs*, 566 S.W.2d 375 (Tex. Civ. App. — Houston [1st Dist.] 1978, no writ). Consequently, plaintiff is unable to recover on a possible claim for conversion.

Based on the information provided in plaintiff's pleading, plaintiff can prove none of the three (3) requisite elements of its common law conversion claims. With respect to the negligence claim, plaintiff has produced no evidence that Defendant owes any duty to plaintiff. In *Dilling*, the Texas Supreme Court held that a bank was not negligent in a banking context. See, *NationsBank, N.A. v. Dilling*, 922 S.W.2d 950, 954 (Tex. 1996). Among other claims, the *Dilling* plaintiff sued the bank for negligent hiring. However, the Court held that NationsBank did not owe the plaintiff a duty. Specifically, the Court reasoned as follows: "The fact that it may have been foreseeable that a negligently employed teller would improperly issue checks does not make it foreseeable that a third-party, who never came into to direct contact with the teller would rely on the issuance of cashier's checks to make investment decisions. We therefore hold that NationsBank establishes a matter of law that it owed no duty to *Dilling*." See, *Id.* at 954. Similarly, what duty did defendant owe to plaintiff, and how was it foreseeable that plaintiff would get allegedly harmed?

To sustain a negligence action, a plaintiff must first establish some duty owed to it by the bank. See, *Miller-Rogaska v. Bank One, Texas*, 931 S.W.2d 655, 663 (Tex. App. — Dallas 1996, no writ). Whether a duty exists is a question of law for the Court. See, *Id.* In this case, Defendant did not owe a duty to plaintiff. Merely by being a bank does not give rise to a duty to society in general. Moreover, plaintiff has produced no evidence that the bank owed a duty to plaintiff, that it breached the duty, and that it caused damages to plaintiff.

Plaintiff appears to be trying to find a creative way to bring claims against Defendant notwithstanding plaintiff's own errors in deciding to do business with other parties. Several courts have held that a non-customer cannot sue a bank for negligence in allegedly improperly opening a bank account. See, e.g., *Eisenberg v. Wachovia Bank*, 301 F.3d 220 (4th Cir. 2002). In *Eisenberg*, the Court reasoned as follows:

Under North Carolina law, "[n]egligence is the failure to exercise proper care in the performance of a legal duty owed by a defendant to a plaintiff under the circumstances." *Cassell v. Collins*, 344 N.C. 160, 472 S.E.2d 770, 772 (1996). A

necessary factor in proving negligence is the existence of a duty of care owed to the particular plaintiff by the defendant. *Pinnix v. Toomey*, 242 N.C. 358, 87 S.E.2d 893, 897 (1955). “Actionable negligence presupposes the existence of a legal relationship between parties by which the injured party is owed a duty by the other, and such duty must be imposed by law.”). We consider whether a bank owes a duty of care to a noncustomer who is defrauded by the bank’s customer through use of its services. We cannot find an applicable precedent from a North Carolina court and look to case law from other jurisdictions. We conclude that the North Carolina Supreme Court, if it were to decide this issue, would hold that Wachovia did not owe Eisenberg a duty of care under the facts presented. . . .

Courts in numerous jurisdictions have held that a bank does not owe a duty of care to a noncustomer with whom the bank has no direct relationship. *See Weil v. First Nat’l Bank of Castle Rock*, 983 P.2d 812, 815 (Colo. Ct. App. 1999); *Volpe v. Fleet Nat’l Bank*, 710 A.2d 661, 664 (R.I. 1998); *Miller-Rogaska, Inc. v. Bank One*, 931 S.W.2d 655, 664 (Tex. App. 1996); *Software Design & Application, Ltd. v. Hoefer & Arnett, Inc.*, 49 Cal. App. 4th 472, 56 Cal. Rptr.2d 756, 760-63 (1996); *Portage Aluminum Co. v. Kentwood Nat’l Bank*, 106 Mich. App. 290, 307 N.W.2d 761, 764-65 (1981); *Pa. Nat’l Turf Club, Inc. v. Bank of W Jersey*, 158 N.J. Super. 196, 385 A.2d 932, 936 (1978); *Gesell v. First Nat’l City Bank*, 24 A.D.2d 424, 260 N.Y.S.2d 581, 581-82 (1965). *McCallum v. Rizzo*, 1995 WL 1146812 (Mass. Super. Ct. Oct. 13, 1995), presents highly analogous facts. Plaintiff McCallum loaned money to the Tsongas Committee, an organization advocating the election of presidential candidate Paul Tsongas. *Id.* at *1. Rizzo, the chief fund raiser for the Tsongas Committee, opened a bank account at Andover Bank bearing the committee’s name and listed himself as sole signatory. *Id.* The bank did not verify that Rizzo was authorized to transact business on behalf of the Tsongas Committee. *Id.* Rizzo used the bank account to convert the proceeds of contributions and loans to the Tsongas Committee to his own use. McCallum’s funds were converted by Rizzo. *Id.*

McCallum sued Andover Bank on a theory of negligence. He argued that the bank “owed a duty to contributors to the Tsongas committee to exercise due care in the opening and handling of the Tsongas Committee account.” *Id.* The *McCallum* court disagreed and followed cases in other jurisdictions which held “a bank’s failure to investigate a customer’s suspicious activity ... does not give rise to liability to the third party who is injured by the customer’s fraud.” *Id.* at *2. The court explained that “the mere fact that a bank account can be used in the course of perpetrating a fraud does not mean that banks have a duty to persons other than their own customers. To the contrary, the duty is owed exclusively to the customer, not to the persons with whom the customer has dealings.”

See *Eisenberg v. Wachovia Bank*, *Eisenberg v. Wachovia Bank*, 301 F.3d 220 (4th Cir. 2002). The *Eisenberg* court also explained that even where a bank account is fraudulently opened, the bank is not liable, and the court explained as follows:

Beyond the *McCallum* rule it has been held that banks do not owe a duty of care to noncustomers even when the noncustomer is the person in whose name an account was fraudulently opened. In *Software Design*, a financial consultant embezzled money from Software Design through a bank account he opened bearing the company name. 56 Cal. Rptr.2d at 759-60. The California Court of Appeal dismissed Software Design's negligence claim against the bank. *Id.* at 760-63. According to the court, "the primary flaw" in Software Design's negligence theory was the lack of a relationship between it and the bank. *Id.* at 760. Even though the bank account used to defraud Software Design bore its own name, the court held that a bank does not owe a duty of care to protect noncustomers against fraud. *Id.*; see also *Volpe*, 710 A.2d at 664 ("[A] bank is not liable in negligence to a noncustomer payee for having failed to ascertain whether a check paid by it bears the payee's genuine endorsement."). But see *Patrick v. Union State Bank*, 681 So.2d 1364, 1371 (Ala. 1996) (holding bank owed duty of care to person in whose name account was opened to ensure that person opening account is not imposter). Contrary to Eisenberg's arguments, *Sun 'n Sand, Inc. v. United California Bank*, 21 Cal.3d 671, 148 Cal. Rptr. 329, 582 P.2d 920 (1978), is not analogous to this case. In that case a Sun'n Sand employee fraudulently deposited company checks into a personal bank account at United California Bank ("UCB"). *Id.* at 335. Sun'n Sand sued the bank for negligently allowing the employee, who was not the payee on the checks, to deposit the checks into her account. Although Sun 'n Sand was not a UCB customer, the California Supreme Court held that the bank had a limited duty of inquiry based on the highly suspicious acts of the employee. *Id.* at 344-45. The court stressed that the duty it was recognizing was "narrowly circumscribed: it is activated only when checks, not insignificant in amount, are drawn payable to the order of a bank and are presented to the payee bank by a third party seeking to negotiate the checks for his own benefit." *Id.* at 346. There are no such special circumstances in this case. The act of opening a bank account under a "dba" name is not in itself suspicious enough to give rise to a duty of inquiry. Eisenberg was neither a Wachovia customer nor the person in whose name Reid's fraudulent bank account was opened. Bear Stearns would be the beneficiary of any duty of care which Wachovia might owe to a noncustomer. See *id.* Eisenberg instead falls into the undefined and unlimited category of strangers who might interact with Wachovia's bank customer. In *McCallum* the Massachusetts Superior Court noted that the maintenance of a bank account was intended to benefit the person who opened the account. *McCallum*, 1995 WL 1146812 at *3. The court reasoned that to extend a duty of care to strangers like Eisenberg would be contrary to the normal understanding of the purpose of a bank account and would expose banks to unlimited liability for unforeseeable frauds. *Id.*

See *Id.* at 226. The *Eisenberg* court also reasoned as follows:

Several other courts have relied on similar policy considerations in rejecting an argument that banks owe a duty to noncustomers. See *Software Design*, 56 Cal. Rptr. 2d at 763 ("Better that the one contemplating the services of a financial advisor do the background check and then monitor the services. It is that person

who has the most control and the most to win or lose, and with whom the investigative tasks should rest.”); *Weil*, 983 P.2d at 814 (“It would be unreasonable to require banks to make an independent investigation of their customers’ authority to use any particular unregistered trade name; and a duty to inquire only of the customer would not prevent the kind of harm plaintiff suffered.”); *Pa. Nat’l Turf Club*, 385 A.2d at 936 (“plaintiff was the party who assumed the risk associated with that hazardous activity ... [and] cannot recoup by attempting to shift responsibility to the bank which had no relationship with it.”).

We are persuaded by the reasoning articulated in the numerous cases holding that a bank does not owe noncustomers a duty of care. The reasoning and result in *McCallum* are particularly persuasive as the *McCallum* facts are indistinguishable from the facts of this case. We have no doubt that the North Carolina Supreme Court would reach a similar conclusion as that in *McCallum* and hold that Wachovia does not owe Eisenberg a duty of care.

See Id. at 226 and 227. Ultimately, the *Eisenberg* court held that Wachovia did not owe Eisenberg a duty of care, and that Eisenberg could not maintain a claim of negligence against Wachovia.

In *Guerra v. Regions Bank*, the bank was sued for allegedly negligently opening up a banking account. *See, Guerra*, 188 S.W.3d 744 (Tex. App. — Tyler 2006, no pet.). *See Exhibit K.* In *Guerra*, another individual opened up a bank account in his name and also included the plaintiff’s name and information on the account. The wrongdoer then drafted many checks that were later returned “n.s.f.” Various merchants then brought claims against both the wrongdoer and plaintiff. The wrongdoer was even arrested and had plaintiff’s identification with him. Plaintiff (*Guerra*) filed a lawsuit against Regions Bank and alleged that Regions had failed to adequately investigate the identity of the person opening the account, failed to verify the identity of persons whose names appeared on the account and checks, and failed to follow its own procedures and policies when it opened the bank account, and failed to verify that the person opening up the account had the authority to do so. *See Id.* at 746.

Regions Bank then filed a motion for summary judgment on both traditional and no-evidence grounds. The trial court granted the motion for summary judgment and it was affirmed on appeal. The *Guerra* court confirmed that whether a duty exists is a question of law for the court. The court explained that the *Guerra* plaintiff needed to first establish some sort of duty that the bank owed to him. *See Id.* at 747. *Guerra* conceded that he was not a customer of the bank and that he did not have any other relationship with the bank. Consequently, under the *Miller-Rogaska v. Bank One* case, the *Guerra* court confirmed that the bank had no duty to the *Guerra* plaintiff as a matter of law. *See Id.* at 747, citing *Miller-Rogaska, Inc. v. Bank One, Texas, N.A.*, 931 S.W.2d 655, 663 (Tex. App. — Dallas 1996, no writ). Ultimately, the bank confirmed that if there is no duty, then there is no claim for negligence and the bank would not be liable to that plaintiff.

To prevail on its causes of action against Defendant for negligence, plaintiff must prove: (1) Defendant owed it a respective legal duty; (2) Defendant breached its respective duty to

them; and (3) Defendant's breach proximately caused plaintiff's injury. *See D. Houston, Inc. v. Love*, 92 S.W.3d 450, 454 (Tex. 2002).

Similarly, in the Texas case of *Moody National Bank v. Texas City Development*, 46 S.W.3d 373 (Tex. App. — Houston [1st Dist.] 2001, pet. denied) (holding the Texas UCC preempts any negligence claim that "falls squarely within the parameters" of a specific UCC provision), the court had the same analysis. In *Moody*, a creative plaintiff likewise tried to sue a bank for negligence in allegedly improperly opening and/or monitoring a bank account. Just as other courts have done, the *Moody* court chastised the plaintiff and said that the real wrongdoers were to blame. The court explained that the *Moody* plaintiff was trying to take the fact that it had chosen to do business with wrongdoers, and that this fact should somehow make a bank responsible for plaintiff's alleged large losses. However, banks are not insurers, and plaintiffs should take responsibility for choosing to do business with people that may ultimately try to harm them. Consequently, for all of these reasons, summary judgment is proper.

I. COURTS ARE SLOWLY ANALYZING ISSUES THAT ARE BEING RAISED BY PLAINTIFFS UNDER UCC SECTION 4A. TO MY KNOWLEDGE, NO TEXAS COURT HAS RULED ON 4A.505 ISSUES.

As a reminder, UCC Section 4A.505 has been interpreted differently from UCC Section 4.406. Some courts have not allowed a bank to limit the reporting time frame for such cases. Thus, I wanted to provide some briefing on Section 4A reporting requirements.

1. Because plaintiff did not timely report the alleged unauthorized wire transfer within one year, plaintiff is precluded from claiming to the contrary.

TEX. BUS. & COM. CODE § 4A.505 states as follows:

If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment **unless the customer notifies the bank of the customer's objection to the payment within one year** after the notification was received by the customer.

Because plaintiff is arguing so vigorously that the wire transfer was unauthorized, plaintiff must also demonstrate that plaintiff notified the bank of plaintiff's objection within one year.

The Code Construction Act provides that "a uniform act included in a code shall be construed to effect its general purpose to make uniform the law of those states that enact it." TEX. GOV'T CODE ANN. § 311.028 (Vernon 1998). The Texas Business and Commerce Code ("TBCC") is that type of uniform act to which the Code Construction Act applies. By its own terms, the TBCC promotes the laudable goal of making "uniform law among the various jurisdictions". *See* TEX. BUS. & COM. CODE § 1.102 (Vernon 1998). Thus, this Court can look to other jurisdictions in determining and applying the TBCC.

In *Zengen*, the Supreme Court of California ruled against a plaintiff in a similar situation. *See Zengen, Inc. v. Comerica Bank*, 158 P.3d 800 (Cal. 2007). In *Zengen*, a wrongdoer

purportedly embezzled large amounts of money by directing four fund transfers. The transactions appeared on plaintiff's monthly bank statements, which plaintiff acknowledged it received. plaintiff's office manager then purportedly told the bank that an authorized signor had not signed the wire transfer request and that the wrongdoer had no authority to transfer the funds and that the wire transfer request was fraudulent and not authorized. *See Id.* at 803. In *Zengen*, plaintiff argued that the bank had violated California's version of UCC Section 4A. The *Zengen* plaintiff also argued that it had timely and properly notified the bank of the alleged unauthorized wire transfers.

In this case, it appears that plaintiff is arguing a 4A violation but it is ignoring section 4A.505. Section 4A.505 states that a customer is precluded "from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one year after the notification was received by the customer." The *Zengen* court explained that a customer must inform the bank in some fashion it believes the bank should not have accepted the payment order or otherwise is liable for the loss. **Plus, the court explained that merely informing the bank the payment order was unauthorized does not inform the bank that the customer considers it to be liable for the loss.** *See Id.* at 810. In *Zengen*, the court analyzed the California section of UCC 4A.505 and reasoned that **a customer must object "to what the bank did," not merely inform the bank the payment order was unauthorized.** *See Id.* at 810. In other words, merely stating that the payment order was unauthorized was not enough.

Instead, the plaintiff must notify the bank of the relevant facts, and the plaintiff must notify the bank that it may be liable for the loss. The *Zengen* court explained that its interpretation of section 4A.505 was consistent with the Uniform Commercial Code's drafters' concern that:

parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately. Reasonably prompt notification of a claim against the bank is important so the bank can investigate the matter, prepare a defense, anticipate possible liability, and take steps to guard against future liability.

The court also explained that such a claim is best investigated reasonably promptly while memories are fresh. The *Zengen* court also explained as follows:

Section 11505's [California's version of UCC 4A.505) notice requirement is not technical. The purpose of the notification requirement is to inform the bank reasonably promptly that the customer believes it is liable for the loss. That way, the bank knows it should take appropriate steps to protect itself. The customer's notice need only be sufficient to satisfy this purpose. The customer does not have to state specifically that it objects to the debiting or otherwise use any particular words. While it would certainly be preferable and clearer, and might avoid unnecessary litigation, for the customer to tell the bank expressly that the bank erred in processing the payment orders, or that it is liable for the loss, or use some other clear language, such specific words are not always necessary. **What is necessary is that the customer convey to the bank in some way that it objects**

to what the bank did or, stated slightly differently, it must in some way assert a claim against the bank. Whether the notification is sufficient in a given case depends on the overall circumstances.

We think the test should be, under all of the relevant circumstances, a reasonable bank would understand from the customer’s communication that the customer was objecting to what the bank had done in accepting the payment orders or otherwise considered the bank liable for the loss. If a reasonable bank would so understand the communication, it would know it should take appropriate steps to protect itself, thus satisfying the purpose behind section 11505.

See Id. at 811 and 812 (emphasis added).

Plaintiff has produced no evidence stating that plaintiff was going to sue the bank. Plaintiff’s correspondence to the bank contains no words stating that the wire transfer was not authorized. The correspondence does not clearly and/or specifically put the bank on notice that it might be sued. The correspondence is not asserting a claim against the bank. Plus, there is no issue that plaintiff was not aware that the wire transfer had been sent in plaintiff’s name. Plaintiff, very quickly, knew that the wire transfer had been sent.

Simply put, plaintiff has presented no evidence that plaintiff clearly objected to the wire transfer, and plaintiff has presented no evidence that plaintiff timely and/or clearly put the bank on notice that the wire transfer was allegedly unauthorized.²⁰

In *Fitts*, the Supreme Court of Alabama found that 4A.505 statute of repose applied to bar a plaintiff’s contest of an alleged improper funds transfer. *See Fitts v. AmSouth Bank*, 917 So.2d 818 (Ala. 2005).²¹ In *Fitts*, the plaintiffs learned of the transfer at the latest in mid-May 2001. They did not contest the funds transfer until some two years later. Consequently, the plaintiffs were precluded from proceeding against AmSouth to recover the alleged improper funds transfer.²² Thus, in this case, even if the Court assumes that the wire transfer was unauthorized, summary judgment is still warranted for the bank because plaintiff did not timely and/or properly “notify” and/or “object” to the alleged unauthorized wire transfer within one year.

Similarly, banks can make the argument that plaintiffs’ common law claims are displaced and/or preempted under a UCC Section 4A analysis.

²⁰ Again, under 4A.505, the issue is not whether or not the wire transfer was authorized. The issue is whether or not Plaintiff timely and properly notified the bank that the wire transfer was unauthorized.

²¹ Similarly, in the *Regatos* case, a court also explained UCC 4A.505 may preclude a customer’s right to contest a wire transfer. *See Regatos v. North Fork Bank, et al.*, 5 N.Y.3d 395, 838 N.E.2d 629 (N.Y. 2005). This is a case that held that a deposit agreement purportedly cannot limit the one year reporting requirement for reporting alleged improper 4A funds transfers.

²² As discussed below, the *Fitts* court also concluded that the Fitts’ common law claims were precluded.

2. **All of plaintiff's common law claims are displaced and/or preempted due to plaintiff's 4A claims.**²³

Since plaintiff is truly complaining about an alleged unauthorized UCC Article 4A wire transfer, all other claims should be precluded and/or preempted as a matter of law. In *Moody National Bank*, the court held that common law claims were preempted when plaintiff brought claims against defendant bank concerning a wire transfer. See *Moody Nat'l Bank v. Texas City Devel. Ltd.*, 46 S.W.3d 373 (Tex. App. — Houston [1st Dist.] 2001, pet. denied). The *Moody* court reasoned that “[c]ommon law claims are precluded when a claim would impose liability inconsistent with any of [Article 4As] provisions.” See *Id.* at 378. In support of its reasoning, the *Moody* court reviewed Texas and Business Code § 4A.102. This section states, “except as otherwise provided in § 4A.108, this chapter applies to funds transfers defined in § 4A.104.” As part of the official comment to § 4A.104, the comment states as follows:

The rules that emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article. **Consequently, resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.**

The *Moody* court restated such analysis in its opinion. In this case, plaintiff's alleged damages all related to the alleged improper wire transfer being done. Thus, all of plaintiff's common law claims should be preempted.

Furthermore, there are other courts in other states that have also precluded and/or exempted various other claims in similar cases. For example, in the *Zengen* case, the court explained as follows:

Courts from other jurisdictions have reached similar conclusions in considering the provisions of article 4A. (*Grain Traders, Inc. v. Citibank, N.A.* (2d Cir. 1998) 160 F.3d 97, 103; *Community Bank FSB v. Stevens Financial Corp.*, (N.D. Ind. 1997) 966 F. Supp. 775, 788; *Impulse Trading v. Norwest Bank Minn., N.A.*, (D. Minn. 1995) 907 F. Supp. 1284, 1287-1288; *Fitts v. Amsouth Bank* (Ala. 2005) 917 So.2d 818, 824 [“if the situation made the basis of a dispute is addressed in Article 4A, then the provisions of Article 4A provide the exclusive rights and remedies of the parties involved”]; *Corfan Banco v. Ocean Bank* (Fla. Dist. Ct. App. 1998) 715 So.2d 967, 9791; *Aleo Intern., Ltd. v. Citibank, N.A.* (N.Y. Sup. Ct. 1994) 160 Misc.2d 950, 612 N.Y.S.2d 540; *Moody Nat. Bank v. Texas City Development* (Tex. Ct. App. 2001) 46 S.W.3d 373, 377-379.) As one court observed, “The uniformity and certainty sought by the statute for these transactions could not possibly exist if parties could opt to sue by way of [preUniform Commercial Code] remedies where the statute has specifically

²³ Banks may or may not want to “educate” Plaintiff's counsels on 4A claims as the specific facts of each case may dictate.

defined the duties, rights and liabilities of the parties.” (*Corfan Banco v. Ocean Bank, supra*, at p. 971, fn5.)

See Id. at 808.

The *Zengen* court further explained that the gravamen of each of the *Zengen* plaintiff’s causes of action against the bank, including the one based on the California version of the Uniform Commercial Code, were all essentially the same — *i.e.*, that the bank should not have accepted and acted upon the alleged unauthorized wire transfer. *See Id.* at 808. Thus, the *Zengen* court precluded all of the common law causes of action.

Likewise, in the *Fitts* case, the court concluded that Article 4A has displaced common law claims. *See Fitts v. AmSouth Bank*, 917 So.2d 818 at 823. The *Fitts* case also quoted the official comment to section 4A.102. The *Fitts* court was persuaded by the express intent of the drafters and found that other claims should be precluded as a matter of law. Thus, all of plaintiff’s causes of action should be displaced and/or preempted as a matter of law.

Plaintiff tries to argue that the *Moody National Bank* case is inapplicable in this matter. However, plaintiff seems to wholly ignore the fact that the holding in the *Moody National Bank* case was that the common law claims were preempted. Plaintiff cites to other case law from other states, but the *Moody* case is the one Texas case that has analyzed and adopted this preclusion issue in a 4A matter.

Plaintiff tries to argue that the *Moody* case does not apply because a specific section of 4A was implicated in the *Moody* case but such is allegedly not the case in this case. However, this is not true. As seen herein, under Section 4A.102, Chapter 4A of the Texas version of the UCC applies to fund transfers. Indeed, the *Moody National Bank* case is listed in the “annotations” section of the Texas and Business Code Section 4A.102 under this particular section. Furthermore, under the funds transfer definitions in Section 4A, the funds transfer does purport to be a wire transfer. While the facts involved in the *Moody National Bank* decision are somewhat different, the court’s overall analysis should remain the same. In other words, if Article 4A is found to apply, all other common law causes of action should be preempted.²⁴

Plaintiff also makes a second argument that the *Moody National Bank* case might not apply as plaintiff is apparently arguing that there was no “sender” in this matter. However, the sender was plaintiff. The bank believed that it had authority and authorization from plaintiff to do the wire transfer. Again, the bank was not paying its own debt. The bank was sending the wire transfer proceeds on plaintiff’s behalf. This is what happens in all wire transfers. A bank sends a wire transfer on someone’s behalf. Unfortunately, sometimes the party later complains and argues that they truly did not authorize the wire transfer. Notwithstanding such facts, just as in *Moody National Bank*, in this case, there is a wire transfer with a sender/originator as well as all of the other parties necessary to effectuate a funds transfer.

Furthermore, plaintiff again continues to ignore the overall holding of the *Moody* case which is that common law claims should be preempted when an Article 4A issue truly governs the dispute. Plaintiff also cites the case of *Sheerbonnet, Ltd., vs. American Express Bank, Ltd.*,

²⁴ Likewise, in this case, Chapters 4A.202, 4A.204, and 4A.505 are all implicated in this matter.

951 F. Supp. 403 (S.D.N.Y. 1996). However, this case was distinguished in the *Moody National Bank* case. Plus, in a later decision, the New York Court of Appeals in 2005 stated:

“Article 4-A was intended, in significant part, to promote finality of banking operations and to give the bank relief from unknown liabilities of potentially indefinite duration (*see Banque Worms v. BankAmerica Intl.*, 77 N.Y.2d 362, 371 [1991]). This legislative purpose does not suggest that those interests alter (or should alter) the statute’s fine-tuned balance between the customer and the bank as to who should bear the burden of unauthorized transfers.)

See Regatos v. North Fork Bank, et al., 5 N.Y.3d 395, 838 N.E.2d 629 (N.Y. 2005)

In *Sheerbonnet*, one of the facts that led to plaintiff’s claim for damages was that regulators in England and Luxembourg suspended the operations of a faltering bank.²⁵ In the United States, the Federal Reserve Bank suspended the bank’s bank accounts and seized the bank’s New York operations. Notwithstanding getting these notices, the defendant bank tried to effectuate the wire transfer but then the proceeds of the wire transfer remained frozen in New York. Defendant bank then also asserted its rights over the virtually entire amount as an offset against debts owed to it by the insolvent bank. Consequently, none of the money ever reached the plaintiff.

The facts involved in this case are distinguishable. In this case, the wire transfer was fully effectuated. Indeed, no one was disputing that the intended beneficiary, Austin Jet Ltd, got the funds. Understandably, due to the unique facts in *Sheerbonnet*, the court determined that the plaintiff could proceed on claims outside of Article 4A.

Plaintiff also cites the case of *Impulse Trading, Inc. v. Norwest Bank Minnesota, N.A.* with a proposition that plaintiff’s common law claims are not preempted. See plaintiff’s motion, page 7, wherein plaintiff cites *Impulse Trading, Inc. v. Norwest Bank Minnesota, N.A.*, 907 F. Supp. 1284 (D. Minn. 1995). Plaintiff neglects to mention that while the *Impulse Trading* court did find that one claim was not preempted, all of the other claims were found to be preempted, including claims for wrongful setoff, conversion, and negligence. Indeed, the court specifically stated that Article 4A preempts plaintiff’s common law claims as they relate to the funds transfer. *See Id.* at 1288. Plus, the court cited several cases that supported the argument that preemption precluded other such claims. Specifically, the court reasoned as follows:

In the only case the Court has located specifically addressing the scope of Article 4A’s preemption, the court found common law tort claims to be preempted by Article 4A. *See Donmar Enterprises, Inc. v. Southern Nat’l Bank of North Carolina*, 828 F. Supp. 1230, 1235-36 (W.D.N.C. 1993) (finding that Federal Reserve Board Regular J which adopts Article 4A of the U.C.C. preempts both contradictory and duplicative causes of action for wrongful payment and negligence), *aff’d*, 64 F.3d 944 (4th Cir. 1995). Preemption is also in accord with the Minnesota courts’ general interpretation of the U.C.C. as barring all common law tort claims arising out of commercial transactions except those involving

²⁵ These cases are provided to provide the alternative arguments.

personal injury. *See Hapka v. Paquin Farms*, 458 N.W.2d 683, 688 (Minn. 1990) (finding that in cases involving commercial transactions the U.C.C. preempts tort claims for strict products liability and negligence); *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159, 162 (Minn. 1981) (To allow tort liability in commercial transactions would totally emasculate ... the U.C.C. Clearly, the legislature did not intend for tort law to circumvent the statutory scheme of the U.C.C.”).

See Id. at 1288.

The *Impulse Trading* court did allow one claim to remain because it did not relate directly to the funds transfer itself. However, the court explained that under Minnesota law, there is no breach of fiduciary duty claim as a relationship between a bank and its customer was that of a creditor/debtor.²⁶ The court explained that under Minnesota law, a special relationship arises only where a bank “knows or has reason to know that the customer is placing his trust and confidence in the bank and is relying on the bank ... to counsel and inform” the customer.” *See Id.* at 1289.²⁷ Thus, plaintiff’s analysis is misplaced and plaintiff’s common law claims should be preempted.

J. POSSIBLE PRESENT OR FUTURE ISSUES THAT MAY ARISE AT YOUR BANK.²⁸

I also think that there will be other issues in new court opinions with regard to a bank’s ability to implement reasonable security measures and use same as a defense to UCC Section 4A claims in the future. To my knowledge, there are few court opinions on this issue. However, I do have some briefing on these issues.

With regard to possible future issues regarding checks and/or items, I think there are several present issues since some plaintiffs are already making “new” UCC arguments. For example, banks are already seeing issues where after a check is deposited remotely, the original check is later presented at a check cashing service and/or other bank. Since both the remote scanned image and original checks are purportedly “items,” and purportedly are true and correct items, how are banks going to handle these issues? Is the original “item” that was a scanned image the “proper item” or does the original check remain the “proper” item? Plus, is the original check now considered a counterfeit item since it was later negotiated after the original “item” had been already negotiated? How do holder in due course claimants get treated? I think banks need to have good, strong remote capture agreements and/or deposit agreements to address such issues so that if they face such issues, the banks will hopefully not be liable for the loss.

Another issue that is currently arising that courts have not fully evaluated is the issue on when a maker’s bank makes a forged endorsement claim against the depository bank. The other bank may check its customers’ accounts, and may determine that the customer has run off with

²⁶ The court explained that a fiduciary relationship did not arise unless there was a special relationship.

²⁷ Likewise, in Texas, there would be no fiduciary duty. Indeed, the bank was simply acting as a bank trying to assist its customer. For these additional reasons, this Court should determine that Plaintiff is not able to bring common law claims against the bank as Chapter 4A of the UCC governs this dispute.

²⁸ There is no section (I) to this paper.

the funds, and there are no more funds in the account. Consequently, in many circumstances, the depository bank that accepted that forged endorsement would bear the loss. However, several banks have begun taking the position, as allowed under the applicable section of the UCC, that if the loss is not timely reported pursuant to the maker's bank's deposit agreement with its own customer, it can purportedly and properly deny the claim. Again, I think this issue has not been fully adjudicated in the court.

One may argue that the depository bank may still be compelled to bear the loss in such a situation. In other words, if the purportedly untimely reporting did not truly cause any damages to the depository bank (*i.e.*, the money had been removed prior to any purportedly timely reporting that may have occurred), then there's really no harm by the fact that the "report" may not have been timely. It is simply a procedural technicality. As banks will be on both sides of this issue, there will likely be future court opinions on such issues.

For further information regarding these issues, please contact Pat Huttenbach, at Hirsch & Westheimer, P.C., either by phone by calling 713-220-9184 or by email at phuttenbach@hirschwest.com.