InBrief

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Kentucky Supreme Court Rules In Favor Of Bank On Major Check Fraud Case

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On June 19, 2014, the Supreme Court of Kentucky rendered its unanimous opinion in favor of Commonwealth Bank & Trust Company in *Mark D. Dean, P.S.C. v. Commonwealth Bank & Trust Company.* In considering an issue of first impression, the Kentucky Supreme Court held that the Uniform Commercial Code is intended to occupy the field to the exclusion of common law claims in the areas in which it provides comprehensive rights and remedies, such as the check fraud loss provisions of Articles 3 and 4. M&P's John McGarvey, Eric Jensen and Brad Salyer represented Commonwealth Bank.

Mark D. Dean, P.S.C. is a sole practitioner law firm in Shelbyville, Kentucky. The firm maintained an escrow account at Commonwealth, and Dean and his bookkeeper were authorized signatories on the account, having signed a signature card requiring one signature for any transaction on the account. Beginning in 2003, the bookkeeper began embezzling funds from the account by kiting checks between Commonwealth Bank and another local bank. In all, she embezzled over $800,000 from the law firm. Each month, Commonwealth sent a detailed statement containing all account activity to the address listed on the signature card.

In 2008, Dean claimed that he first became aware of the check-kiting scheme. In 2009, the law firm filed suit against Commonwealth, asserting claims for violations of Articles 3 and 4 of the Uniform Commercial Code, aiding and abetting fraud and breach of duty of ordinary care, common law negligence, and breach of contract and duty of good faith and fair dealing. The firm also sought punitive damages.

The trial court granted Commonwealth summary judgment on the basis that the UCC claim was barred by the statute of limitations, and that the plaintiff had failed to identify any facts to support its common law claims. The Court of Appeals affirmed the trial court, but on different grounds. The Court of Appeals held that the bookkeeper's signatures on the checks were "unauthorized signatures" within the meaning of section 4-406 of the UCC, as she had exceeded her authority to act on behalf of the firm. The Court of Appeals concluded that the one-year bar to timely examine bank statements and bring unauthorized signatures to the bank's attention barred all of the firm's claims.

The Supreme Court of Kentucky affirmed the summary judgment, but on different grounds than the trial court or the Court of Appeals. The Supreme Court determined that 4-406 of the UCC was not applicable as the bookkeeper was authorized to sign checks by virtue of the signature card. The Court pointed out that Kentucky banks cannot be placed in the position of having to police what an authorized signatory is doing when writing perfectly valid checks on an existing account.

Instead, the Supreme Court determined – as the trial court had and as argued by M&P – that the firm's UCC claim was barred by the three-year statute of limitations, which began running when the monthly bank statements were provided to the account holder. Reasonable diligence would have revealed the losses, and the account holder was in a unique position to best

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UNITED STATES SUPREME COURT ENFORCES PARTIES' FORUM SELECTION

You have entered into a written contract that provides that the parties to the contract agree that any legal action shall be commenced in the state or federal court in a certain locality. However, when a dispute occurs you get served with a lawsuit naming you as a defendant in a federal court in an entirely different location. What options are available to seek enforcement of the contractual forum provision, and is the court – which may well have jurisdiction over the parties and the subject matter – going to move the case to the parties' agreed upon forum? This was the question answered by the Supreme Court of the United States in *Atlantic Marine Construction Co., Inc. v. United States District Court for the Western District of Texas, et al.*

Atlantic Marine involved a common construction contract between Atlantic Marine (a Virginia corporation) and a Texas-based subcontractor. After a payment dispute, the Texas subcontractor filed suit in United States District Court for the Western District of Texas. The subject matter of the contract was work to be completed at Fort Hood in Texas. Atlantic Marine was subject to personal jurisdiction in Texas, and the amount in controversy satisfied the jurisdictional requirement of the federal court on diversity grounds – in other words, the Texas court had jurisdiction over the subject matter and parties and venue was proper.

However, the contract at issue contained a forum-selection provision that stated that all disputes between the parties "shall be litigated in the Circuit Court for the City of Norfolk, Virginia, or the United States District Court for the Eastern District of Virginia, Norfolk Division." The Texas court refused to dismiss the case due to improper venue and also refused to transfer the case to the Eastern District of Virginia under 28 U.S.C. 1404. The Texas Court reasoned that a forum-selection clause was only one of a list of factors that the court should consider. The court then concluded that transfer of the case might affect the availability of witnesses and add significant expense for those witnesses willing to travel to Virginia, and these factors weighed against transfer.

The United States Court of Appeals for the Fifth Circuit concluded that the Texas court did not abuse its discretion in refusing to transfer the case after conducting its balancing of interests analysis. There was no dispute that the forum-selection provision was valid.

The Supreme Court – in a unanimous opinion by Justice Alito – stated that 28 U.S.C. 1404 permits transfer of a case "to any other district where venue is also proper or to any other district to which the parties have agreed by contract or stipulation." The Court then stated its holding that "a proper application of section 1404(a) requires that a forum-selection clause be given controlling weight in all but the most exceptional cases."

Mechanically, the Court held that the appropriate way to enforce a forum-selection clause is through the traditional doctrine of *forum non conveniens* (translated "forum not agreeing"), and that Section 1404(a) is merely a codification of the doctrine allowing for transfer to another federal district court instead of dismissal. For those forum-selection provisions that exclusively provide for a non-federal forum, the Court stated that Section 1404(a) has no application, but that the doctrine of *forum non conveniens* still applies and that a court should undergo the same analysis in deciding whether to transfer venue.

When faced with a valid forum-selection clause, the Supreme Court held that a court "should ordinarily transfer the case to the forum specified in that clause." Unlike a typical transfer request, the court should only consider public-interest considerations, and should disregard the convenience of the parties. Enforcement of valid forum-selection provisions that were bargained for by the parties "protects their legitimate expectations and furthers vital interests of the justice system."

Bradley Salyer

CHECK FRAUD *(Continued)*

determine whether suspicious activity had occurred by timely reviewing his bank statements. The fact that the bookkeeper diverted the monthly bank statements did not relieve Dean of this duty.

Significantly, the Supreme Court also determined that the firm's common-law causes of action were barred, as they were displaced by the comprehensive UCC provisions governing check fraud loss in Articles 3 and 4. The Court held that determining whether the UCC has displaced other principles of law and equity must be decided on a case-by-case basis, and that the "proper balance tends to favor application of the UCC and displacement of other law."

John McGarvey
Bradley Salyer

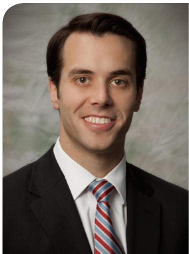
Did You Know?

Mindy Sunderland

The 2010 Amendments to Article 9 took effect in California, Alabama and Vermont on July 1, 2014. California's filing office will not offer a grace period for acceptance of old forms, which are forms issued prior to the April 20, 2011 revision date. Vermont will accept old forms until August 1, 2014. Alabama is currently providing an unlimited grace period on the use and acceptance of old forms. Both Vermont and Alabama adopted Alternative A, the "Only If" approach, for individual debtor name sufficiency under §9-503(a)(4). California, however, adopted a non-uniform version of §9-503(a)(4), which provides that only the "individual name of the debtor" or the "surname and first personal name" of the debtor will be sufficient.

The New York legislature has passed the bill to enact the 2010 Amendments, which has been sent to the Governor. The bill also included Revised Article 1 and Revised Article 7. The bill will take effect upon the Governor's signature, meaning that secured creditors filing in New York need to be prepared to comply on short notice. New York has also adopted Alternative A, the "Only If" approach.

2014 LEGISLATIVE UPDATE


Morgan McGarvey

The 2014 legislative session ended at midnight on April 15th and the bills passed during the session will officially become law on July 15, 2014. Several are of importance to the banking industry. Senate Bill 36 was passed by the General Assembly to decrease the time period required by KRS 426.530 for the right of redemption of real property, which occurs when real property is sold at judicial sale for less than two-thirds of its appraised value, from one year to six months. This law expands legislation passed in 2013 that reduced the right of redemption in an execution sale on personal property from one year to six months. House Bill 206 amended KRS 382.520 to state that interest rate reductions of a loan shall continue to be secured by the original mortgage, whether provided for in the mortgage or not. Senate Bill 114 amends KRS 286.4-530, relating to consumer loan companies, to increase the dollar amount classifications used to determine maximum charges on a loan not to exceed $15,000.00. Senate Bill 138 amends KRS 454.210, Kentucky's long arm statute, to allow a court clerk to electronically transmit the summons and complaint to the Secretary of State when it is acting as the statutory agent for a defendant for the purposes of service of process. House Bill 78 created KRS Chapter 386B to enact the Kentucky Uniform Trust Code.

Significantly, House Bill 369 amends the statute of limitations for written contracts, effective for written contracts executed after July 15, 2014. KRS 413.160 and 413.090 are amended to provide that the statute of limitations for an action upon a written contract executed after July 15, 2014, unless otherwise provided by statute, is 10 years.

Although not many bills dealing with creditor-debtor relations made the rounds in Frankfort this year, the legislature did pass several important pieces of legislation as well as a $2.3 billion budget. The highlights from this session include:

• Human trafficking
SB 184 allows judges to review files of victims of human trafficking and clear non-violent offenses resulting from trafficking from their record.

• Adult abuse registry
SB 98 creates an adult abuse registry and requires agencies that employ adult caregivers to check the registry database before hiring a personal care staff member. The registry will be maintained by the Cabinet for Health and Family Services and will also be available for individuals or families seeking to hire a caregiver. Currently, nursing homes, adult care agencies and families have no way of knowing if a potential employee has been fired for confirmed abuse or neglect.

• Security breach notifications
HB 232 requires consumer notification when a data breach compromises a consumer's personal information. This legislation grew out of the Target Corporation security breach that occurred last holiday season. It was amended to require "cloud" computing service providers that contract with schools to ensure that student data is secure.

• Cannabis oil
SB 124 will allow medical use of cannabis oil (not the same thing as medical marijuana) to treat specific medical conditions—including epilepsy—under the guidance of a physician and oversight of the University of Kentucky or University of Louisville research hospitals.

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FirmNews

M&P IS PLEASED TO ANNOUNCE:

Mindy Sunderland was selected as a Business First "Forty Under 40" honoree.

Ben Chandler was inducted into the University of Kentucky College of Law Hall of Fame.

Scott White is the recipient of the 2014 Robert F. Houlihan Memorial Award, which is given annually to the outstanding KYLAP Volunteer. He has also been re-elected as the chair of the Fayette County Board of Health for a second one-year term.

John McGarvey (banking law and collections law) and **Molly Rose** (collections law) were recognized as 2014 "Top Lawyers" by *Louisville Magazine*.

Sarah Mattingly was featured in Commerce Lexington's Ambassador Spotlight in the June issue of *Business Focus*.

John McGarvey, Mindy Sunderland and **Thurman Senn** will be presenters at the 34th Annual Conference on Legal Issues for Financial Institutions hosted by the University of Kentucky College of Law.

Actual resolution of legal issues depends on many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter. If you have any questions about this newsletter, or suggestions for future articles, contact Mindy Sunderland, Editor.

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