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Gil v. Bank of America, National Association

Cite as 06 C.D.O.S. 1213

EDUARDO GIL et al., Plaintiffs and Appellants,

v.

BANK OF AMERICA, NATIONAL ASSOCIATION, Defendant and Respondent.

No. B181249

In the Court of Appeal of the State of California

Second Appellate District

Division Two

(Los Angeles County Super. Ct. No. BC309371)

APPEAL from a judgment of the Superior Court of Los Angeles County. Victor H. Person, Judge. Affirmed.

COUNSEL

Daar & Newman and David Daar for Plaintiffs and Appellants.

Barton, Klugman & Oetting and Robert Louis Fisher for Defendant and Respondent.

Filed February 9, 2006

Appellants Eduardo Gil (Eduardo) and Rafael Gil (Rafael) appeal from a judgment entered after the trial court granted the demurrer of respondent Bank of America, National Association (Bank) to their second amended complaint. We are asked to determine whether the California Uniform Commercial Code supersedes a payee's

common law cause of action for negligence where the collecting bank accepted a check with a missing indorsement. We conclude that missing indorsements are unauthorized indorsements covered by the California Uniform Commercial Code. Furthermore, we hold that the negligence cause of action stated here is subsumed in a conversion action dictated by the California Uniform Commercial Code. The judgment of the trial court is affirmed.

CONTENTIONS

Appellants contend that the trial court erred in granting Bank's demurrer because: (1) the California Uniform Commercial Code does not supersede common law negligence claims where Bank paid on a check with a missing indorsement; (2) under the California Uniform Commercial Code, the Bank is liable for conversion; and (3) appellants stated a cause of action for misrepresentation.

FACTS AND PROCEDURAL BACKGROUND

Appellants filed the operative second amended complaint (SAC) on October 4, 2004, against Bank and other defendants [\[FOOTNOTE 1\]](#) for, among other causes of action, misrepresentation, negligence, and conversion. [\[FOOTNOTE 2\]](#)

The SAC alleged the following. Eduardo and his son Rafael, owned a house in Whittier, which was damaged by fire in January 2002. In response to appellants claim, on March 7, 2002, Allstate Insurance Company (Allstate) drew a check on its account at Bank, in the amount of \$50,463.53 made payable to Eduardo, Washington Mutual, and insurance adjuster Claims West Adjusters (the check). Washington Mutual was the lender-lienholder of the Whittier residence. J. Reyes Construction Company (Reyes) contracted with appellants to repair the Whittier residence. Allen Connette (Connette), an employee of Claims West Adjusters, and Marco Galindo (Galindo), an employee of Reyes, falsely represented to Eduardo that upon Eduardo indorsement, they would present the check to Washington Mutual. After Eduardo indorsed the check, it was accepted by Bank and deposited into Reyes account at a branch of Bank, without the indorsement of Washington Mutual. Reyes failed to repair the Whittier residence and abandoned the project.

The SAC alleged that as part of a fraudulent scheme, Ezequiel Montejano (Montejano), Bank branch manager, established a practice of accepting fire insurers checks and depositing them into Reyes account at Bank, without the necessary indorsements by lienholder financial institutions named as payees. This happened on at least four separate occasions. The SAC alleged that by accepting the check without the indorsement of Washington Mutual, Bank was negligent and also committed conversion within the meaning of California Uniform Commercial Code section 3420.

Bank paid Washington Mutual \$50,463.53 in 2004. Appellants alleged that they suffered consequential and special damages, which included giving up the family home.

On December 16, 2004, the trial court granted Bank demurrer to appellants SAC.

This appeal followed.

DISCUSSION

I. Standard of Review

The appellate court assumes the truth of all properly pleaded material allegations of the complaint, and gives the complaint a reasonable interpretation by reading it as a whole and its parts in their context [citation]. (*Silberg v.*

Anderson (1990) 50 Cal.3d 205, 210.) When a demurrer is sustained, we determine whether the complaint states facts sufficient to constitute a cause of action; when it is sustained without leave to amend, we decide whether there is a reasonable possibility that the defect can be cured by amendment. (*Blank v. Kirwan* (1985) 39 Cal.3d 311, 318.) If the complaint can be cured, the trial court has abused its discretion. (*Ibid.*)

II. Negligence

A. Missing indorsements are covered under the

California Uniform Commercial Code

In their SAC, appellants prayed for consequential, special and punitive damages. However, under the California Uniform Commercial Code (the Code), [\[FOOTNOTE 3\]](#) the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this code or by other rule of law. (1106, subd. (1).) In an attempt to circumvent that section, appellants contend that the Code does not supersede claims of common law negligence, where, as here, Bank paid on a check with a missing indorsement.

Appellants argument is two-pronged: First, they claim that the Code addresses forged or unauthorized indorsements, but not missing indorsements. Next, they assert that since missing indorsements are not covered by the Code, common law negligence principles apply. They are wrong on both counts.

The purpose of the Code is to simplify and clarify the law governing commercial transactions in a uniform manner among the various jurisdictions. (1102.) The Code states that unless displaced by particular provisions, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions. (1103.)

The definitions set forth in *Roy Supply, Inc. v. Wells Fargo Bank* (1995) 39 Cal.App.4th 1051, 1066-1067 are helpful to our discussion of the statutory provisions governing the check collection process and duties and liabilities between banks and customers. A check is a draft drawn on a bank and payable on demand. (3104, subd. (2)(b), 4104, subd. (3).) A presentment is a demand for acceptance or payment of the check made upon the person or entity responsible for payment. (3504, subd. (1), 4104, subd. (3).) The bank upon which the check is drawn and by which it is payable is referred to as the drawee or payor bank. (4105, subd. (b).) When a maker or drawer issues a check in favor of a payee, that person will generally submit the check to a bank which may or may not be the payor bank. Regardless whether it is also the payor bank, the first bank to which a check is submitted for collection is called the depository bank. (4105, subd. (a).) If the depository bank is not also the payor bank, it will present the check to the payor bank either directly or through one or more intermediary banks, defined as any bank to which the check is transferred in the course of collection except the depository bank and the payor bank. (4105, subd. (c).) In this process any bank handling the check for collection, including the depository bank but excluding the payor bank, is referred to as a collecting bank. (4105, subd. (d).) (*Roy Supply, Inc. v. Wells Fargo Bank, supra*, at p. 1059, fn. omitted.)

An action for negligence in making payment over an unauthorized signature is explicitly controlled and displaced by section 4406, subdivision (f), [\[FOOTNOTE 4\]](#) which codifies the duties of customers in asserting a forgery against a payor bank without regard to care or lack of care of either the customer or the bank. . . . (*Roy Supply, Inc. v. Wells Fargo Bank, supra*, 39 Cal.App.4th at p. 1066.) Under section 4207, subdivision (a)(2), customers or collecting banks that transfer items warrant that all signatures on the item are authentic and authorized, and the liability of the collecting bank arises from its implied warranty of the indorsement rather than negligence principles. (*Cal. Mill Supply Corp. v. Bank of America* (1950) 36 Cal.2d 334, 339.) These warranty provisions of section 4207

also apply here the validity of an [i]ndorsement is not in issue but the [i]ndorsement is missing. (*Feldman Constr. Co. v. Union Bank* (1972) 28 Cal.App.3d 731, 736.)

Nevertheless, appellants urge that the Code addresses forged indorsements, but not unauthorized indorsements. They are incorrect. In 1992, the Legislature amended section 3403, subdivision (b) so that it explicitly defines an unauthorized signature to include checks lacking a required signature. (*Edward Fineman Co. v. Superior Court* (1998) 66 Cal.App.4th 1110, 1116.) Section 3403, subdivision (b) now provides: if the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking.

The comment to section 3403, subdivision (b) states: . . . Subsection (b) clarifies the meaning of authorized in cases in which an instrument contains less than all of the signatures that are required as authority to pay a check. . . . Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4-406(4) because A signature was neither unauthorized nor forged. The other cases correctly pointed out that it was the customer signature at issue and not that of A; hence, the customer signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) follows the latter line of cases. (23A Pt. 2 West U. Laws. Ann. (2002) U. Com. Code, com. to 3403, p. 406.)

Moreover, required signatures are not limited to officers of an organization, but apply here, where one payee is an individual, and the other is the lender whose loan was secured by a trust deed on appellants house. The comment explains that organization is construed broadly, including not only commercial entities, but also two or more persons having a joint or common interest, including a husband and wife signing an instrument. (23A Pt. 2 West U. Laws. Ann. (2002) U. Com. Code, com. to 3403, p. 406.)

We conclude that the Code supersedes claims based on missing indorsements.

B. Common law negligence principles with respect to the relationship between payees and collecting banks are superseded by the Code

Our conclusion that the Code supersedes claims based on missing indorsements does not end the discussion, because section 3420, which specifically addresses the payee right to action for conversion, does not refer directly to a negligence cause of action. Appellants therefore submit that common law negligence principles are not superseded by section 3420. Again, we disagree.

Prior to the enactment of the Code, the true owner of an instrument collected on a forged indorsement could recover in a direct suit against a collecting bank even though the bank had acted in good faith and *with the highest degree of care* (*Cooper v. Union Bank* (1973) 9 Cal.3d 371, 380, italics added.) The payor bank was strictly liable to the true owner; the collecting banks that handled the instrument for collection were strictly liable to the payor bank for breach of warranty of good title. (*Id. at p. 381.*) In *Cooper v. Union Bank*, our Supreme Court explained that the drafters of the Code intended to codify prior California decisions, and under section 3420 (formerly section 3419), a payee could pursue an action for conversion against the collecting bank. (*Cooper v. Union Bank, supra*, at p. 383.) Thus, the drafters intended to meld actions for negligence and conversion into one remedy under the conversion statute. Hence, it is true, as appellants state, that a collecting bank which cashes a check on the unauthorized indorsement of the payee is liable to the payee; but it is through an action in conversion, not negligence. (*Id. at p. 382, fn. 13.*)

Furthermore, the comment to section 3420 informs us that the depository bank is ultimately liable in a forged

indorsement case and the owner of the check should not be required to bring multiple actions against the payor banks, which in turn would assert warranty rights against a depository bank. The comment concludes: f suit is brought against both the payor bank and the depository bank, the owner, of course, is entitled to but one recovery. (23A Pt. 2 West U. Laws. Ann. (2002) U. Com. Code, com. to 3420, subd. (c), p. 509.) Thus, if appellants were allowed to pursue a negligence claim against Bank, they would receive, at a minimum, a double recovery.

Equitable Life Assur. Soc. of the U.S. v. Okey (1987) 812 F.2d 906 (*Equitable Life*) persuasively explains that a conversion action under the South Carolina Commercial Code subsumes both conversion and negligence claims based on unauthorized indorsements. In reaching its conclusion, the *Equitable Life* court cited a California case, *Joffe v. United California Bank* (1983) 141 Cal.App.3d 541, 557-558, which held that a customer does not have a negligence cause of action against a depository bank because actions arising from unauthorized signatures comes within the protection of the Code. The *Equitable Life* court stated that oth negligence and conversion require a consideration whether there was payment over an unauthorized indorsement and evaluation of the reasonableness of the defendant actions. This duplication suggests that the Code cause of action comprehensively covers the field of legal theories available when a check is paid over an unauthorized indorsement. (*Equitable Life, supra*, at p. 909.) The court also held that the potentially differing remedies between the negligence and conversion claims was an insufficient reason to defeat the legislative intent of codifying common law. (*Id.* at pp. 910-911.)

Appellants urge, however, that Bank owed and breached a duty of care to them under common law. We do not agree. Appellants contention that Bank breached a duty of care owed to Eduardo y not exercising ordinary care when it allowed [Reyes] to deposit the check in its account otwithstanding suspicious circumstances indicative of a fraud is directly contrary to case law which holds that bank owes no duty to nondepositors to investigate or disclose suspicious activities on the part of an accountholder. (*Casey v. United States Bank Nat. Assn.* (2005) 127 Cal. App.4th 1138, 1149 (*Casey*)). *Casey* noted that *Sun Sand, Inc. v. United California Bank* (1978) 21 Cal.3d 671, 695 articulates the one narrowly circumscribed situation under which a bank has a duty to a nondepositor to investigate a banking situation. Unlike here, that situation exists when large checks, drawn payable to the order of a bank are presented to the payee bank by a third party seeking to negotiate the checks for his or her own benefit. (*Casey, supra*, at p. 1151, fn. 3.)

We are not convinced by appellants citation to *In re McMullen Oil Co.* (Bnkr. C.D. Cal. 2000) 251 B.R. 558, 572 for the proposition that common law negligence actions are not barred by the Code. That case discussed the required elements of a tort claim for negligence where the payee sued the depository for negligence in a missing indorsement situation. In concluding that the payee stated a cause of action for negligence rather than conversion, the bankruptcy court noted that the negligence cause of action was governed by the Code. It stated that the action was based on section 3103, subdivision (a)(7) which requires a bank to adhere to reasonable commercial standards in fulfilling its duty of ordinary care. Accordingly, the statue of limitations of section 3118 subdivision (g), governed that case as an action to enforce a duty rising under this divisionNor are appellants assisted by their citation to *Mandelbaum v. P & D Printing Corp.* (1995) 279 N.J. Super. 427 [652 A.2d 1266], which held that a payee could state a cause of action for conversion under the New Jersey code. Appellants citation to the court statement that payment by a depository bank of a check with a missing indorsement is contrary to reasonable commercial practices is unavailing, since the court referred to the conversion statute in reversing summary judgment. (*Id.* at p. 439.)

Finally, appellants citations to cases concerning the rights of a drawer as against a collecting bank and the drawee are not persuasive, since here, the rights of the payees are at issue. *Fireman Fund Ins. Co. v. Security Pacific Nat. Bank* (1978) 85 Cal.App.3d 797 held that noncustomer drawer whose signature was forged on a check drawn upon his account is precluded, by divisions 3 and 4 of the California Uniform Commercial Code, from bringing a direct cause of action based upon statutory or common law negligence against a collecting bank after final payment has been made by the drawee bank. (*Id.* at pp. 829-830.) In dicta, upon which appellants grasp, the court stated that its holding did ot go so far as to preclude a *drawer* direct cause of action for common law negligence against a collecting bank for the negligent handling of a check bearing a forged indorsement in all cases, when the facts

indicate that the bank participated in the acts causing the loss. (*Id.* at p. 830, italics added.) Other cases cited by appellants are similarly distinguishable. (See *Sehremelis v. Farmers & Merchants Bank* (1992) 6 Cal.App.4th 767, 775 [plaintiffs who were in same position as drawers of checks could pursue negligence action against collecting banks] and *Joffe v. United California Bank, supra*, 141 Cal.App.3d at p. 556 [the risk to the drawer is sufficiently foreseeable to impose a duty on the depository bank not to ignore the danger signals inherent in an attempted negotiation by third party].)

Absent extraordinary and specific facts, a bank does not owe a duty of care to a noncustomer. (*Software Design & Application, Ltd. v. Hoefler & Arnett, Inc.* (1996) 49 Cal.App.4th 472, 479.) Those special circumstances are not alleged here.

We conclude the trial court did not err in sustaining Bank demurrer to the cause of action for negligence.

III. Conversion

Appellants urge that the SAC properly stated a claim for conversion under section 3420, subdivision (a) which provides: 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. However, under section 3420, subdivision (b), [\[FOOTNOTE 5\]](#) recovery under conversion may not exceed the amount of the plaintiff interest in the instrument. Furthermore, as previously stated, the comment to section 3420, subdivision (c) states: if suit is brought against both the payor bank and the depository bank, the owner, of course, is entitled to but one recovery. (23A Pt. 2 West U. Laws Ann. (2002) U. Com. Code, com. to 3420, subd. (c), p. 509.

Appellants allege in their SAC that after the discovery that Reyes deposited the original check into his account, Bank paid Washington Mutual the amount of the original check. Thus, appellants cannot recover twice.

We conclude that the trial court did not err in sustaining the demurrer to the cause of action for conversion.

IV. Fraud

We disagree with appellants contention that they stated a claim for fraud. The elements of fraud are a misrepresentation, knowledge of its falsity, intent to defraud, justifiable reliance and resulting damage. (*Universal By-Products, Inc. v. City of Modesto* (1974) 43 Cal.App.3d 145, 151.) Fraud causes of actions must be pled with specificity in order to give notice to the defendant and to furnish him or her with definite charges. (*Committee on Children Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 216.) In drafting the complaint, (a) [g]eneral pleading of the legal conclusion of fraud is insufficient; the facts constituting the fraud must be alleged. (b) Every element of the cause of action for fraud must be alleged in the proper manner (i.e. factually and specifically), and the policy of liberal construction of the pleadings . . . will not ordinarily be invoked to sustain a pleading defective in any material respect. [Citations.] (*Ibid.*)

Appellants have failed to state with specificity the first element of a misrepresentation made by Bank. The SAC allegations of false statements made are attributed to Connette, a principal of Claims West Adjusters, and Galindo, an employee of Reyes. Thus, the allegations that they falsely represented to Eduardo that after he indorsed the check, they would present it to Washington Mutual, do not support a claim against Bank.

We also reject appellants argument that the SAC sufficiently pleads that Montejano made express or implied misrepresentations to appellants. The SAC makes general and conclusory allegations that Montejano participated in

a fraudulent scheme against appellants and that by virtue of his office he made implied misrepresentations that he would follow general banking practice. These allegations are simply not specific enough to show the factual basis of a fraud cause of action. This is not like *Rutherford v. Rideout Bank* (1938) 11 Cal.2d 479, 481, cited by appellants, where the bank manager made false representations to the plaintiff that if she did not execute an agreement, the bank would foreclose on the mortgage. Nor are we persuaded by appellants citation to *Universal By-Products, Inc. v. City of Modesto, supra*, 43 Cal.App.3d 145, where the plaintiff stated a claim for deceit by alleging that at the time the City of Modesto notified bidders and called for bids for garbage collection, the city impliedly represented that it would consider and accept bids in good faith. Appellants have not alleged any implied representations made specifically to appellants by Montejano.

We conclude that the trial court did not err in sustaining the demurrer to the cause of action for fraud. Accordingly, it follows that as to the negligence and fraud causes of action, appellants are not entitled to specific, consequential or punitive damages.

DISPOSITION

The judgment is affirmed. Bank shall receive costs of appeal.

CHAVEZ, J.

We concur: BOREN, P.J., ASHMANN-GERST, J.

..... FOOTNOTE(S).....

FN1. Defendants New Beginnings Public Adjustment Company, Claims West Adjusters, Glennis Romero, Marco Galindo, Ezequiel Montejano, Jose Guadalupe Reyes doing business as J. Reyes Construction Company, Surety Company of the Pacific, Allstate Insurance Company, Washington Mutual Bank, and Allen Connette are not parties to this appeal.

FN2. The other causes of action, not relevant for the purposes of this appeal, were for breach of fiduciary duty, breach of written construction contracts, action on contractor bond, and equitable relief.

FN3. All further statutory references are to the California Uniform Commercial Code, unless otherwise indicated.

FN4. Section 4406, subdivision (f) provides: ithout regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (subdivision (a)) discover and report the customer unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subdivision, the payer bank may not recover for breach of warranty under Section 4208 with respect to the unauthorized signature or alteration to which the preclusion applies.

FN5. Section 3420, subdivision (b) provides: n an action under subdivision (a), the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff interest in the instrument.