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Who Is a "Customer" When a Check Is Wrongfully Dishonored? The Answer Is Not Child's Play

PATRICK R. KINGSLEY AND A. NICOLE STOVER

UCC § 4-402 authorizes a cause of action against a payor bank for wrongfully dishonoring the properly payable item of a "customer." Judicial expansion of the definition of "customer" under § 4-402 has forced financial institutions to question what should be a uniform issue: Who is the customer?

The Uniform Commercial Code authorizes a cause of action against a payor bank that wrongfully dishonors a customer's properly payable item. Under UCC § 4-402, "a payor bank is liable to its *customer* for damages proximately caused by the wrongful dishonor of an item." Critical to assessing liability exposure under this section is determining exactly which persons or entities have standing to sue as a "customer."

In the case of an individual, the identity of the customer is simple: the person who is the named account holder. But in the case of corporations (especially small, closely-held corporations) the answer is less clear. Certainly

Patrick R. Kingsley is a partner in the litigation practice group at Stradley, Ronon, Stevens & Young, LLP, in Philadelphia. His primary focus is in representing the financial services industry, including banks, mortgage companies, broker-dealers, lenders, mutual fund complexes, sureties, insurance companies, and investment advisors. Nicole Stover, an associate in the firm's litigation practice group in Philadelphia, focuses her practice on complex commercial litigation, financial services and employment. The authors can be reached at pkingsley@stradley.com and nstover@stradley.com, respectively.

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the corporation itself is a customer, but does the definition end there? What about the president of the corporation? The directors and officers? The authorized signatories? The president's family members? A recent case in Pennsylvania addressed all of these issues and tested the limits of the definition of "customer" to the extremes.

BABY ON THE BOARD

In a recent case in Pennsylvania, *Jana v. Wachovia Bank, N.A.*, plaintiffs brought an action for an alleged wrongful dishonor of a check not only in the name of the corporation identified as the customer on the account, but also on behalf of the corporation's vice-president and her child, who was three-years-old at the time the account was established.[1] The mother was closely connected to the corporation, acting as an officer, director, shareholder and designated signatory on the account as well as guarantor on loan documents associated with the account. The child argued that he should be considered a "customer" on the account of the closely-held corporation because the bank allegedly knew that dishonoring the corporation's check would cause him financial harm and that he bore a close relationship to the corporation. If a person or entity other than the named account holder is to be considered a customer, this case gave the court the perfect opportunity to expand or limit that definition given the juxtaposition of these two plaintiffs.

WHOSE CHECK IS IT ANYWAY?

A "customer" is defined in UCC § 4-104 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." This definition is not particularly enlightening, although if read literally it would seem to limit the customer to the named account holder. Who is the individual or entity "having an account" with the bank if not the named account holder? Courts have struggled to determine whether such a literal reading is required to ensure uniformity of application or, alternatively, if such a reading is too restrictive and ignores the true relationship between the bank and the corpo-

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rate personnel who interact with it.

The Expansive View

Rather than simply identifying the named account holder as the "customer," several jurisdictions engage in a factual analysis to determine whether the financial institution "regarded" the plaintiff as its customer and/or whether the named account holder and the plaintiff had a sufficiently close relationship to justify customer status. The 2002 Comment to § 4-402 recognizes and cites three cases supporting the expansive view: *Murdaugh Volkswagon, Inc. v. First National Bank*;[2] *Karsh v. American City Bank*;[3] and *Koger v. East First National Bank*.[4]

In *Murdaugh*, a president and sole stockholder of a corporation argued that she could be deemed a "customer" of the bank. The court found that the bank's interpretation of "customer" to include only named account holders was "unjustifiably narrow" given the "close intertwinement" between the plaintiff and the corporate account holder. The court chose to apply an expansive interpretation of § 4-402 to include persons or entities having such a close relationship with the named account holder that harm resulting from the dishonor could be foreseen by the bank. The court held that the bank's acceptance of a personal guarantee from the president for the corporation's obligations justified a finding that the bank regarded the president as its "customer."

The court in *Karsh* similarly held that the president and sole owner of a corporation was a "customer." The court relied on the fact that the corporation was an undercapitalized, transparent shell and reviewed the bank's history of directly communicating with the corporation's president. The court also relied heavily on the fact that the bank required the president to guarantee the corporation's obligations on the account.

The *Koger* court also found that the corporation's capitalization was a significant factor in determining the customer standing of a corporate stockholder. Although claiming to disagree with the "liberal" interpretation of the definition of "customer," the court explained that, if the stockholder had alleged that the corporation was an undercapitalized shell, then the claim under § 4-402 may have survived a motion to dismiss.

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Additional cases interpreting the definition of "customer" also find significant the existence of guarantees on behalf of the corporation and the course of dealing between the bank and corporate personnel. Corporate owners who personally guaranteed the undercapitalized corporation's loans were also granted "customer" standing in *Kendall Yacht Corp. v. United California Bank*.[5] In *Kendall*, the owners controlled the corporation's finances and guaranteed its obligations to the bank and to the corporation's employees. The court applied what it described as a "flexible and reasonable interpretation" of the definition of "customer," stating that "[s]uch a narrow and technical reading of the statute and the term 'customer' does not seem warranted." Key to the court's decision was its finding that the bank could foresee that the dishonor of the corporation's checks would reflect on the personal credit and reputation of the owners.

In *Kesner v. Liberty Bank & Trust Co.*, the court denied customer standing to a corporation's treasurer who sought damages for dishonor of the corporation's checks.[6] However, the court identified the key factors in determining customer status to be the capitalization of the corporation and whether the corporation could stand alone as a legally distinct entity. Although embracing the expansive view, the court found that, under the facts presented, there was no "ambiguity" as to who had the account with the bank because the corporation was sufficiently capitalized.

More recently, the court in *Parrett v. Platte Valley State Bank & Trust Co.*, held that a corporate officer who was the principal shareholder and president would have customer standing.[7] The officer's personal guarantee of the corporation's obligations to the bank and course of dealing with the bank made it foreseeable to the bank that the dishonor of the corporation's check would harm the officer, against whom criminal charges were brought in connection with the dishonored check.

In *Thrash v. Georgia State Bank of Rome*, the president of a depositor corporation was held not to be a "customer" because the president was a minority shareholder of the named account holder.[8] However, the court accepted the expansive view and qualified its opinion by stating that the plaintiff was unable to establish a sufficiently close relationship with the named account holder to confer "customer" status.

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The Literal View

In contrast, several jurisdictions have applied the plain meaning of § 4-402 to find that the definition of "customer" does not include any person or entity other than the named holder of an account. The earliest case to discuss the tension between the literal and expansive view was *Loucks v. Albuquerque National Bank*, which is also cited in the 2002 Comment to § 4-402.[9] In *Loucks*, partners holding a partnership account were denied "customer" standing to sue a bank for dishonor of a check payable to the partnership. The partners opened a checking account in the name of the partnership, and the bank dishonored a check drawn on the account after the bank charged the partnership account with a debt owed by one of the partners. The court explained:

> [T]he relationship, in connection with which the wrongful conduct of the bank arose, was the relationship between the bank and the partnership. The partnership was the customer, and any damages arising from the dishonor belonged to the partnership and not to the partners individually.

In *Farmers Bank v. Sinwellen Corp.*, the plaintiff was the corporation's president, opened the account, and even determined who would draw on the account.[10] Despite these facts, the court dismissed his claim because he was not a "customer." The court held that the statutory definition of "customer" includes "only a person having an account with a bank; the language is plain and does not require construction." Although the court went on to conclude that its finding was based in part on the lack of evidence that the bank regarded the president as its customer, this was a separate and independent basis for its ruling.

In *Singleton v. American Security Bank of Ville Platte, Inc.*, the court held that a bank was not liable to its corporate customer's majority shareholder, corporate officer and signatory on the account for the dishonor of a corporate check because only the corporation was a "customer." The court based its ruling solely on the plain meaning of "customer" in § 4-402.[11]

In *Plummer v. Prairie State Bank*, a husband and wife — who were pres-

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ident and secretary of a closely-held corporation — were denied "customer" standing under § 4-402. [12] The court refused such standing despite the fact that the husband and wife were the majority shareholders, personal guarantors and signatories on the account. Key to the court's analysis was the husband and wife's use of the corporate form to argue that their personal debts could not be charged to the corporation.

POLICY CONSIDERATIONS

Several policy considerations seemingly favor application of the literal view limiting the definition of "customer" to the named account holder. For example, one of the primary goals of the UCC is uniformity, yet judicial expansion of the definition of "customer" erodes that goal. If the expansive view is applied, banks will not know with certainty the identity of their customers until *after* a trial, when a judge or jury so informs them.

Second, plaintiffs claiming customer status allege that they are entitled to stand in the shoes of the corporation as the named account holder for purposes of a wrongful dishonor action. However, it is inequitable to allow a plaintiff to reap the financial benefits or protections the corporate form affords, yet strip away the corporate veil whenever it poses an economic disadvantage.[13] In other words, it seems unfair for individuals to be allowed to embrace or reject the very corporate form they have created depending on the circumstance.

Third, it would also be easy enough for any individuals involved to ensure they are viewed as customers of the bank, if that is what they want. They could simply add their names to the account. A corporation wishing to ensure application of § 4-402 to the corporation's owners and officers individually should be required to add such persons as named account holders, thereby giving notice to the bank of potential liability to specific individuals in addition to the corporation.

Finally, principles of statutory construction appear to favor application of the literal view. As one court has held when interpreting the definition of "customer" under § 4-402, "the language is plain and does not require construction."[14] The 1990 amendments to the UCC also seem to support the literal view. Before 1990, only the "customer" had the right to stop payment

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of checks drawn on the customer's account. Recognizing the narrowness of the term "customer," the 1990 amendments to Article 4 revised § 4-403 to expand who could stop payment to include "a customer *or any person authorized to draw on the account if there is more than one person.*"[15] Revisions were also made to § 4-402 in 1990. Those revisions, however, did not involve an expansion of the definition of "customer" nor did they involve an expansion of who had standing to sue under § 4-402.[16] The failure to amend § 4-402 suggests that it was not intended that § 4-402 grant a statutory cause of action for wrongful dishonor to any person other than the financial institution's named account holder.

TAKING CANDY FROM A BABY

In *Jana v. Wachovia*,[17] the court was faced with two relatively extreme examples of § 4-402 claimants: a little boy who could not read or write at the time the account was opened and his mother, who was an officer, director, shareholder, designated signatory and personal guarantor of the corporation. In the end, the court opted for the expansive view but even having done so, it could not stretch the expansive view to include the child of a corporate owner.

The child argued that the bank allegedly knew that a dishonor of the corporation's check could harm his financial interest, despite the fact that he was only three years old at the time the account was created. The court ultimately decided that the child could not be considered a customer because he played no role in the corporation's management, had limited interactions with bank representatives and was not a signatory on the corporation's account. Based on these facts, the court granted summary judgment in favor of the bank on the child's claim under § 4-402 for lack of standing as a "customer."

Allowing the child's mother's claim to survive, the court held that "customer" standing could be achieved if the evidence supports a finding that the plaintiff "bore such a close relationship to the corporation that she should be permitted to bring a cause of action for wrongful dishonor." The court cited decisions favoring a more liberal interpretation of the definition of "customer" and left open the possibility that such a claim could exist given the right factual circumstances. Evidence supporting a finding of "customer" standing included:

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- The bank's subjective view that the corporation and the individual plaintiff are one and the same;
- The individual's personal guarantee of the corporation's obligations to the bank;
- The forseeability that a dishonor of the corporation's check would result in harm to the individual plaintiff;
- Under-capitalization of the corporation; and
- The identity of the named account holder.

Because the mother was a shareholder and vice-president of the corporation and had personally guaranteed certain of the corporation's obligations to the bank, the court held that a trial was required to determine whether the bank could have foreseen that the dishonor of the checks drawn on the corporation's account would harm the mother individually. The court issued this ruling despite the bank's arguments that the mother sought to disregard the very corporate form she established as a tax shelter.

CONCLUSION

Given the unwillingness of many courts to limit the definition of "customer" to the named account holder, financial institutions should take caution when servicing corporate checking accounts. Courts focus primarily on the capitalization of the corporation, the signatories on the account and whether personal guarantees were issued. Given the varying court decisions, a financial institution should consider that a court may conduct a detailed — and expensive — factual analysis into the interactions between the bank and corporate representatives. In order to limit potential liability, financial institutions should closely examine whether personal guarantees of the corporation's obligations to the bank are necessary and appropriate and, if so, whether language clearly defining the identity of the "customer" to the exclusion of all others is feasible. Account opening documents confirming that only the named account holder will be deemed the "customer" should also be considered.

Take this issue seriously. It is not child's play.

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NOTES

[1] *Jana v. Wachovia*, 2006 WL 3731190 (Phila. Court of Common Pleas, Dec. 15, 2006). The authors were counsel for Wachovia Bank in this action.
[2] 801 F.2d 719 (4th Cir. 1986).
[3] 113 Cal. App. 3d 419 (1980).
[4] 443 So.2d 141 (Fla. App. 1983).
[5] *Kendall Yacht Corp. v. United California Bank*, 123 Cal. Rptr. 848 (Cal. App. 1975). Relying on *Kendall*, the court in *American Nat'l Bank v. Stanfill*, 205 Cal. App.3d 1089 (Cal. App. 5th D. 1988), held that a trial was required to determine whether directors of corporation who personally guaranteed corporation's loans to the bank were "customers" entitled to bring a wrongful dishonor claim. *See also C-K Enterprises Inc. v. Depositors Trust Company*, 438 A.2d 262 (Me. 1981) (granting standing to a depositor who signed checks on behalf of the corporation and satisfied the corporation's obligations by buying back bad checks with her personal funds).
[6] *Kesner v. Liberty Bank & Trust Co.*, 390 N.E.2d 259 (Mass. App. 1979).
[7] *Parrett v. Platte Valley State Bank & Trust Co.*, 459 N.W.2d 371 (Neb. 1990).
[8] 375 S.E. 2d 112 (Ga. App. 1988).
[9] *Loucks v. Albuquerque National Bank*, 418 P.2d 191 (N.M. 1966).
[10] 367 A.2d 180 (Del. 1976).
[11] *Singleton v. American Security Bank of Ville Platte, Inc.*, 849 So.2d 72 (La. App. 3d Cir. 2003).
[12] *Plummer v. Prairie State Bank*, 1989 WL 145436 (D. Kan. 1989), *aff'd* 951 F.2d 1260 (10th Cir. 1991).
[13] Fletchers Cyclopedia § 41.20 ("The corporate entity will not be disregarded merely for the benefit of the individual shareholders when the corporate form works to their detriment or disadvantage."); Am. Jur. Corp. § 47 (citing *Schenley Distillers Corp. v. U.S.*, 326 U.S. 432, 437 (U.S. 1946)) ("[C]orporate entities will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person."); *Schenley*, 326 U.S. at 437 ("One who has created a corporate arrangement, chosen as a means of carrying out his business purposes, does not have the choice of disregarding the corporate entity in order to avoid the obligations which the statute lays upon it for the protection of the public."); *Thompson v. Fare*, 173 F. Supp. 2d 368 (E.D. Pa. 2001) ("a corporation that raises the corporate veil to gain economic advantages may not simply pierce that veil whenever it poses economical disadvantages"); *Sams v. Redevelopment Authority of the City of New Kensington*, 244 A.2d 779 (Pa. 1968) ("one cannot choose to accept the benefits incident to a corporate enterprise and at the same time

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brush aside the corporate form when it works to their detriment...the shareholders cannot be heard to argue that the courts should not treat them as a corporation for some purposes and as a corporation for other purposes whichever suits their present economic interest.").

[14] 367 A.2d 180 (Del. 1976).

[15] Official Comment 5 to § 4-403, as revised in 1990, notes that "if there is more than one person authorized to draw on a customer's account any one of them can stop payment of any check drawn on the account" and that "if there is a customer, such as a corporation, that requires its checks to bear the signatures of more than one person, any of these persons may stop payment on a check."

[16] The 1990 amendments to Article 4 made several revisions to § 4-402, including a revision to state positively what had been assumed under the original version of § 4-402, that if a bank fails to honor a previously payable item it may be liable to its customer for wrongful dishonor. But, those revisions did not expand the provisions of § 4-402 to give a statutory cause of action under § 4-402 to anyone other than the "customer."

[17] *Jana v. Wachovia*, 2006 WL 3731190 (Phila. Court of Common Pleas, Dec. 15, 2006). The authors were counsel for Wachovia Bank in this action.

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