

RENDERED: FEBRUARY 19, 2016; 10:00 A.M.  
TO BE PUBLISHED

# Commonwealth of Kentucky

## Court of Appeals

NO. 2014-CA-00762-MR

HAROLD BAERG, JR.; AND  
KATHLEEN M. BAERG

APPELLANTS

v. APPEAL FROM FAYETTE CIRCUIT COURT  
HONORABLE THOMAS L. CLARK, JUDGE  
ACTION NO. 12-CI-03758

ANGELA FORD; ATI VENTURES, LLC;  
AND VILLA PARIDISIO, LLC

APPELLEES

AND

NO. 2014-CA-00791-MR

FAISAL SHAH

APPELLANT

v. APPEAL FROM FAYETTE CIRCUIT COURT  
HONORABLE THOMAS L. CLARK, JUDGE  
ACTION NO. 12-CI-03758

ATI VENTURES, LLC;  
ANGELA FORD;  
ANGELA FORD, P.S.C.;  
AND VILLA PARIDISIO, LLC

APPELLEES

OPINION  
REVERSING

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BEFORE: COMBS, DIXON, AND D. LAMBERT, JUDGES.

D. LAMBERT, JUDGE: Faisal Shah and Harold and Kathleen Baerg (the Baergs) appeal from two separate orders of the Fayette Circuit Court granting summary judgment in favor of Angela Ford and three companies Ford controls (collectively Ford). Ford sued both Shah and the Baergs for conversion. After review, we reverse the circuit court's decisions in this consolidated opinion.

**I. BACKGROUND**

In 2011, attorney Seth Johnston formed two Delaware limited liability companies on behalf of Ford: Villa Paridisio, LLC and ATI Ventures, LLC. Ford directed Johnston to open bank accounts for these entities at various banks. Ford also deposited money into the accounts after they were opened. From the record, Ford deposited \$1,856,000 into Villa Paridisio's account at PNC Bank and \$750,000 into ATI Ventures' account at Republic Bank. Johnston later transferred all of the funds from Villa Paridisio's account at PNC Bank into a new account at BB&T.

In 2012, Johnston purchased a \$150,000 cashier's check from Republic Bank with funds from ATI Ventures' account. Johnston, as the only signatory on ATI Ventures' account, was ostensibly acting in his capacity as Ford's representative. However, this was not the case. Unbeknownst to Ford,

Johnston negotiated the check to an individual named Zafir Nassar, who subsequently negotiated the check to appellant Faisal Shah for \$12,000. Shah deposited the check in his personal account at Chase Bank, the payee of the check, and then wrote a personal check to a distribution company owned by Nassar for \$138,000.

While Johnston was opening bank accounts for Ford and causing money to be drawn on one of them without her knowledge, he also assisted the Baergs, two real estate investors, in completing certain real estate transactions. One such transaction was a Section 1031<sup>1</sup> real estate exchange in which the Baergs sold an apartment complex in Texas for \$1.1 million. At closing, the Baergs allowed the sales proceeds to flow into the bank account of an intermediary company organized and managed by Johnston called Emerald Riverport, LLC. The Baergs eventually acquired like kind property in California, albeit after Johnston usurped the sales proceeds for his personal use and paid the seller of the California property with wire-transferred funds from Ford's Villa Paradisio account.

Ford sued Johnston for his wrongdoings. She also sued Shah and the Baergs for common law conversion. In her complaints, Ford alleged that Shah and

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<sup>1</sup> The Internal Revenue Code provides certain exceptions to the general rule requiring taxpayers to recognize gains or losses upon the sale or exchange of property. Under Section 1031(a), a taxpayer is not required to recognize gains or losses "if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade of business for investment." 26 Code of Federal Regulations (C.F.R.) § 1.1031(a)-1. A qualified intermediary under 26 C.F.R. § 1.1031(k)-1(g)(4) may be used to effectuate these exchanges.

the Baergs exercised dominion and control over the cashier's check and Villa Paridasio's funds, respectively, and intended to deprive her of her property. Ford also alleged that the Baergs knew or should have known about Johnston's illicit wire transfers because Emerald Riverport did not appear as the originator on the face of any payment order initiated by Johnston. Ford later moved for summary judgment.

In response, Shah and the Baergs both countered that the loss must lie with Ford because she was in the best position to monitor the activity of Johnston. They also claimed that neither the cashier's check nor the wired funds could be converted under Kentucky law. The circuit court ultimately accepted Ford's position and ordered Shah and the Baergs to pay Ford. The circuit court denied subsequent motions to alter, amend or vacate. This appeal followed.

## II. STANDARD OF REVIEW

Under CR<sup>2</sup> 56.03, summary judgment is only appropriate when no genuine issues of material fact exist and "the moving party is entitled to a judgment as a matter of law." That is to say, summary judgment may only be granted when it appears, as a matter of law, "that it would be impossible for the respondent to produce evidence at the trial warranting a judgment in his favor and against the movant." *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 483 (Ky. 1991). Furthermore, "[a]n appellate court need not defer to the trial court's decision on summary judgment . . . because only legal questions and no

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<sup>2</sup> Kentucky Rules of Civil Procedure.

factual findings are involved.” *Coomer v. CSX Transp., Inc.*, 319 S.W.3d 366, 370-71 (Ky. 2010).

### III. DISCUSSION

#### 1. Summary Judgment against Shah was Improper

On appeal, Shah first asserts that he cannot be liable to Ford as a matter of law because a cashier’s check cannot be converted. Shah then claims that the loss must lie with Ford because she authorized Johnston to engage in transactions with Republic Bank on her behalf. For the following reasons, we disagree with Shah’s first argument but agree with the second.

As to Shah’s first argument, it simply has no legal merit. KRS<sup>3</sup> 355.3-420 provides that instruments can be converted, and a review of the cashier’s check at issue shows that it was both an instrument and a check under KRS 355.3-104(3); it was an unconditional “order” to pay Chase Bank \$150,000 on demand, and Republic Bank was both the “drawer” and the “drawee.” KRS 355.3-103. However, as Ford did not sue under KRS 355.3-420 and Shah only preserved the argument at bar,<sup>4</sup> we will not address the propriety of Ford’s common law conversion claim in light of Kentucky’s adoption of the Uniform Commercial Code (UCC).<sup>5</sup> *See Fischer v. Fischer*, 348 S.W.3d 582, 590 (Ky. 2011) (holding

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<sup>3</sup> Kentucky Revised Statutes.

<sup>4</sup> Ford called Shah’s attention to the potential applicability of KRS 355.3-420 as early as May 2013.

<sup>5</sup> KRS Chapter 355, *et seq.*

that an appellate court cannot reverse the trial court on an unpreserved legal ground unless palpable error occurred).

Common law “[c]onversion is an intentional tort that involves the wrongful exercise of dominion and control over the property of another.” *Jones v. Marquis Terminal, Inc.*, 454 S.W.3d 849, 853 (Ky. App. 2014). And in Kentucky, the following elements comprise a common law conversion claim:

- (1) the plaintiff had legal title to the converted property;
- (2) the plaintiff had possession of the property or the right to possess it at the time of the conversion;
- (3) the defendant exercised dominion over the property in a manner which denied the plaintiff's rights to use and enjoy the property and which was to the defendant's own use and beneficial enjoyment;
- (4) the defendant intended to interfere with the plaintiff's possession;
- (5) the plaintiff made some demand for the property's return which the defendant refused;
- (6) the defendant's act was the legal cause of the plaintiff's loss of the property; and
- (7) the plaintiff suffered damage by the loss of the property.

*Ky. Ass'n of Counties All Lines Fund Trust v. McClendon*, 157 S.W.3d 626, 632 n. 12 (Ky. 2005) (quoting 90 Corpus Juris Secundum (C.J.S.) *Trover and Conversion* § 4 (2004)).

Regarding Shah's second argument, *supra*, it is well established that a “principal is bound by the act of his appointed or recognized agent when it is within that sphere of the agent's apparent authority.” *Clark v. Burden*, 917 S.W.2d 574, 579 (Ky. 1996). Moreover, “[t]hat a principal did not approve an individual transaction [with a bank] does not change the fact that an agent can have apparent authority to . . . engage in the transaction, at least when viewed from the

perspective of the bank.” *Mark D. Dean, P.S.C. v. Commonwealth Bank & Trust Co.*, 434 S.W.3d 489, 500 (Ky. 2014). All that is required to create apparent authority is a manifestation from the principal that his agent had authority, a reasonable belief by a third party that the agent had authority based on the manifestation, and a direct link between the principal’s manifestation and the third party’s belief. *Id.*

Here, although there is some debate as to whether a remitter relinquishes title to a cashier’s check at the time of purchase,<sup>6</sup> Ford lost any possessory interest in the check once Johnston negotiated it to Nassar. Ford cloaked Johnston with apparent authority to engage in transactions with Republic Bank by directing him to open the account and by failing to either remove his signature from the account’s signature card or add hers. Republic Bank thus reasonably issued an enforceable \$150,000 cashier’s check to Johnston, and when Johnston subsequently transferred the check to Nassar, Ford’s rights in the check also transferred.

## **2. Summary Judgment against the Baergs was Improper**

Unlike Shah, the Baergs challenge Ford’s common law conversion claim under the UCC. The Baergs first argue that UCC Article 4A preempts Ford’s common law claim because Johnston’s wire transfers were “funds

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<sup>6</sup> Cf. Gregory E. Maggs *Determining the Rights and Liabilities of the Remitter of A Negotiable Instrument: A Theory Applied to Some Unsettled Questions*, 36 B.C.L. Rev. 619, 654-55 (1995) (noting that UCC 3-420 does not exclude remitters from the class of potential plaintiffs to a conversion claim and proposing that remitters are persons entitled to enforce as non-holders in possession, provided they maintain a possessory interest).

transfer[s]” under KRS 355.4A-104 and Article 4A supplies the exclusive law with respect to funds transfers. The Baergs alternatively argue that Ford could not satisfy the elements of a common law conversion claim because she relinquished title to the funds once the beneficiary’s bank accepted Johnston’s authorized transfers. For the following reasons, we are persuaded by the Baergs’ alternative argument.

In Kentucky, Article 4A is “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.” U.C.C. § 4A-102, cmt.; *see also* KRS 355.1-103 (adopting UCC’s official comments as the express intent of the legislature).<sup>7</sup> Furthermore, Article 4A covers situations involving funds transfers, and more precisely “credit” transfers described in U.C.C. § 4A-104, cmt. 4. KRS 355.4A-102. Therefore, Article 4A bars common law claims involving misconduct during the funds transfer process. However, as highlighted in *Koss Corp. v. American Exp. Co.*, 233 Ariz. 74, 82, 309 P.3d 898, 906-07 (Ct. App. 2013), the alleged misconduct must have occurred during the course of a funds transfer itself, and not outside or after completion of the process. This is because the UCC’s drafters did not intend for parties “to use Article 4A as a shield for fraudulent activity” when they knew or should have known that the transferred funds were fraudulently obtained. *Regions Bank v. Provident Bank, Inc.*, 345 F.3d 1267, 1276

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<sup>7</sup> This aligns with our Supreme Court’s observation that the UCC exclusively governs commercial transactions in a majority of jurisdictions when the UCC has already supplied “a comprehensive remedy for the parties to a transaction[.]” *Mark D. Dean, P.S.C.*, 434 S.W.3d at 506.



(11th Cir. 2003). Additionally, it follows the UCC’s admission that its provisions do not displace all common law claims. KRS 355.1-103(2). Notably, a funds transfer is complete when the beneficiary’s bank accepts a payment order “for the benefit of the beneficiary of the originator's payment order.” KRS 355.4A-104(1).

Here, Ford once again cloaked Johnston with apparent authority to originate the funds transfers. She allowed Johnston to open and serve as the lone signatory on the Villa Paradisio account and thus authorized the transactions under KRS 355.4A-202 just as though she were the sender. *See* U.C.C. § 4A-203, cmt. 2. Nevertheless, Article 4A does not preempt Ford’s common law claim because the Baergs were not a party to any of the funds transfers. Johnston, acting for Villa Paradisio, was the originator, BB&T was the originating bank, and the beneficiary was the seller of the California property—not the Baergs. The Baergs only acquired the property, allegedly with funds they knew were Ford’s, after the beneficiary bank accepted the funds for the beneficiary’s benefit. Thus, the Baergs’ alleged misconduct occurred after the funds transfer process was complete.

Because we have held that Article 4A did not preempt Ford’s common law conversion claim, we must now address the Baergs’ argument that the funds at issue cannot be converted as a matter of law. In support of their position, the Baergs cite *People's Nat. Bank v. Jones*, 61 S.W.2d 17, 19 (1933), which provides, as an exception to the general rule precluding thieves from passing clear title to stolen property, that *bona fide* purchasers of stolen money obtain clear title to their purchase. Despite this citation, we also observe that a conversion

action may still lie when stolen money is identifiable and earmarked for a specific purpose. *See Hargis v. Spencer*, 71 S.W.2d 666, 669-70 (1934). Given our Supreme Court’s recent acknowledgment that “[m]oney is property which is capable of being converted” in *Hearn v. Commonwealth*, 80 S.W.3d 432, 435 (Ky. 2002), we now hold that traceable funds such as the ones in this case are subject to conversion. Accordingly, we must now ask whether the trial court properly found that each of the seven elements provided in *McClendon, supra*, were met.

Here, Ford cannot satisfy the second element because valid title to the funds passed to the seller of the California property upon completion of the funds transfers. The funds were transferred pursuant to Johnston’s authority—not stolen—and Ford did not allege that the beneficiary’s bank either knew or should have known about Johnston’s fraud or otherwise accepted the funds in bad faith. Therefore, Ford was divested of any continuing interest in the funds the moment the beneficiary’s bank accepted them from Johnston, and her conversion claim must fail as a matter of law.

The Fayette Circuit Court’s summary judgment orders are hereby reversed.

DIXON, JUDGE, CONCURS.

COMBS, JUDGE, DISSENTS AND FILES SEPARATE OPINION.

COMBS, JUDGE, DISSENTING. I concur with the majority opinion with respect to the banks because Ford did indeed clothe Johnston with apparent authority as her agent. However, I dissent as to Shah and Baergs.

The outcome in this case effectively results in utilizing article 4A of the UCC “as a shield for fraudulent activity” – the very purpose that the drafters did **not** intend according to the correct observation of the majority opinion.

Opinion at p.9.

Shah and the Baergs were aware of the fraudulent conduct of Johnston and colluded with him in manipulating the fraudulent transfer of funds. In conspiratorial fashion, they profited from his wrongdoing.

Consequently, I would affirm the summary judgment of the trial court.

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