COMMERCE CASE MANAGEMENT PROGRAM DECISIONS:

NEGOTIABLE INSTRUMENTS AND THE U.C.C.

by

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The following summaries address negotiable instrument and Uniform Commercial Code ("U.C.C.") opinions issued by the Commerce Court. We have included cases examining the liability that arises during the presentment, honor, and reimbursement of negotiable instruments. Additionally, we have included cases examining the creation and continuing nature of security interests. We have excluded cases decided upon the U.C.C. provisions of other jurisdictions. The summaries are current through August of 2009.

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This work is part of a joint project between the Philadelphia Bar Association's Business Law Section and its Business Litigation Committee and students from local law schools. Students work with a lawyer mentor/editor to summarize and describe opinions in the Commerce Case Management Program by distinct areas of subject matter. Each lawyer works with one, two or three law students on a particular area of the law in which the Commerce Program Judges have issued opinions, with the students doing the research and writing and the lawyer guiding and editing the work. As completed, each "chapter" will be posted on the Business Litigation Committee's web page, available at http://www.philadelphiabar.org/page/BLSLitigation?appNum=1&wosid=bdWYbOMtUSwkL3ULtb6uXM, with the goal to catch up to the hundreds of opinions already written, and then to keep up with opinions added annually. Ideally, we hope to publish this compilation in a single book. If you are interested in participating in this project, that has so many potential benefits, please contact Lee Applebaum at (215) 893-8702 or lapplebaum@finemanlawfirm.com. The views, information and content expressed herein are those of the authors and do not represent the views of the Philadelphia Bar Association or any other firm or entity.

Abrams v. Toyota Motor Credit Corp., April Term 2001, No. 503, 2001 Phila. Ct. Com. Pl. LEXIS 83 (C.C.P. Phila. December 5, 2001) (Herron, J.) (UCC § 2A-504 does not create a private right of action for previously liquidated damages). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/abrams.pdf.

Plaintiff Karen Abrams ("Plaintiff") filed a class action against Defendant Toyota Motor Credit Corp. ("Defendant") challenging the legality of the early termination formula set forth in Defendant's standard motor vehicle lease on the ground that the formula is unfair, deceptive and unreasonable and asserts a claim under § 2A-504 of the Uniform Commercial Code ("UCC").

Defendant filed Preliminary Objections presently before the court, asserting in part that Plaintiff failed to state a cognizable cause of action under § 2A-504 of the Uniform Commercial Code ("UCC").

The Complaint set forth the following allegations in pertinent part:

> 1) The Lease in issue constitutes a lease contract as contemplated in Article 2A of the Uniform Commercial Code.
>
> 2) The early termination formula constitutes a provision for liquidated damages, at common law, and as contemplated in § 2A-504.
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> 3) The early termination formula of Defendant's Lease is unreasonable as written and as applied, in light of the then-anticipated harm caused by the default or early termination.

The Court sustained Defendant's demurrer holding that (1) Section 2A-504 does not provide the remedy sought by plaintiff in the present instance, and (2) recovery would otherwise be barred by the voluntary payment rule.

First, the contested provision of the UCC, § 2A-504, does not provide for a private right of action for recovering previously collected liquidated damages, regardless of how the recovery is required. Generally, § 2A-504 provides that: "Damages payable

by either party…may be liquidated in the lease agreement…by a formula that is reasonable." However, the lessee's (Plaintiff's) right to restitution only applies where the lessor withholds or stops delivery of the leased goods according to the clear and explicit terms of § 2A-504. Here, Defendant (lessor) provided Plaintiff with the use of the motor vehicle pursuant to the terms of the lease. Therefore, taking the factual allegations in this count as true, the court holds that § 2A-504 does not provide the remedy sought by Plaintiff in the present instance.

Second, the Plaintiff's claim under § 2A-504 is barred by the voluntary payment rule. The rule provides, "[w]here, under a mistake of law, one voluntarily and without fraud or duress pays money to another with full knowledge of the facts, the money paid cannot be recovered." Acme Markets, Inc. v. Valley View Shopping Ctr., Inc.[2] In an attempt to escape the rule, Plaintiff claims that the payment arose from a mistake of fact that resulted from a misrepresentation. Notwithstanding this argument, the Complaint does not allege Defendant misrepresented anything to Plaintiff. At best, the Complaint suggests that Plaintiff rendered payment under a mistaken belief that the lease's formula was lawful. As such, Plaintiff's payment may have been made under a mistake of law, not a mistake of fact. Therefore, the claim for recoupment is barred by the voluntary payment rule.

[2] 342 Pa. Super. 567, 569, 493 A.2d 736, 737 (1985) (citing Ochiuto v. Prudential Ins. Co. of America, 356 Pa. 382, 384, 52 A.2d 228, 230 (1947)).

IRPC, Inc. v. Hudson United Bancorp, February Term 2001, No. 0474, 2002 Phila. Ct. Com. Pl. LEXIS 77 (C.C.P. Phila. January 18, 2002) (Sheppard, J.) ((1) According to § 1103, principles of law and equity may supplement provisions of the UCC unless specifically displaced, and (2) the Economic Loss Doctrine bars the negligent supervision claim). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/irpc-op.pdf.

The accountant and comptroller for Plaintiff IRPC was found to have embezzled funds deposited in accounts with Defendant Hudson United Bancorp. As a result, Plaintiff alleged that Defendant failed to comply with sound banking practices and failed to inform Plaintiff of the embezzler's conduct. Specifically, Plaintiff asserted Counts for breach of fiduciary duty by the accountant and comptroller, negligent supervision, breach of contract, securities fraud and common law fraud. Defendant raised four Preliminary Objections challenging the legal sufficiency of the claims set forth in the complaint. The Court held as follows:

1. Plaintiff's claim cannot be dismissed although it did not identify the UCC provisions, where the UCC provides a basis of relief for Plaintiff's allegations.

Defendant contended that the UCC displaced Plaintiff's claims. 13 Pa. C.S. § 1103 provides that principles of law and equity may supplement the UCC unless they are displaced by particular UCC provisions. Although no previous Pennsylvania case addressed the displacement issue as applicable to the one presented to the court, Defendant cited Sebastian v. D&S Express, Inc.,[3] in which the court analyzed whether under Pennsylvania law, UCC §3404 displaces and therefore precludes a common law negligence action. The Sebastian court held that the "UCC does not displace the common law of tort unless reliance on the common law would thwart the purposes of the

[3] 61 F. Supp. 2d 386 (D.N.J. 1999).

Code. Yet, where the Code provides a comprehensive remedy for the parties to a transaction, a common law action will be barred."

By making this argument, the Defendant conceded that the UCC provided a basis of relief for Plaintiff's allegations and instead focused on the Plaintiff's failure to identify the relevant statutes. The court held that this did not constitute sufficient grounds to dismiss the claims. Although the Plaintiff's complaint must include the facts upon which the claims are based, there is no requirement that a plaintiff's complaint title a count with a specific cause of action alleged thereunder. Therefore, even if Defendant's argument that the UCC displaced Plaintiff's claims were correct, Plaintiff still would not be precluded from proceeding with any of the claims set forth in the Complaint. If Plaintiff were asserting parallel claims for UCC and common law violations, Hudson's argument might have merit; however, in their current form, Plaintiff presented legally sufficient claim and the pertinent objections were overruled.

2. Plaintiff's claim for negligent supervision is barred by the Economic Loss Doctrine.

Defendant Hudson challenged the legal sufficiency of the negligent supervision count, and argued that Plaintiff did not allege Defendant's employee acted outside the scope of his employment with Defendant, and, alternatively, that the claim is barred by the Economic Loss Doctrine. The Court rejected the former argument because the elements could be inferred from the facts. However, the court found merit in the latter contention that the claim is barred by the Economic Loss Doctrine, thereby requiring dismissal of the negligent supervision claim.

The purpose of the Economic Loss Doctrine, as adopted in Pennsylvania, is "maintaining the separate spheres of the law of contract and tort." New York State Elec.

& Gas Corp. v. Westinghouse Elec. Corp.[4]; see also REM Coal Co. v. Clark Equip. Co.[5] ("negligence and strict liability theories do not apply in an action between commercial enterprises involving a product that malfunctions where the only resulting damage is to the product itself"); and East River S.S. Corp.[6] (Where "no person or other property is damaged, the resulting loss is purely economic.").

Plaintiff suffered only economic damages, and was therefore barred by the doctrine. There is some dispute over whether the Economic Loss Doctrine bars recovery for certain intentional torts, but none were raised on the facts of the instant case. As such, Plaintiff's negligent supervision claim was barred by the Economic Loss Doctrine and the pertinent objection was sustained.

York Paper Co. v. Bartash Printing, Inc., August Term 2001, No. 3111, 2002 Phila. Ct. Com. Pl. LEXIS 25 (C.C.P. Phila February 6, 2002) (Herron, J.) (Contractual duty of good faith provided by § 1203 has questionable status in Pennsylvania as a claim, but it may be asserted as an affirmative defense.)
This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/york302.pdf.

This dispute arose out of the alleged failure to pay on the part of defendant Bartash Printing, Inc. ("Bartash") for paper goods supplied by plaintiff York Paper Co. ("Plaintiff"). Bartash counterclaimed for damages due to the inferior quality of the paper goods. Consequently, Plaintiff joined defendant Roxcel Corp. ("Roxcel"), the original supplier of the paper. In defense, Roxcel counterclaimed that Plaintiff's claims are barred by its bad faith in carrying out the transaction in question. Plaintiff filed Preliminary Objections to the bad faith counterclaim of Roxcel.

[4] 387 Pa. Super. 537, 550, 564 A.2d 919, 925 (1989).
[5] 386 Pa. Super. 401, 412-13, 563 A.2d 128, 134 (1989).
[6] 476 U.S. 858, 870 (1986).

Plaintiff attempted to characterize Roxcel's bad faith affirmative defense as a claim for breach of the contractual duty of good faith, which has questionable status in Pennsylvania. Pennsylvania case law is not clear as to when a party has a legitimate claim for the breach of the contractual duty of good faith. Some Pennsylvania courts, relying on the common law, have held that there is a duty of good faith and fair dealing in every contract. Other Pennsylvania courts have instead stated that the contractual duty of good faith arises only in limited circumstances.

The Court declined to examine the legitimacy of the bad faith claim, recognizing that the contractual relations in the instant case are governed by the Uniform Commercial Code ("UCC"). According to the UCC, "[e]very contract or duty…imposes an obligation of good faith in its performance or enforcement." 13 Pa. C.S. § 1203. Moreover, the court found that Roxcel did not attempt to assert a claim for the breach of the contractual duty of good faith, but merely set it forth as an affirmative defense. In these specific circumstances, the court reached the narrow conclusion that a party responding to a UCC breach of contract claim may assert as an affirmative defense that the claimant failed to act in good faith.

Therefore, the Court concluded that the Preliminary Objections were without merit and Roxcel may proceed with the bad faith claim as an affirmative defense.

Walden v. Mercedes Benz Credit Corp., June Term 2004, No. 4641, 76 Pa. D. & C.4th 193 (C.C.P. Phila. April 27, 2005) (Sheppard, J.) ((1) A buyer in the ordinary course of business cannot extinguish a security interest that encumbered the property prior to seller's acquisition according to §§ 2403, 9315, and 9320, and (2) subject to the rights provided by § 9623, secured creditor may repossess collateral upon default according to § 9609).
This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/040604641.pdf.

This case arose out of dispute over the title of a Mercedes Benz automobile ("Vehicle") in which Plaintiff Michael Walden ("Plaintiff") and Defendant Mercedes Benz Credit Corp. ("Defendant") both claimed a security interest. The Vehicle was originally purchased by a party unrelated to the present matter that the parties refer to as "Customer." Customer financed the purchase of the Vehicle through Defendant by granting Defendant a security interest in the Vehicle. Customer subsequently transferred the Vehicle to another automobile dealership ("Dealership") and ceased making the required payments to Defendant. Plaintiff purchased the Vehicle from the Dealership. Defendant claimed that the Customer and the Dealership were part of an automobile theft ring. Moreover, Defendant claimed that Plaintiff did not have a valid title and that the Defendant should be entitled to possession of the Vehicle due to its perfected security interest. Plaintiff filed a motion for preliminary injunction to preclude Defendant from re-possessing the Vehicle.

The Court held that Defendant may repossess the Vehicle, because Plaintiff acquired the vehicle subject to Defendant's security interest and there was a default on the original agreement. Specifically, the Court held as follows:

1. The Plaintiff received good title to the Vehicle. Customer had the power to transfer good title to a good faith purchaser for value, since the Vehicle was originally delivered to Customer under a transaction of purchase. 13 Pa. C.S. § 2403(a)(4).

Additionally, since Customer entrusted possession of the Vehicle to Dealership, which was a "merchant who deals in goods of that kind," Dealership had the power to transfer all rights of Customer to a buyer in the ordinary course of business even if the Dealership's disposition of Vehicle was larcenous. 13 Pa. C.S. §2403(b),(c). Therefore, Customer and/or Dealership were capable of transferring good title in the Vehicle to Plaintiff, even if one (or both) of them was guilty of theft with respect to the Vehicle.

2. However, the title received by Plaintiff remained encumbered by Defendant's security interest. Although the Dealership passed title to the Vehicle to Plaintiff, the transfer did not extinguish the Defendant's security interest in the Vehicle. Normally, a buyer in the ordinary course of business takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence. 13 Pa. C.S. § 9320(a). Nonetheless, Plaintiff cannot claim the benefit of § 9-320 because Defendant's security interest was not created by Dealership, but rather by Dealership's transferor (Customer). Therefore, Plaintiff received title subject to security interests created prior to the immediate transferor (Dealership). Consequently, Defendant's security interest continued in the Vehicle notwithstanding its sale or other disposition. 13 Pa. C.S. § 9315.

3. Accordingly, the court held that Defendant may repossess the Vehicle, since Plaintiff purchased the Vehicle subject to Defendant's perfected security interest, and there was a default by Customer on the loan underlying the security interest. 13 Pa. C.S. § 9609. However, Plaintiff is entitled to notice of disposition of the sale, to redeem the Vehicle before disposition, and to an accounting for the surplus, if any after disposition, because he has an ownership interest in the Vehicle. 13 Pa. C.S. § 9623.

Di Giorgio Corp. v. Dis-Food Corp., May Term 2004, No. 3202, 2005 Phila. Ct. Com. Pl. LEXIS 232, 58 U.C.C. Rep. Serv. 2d (Callaghan) 153 (C.C.P. Phila. May 25, 2005) (Jones, J.) (Where goods have been accepted, seller may enforce an oral agreement that would otherwise violate the Statute of Frauds per §§ 2201, 2606, and 2709). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/040503202.pdf.

Plaintiff Di Giorgio Corporation ("Plaintiff") filed a motion for summary judgment to collect unpaid invoices from Defendants Dis-Food Corporation ("Dis-Food"), Sal-Nik Corporation ("Sal-Nik") and Salvatore Chillemi ("Chillemi"). Chillemi executed unconditional guaranties for the payment of merchandise sold and delivered to Dis-Food and Sal-Nik. From March 2004 to May 2004, Plaintiff sold and delivered merchandise on behalf of itself and another third-party supplier per the terms of a separate merchandising agreement. Dis-Food and Sal-Nick failed to make any payments for any of that merchandise. Plaintiff sued for the recovery of the payments and the enforcement of the guaranties.

In response, Defendants counterclaimed for breach of oral contract, legal fraud, fraud in the inducement and unjust enrichment. The court previously dismissed the fraud counterclaims, so that only the breach of oral contract and unjust enrichment claims remained. First, Defendants alleged that Plaintiff orally agreed to provide a credit as an incentive to do business that has not been received. Second, Chillemi asserted that Plaintiff is not entitled to recover all amounts because the guaranty for the Dis-Food debt had terminated.

First, the court held that an oral contract for the sale of goods that would otherwise violate the Statute of Frauds can become enforceable where the goods are delivered and accepted.

Plaintiff filed a Motion for Summary Judgment, asserting that it is entitled payment on invoices submitted for groceries, meat products and advertising circulars. Dis-Food and Sal-Nik admit that they ordered and received groceries from Plaintiff and did not return any of them. They also admit that the invoices for advertising circulars is due and owing. Plaintiff maintains that § 2709 of the Pennsylvania Uniform Commercial Code governs the instant motion. As provided in § 2709, "when the buyer fails to pay the price as it becomes due the seller may recover…the price of: (1) goods accepted or conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer…." 13 Pa. C.S. § 2709(a)(1)

Defendants counterclaim for an entitlement to a credit according to an oral agreement allegedly entered into by Plaintiff. Plaintiff disputes that such an agreement was ever made. Further, Plaintiff argues that such an oral agreement would be unenforceable under the Statute of Frauds, Title 13 Pa. C.S. § 2201. The statute generally provides:

> A contract of the sale of goods for the price of $500.00 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker.
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> [13 Pa. C.S. § 2201(a).]

However, the Defendants claim that statutory exceptions are applicable. Defendants cite subsection (c)(3) which states: "[A] contract which does not satisfy the requirements of subsection (a)…is enforceable: with respect to goods for which payment has been made and accepted or which have been received and accepted." 13 Pa. C.S. § 2201(c)(3). Goods are deemed to be accepted when the buyer fails to make an effective

rejection or "does any act inconsistent with the ownership of the seller…." 13 Pa. C.S. § 2606.

An oral contract is not unlawful and it may be voluntarily performed by the parties. The UCC comment explicitly states that an oral contract is not void, it is merely unenforceable. Moreover, subsection (3)(c) makes it possible to lose the Statute of Frauds defense where goods have been received and accepted. Stated otherwise, an oral agreement that would otherwise be unenforceable due to the Statute of Frauds can become enforceable where a party accepts the goods upon the agreement. The Plaintiff's Motion for Summary Judgment is denied since the court cannot conclusively determine the amount Defendants owe since a question of fact exists as to whether the defendants are entitled to a credit.

Second, the Court held that it cannot grant summary judgment solely on the basis of oral testimony on a disputed issue of material fact.

Plaintiff attempts to recover sums allegedly due to a third party supplier according to the terms of a separate merchandising agreement for products sold and delivered to Defendants. Plaintiff points to a guarantee of accounts receivable provision in its merchandising agreement with the third-party supplier, demanding payment according to § 2709 of the Uniform Commercial Code. However, Defendants maintain that factual issues remain as to whether Plaintiff paid the third party according to the merchandising agreement. Although Plaintiff has submitted an affidavit that it paid the third party according to the guaranty provision, oral testimony is generally insufficient to establish the absence of a genuine issue of material fact. Pa. R. Civ. P. 1035.3. Therefore, the Plaintiff's Motion for Summary Judgment is denied in this regard.

Victory Clothing Co. v. Wachovia Bank, February Term 2004, No. 1397, 2006 Phila. Ct. Com. Pl. LEXIS 146, 59 U.C.C. Rep. Serv. 2d (Callaghan) 376 (C.C.P. Phila. March 21, 2006) (Abramson, J.) (A negligent depositary bank may be liable to drawer for a double forgery under §§ 3404 and 3405 subject to comparative fault principles). This opinion is available online at http://fjd.phila.gov/pdf/cpcvcomprg/040201397-032106.pdf.

This matter arose out of thefts from the commercial checking account of plaintiff Victory Clothing Co. ("Plaintiff") by its office manager and bookkeeper ("Bookkeeper"). From August 2001 through May 2003, the Bookkeeper deposited about two hundred checks drawn on Plaintiff's corporate account with defendant Hudson Bank. The Bookkeeper engaged in a system of "double forgeries" in order to carry out the scheme, whereby she would forge the signature of Plaintiff's owner on a corporate check and then forge the indorsement of a fictional payee on the reverse side of the check. After forging the name of the payee, the Bookkeeper would then indorse the check with her name and/or account number in order to deposit the funds in her own personal bank account with defendant Wachovia Bank ("Defendant").

At the time of the Bookkeeper's fraud, Defendant's policies and regulations regarding the acceptance of checks for deposit provided that "checks payable to a non-personal payee can be deposited only into a non-personal account with the same name."

Plaintiff contended that Defendant's actions (accepting checks payable to various businesses for deposit into the Bookkeeper's personal account) were commercially unreasonable, contrary to Defendant's own internal rules and regulations and exhibited a want of ordinary care. Specifically, Plaintiff asserted a claim under 13 Pa. C.S. § 3405 which outlines the extent of liability for both the employer and bank in the event of a fraudulent indorsement by an employee.

This case involved a double forgery which is a question of first impression in the Pennsylvania courts. A double forgery occurs when the negotiable instrument contains both a forged maker's signature and a forged indorsement. The issue to be resolved is the allocation of loss in a double forgery situation.

The Uniform Commercial Code ("UCC") does not specifically address the allocation of liability in a double forgery situation. Consequently, courts have been left to determine loss allocation in these situations. The seminal case, Perini Corp. v. First National Bank,[7] held that liability should be incurred by the drawee bank for a double forgery.

First, the Perini court recognized that the depositary bank's ability to detect a forged indorsement is reduced in the case of a double forgery since someone forging a check can readily assume the payee's identity as either himself or a fictitious person. Moreover, the court recognized the UCC's commitment to finality. For these reasons, the Perini court decided to treat instances of double forgery as a single forgery in which only the maker's signature was forged.

Second, the Perini Court additionally observed the loss causation principle, which recognizes that the check was never validly drawn so that no true payee can appear with a claim against the drawer or drawee. Consequently, the Perini court held that liability should fall on the drawee bank in double forgery situations.

Since Perini was decided, Articles 3 and 4 of the UCC were revised in 1990. Prior to the revisions, the case law was uniform in treating double forgery cases just as a forged drawer's signature (with the loss falling on the drawee bank). However, the

[7] 553 F.2d 398 (5th Cir. 1977).

revisions changed this rule by shifting to a comparative fault approach. Under the revised approach, the loss in double forgery cases is allocated between the depositary bank and the defrauded corporation based on the extent that each party contributed to the loss. A depositary bank may no longer escape liability in double forgery situations as they did under the prior law.

The revised 13 Pa. C.S. §3405, under which Plaintiff asserts the present claim, provides in relevant part:

> If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.
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> [13 Pa. C.S. § 3405(b).]

Although Defendant contended that this section does not apply to double forgery situations, at least one court has held that it does. See Gina Chin & Associates, Inc. v. First Union Bank[8] (Virginia Supreme Court holding that §§ 3-404 and 3-405 may be used by a drawer against the depositary bank in double forgery situations). The Gina Chin court rejected the contention that §§ 3-404 and 3-405 may only be applied to forged indorsements, and not to double forgery situations. Instead, the Gina Chin court held that the revisions "allow[ ] 'the person bearing the loss' to seek recovery caused by the negligence of any person paying the instrument or taking it for value based on comparative negligence principles." Id. The Court held that a drawer is not precluded from seeking recovery from a depositary bank in a double forgery situation under the revised UCC's § 3-405, finding the reasoning of Gina Chin persuasive.

[8] 256 Va. 59, 500 S.E. 516 (Va. 1998).

Defendant also raised the "Fictitious Payee Rule" under 13 Pa. C.S. § 3404(b) in its defense. Under § 3404, the indorsement is deemed to be "effective" where the employee did not intend for the payees to receive payment. The Fictitious Payee Rule applies to a scenario where a dishonest employee writes checks to a company's actual vendors, but intends that the vendors never receive the money; instead, the employee forges the payees and deposits the checks at another bank. Since the indorsement is "effective," the loss is incurred by the company whose employee committed the fraud, and not the drawee bank that was merely debiting the company's account.

Although a double forgery situation is treated as a Fictitious Payee Situation under the revised § 3-404(b), the Fictitious Payee Rule must be considered in light of the entire revision which has introduced comparative fault. Under the old UCC, the fictitious payment rule was an insurmountable defense for plaintiffs, because courts held that any negligence on the part of the depositary bank was irrelevant. Under the revised UCC, the drawer now has the right to sue the depositary bank directly based on the extent to which the bank's own negligence contributed to the loss. Thus, the Fictitious Payee Rule functions to raise countervailing issues of fact to be considered in assessing comparative fault.

Therefore, the court found that Plaintiff and Defendant are comparatively negligent. On one hand, Defendant failed to exercise ordinary care and that failure substantially contributed to Plaintiff's loss. On the other hand, Plaintiff was negligent in supervising its Bookkeeper and not discovering the fraud for almost two years. For the foregoing reasons, the court held that Defendant is 70% liable for the loss and Plaintiff is 30% liable for the loss.

United States Steel Corp. v. Express Enterprises, March Term 2005, No. 0140, 2006 Phila. Ct. Com. Pl. LEXIS 149, 59 U.C.C. Rep. Serv. 2d (Callaghan) 389 (C.C.P. Phila. March 22, 2006) (Sheppard, J.) (Common law negligence is displaced according to §1103 where the UCC provides a remedy for the improper honor of a negotiable instrument under §3404). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/050300140.pdf.

Defendant Express Enterprises of Pennsylvania, Inc. ("Defendant") raised Preliminary Objections to plaintiff United States Steel Corporation's ("Plaintiff") claims of common law negligence (Count I) and failure to exercise ordinary care pursuant to 13 Pa.C.S. §§ 3404 and 3405 pertaining to imposters, fictitious payees and employer's responsibility for fraudulent endorsement by employee (Count II). This action arose from allegations that worker's compensation checks were fraudulently obtained and cashed. A majority of the checks in question were cashed at Defendant's check cashing agency.

The court held that the Uniform Commercial Code ("UCC") displaces the Plaintiff's allegations of common law negligence, dismissing Count I. Accordingly, principals of law and equity supplement the UCC unless they are displaced by particular UCC provisions. Although Pennsylvania courts have not spoken on the issue of displacement in the present circumstances, the court found persuasive reasoning in Gress v. PNC Bank, National Association,[9] and Metro Waste, Inc. v. Wilson Check Cashing, Inc.[10]

In Gress, the court held that §3420 displaces any negligence actions based on wrongfully paying a negotiable instrument to a person not entitled to enforce the

[9] 100 F. Supp. 2d 289 (E.D. Pa. 2000).
[10] March Term 2003, No. 2117, 2003 Phila. Ct. Com. Pl. LEXIS 56 (Sept. 23 2003) (Jones, J.), available at http://fjd.phila.gov/pdf/cpcvcomprg/metro-op.pdf.

instrument or receive payment. The Gress court recognized that the UCC intends to produce inter-jurisdictional uniformity and that the displacement of tort liability with respect to such activities is vital to that project, citing a variety of other jurisdictions for the proposition. Additionally, the Metro court concluded that a common law negligence action is barred where §3404 provided a comprehensive remedy for the parties to a transaction.

In the instant case, the court held that §3404 displaces Plaintiff's common law claim of negligence. Plaintiff alleged that Defendant paid a check to a third party on the basis of a forged signature. This claim is covered by the UCC, and a comprehensive remedy is provided for by UCC §3404. Therefore, the common law is displaced by the UCC. Accordingly, Defendant's Preliminary Objection is sustained and Count I is dismissed. The §3405 claim under Count II is also dismissed, as it pertained to Count I.

Nestle USA, Inc. v. Wachovia Corp., August Term, 2005, No. 01026, 2006 Phila. Ct. Com. Pl. LEXIS 215, 59 U.C.C. Rep. Serv. 2d (Callaghan) 920 (C.C.P. Phila. May 11, 2006) (Sheppard, J.) ((1) Drawer lacks standing to bring conversion claim and breach of transfer and presentment warranty claims against depositary bank according to §§ 3416, 3417, and 3420, and (2) common law negligence claim is displaced according to § 1103 where a remedy for fraudulent endorsement has been provided by §§ 3404 and 3405). This opinion is available online at http://fjd.phila.gov/pdf/cpcvcomprg/050801026.pdf .

Plaintiff Nestle USA, Inc. ("Nestle") has asserted claims against defendants Wachovia Corp. ("Wachovia") and First Premier Bank ("First Premier") for negligence, conversion, and breach of certain Uniform Commercial Code ("UCC") warranties. Nestle alleged that one of its employees executed 386 "Rapidrafts" (a negotiable instrument similar to a check) made payable to an entity called "AP." The employee opened an account with Wachovia into which all of the Rapidrafts were deposited. Of

those Rapidrafts, 260 were made payable through First Premier. Defendants Wachovia and First Premier have Preliminary Objections. The Court held as follows:

1. The count alleging breach of transfer warranties against Wachovia is dismissed. A transfer warranty arises according to 13 Pa. C.S. § 3416 when a negotiable instrument is transferred. However, this transfer warranty provision in unavailable to Nestle because it is not a party to which an instrument has been transferred. Specifically, 13 Pa. C.S. § 3203(a) instructs that "[a]n instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." Additionally, transfer of an instrument vests any right of the transferee in the transferor. Id. at § 3203(b). Since the Rapidrafts were never transferred to Nestle and it has no interest in trying to enforce them, Nestle does not have standing to bring claims against Wachovia for breach of transfer warranties.

2. The count alleging breach of presentment warranties against Wachovia and First Premier is dismissed. In order to bring a presentment warranty claim under 13 Pa. C.S. §3417(a), the party must be a drawee. A "drawee" is the person ordered in a draft to make a payment, e.g. the drawee is a bank at which the drawer has an account. In the instant case, Nestle (the drawer) did not have an account at First Premier. Since Nestle is not the drawee, Nestle does not have standing to bring claims against First Premier and Wachovia for breach of presentment warranties.

3. The counts alleging conversion against Wachovia and First Premier are dismissed. The UCC limits who may bring a claim for conversion. 13 Pa. C.S. § 3420. "An action for conversion of an instrument may not be brought by the issuer or acceptor of the instrument . . ." Id. "'Issuer' means a maker or drawer of an instrument." Id. at §

3105. A "drawer" is "a person who signs or is identified in a draft as a person ordering payment." Id. at § 3103(a). In this case, Nestle is the drawer and/or issuer, and its claims for conversion against Wachovia and First Premier are dismissed.

4. The counts alleging negligence against Wachovia and First Premier are dismissed. Nestle asserted claims of common law negligence against both defendants. However, the UCC displaces common law negligence claims with respect to negotiable instruments. Moreover, no cause of action exists for common law negligence where only an economic loss is sustained. Nestle's claimed loss, or the amounts paid via Rapidrafts, are merely an economic loss. Regardless, Nestle may be able to bring a comparative negligence claim against Wachovia pursuant to the fraudulent endorsement provision set forth in §§ 3404 and 3405 that provide for depositary bank liability.

Jana v. Wachovia, January Term 2005, No. 2800, 2006 Phila. Ct. Com. Pl. LEXIS 479, 61 U.C.C. Rep. Serv. 2d (Callaghan) 583 (C.C.P. Phila. December 15, 2006) (Sheppard, J.) (Wrongful dishonor of corporation's checks per § 4402 can result in actionable damages for the person who controls the corporation). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/050102800.pdf.

Plaintiff Pamela Jana ("Jana"), on behalf of herself and minor son Jerry Jana, Jr. ("Son") and Heronwood Inc. ("Heronwood") asserted claims against defendants, Wachovia, N.A. and Wachovia Bank of Delaware, N.A. ("Defendants") for the alleged wrongful dishonor of two checks drawn on an account with Defendants, pursuant to 13 Pa.C.S.A. § 4402.

Jana and her husband invested in certificates of deposit ("CDs") at various savings & loan and mutual savings banks. In the event these banks became publicly owned, certificate holders were entitled to purchase shares of the bank at a favorable price. The stock could subsequently be resold by the certificate holder in the public

market for a profit. Jana and her husband formed corporations in several states to acquire CDs, including Heronwood and a subsidiary of Heronwood, Altoona, Inc. ("Altoona").

In August 2008, a demand deposit account ("Account") was opened in the name of Heronwood with CoreStates Bank (which was later acquired by another bank and then merged with Defendants). Jana and her husband were the authorized signatories on the Account. Son was not a signatory or otherwise named.

Subsequently, Jana learned that Keystone Savings Bank ("Keystone"), a mutual savings company, planned to convert to a stock savings bank. Jana, Son and Heronwood sought to purchase shares of Keystone stock with three separate checks drawn on the Account with Defendants on September 12, 2003, each of which were signed by Jana. The checks were made payable to Keystone on behalf of Jana, Son and Altoona.

All three checks were initially dishonored due to alleged micro-encoding errors. The checks First Union provided did not have the account number micro-encoded on the check, rather the number was handwritten. First Union ultimately processed the check written on behalf of Altoona, but dishonored the checks written on behalf of Jana and Son. First Union later agreed to honor all of the checks, but the stock purchase deadline had elapsed with Keystone. As a result, profits were allegedly lost. Defendants motion for summary judgment. The Court held as follows:

1. Heronwood cannot recover consequential damages because it did not lose an investment opportunity due to Wachovia's conduct. In the event of a wrongful dishonor, a payor bank is liable to its customers for damages it proximately caused including consequential damages. 13 Pa.C.S. § 4402(b). "Customer" is defined as "a person having an account with a bank or for whom a bank has agreed to collect items, including

a bank that maintains an account at another bank." 13 Pa.C.S. § 4104. Although Heronwood is a customer of Defendants, it was not a depositor at Keystone. Heronwood did not request to purchase stock at Keystone. Therefore, a wrongful dishonor by Defendants did not result in a lost opportunity to purchase stock at Keystone. Accordingly, Heronwood cannot recover under § 4402 because it did not suffer damages as a result of the dishonor. The claim is dismissed.

2. Jana may be considered a "customer" depending on the nature of her relationship with the corporation which gives rise to liability for Defendants under 13 Pa.C.S.§ 4402(b). Jana and her husband were the authorized signatories on the Account. In the absence of any Federal, Pennsylvania or other state decisions with similar facts, the court considered other relevant cases from other jurisdictions.

The Fourth Circuit held that a plaintiff had standing to assert a § 4-402 claim for wrongful dishonor of a corporate check where the plaintiff was the president and sole stockholder of the corporation. Murdaugh Volkswagen, Inc. v. First Nat. Bank.[11] The plaintiff was deemed a customer of the bank for the purpose of § 4-402 because a close link existed between the plaintiff (president) and corporation. Id. The court considered that the bank treated the plaintiff and corporation as one entity, requiring the plaintiff to assume the corporation's obligations by mortgaging her home and personally borrow funds for the benefit of the corporation. Id.

Additionally, the Nebraska Supreme Court found that a corporate officer who signed a check on behalf of the corporation was a customer under § 4-402 where the officer was the principal shareholder, president, chief operating officer and signatory to

[11] 801 F.2d 719 (4th Cir. 1986).

the corporate account. Parrett v. Platte Valley State Bank & Trust Co.[12] The court observed that it was foreseeable that dishonoring the corporation's check would reflect directly on the officer against whom criminal charges had been brought in connection with the dishonored check. Id.

Similarly, the California Court of Appeal held that the president and sole owner of a corporation was a proper party for a § 4-402 action because the depositor corporation had not issued stock, was undercapitalized, and was merely a shell having no liability as a separate, distinct legal entity. Karsh v. American City Bank.[13] The president controlled the corporation's financial affairs and personally vouched for fiscal responsibility, and the bank dealt directly with the president at all times, including the satisfaction of all corporate obligations and personal guaranties. Id.; see also Kendall Yacht Corp. v. United California Bank[14] (corporate owners were entitled to sue where it was foreseeable that the wrongful dishonor would directly harm owners).

In contrast, other courts have adopted a narrower interpretation of "customer" for § 4-402 purposes. For example, the New Mexico Supreme Court has held only the partnership was the customer of the bank, so that the partners, as individuals, did not have a cause of action against the bank for the wrongful dishonor. Loucks v. Albuquerque National Bank.[15] However, many of the courts that adopt the narrower approach seem to except situations where the evidence demonstrates that the corporation and the individual were one and the same or that the bank regarded the officer as its customer.

[12] 459 N.W.2d 371 (Neb. 1990).
[13] 169 Cal. Rptr. 851 (Cal. App. 1980).
[14] 123 Cal. Rptr. 848 (Cal. App. 1975).
[15] 418 P.2d 191 (N.M. 1966).

A synopsis of the case law suggests that where a dishonored check was drawn on the account of a small business entity, such as a closely held corporation, the wrongful dishonor can result in some actionable damages to the persons who control the corporation. In such instances, evidence may be presented to show that the person injured bore such a close relationship to the corporation that he or she should be permitted to bring an action for wrongful dishonor under the Uniform Commercial Code. Pertinent evidence can include the failure to issue stock, undercapitalization of the business or corporation, the person's guarantee of the business' obligations, or the fact that the bank, in some way, treated the person and the business as a single entity. See Randy R. Koenders, Who may recover for wrongful dishonor of check under UCC § 4-402.[16] Such a finding would be precluded where there is evidence that the account on which the item was written carried only the corporate name and not the person's name, that the bank did not regard the person and the business as a single entity, or that the business entity was not undercapitalized. Id.

In the present case, the Court held that Jana submitted sufficient evidence to show that she bore a close relationship to the corporation so that a factual issue exists as to whether Jana can be considered a customer. Additionally, it is a question of fact whether it was foreseeable to Defendants that the dishonor of the checks would harm Jana, individually. These questions of facts are issues to be submitted to a jury, precluding the entry of summary judgment in favor of the Defendants. (However, the court further held that Son cannot satisfy the criteria because he was not a signatory or otherwise formally connected to the Account, nor did he ever have a role at Heronwood.)

[16] 88 A.L.R. 4th 613 (2006).

Shamis v. Citizens Bank, December Term 2004, No. 0973, 2007 Phila. Ct. Com. Pl. LEXIS 199 (C.C.P. Phila. July 10, 2007) (Sheppard, J.), appeal quashed, 953 A.2d 849 (Pa. Super. 2008) ((1) Bank that reimbursed another party for honored checks is not a payor bank according to § 4105, and (2) the drawer may not bring a conversion claim under § 3420 on a negotiable instrument). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/041200973.pdf.

Plaintiff Mikhail Shamis ("Plaintiff") appeals summary judgment granted in favor of defendants Citizens Bank ("Citizens") and Legg Mason Wood Walker, Inc. ("Legg Mason") in a case arising from the alleged conversion of a negotiable instrument. Plaintiff filed the instant action against defendants Citizens and Legg Mason alleging "improper payment of check on fraudulent endorsement." The court granted summary judgment in favor of Citizens and Legg Mason. Plaintiff now appeals.

The court held as follows:

Plaintiff opened a brokerage account with Legg Mason and executed an account agreement. According to the terms of the agreement, Legg Mason was to reimburse Bank One, a separate bank, which was authorized to honor checks presented against the brokerage account.

In August 2002, Plaintiff issued a check for $100,000.00 to Michael Kogan ("Kogan") in order to invest in a company. In accordance with the account agreement, Bank One honored the check and was reimbursed by Legg Mason. Kogan misappropriated those funds by depositing them directly into his personal account with Citizens, instead of investing in a company. Kogan pled guilty to fraud and was incarcerated.

1. The Court held that it did not err in granting summary judgment in favor of Legg Mason when it found that Legg Mason was not the drawee bank. Plaintiff argues

that Legg Mason was the drawee bank because it drew money from plaintiff's brokerage account. However, Legg Mason complied with the terms of the account agreement and its role was thereby limited to reimbursing Bank One for the checks it honored.

Under the Uniform Commercial Code, a "drawee" is defined as "[a] person ordered in a draft to make payment." 13 Pa.C.S.A. § 3103(a). Moreover, a "payor bank" is "[a] bank that is the drawee of a draft." 13 Pa.C.S.A. § 4105. Therefore, Legg Mason is not liable as a matter of law because its role was limited strictly to reimbursement.

2. The Court held that it did not err in granting summary judgment in favor of Citizens when it found that Citizens was not liable. However, Plaintiff's claim for conversion against Citizens is barred under 13 Pa.C.S.A. § 3420 (UCC § 3-420) because Citizens had no banking relationship with plaintiff.

Although the Uniform Commercial Code incorporates the common law of conversion, it restricts who may bring claims. As a negotiable instrument claim, § 3-420 is applicable, thereby permitting only a drawee or a payee to assert a claim for conversion. Moreover, it expressly provides "[a]n action for conversion of an instrument may not be brought by the issuer [drawer]…of the instrument." 13 Pa.C.S.A. § 3420(a). Therefore, the plaintiff, as the drawer, is barred from bringing such a claim.

The quoted language of § 3-420 resolves a conflict under the former Article 3 over whether the drawee of a check with a forged endorsement can assert rights against a depositary bank. 1B James J. White & Robert S. Summers, Uniform Commercial Code § 15-4 (3d ed. 1993). Now, "[t]here is no reason why a drawer should have an action in conversion." Id. A check represents an obligation, not the property, of the drawer. Id.

Plaintiff has no contractual banking relationship with Citizens. Plaintiff issued a check to Kogan who deposited it into his personal account at Citizens. As a matter of law, Plaintiff's claim is barred under § 3-420.

Dowana v. Boykai, October Term 2006, No. 01409, 2007 Phila. Ct. Com. Pl. LEXIS 248 (C.C.P. Phila. July 18, 2007) (Bernstein, J.) (Bank that deposited checks payable to corporation into an unrelated account may be liable to the corporation for conversion and negligence according to §§ 3404, 3405, and 3420). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/061001409.pdf.

Defendant Citizens Bank, N.A. ("Defendant") filed Preliminary Objections. Plaintiffs, shareholders-partners in Helping Hand Staffing, Inc. ("HHS"), brought action against another shareholder-partner in HHS, who allegedly deposited checks payable to HHS into an account with Defendant in the name of a competing business, H. H. Professional Home Care. Plaintiffs also asserted claims against Defendant based upon its acceptance of such checks for deposit.

Plaintiffs alleged that Defendant was liable for conversion, negligence, breach of contract, breach of warranty, bad faith, and punitive damages. Although Plaintiffs improperly titled their claim as one brought pursuant to § 3403(c), the court did not dismiss the claim because the allegations otherwise asserted a valid cause of action against Defendant. The Court held as follows:

1. Plaintiffs asserted a valid claim for conversion. Plaintiffs alleged that Defendant made or obtained payment on checks on which the shareholder-partner of HHS was not entitled to enforce or receive payment. Under the Pennsylvania Uniform Commercial Code ("UCC"):

> The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person

> not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment.
>
> [13 Pa. C. S. § 3420.]

2. Plaintiffs have standing to bring a conversion claim. The UCC places constraints who may bring conversion claims against a bank:

> An action for conversion of an instrument may not be brought by the issuer or acceptor of the instrument or a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a copayee.
>
> [Id.]

HHS was allegedly the "payee" and Plaintiffs assert that the checks were delivered to HHS' agent or co-payee.

3. Plaintiffs assert a valid claim for comparative negligence. Although no cause of action exists for common law negligence that causes only economic loss, common law negligence claims are displaced by the provisions of the UCC concerning the wrongful payment of negotiable instruments. The UCC contains its own comparative negligence provisions with respect to imposters under § 3404. Plaintiffs asserted a valid negligence claim by alleging that Defendant failed to exercise ordinary care in permitting the improper deposit of checks. Additionally, the UCC contains comparative negligence provisions with respect to fraudulent indorsements by employees under § 3405. Plaintiffs allege that Defendant failed to exercise ordinary care in permitting the shareholder/partner to deposit checks made payable to his employer HHS into H.H. Professional Home Care's account, thereby asserting other valid grounds for a negligence claim.

4. Plaintiffs do not have a valid claim for breach of warranty. The UCC recognizes that a bank may only be liable for breach of a transfer warranty or a

presentment warranty. A transfer warranty is only enforceable against a party who transfers an instrument for consideration. Defendant did not transfer the checks to plaintiffs, and therefore, cannot be liable for breach of a transfer warranty. A presentment warranty is only enforceable against the party transferring the instrument to the drawee. Here, Plaintiffs are not the drawees, and therefore, cannot assert a breach of presentment warranty claim.

5. Plaintiffs remaining claims are not valid. There is no "implied at law" contract under which Plaintiffs could bring a claim. There is no cause of action for bad faith under either the UCC or common law that may be asserted against Defendant. Plaintiffs may not recover punitive damages on either their conversion or negligence claims against Defendant.

Nestle USA, Inc. v. Wachovia Bank, August Term 2005, No. 041562, 2007 Phila. Ct. Com. Pl. LEXIS 293 (C.C.P. Phila. November 5, 2007) (Sheppard, J.) (Court grants Defendant partial summary judgment, ruling portions of Plaintiff's claims are time barred per § 3118). This opinion is available at http://fjd.phila.gov/pdf/cpcvcomprg/050801026-110507.pdf.

The Court in Nestle determined that the three year statute of limitations which governs actions brought under Section 3 of the UCC is applicable to the negligence claims asserted under 13 Pa.C.S. §§ 3404 and 3405 alleging improper deposit of negotiable instruments. 13 Pa.C.S. § 3118(g)(3).

Plaintiff Nestle USA ("Plaintiff") argued that the statute of limitations should be tolled due to the fraudulent concealment of the injury by the Defendant Wachovia Bank ("Defendant"). In support of its argument, Plaintiff contended that Defendant "improperly" set up the account into which Plaintiff's negotiable instruments were wrongly deposited. Defendant allegedly failed to obtain proper documentation when it

opened the account. Plaintiff argues that the statute of limitations should be tolled on the theory of fraudulent concealment because Defendant failed to disclose to Plaintiff that its instruments were being wrongly deposited.

The court held that the statute of limitations should not be tolled because the Plaintiff did not allege that Plaintiff concealed its wrongdoing. The statute of limitations should be tolled for fraudulent inducement only if Plaintiff can point to facts which clearly show that Defendant in some manner concealed the improper deposits. In order to find fraudulent concealment, the Plaintiff must show that in addition to committing the acts that constitute the wrong for which it is suing, Defendant did or said something that amounts to concealment of the wrongdoing. In this case, the court found that Plaintiff merely alleged that Defendant failed to discover its own wrongdoing and notify the Plaintiff, which are omissions that do not constitute fraudulent concealment.

Furthermore, the court found that such omissions could substantiate the underlying negligence even though they do not constitute fraudulent concealment. The court stressed that the statute of limitations should be strictly applied in order to adhere to the UCC. The strict interpretation of the UCC statute of limitations is consistent with the policy goal of Pennsylvania courts for "uniformity of law, negotiability, and finality with respect to negotiable instruments."

Partial summary judgment was granted, and the relevant portion of Plaintiff's claims was time barred.