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Commonwealth of Kentucky

Court of Appeals

NO. 2010-CA-002152-MR

MARK D. DEAN, P.S.C. APPELLANT

v.

APPEAL FROM SHELBY CIRCUIT COURT
HONORABLE CHARLES R. HICKMAN, JUDGE
ACTION NO. 09-CI-00050

COMMONWEALTH BANK
& TRUST COMPANY APPELLEE

OPINION
AFFIRMING

** ** ** ** **

BEFORE: TAYLOR, CHIEF JUDGE; ACREE AND VANMETER, JUDGES.

ACREE, JUDGE: Appellant Mark D. Dean, PSC (Dean) appeals the Shelby Circuit Court's entry of summary judgment in favor of the Appellee, Commonwealth Bank & Trust Company (Commonwealth). Dean argues the circuit court erred by failing to apply the discovery rule to its claim under the Uniform Commercial Code, Kentucky Revised Statutes (KRS) 355.1-101, *et seq.*

(Code or UCC); Dean also argues that the court erred by granting summary judgment in favor of Commonwealth despite the existence of genuine issues of material fact. Finding no genuine issue of material fact and that Commonwealth is entitled to judgment as a matter of law, we affirm.

I. Facts and Procedure

Dean is a Kentucky professional services corporation with its principal place of business in Shelbyville, Kentucky. Dean's sole proprietor and operator is Mark Dean.

In 1998, Mark opened an escrow account for the firm with Commonwealth. Both he and Jody Wills, the firm's bookkeeper and secretary until May 2005, were authorized signatories. Part of the account agreement is printed on the signature card above Mark's and Jody's signatures; it confirms that "the undersigned is (are) acting on behalf of the business entity [Dean]." The signature card also indicates only one signature is necessary for any transaction on the account and it incorporates a Deposit Account Agreement, which sets out additional terms, including the provision that "[y]ou [Dean] are responsible for promptly examining your statement each statement period and reporting any irregularities to us [Commonwealth]."

In September 2003, Jody began illegally diverting funds from this account and another of Dean's accounts held at a second local bank using a method of transfers known as check-kiting. To further this endeavor, Jody used preprinted checks and counter checks provided to her by the bank tellers at Commonwealth.

On a monthly basis Commonwealth sent detailed statements of account activity and copies of all checks, counter checks, and deposit slips to the address listed on the signature card. Many of the checks were signed by Jody, and several of those were for very large amounts. Dean maintains, and Commonwealth does not dispute, that Jody intercepted the monthly statements to prevent Mark, on Dean's behalf, from discovering her scheme.

In January 2005, Belinda Nichols, Commonwealth's Market President for Shelbyville, learned of suspicious activity on Dean's escrow account indicative of check-kiting; she arranged a meeting with Mark on February 1, 2005, to discuss the account activity. Following that meeting, a hold was placed on the escrow account. The last activity in the account occurred in March 2005.

Jody was subsequently indicted on criminal charges related to the theft. Despite his February 1, 2005 meeting with Nichols and the hold on the escrow account beginning in March of the same year, Dean contends he was entirely unaware of Jody's unlawful activity until notified by law enforcement officials in September 2008.

Mark, on behalf of Dean, believed Commonwealth had failed to adequately satisfy a duty to protect Dean's account from theft. On January 23, 2009, Dean filed suit asserting four claims. The first claim alleged a violation of the Code, specifically KRS 355.4-405 and 355.4-406. Three other claims were not Code-based; they were: (1) "Aiding and Abetting Fraud and Illegal Activity and Breach of Duty of Ordinary Care"; (2) common law negligence; and (3) "Breach of

Contract and Breach of Duty of Good Faith and Fair Dealing." Dean sought punitive damages, based on a contention that Commonwealth had "acted with gross negligence, reckless disregard of the rights of Dean, and with malice and oppression in its actions toward Dean." Discovery ensued.

Commonwealth filed a motion for summary judgment on all claims, asserting that Dean's Code claim was barred by the Code's three-year statute of limitations, KRS 355.4-111, and that his common law claims were displaced by the Code and, therefore, likewise subject to the Code's limitations statute. The circuit court granted the motion on the Code claim, but initially declined to enter summary judgment on the common law claims, finding the Code's statute of limitations did not govern them.

Commonwealth then renewed its motion for summary judgment on the common law claims; this time the circuit court was persuaded. More precisely, the circuit court concluded there were no genuine issues of material fact and, based on the uncontroverted facts presented, Dean could not prevail on any common law causes of action. This appeal followed.

II. Standard of Review

In reviewing a trial court's grant of a motion for summary judgment, we must ascertain "whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law." *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky. App. 1996); Kentucky Rules of Civil Procedure (CR) 56.03. In doing so, "[t]he trial court must

view the evidence in the light most favorable to the nonmoving party, and summary judgment should be granted only if it appears impossible that the nonmoving party will be able to produce evidence at trial warranting a judgment in his favor." *Lewis v. B & R Corp.*, 56 S.W.3d 432, 436 (Ky. App. 2001) (citing *Steelvest v. Scansteel Serv. Ctr., Inc.*, 807 S.W.2d 476, 480–82 (Ky. 1991)). In discussing the word "impossible" as set forth in the summary judgment standard, the Kentucky Supreme Court has held it is meant to be "used in a practical sense, not in an absolute sense." *Lewis*, 56 S.W.3d at 436. "Because summary judgment involves only legal questions and the existence of any disputed material issues of fact, an appellate court need not defer to the trial court's decision and will review the issue *de novo*." *Id.,* citing *Scifes,* 916 S.W.2d at 781.

III. Analysis

Dean argues that KRS 355.4-111, a three-year statute of limitations, combined with the discovery rule, allows it to pursue its Code and non-Code claims against Commonwealth. We disagree and conclude that a rule of substantive law, KRS 355.4-406, and not a statute of limitations, prohibits the pursuit of these claims.

The Code imposes the "duty of a customer to examine their [sic] bank statements in a prompt and reasonable fashion[.]" *Concrete Materials Corp. v. Bank of Danville & Trust Co.*, 938 S.W.2d 254, 258 (Ky. 1997); KRS 355.4-406(3). More particularly, "the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not

authorized" and then "the customer must promptly notify the bank of the relevant facts." KRS 355.4-406(3). This is consistent with the parties' agreement as well.

Among the things a customer must look for when examining its statements is an "unauthorized signature," defined not only as a forgery, but also "as a signature made by one exceeding actual or apparent authority." KRS 355.3-403, Official Comment 1[1] (citing KRS 355.1-201(43) (defining "'Unauthorized' signature")); *see also* KRS 355.3-406, Official Comment 2 ("Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency."). Jody exceeded her authority when she engaged in the check-kiting scheme. Therefore, hers was an unauthorized signature that Dean would have discovered if it had complied with its duty under KRS 355.4-406(3) to examine its bank statements.

There are legal repercussions for an inattentive customer like Dean.

> Without regard to care or lack of care of either the customer or the bank, a customer who does not within one (1) year after the statement or items are made available to the customer (subsection (1)) 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.

KRS 355.4-406(6).

[1] Beginning with the 2006 revisions to Kentucky's version of the Code, "Official comments to the Uniform Commercial Code, as published from time to time by the National Conference of Commissioners on Uniform State Laws [NCCUSL], represent the express legislative intent of the General Assembly and shall be used as a guide for interpretation of this chapter, except that if the text and the official comments conflict, the text shall control." KRS 355.1-103(3). Therefore, it behooves both bench and bar to read these official comments in their entirety.

We make special note of the fact that the Legislature was not creating another statute of limitations; rather, compliance with 4-406 of the UCC is "a precondition to a customer's lawsuit against a bank." *Napleton v. Great Lakes Bank, N.A.*, 945 N.E.2d 111, 117 (Ill. App. 2011)("[M]any other jurisdictions have come to the same conclusion[.]" (Citations and internal quotation marks omitted)). Here, Dean's "failure . . . to inspect its bank statement and to notify the bank of the claimed unauthorized withdrawals within one year of the time the statements and items were made available to it, precludes any claim for such unauthorized withdrawals." *Concrete Materials*, 938 S.W.2d at 260. The one-year period in which a customer must comply with the duty imposed by the statute establishes a "substantive bar that destroys the right to sue the bank, regardless of the theory on which the plaintiff brings suit." *Id.* at 259 (quoting Anderson, *Uniform Commercial Code*, Vol. 6 § 4–406:15 at 206). This interpretation is consistent with that of the majority of jurisdictions in which section 4-406(f) of the UCC – the source of KRS 355.4-406(6) – has been considered, as we discuss below.

Just as *Concrete Materials* holds, UCC section 4-406 has been consistently interpreted as barring any untimely claims, whether under the UCC or under the common law. *See*, *e.g.*, *Euro Motors, Inc. v. Southwest Fin. Bank & Trust Co*., 696 N.E.2d 711, 716 (Ill. App. 1998); *Wetherill v. Putnam Invs.*, 122 F.3d 554, 558 (8th Cir. 1997)(citing additional authority). The time limit imposed by UCC section 4-406 is applicable without regard to the theory on which the customer brings the action. *Euro Motors*, 696 N.E.2d at 716; *Siecinski v. First State Bank of*

East Detroit, 531 N.W.2d 768, 770-71 (Mich. App. 1995); *Arkwright Mut. Ins. Co. v. State Street Bank & Trust Co.*, 703 N.E.2d 217, 221 (Mass. 1998)("Although at least one court has permitted a recovery on a [California common law claim], we note that commentators have soundly criticized this approach." (Citations omitted)).

Courts that considered Dean's specific theories of recovery "have held that U.C.C. § 4-406(f) [KRS 355.4-406(6)] bars all claims against a bank, including conversion and breach of fiduciary duty, which underlie plaintiffs' aiding and abetting claims." *American Fed. of Teachers, AFL-CIO v. Bullock*, 605 F.Supp.2d 251, 262 (D.D.C. 2009). The commercial certainty doctrine and the purposes of the UCC are compelling reasons for treating KRS 355.4-406(6) as a bar regardless of the theory underlying the action. *See* KRS 355.1-103(1).

However, this does not end the analysis. Although KRS 355.4-406 reads identically as when *Concrete Materials* was decided, the Legislature has since amended KRS 355.1-103 to provide that the "[o]fficial comments to the Uniform Commercial Code . . . represent the express legislative intent of the General Assembly and shall be used as a guide for interpretation[.]" KRS 355.1-103(3). Therefore, we must look to the official comments to KRS 355.4-406 where we learn that the statute

> does not . . . preclude a customer . . . from asserting its [claim based on an] unauthorized signature . . . against a bank in those circumstances in which under subsection [(3)] the customer should not "reasonably have discovered the unauthorized payment." Whether the

> customer has failed to comply with its duties under subsection [(3)] is determined on a case-by-case basis.

KRS 355.4-406, Official Comment 1 (quoting KRS 355.4-406(3)). The Legislature clearly intended that courts consider the customer's individual circumstances and allow a claim despite the bar of KRS 355.4-406(6), provided those circumstances make it unreasonable to expect that the customer should have discovered the unauthorized payment.[2]

We have considered the uncontroverted facts, and Dean's argument, in light of the legislative intent of KRS 355.4-406 and we conclude, as did the circuit court, that Mark, on Dean's behalf, should reasonably have discovered Jody's unauthorized transactions.

Dean argues that Mark could not have concluded that Jody was embezzling any sooner than the date on which FBI forensic accountants were able to reveal Jody's scheme. We are not persuaded by that argument.

The FBI was undertaking a criminal investigation to establish Jody's guilt beyond a reasonable doubt, a much higher threshold of examination than Mark needed to alert Dean of the appearance of an impropriety in its own accounts, and to notify the bank. Dean needed to *prove* nothing, only to alert the bank of what should have appeared to Dean as improper. In fact, Mark effectively acknowledges that when, finally, he did look at the bank statements, he *was* alerted

[2] This discussion of legislative intent in no way addresses, affects, or incorporates any "discovery rule" or related concept. Discovery rules, when applicable, apply only to statutes of limitation. As noted earlier, KRS 355.4-406 is not a statute of limitation. It is the mandatory precondition that customers notify the bank, according to the terms of KRS 355.4-406, prefatory to the filing of a complaint, the timing of which *is* governed by a statute of limitations, KRS 355.4-111.

to Jody's curious accounting and check-writing practices, such as using counter checks and preprinted checks, and making checks payable to the bank in unusual amounts. The problem in this case is not an *inability* to discern unauthorized check-writing, but simple *dilatoriness* in doing so. Dean's dilatoriness is an inadequate basis for concluding that it could not reasonably have discovered the unauthorized payments.

The three-year statute of limitations, KRS 355.4-111, is irrelevant under these facts; therefore, the discovery rule is equally irrelevant. Mark's failure, on behalf of Dean, to timely examine the firm's bank statements, combined with his failure, on Dean's behalf, to timely notify the bank as required by KRS 355.4-406(3), resulted in "the absolute prohibition provided by KRS 355.4-406(4) to those claims that are more than a year old[.]" *Concrete Materials*, 938 S.W.2d at 258. All of Dean's claims are more than a year old. This failure to comply with KRS 355.4-406 is a dispositive bar to all claims asserted by Dean against Commonwealth, whether based on the Code or based on common law. There being no genuine issues of material fact relative to that bar, we find no error in the circuit court's grant of summary judgment.

IV. Conclusions

For the reasons stated, the Shelby Circuit Court's orders of summary judgment are affirmed.

ALL CONCUR.

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