IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

DOCKET NO. 30,829
SECOND JUDICIAL DIST. CT. NO. CV 2006-00832
(Honorable Alan Malott)

ASSOCIATED HOME AND RV SALES, INC. a New Mexico corporation, d/b/a ENCHANTMENT RV and ENCHANTMENT RV SERVICE, a New Mexico corporation; TEAM EVENTS, INC., a New Mexico corporation; MOBILE HOME RECOVERY, Inc., a New Mexico corporation; and MDM COMPANY, INC., a New Mexico corporation, Plaintiffs-Appellants,

vs.

BANK OF BELEN, Defendant-Appellee

APPELLEE'S ANSWER BRIEF

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SUMMARY OF PROCEEDINGS

I. Nature of the Case

Plaintiffs are four related corporations: Associated Home and RV Sales, Inc. ("AHRVS"), Team Events, Inc. ("TE"), Mobile Home Recovery, Inc. ("MHR") and MDM Company, Inc. ("MDM") (collectively "Plaintiffs"). They are owned and operated by Michael Grier, his son Michael Grier, Jr., and his daughters Idamay Romero and Michelle Grier. (RP 110, 115). One of Plaintiffs' employees, Jennifer Grano, embezzled approximately $285,000.00 from Plaintiffs over a 20 month period by writing checks on Plaintiffs' a ccounts at Bank of Belen and forging the signature of Idamay Romero and/or Michael Grier. In this lawsuit, Plaintiffs seek to recover the embezzled funds from their Bank.

II. Statement of the Facts

Michael Grier is the Chief Executive Officer ("CEO") of all four Plaintiff corporations. (RP 209, 212, 2 31, 2 38, 24 3). AHRVS, MHR and MDM are involved in the sale and purchase of recreational vehicles. (RP 210, 232) and TE handles the bookkeeping and payroll for all four corporations. Grier's two daughters, Michelle Grier and Idamay Romero, and his son, Michael Grier Jr. are employed by TE. (RP 210). All four corporations operate out of the same office. Idamay has primary control of bookkeeping for all four corporations. (RP 211).

Defendant Bank of Belen, n/k/a MyBank ("Belen") is a New Mexico bank. (RP 110, 115). During the relevant time, Plaintiffs' corporate bank accounts were maintained at Belen. (RP 215). When each account was opened, Grier, Idamay and/or Michael Jr. signed signature cards indicating which of them were authorized signers. (RP 111, 116). Belen provided monthly statements (including photocopies of all cancelled checks) to Plaintiffs for each account. (RP 221, 225, 233, 244). Plaintiffs received all account statements within one month of the issue date. (RP 220-221, 225, 233, 244).

On or about January 15, 2003, Grier hired Jennifer Grano to assist with bookkeeping for all four companies. Grano was responsible for balancing the accounts, taking deposits to Belen and keeping company records. (RP 213-214, 243). Every month, either Grier or Idamay reviewed and reconciled the account statements and cancelled checks with the companies own records for each account. (RP 218-219, 221).

On February 14, 2003, less than a month after she was hired, Grano began stealing from Plaintiffs by forging Idamay's signature on corporate checks. (RP 111, 226). From February 14, 2003 to October 15, 2004, Grano forged 211 checks and stole $283,546.85 thereby. The majority of those checks were payable to Grano or to cash, although approximately twenty checks were payable to other businesses. (RP 111). Plaintiffs first notified Belen of any of the forgeries

verbally on October 27, 2004. (RP 215). Subsequently, on November 4 and 19, 2004, Grier, Idamay, and Michael Jr. signed and submitted written forgery affidavits. (RP 216-217, 262-311). Belen declined Plaintiff's demand to recredit Plaintiffs' accounts for the money embezzled by Grano. (RP 116).

III. Statement of the Proceedings

On February 1, 2006, Plaintiffs filed a Complaint for Damages alleging five causes of action: (1) negligence; (2) fraud and constructive fraud; (3) negligent misrepresentation; (4) breach of contract; and (5) Unfair Trade Practices. On April 5, 2006, Belen filed a Combined Motion to Dismiss and Brief in Support, pursuant to Rule 1-012(B)(6) NMRA. (RP 12-25). Before the Motion to Dismiss was heard, Plaintiffs were granted leave to amend their Complaint. (RP 82-83).

On August 16, 2006, Plaintiffs filed their First Amended Complaint for Damages, asserting the same five causes of action and merely adding the following sentence: "On November 4, 2004, Plaintiffs gave notice to the Defendant as to the above in the form of Affidavits of Check Forgery and subsequent correspondence." (RP 84-89). On September 15, 2006, Belen filed its Combined Motion to Dismiss the First Amended Complaint and Brief in Support, asserting that the First Amended Complaint failed to state a claim upon which relief could be granted because NMSA 55-4-406 preempts Plaintiffs' common law and statutory claims. (RP 90-97). Belen's motion was heard on December 5, 2006, (Tr. 12-5-06). In an

Order filed February 26, 2007, the District Court dismissed Plaintiffs' causes of action for negligence, negligent misrepresentation, breach of contract and unfair trade practices, but did not dismiss the fraud claim. (RP 108). Plaintiffs were allowed ten days to amend their First Amended Complaint. (RP 108).

On March 8, 2007, Plaintiffs filed their Second Amended Complaint for Damages, which added a UCC claim for paying the forged checks. (RP 110-114). On March 20, 2007, Belen filed its Answer to Second Amended Complaint, (RP 115-119), and on May 8, 2007, Belen filed its Combined Motion to Dismiss Plaintiffs' Fraud Claim and Brief in Support, (RP 121-128) pursuant to Rules 1-012(B)(6) and 1-009 NMRA. (RP 121-128). After a hearing on July 31, 2007, (Tr. 7-31-07), the District Court issued a written order dismissing Plaintiffs' fraud claim without prejudice, holding that "Count II does not comply with the requirements of NMRA Rule 1-009(b); and pursuant to NMRA Rule 1-012(B)(6), Count II fails to state a claim upon which relief can be granted." (RP 142-143).

After discovery, on May 20, 2010, Belen filed its Combined Motion for Summary Judgment and Memorandum in Support (RP 190-335) on the grounds that Plaintiffs failed to comply with the notification requirements of NMSA 55-4-406 and were therefore statutorily prohibited from asserting any claim against Belen for paying the forged checks. The motion for summary judgment was heard on July 20, 2010, (TR. 7-20-10), and on July 27, 2010, the District Court granted

the motion and entered judgment in favor of Belen by letter ruling. (RP 360-362). Plaintiffs filed their Notice of Appeal on October 13, 2010. (RP 366-367).

STANDARDS OF REVIEW

Plaintiffs seek reversal of the District Court's orders dismissing their causes of action for negligence, negligent misrepresentation, breach of contract, unfair trade practices and fraud, and of the order granting Belen's motion for summary judgment on their UCC claim.

A motion to dismiss is reviewed *de novo*.

> "[B]ecause a motion to dismiss addresses only the legal sufficiency of a complaint, both the trial and reviewing courts assume the veracity of all properly pleaded allegations in the complaint." *Sanders v. Estate of Sanders*, 122 N.M. 468, 471, 927 P.2d 23, 26 (N.M. Ct. App. 1996). "Dismissal is proper under Rule 1-012(B)(6) NMRA 2002 when the law does not support the claim under the facts presented."

Stoneking v. Bank of Am., N.A., 2002-NMCA-042, ¶ 4, 132 N.M. 79, 80, 43 P.3d 1089, 1090.

Summary judgment is also reviewed *de novo*.

> With regard to summary judgment, "the standard of review for a motion for summary judgment is whether there are any genuine issues of material fact and whether the moving party is entitled to summary judgment as a matter of law." *Williams v. Cent. Consol. Sch. Dist.,* 1998-NMCA-006, ¶7, 124 N.M. 488, 490, 952 P.2d 978, 980. "An appeal from the grant or denial of a motion for summary judgment presents a question of law."

Bartlett v. Mirabal, 2000-NMCA-036, 128 N.M. 830, 831, 999 P.2d 1062, 1063.

ARGUMENTS AND AUTHORITIES

I. The District Court correctly dismissed Plaintiffs' causes of action for negligence, negligent misrepresentation, breach of contract and unfair trade practices.

The District Court dismissed Plaintiff's causes of action for negligence, negligent misrepresentation, breach of contract and unfair trade practices on the grounds that those claims are displaced by §4-406 of the UCC, NMSA 55-4-406.

The general rule for displacement of the common law by the UCC is set forth in NMSA 1978, Section 55-1-103:

> **Unless displaced by the particular provisions of this act** [this chapter], 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.

(emphasis added); see also *Gallagher v. Santa Fe Fed. Employees Fed. Credit Union*, 2002-NMCA-088, ¶18, 132 N.M. 552, 52 P.3d 412.

When a particular provision of the UCC covers an entire area of the law, the common law is displaced, even where the statute does not expressly mention displacement. *See Rutherford v. Darwin*, 95 N.M. 340, 622 P.2d 245 (Ct.App., 1980); *See also Brummund v. First Nat. Bank of Clovis*, 99 N.M. 221, 225, 656 P.2d 884, 888 (1983). New Mexico courts have found several provisions of the UCC which displace common law causes of action and defenses. *See, e.g.*: *Rutherford*, supra, (NMSA 55-3-206); *Brummund*, supra, NMSA 55-9-311);

Gallagher, supra, (NMSA 55-3-118(g)); *White Sands Forest Products, Inc. v. First Nat'l Bank of Alamogordo,* 2002-NMCA-079, ¶14, 132 N.M. 453, 50 P.3d 202 (NMSA 55-3-406).

UCC §§ 4-401 and 4-406 (NMSA §§ 55-4-401 and 55-4-406) establish the following rights and remedies for banks and their customers with respect to losses resulting from forged and/or altered checks drawn on the customer's account:

1) A forged or altered check is not properly payable and cannot be charged against the customer's account. The customer's bank is strictly liable for the entire loss resulting from such checks. (§ 55-4-401)

2) If the bank provides an account statement and information sufficient to allow the customer to identify the paid items, the customer must exercise reasonable promptness in examining the statement and the items and reporting to the customer's bank any forgeries or alterations. If the customer does so within 30 days after the receipt of the statement, the bank is strictly liable for the entire loss. (§ 55-4-406(a),(c))

3) If the customer notifies the bank more than 30 days but less than one year after receipt of the statement, and customer establishes that the bank did not exercise ordinary care in paying the checks, the loss will

be apportioned between the bank and the customer based on the degree to which the failure of each contributed to the loss. (§ 55-4-406(d),(e))

4) If the customer does not report the forged checks to the bank within one year after receipt of the account statement, the customer is absolutely precluded from asserting any claim against the bank. (§ 55-4-406(f))

Because this statutory method of allocating losses resulting from forged and altered checks establishes the rights and remedies of banks and bank customers under any and all circumstances, it covers the entirety of this area of the law and therefore displaces all other causes of action that may have previously existed. See eg: *Brummund v. First Nat. Bank of Clovis*, 99 N.M. 221, 656 P.2d 884 (1983).

> "The Uniform Commercial Code provides a comprehensive framework for allocating losses when a forged check enters the negotiation process."

Bank Polska Kasa Opieki, S.A. v. Pamrapo Sav. Bank, S.L.A., 909 F.Supp. 948, 956 (D.N.J. 1995).

> "[G]eneral and comprehensive legislation, prescribing minutely a course of conduct to be pursued and the parties and things affected, and specifically describing limitations and exceptions, is indicative of a legislative intent that the statute should totally supersede and replace the common law dealing with the subject matter."

Rutherford v. Darwin, 95 N.M. 340, 343, 622 P.2d 245, 248 (Ct. App. 1980).

> "For the courts to interfere with the [UCC's] statutory scheme by superimposing tort rules, there must be sound policy reasons for finding the statutory scheme to be inadequate."

White Sands Forest Products, Inc., 2002-NMCA-079, ¶14 (quoting *Spectron Dev. Lab. v. Am. Hollow Boring Co.,* 1997-NMCA-025, ¶ 24, 123 N.M. 170, 936 P.2d 852)).

> "Only in very rare instances should a court upset the legislative scheme of loss allocation and permit a common law cause of action."

Bank Polska Kasa Opieki, S.A, 909 F.Supp. at 956 (citing 1 White & Summers, *Uniform Commercial Code* § 16-1 at 783).

Because Section 55-4-406 provides a particularized, detailed, and comprehensive statutory scheme to allocate liability between a bank and its customer for the payment of checks containing unauthorized signatures or alterations, the District Court correctly held that it displaces all common law negligence based claims.

Plaintiffs argue that the District Court erred in finding that NMSA 55-4-406 displaces common law negligence based claims because no New Mexico case specifically holds that it does. Because no New Mexico case specifically holds that it does not, Plaintiffs argument establishes nothing more than the fact that this is an issue of first impression. As noted above, several other provisions of the UCC have been held to displace the common law. Likewise, 55-4-406 displaces negligence based causes of action in cases between banks and their customers

involving forged and/or altered checks. It provides a detailed and comprehensive set of rights, obligations and remedies in that regard, including a duty to exercise ordinary care and consequences for the failure to do so.

UCC § 4-406 establishes a liability scheme wherein a bank is liable to its customer if it charges the customer's account for an item that is not properly payable from that account. § 4-406 also provides a bank with certain defenses when the customer fails to comply with the customer's obligation to exercise reasonable promptness in examining the account statement and items to determine whether any payment was not authorized because of an alteration or unauthorized signature and to promptly notify the bank. In other words, § 4-406 provides both a liability scheme and defenses to liability. *American Airlines Employees Federal Credit Union v. Martin*, 29 S.W.3d 86 (Tex. 2000), s*ee also Canfield v. Bank One, Texas, N.A.*, 51 S.W.3d 828 (Tex.App.–Texarkana 2001); *Tumlinson v. First Victoria Nat. Bank*, 865 S.W.2d 176 (Tex.App.–Corpus Christi 1993). Because Section 55-4-406 details a bank's liability for paying items that are not "properly payable"; provides preconditions to liability in the form of reporting requirements, and a time within which such reports must be made; and provides for the allocation of losses when ordinary care is not exercised, it covers the entire area of the law related to the payment of forged checks and therefore displaces all other causes of action based on the same conduct.

Plaintiffs cite authority from other jurisdictions supporting the general rule under Section 55-4-103 that, unless displaced by a particular UCC provision, the UCC is supplemented by common law. The issue here is whether NMSA 55-4-406 is one of the provisions that displaces common law with respect to liability for unauthorized signatures and alternations on checks. Although this appears to be an issue of first impression in New Mexico, other jurisdictions have held that their state equivalent of UCC 4-406 is so detailed and comprehensive that it displaces all related common law claims.

For example, in *Envtl. Equip. & Serv. Co. v. Wachovia Bank*, N.A., 741 F.Supp.2d 705, 708-12 (E.D. Pa. 2010), the bookkeeper of Environmental Equipment & Service Company ("EES") embezzled over $925,000 from EES by altering the payee and/or amount of company checks paid by Wachovia Bank, N.A. ("Wachovia"). In granting summary judgment in favor of Wachovia, the court held that §§ 4401, 3406, 4406 and 3405 of the Pennsylvania Commercial Code ("PCC") displaced EES's claims of negligence, breach of contract and breach of the duty of good faith and fair dealing. *Id.* at 712-13. The court explained that the statutory regime established by PCC §§ 4401, 3406, 4406, and 3405 "provides a comprehensive remedy for the parties to the transaction—a delicate balance that would be disrupted by the allowance of common law negligence claims." *Id.* at 714.

Similarly, in *Mahaffy & Associates, Inc. v. Long*, 2003 WL 22351271, *2 (Del. Super. Sept. 29, 2003), when an employer discovered that its bookkeeper had been forging company checks for a period of several years, the employer sued the bank that paid the checks for conversion, breach of contract, negligence and violation of banking regulations, based on the bank's failure to discover the bookkeeper's embezzlement. With respect to the employer's common law negligence and breach of contract claims, the court held:

> Title 6 § 4-406 provides highly particularized provisions which set forth, as the title makes clear, a[c]ustomer's duty to discover and report unauthorized signature or alteration." The particularity of the provision sets forth in detail the obligations of the bank's customer, and the preclusions associated with the failure to comply with statutory duties. [...]. Where the legislature has preempted the field by enacting a provision in the UCC which establishes the rights of the parties, competing theories of liability are not permitted. The Code preempts common law duties; an action in negligence or breach of contract cannot stand.

Id. at *6.

In *Bank Polska, S.L.A., supra,* Bank Polska Opieki S.A. ("Bank Polska") entered into a loan agreement with Smolinski-Elektronik, a Polish corporation owned by Andrzej Smolinski ("Smolinski"). Bank Polska gave Smolinski a $2,000,000 check made payable to "Braxton Industries, New York USA." 909 F.Supp. at 950. Smolinski later incorporated Braxton Industries, Inc., forged an endorsement on the check and deposited the $2,000,000 in an account at Pamrapo Savings Bank, S.L.A. ("Pamrapo"). Pamrapo accepted the check and forwarded it

to another financial institution which debited Bank Polska's account $2,000,000. *Id.* Bank Polska sued Pamrapo for common law negligence. Dismissing the negligence claim, the New Jersey district court held that allowing an independent common law negligence action would upset the loss allocation scheme contemplated by the legislature in enacting the UCC and that the circumstances presented would circumvent the drawee's §§ 3-406 and 4-406 defenses. *Id.* at 956; *see also Coastal Group, Inc. v. Dryvit Systems, Inc.*, 274 N.J. Super. 171, 643 A.2d 649 (N.J. Super. Ct. App. Div. 1994) (holding that the trial court correctly dismissed plaintiff's negligence claim as preempted by the New Jersey Code).

Plaintiffs' only argument against preemption or displacement of common law negligence based causes of action is that there is no New Mexico case so holding. However, Plaintiffs fail to cite even one case holding that common law negligence based claims are allowed in cases governed by UCC 4-406, or its statutory equivalent. The cases Plaintiffs rely on are inapplicable and do not support Plaintiffs' argument.

Williams v. Metropolitan Life Ins. Co., 367 F.Supp.2d 844, 849-50 (M.D.N.C. 2005) did not hold that UCC § 4-406 does not displace common law negligence claims. Rather, the court held that the defendants failed to support their argument for displacement by failing to cite any particular UCC provision and failing to explain how any such provision would displace common law negligence

claims. The court also noted that plaintiffs in that case also alleged negligence based on actions other than paying forged checks.

The remainder of Plaintiffs' cases relate to forged endorsements and thus do not apply here. *Cassello v. Allegiant Bank*, 288 F.3d 339 (8th Cir. 2002), involved claims that two banks acted negligently by depositing checks with improper endorsements and by allowing checks to be deposited into accounts that were not accounts of the named payee. *Racso Diagnostic, Inc. v. Cmty. Bank of Homestead*, 735 So.2d 519 (Fla. Dist. Ct. App. 3 1999) involved claims for payment over forged endorsements; *New Jersey Bank, N. A. v. Bradford Securities Operations, Inc.*, 690 F.2d 339 (3d Cir. 1982) involved claims under UCC Article 8, related to the handling of securities; *Mount Vernon Properties, LLC v. Branch Banking And Trust Co.*, 170 Md.App. 457, 465, 907 A.2d 373, 377 (Md. Ct. Spec. App. 2006) involved claims for payment over forged endorsements.

Allowing Plaintiffs to assert common law causes of action for circumstances covered by NMSA 55-4-406 would thwart both 55-4-406 and the general purpose of the UCC. In adopting the UCC, the underlying purpose of New Mexico was to simplify the law governing commercial transactions and to make uniform the law among the various jurisdictions. NMSA 1978, 55-1-103.

> "[T]he UCC serves an important objective not shared by the law of torts [...] Unlike tort law, the UCC has the objective of promoting certainty and predictability in commercial transactions. By prospectively establishing rules of liability that are generally based

> not on actual fault but on allocating responsibility to the party best able to prevent the loss by the exercise of care, the UCC not only guides commercial behavior but also increases certainty in the marketplace and efficiency in dispute resolution."

Putnam Rolling Ladder Co., Inc. v. Manufacturers Hanover Trust Co., 74 N.Y.2d 340, 349, 546 N.E.2d 904 (1989).

> "Displacement of common laws claims by a comprehensive statutory scheme promotes interstate commerce by allowing businesses to rely on one set of laws."

Envtl. Equip. & Serv. Co., 741 F.Supp.2d at 712-13.

Permitting additional causes of action or theories of liability in cases governed by NMSA 55-4-406 would defeat the objective of promoting certainty and predictability in commercial transactions and thus would thwart one of the primary objectives of the UCC. Because such additional theories of liability are not available in other jurisdictions (having been displaced by UCC 4-406) permitting them here will also thwart the objective of making the law governing commercial transactions uniform among the various jurisdictions. Therefore, for all the reasons discussed hereinabove, the District Court correctly held that NMSA § 55-4-406 displaces negligence based causes of action.

Although Plaintiffs argue that the District Court erred in dismissing Counts I, III, IV and V of their First Amended Complaint on that basis, they cite no authority holding that UCC § 4-406 does not displace common law causes of action in cases brought by a customer against their bank for payment of forged

checks. Therefore the Order dismissing those claims should be affirmed.

II. Count II of the Second Amended Complaint was correctly dismissed for failure to satisfy the pleading standards of Rules 1-012(B)(6) and 1-009(b).

Count II of Plaintiffs' Second Amended Complaint was dismissed without prejudice on the grounds that it failed to plead fraud in compliance with the requirements of NMRA Rule 1-009(b) and therefore, pursuant to NMRA Rule 1-012(B)(6), failed to state a claim upon which relief could be granted. Thus, the issue on appeal is whether Plaintiffs adequately pled a claim of fraud.

Rule 1-009(b) states:

> In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge and other condition of mind of a person may be averred generally.

It requires all allegations of fraud to be pled with particularity. The requirement of particularity is satisfied if the allegations of fraud leave no doubt in a defendant's mind as to the claim asserted. *Delgado v. Costello*, 91 N.M. 732, 734-35, 580 P.2d 500, 502-03 (N.M.App. 1978), *Bell v. Weinacker*, 88 N.M. 557, 559, 543 P.2d 1185, 1187 (N.M.App. 1975).

The New Mexico Rules of Civil Procedure are modeled after the Federal Rules of Civil Procedure. *Kinder Morgan CO2 Co., L.P. v. State Taxation & Revenue Dept.*, 2009-NMCA-019, ¶10, 145 N.M. 579, 583, 203 P.3d 110, 114. The substance of Rule 1-009(b) is virtually identical to its federal counterpart,

Fed.R.Civ.P. 9(b).[1] The heightened pleading requirements of Rule 9(b) are well established:

> "To survive a motion to dismiss, an allegation of fraud must 'set forth the time, place, and contents of the false representation, the identity of the party making the false statements and the consequences thereof.'"

Midgley v. Rayrock Mines, Inc., 374 F.Supp.2d 1039, 1047 (D.N.M. 2005). (quoting *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1252 (10th Cir. 1997)). "In other words, the plaintiff must set out set out the 'who, what, where, and when' of the alleged fraud." *Plastic Packaging Corp. v. Sun Chem. Corp.*, 136 F.Supp.2d 1201, 1203 (D.Kan. 2001). A claim of fraud cannot be based on speculation and conclusory allegations. *Midgley*, 374 F.Supp.2d at 1047. Rule 9(b) is intended to protect a defendant's reputation from the harm of accusations of fraud and put a defendant on notice of the allegedly fraudulent conduct so that they can formulate a defense. *Two Old Hippies, LLC v. Catch the Bus, LLC*, 2011 WL 831302, at *4-5 (D.N.M. Feb. 11, 2011); *see also Carl Kelley Const. LLC v. Danco Technologies*, 656 F.Supp.2d 1323, 1333-34 (D.N.M. 2009).

In pleading their fraud claim, Plaintiffs made the following conclusory and speculative allegations:

> "12. Over the course of Plaintiffs' relationship with Defendant, Defendant's agents and employees took actions and represented to

[1] Fed.R.Civ.P. 9(b) states: "Fraud or Mistake; Conditions of Mind. In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally."

> Plaintiffs' owner and principal that Defendant followed certain procedures with regard to the safeguarding of Plaintiffs' funds, including but not limited to the teller limits on check cashing, supervisory approval of checks over a certain limit, use of signature cards to confirm signatures, and confirmation of unusual transactions.
>
> 13. The actions and representations concerning the safeguards alleged to be employed by Defendant were false in that such safeguards were sporadically if ever employed. Upon information and belief, the representations were made by Defendant to Plaintiffs with knowledge that such representations were false and misleading, and the actions taken by Defendant which demonstrated that such safeguards would be taken were of the nature that required an affirmative communication [...] on the part of Defendant to Plaintiffs that in fact such safeguards were sporadically if ever employed in order to inform Plaintiffs of the truth.
>
> 14. Plaintiffs reasonably relied on these representations and omissions and banked with Defendant based on a false sense of security and paid consideration to Defendant in the form of fees associated with the various accounts maintained by Plaintiff with Defendants."

(RP 112-113). The District Court correctly held that these allegations do not meet the pleading requirements of Rule 1-009(b). First, Plaintiffs failed to identify any Belen employee(s) or agent(s) that Plaintiffs claim made the alleged false statements or representations. (RP 112). Plaintiffs' reference to "Defendant's agents and employees" could potentially refer to every employee of Belen. *See Tuscarora, Inc. v. B.V.A. Credit Corp.*, 218 Va. 849, 858, 241 S.E.2d 778, 783 (Va. 1978) (holding that allegations failing to identify the agents, officers or employees of the company plaintiff who are alleged to have perpetrated the fraud lack specificity required to make out a case of fraud). The Court agreed, explaining that

it could not figure out which person in Belen Plaintiffs were referring to as the person who made the alleged affirmative misrepresentations. (Tr. 7-31-07, 11:13-15).

Second, Plaintiffs allege the actions and representations occurred "[o]ver the course of Plaintiffs' relationship with Defendant." (RP 112). At the hearing on the motion to dismiss, the District Court noted that timing was of particular importance; i.e.: whether the alleged representations occurred before or after Plaintiffs opened their accounts at Belen. Plaintiffs' allegation that the representations occurred "over the course of Plaintiffs' relationship with Defendant" fails to allege the time or place sufficient to comply with the pleading requirements of Rule 1-009(b). (Tr. 7-31-07, 9:4-11:2).

Third, Plaintiffs merely allege that "certain procedures with regard to the safeguarding of Plaintiffs' funds" were not followed. This does not allege the contents of the false representation sufficient to comply with Rule 1-009(b).

Furthermore, the fraud claim was dismissed without prejudice. At the hearing, the Court specifically stated that Plaintiffs did not need to move to amend their Complaint immediately. The Court suggested that Plaintiffs could conduct discovery to learn sufficient facts to be able to plead a fraud claim with the required specificity. Notwithstanding the Court's suggestions, Plaintiffs never filed a motion for leave to amend the complaint. Having failed to do so, they

cannot appeal the Order dismissing their fraud claim without prejudice. *Meeker v. Walker*, 80 N.M. 280, 454 P.2d 762 (N.M. 1969).

Finally, Plaintiffs' brief fails to present any arguments or authorities in support of their contention that Count II of their Second Amended Complaint complied with the pleading requirements of Rule 1-009. Plaintiffs' entire argument in this regard is contained in a single sentence: "Enchantment contends that their allegations of fraud and constructive fraud are sufficient to withstand Rule 1-009 NMRA and Rule 1-012 NMRA challenges.". Immediately following that sentence Plaintiffs quote the allegations in their Second Amended Complaint. Plaintiffs do not argue that those allegations set forth the time, place and contents of the alleged false representations and the identity of the person making them sufficient to comply with Rule 1-009, nor do they cite any authorities in support. Therefore, this Court should not consider this issue. *Lewis v. State Human Services Dept.*, 2009 WL 6593933, at *1 (N.M.App.) (citing *In re Adoption of Doe,* 100 N.M. 764, 765, 676 P.2d 1329, 1330 (1984) (stating that an appellate court will not consider an issue if no authority is cited in support of the issue)).

Plaintiffs' brief also argues that there are questions of fact regarding Plaintiffs' fraud claim and that the District Court overlooked Plaintiffs' "clear allegation of reliance". These arguments are irrelevant. Reliance is one of five elements necessary to plead a cause of action for fraud. The Plaintiffs' fraud claim

was dismissed for failure to adequately plead the other four elements. Likewise, whether or not there may be issues of fact is irrelevant because Plaintiffs failed to plead the elements necessary to state a cause of action for fraud.

The District Court correctly held that Plaintiffs' minimal allegations in Count II of the Second Amended Complaint did not allege a claim for fraud under the pleading requirements of Rule 1-009(b) and therefore failed to state a claim under 1-012(B)(6). Plaintiffs made no attempt to amend their complaint to add the necessary allegations. Therefore, Belen respectfully requests this Court to affirm the dismissal of Count II of the Second Amended Complaint.

III. The District Court correctly granted summary judgment in favor of Belen on Plaintiffs' claim under Section 55-4-406

On September 14, 2010, finding that no genuine issue of material fact existed, the District Court correctly granted summary judgment in favor of the Bank. The District Court's decision was based on the undisputed fact that the Bank regularly provided account statements and copies of cancelled checks to Plaintiffs, (RP 360-361) and the undisputed fact that Belen was not notified of Grano's forgeries until nearly a year and a half after Plaintiffs' receipt of the first statement containing forged items. The District Court held that, as a matter of law, Section 55-4-406(d)(2) and bars Plaintiffs' claim against Belen. That ruling is correct and should be affirmed.

a. Recovery against Belen is absolutely barred by Section 55-4-406

NMSA 1978, Section 55-4-401(a) provides that a bank may charge against a customer's account only items that are "properly payable." A check containing a forged drawer's signature is not properly payable. NMSA 1978, Section 55-4-401, comment 1. Accordingly, under Section 55-4-401, a bank that pays a forged check has paid an item that is not "properly payable," and must recredit its customer's account. In other words, the bank is strictly liable for the entire loss. It is irrelevant whether the forgeries are obvious or undetectable.

A customer's right to shift the loss for forged checks to the customer's bank is not unlimited. Section 55-4-401 must be read in conjunction with Section 55-4-406, which specifically describes the liability between a customer and a bank that pays a forged check on the customer's account.

> "Section 55-4-406 was intended to mitigate the effect of the rather harsh rule that the bank is liable for paying drafts which contain unobvious forgery."

Rutherford, 95 N.M. at 344, 622 P.2d at 249.

Where, as here, a bank provides its customer with account statements and copies of the checks, the customer must exercise reasonable promptness in examining the statements and the items to determine whether any payment was not authorized, and must promptly notify the bank of any such items. NMSA § 55-4-406(a), (c).

If the customer fails to promptly (within 30 days after receipt of the account statement - NMSA § 55-4-406(d)(2)) notify the bank, the customer is precluded from asserting against the bank those forged signatures. NMSA § 55-4-406(d)(1). The customer is also precluded from asserting against the bank any subsequent forgery by the same person which the bank paid before receiving notice from the customer of any forgery. NMSA § 55-4-406(d)(2).

In cases where the customer notifies the bank more than 30 days after receipt of the first statement containing forged items, if the customer can prove the bank failed to exercise ordinary care in paying the items and that such failure substantially contributed to the loss, the loss will be allocated between the bank and the customer based on the degree to which each party's failure to perform its respective duties contributed to that loss. NMSA § 55-4-406(e).

NMSA § 55-4-406(f) establishes an outside limit of one year for the customer to discover and report forgeries to the customer's bank:

> "Without 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 (Subsection (a)) 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."

Thus, §§ 55-4-401 and 55-4-406 together establish the following method of allocating losses resulting from forged and altered checks:

1) A forged or altered check is not properly payable and cannot be charged against the customer's account. The customer's bank is strictly liable for the entire loss resulting from such checks. (§ 55-4-401)

2) If the bank provides an account statement and information sufficient to allow the customer to identify the paid items, the customer must exercise reasonable promptness in examining the statement and the items and reporting to the customer's bank any forgeries or alterations. If the customer does so within 30 days after the receipt of the statement, the bank will be liable for the entire loss. (§ 55-4-406(a),(c))

3) If the customer notifies the bank more than 30 days but less than one year after receipt of the statement, and the bank did not exercise ordinary care in paying the checks, the loss will be apportioned between the bank and the customer based on the degree to which the failure of each contributed to the loss. (§ 55-4-406(d),(e))

4) If the customer does not report the forged checks to the bank within one year after receipt of the account statement, the customer is precluded from asserting any claim against the bank. (§ 55-4-406(f))

Because Plaintiffs did not report any forged checks to Belen until a year and a half after plaintiffs received the first account statements containing photocopies of the first forged checks, plaintiffs are precluded from asserting any claim against Belen for those checks. NMSA § 55-4-406(f). Because all checks in this case were forged by the same person, Plaintiffs are likewise precluded from asserting any claim against Belen for all subsequent checks forged by Grano and paid before Plaintiffs notified Belen of any forgeries. NMSA § 55-4-406(d)(2). There were no forged checks after Belen was notified.

The reason for this provision in the statute is explained in the official comments:

> "The rule of Subsection (d)(2) follows pre-Code case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care (See Comment 1) in examining the statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (c) is the opportunity presented to the wrongdoer to repeat the misdeeds. Conversely, one of the best ways to keep down the losses in this type of situation is for the customer to promptly examine the statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items."

NMSA § 55-4-406, Comment 2.

This case provides a clear example of the reason for this provision as explained by the drafters in the above quoted comment. If Plaintiffs had reported

suspected forgeries to Belen within 30 days after receipt of the February 2003 account statements, Belen would not have paid subsequent checks; the total loss would have been limited to those checks that were forged and paid before April 30, 2003; Belen would have been strictly liable to recredit Plaintiffs' account for all of those checks; and Plaintiffs would not have borne any of the loss. Because Plaintiffs did not report any forgeries to Belen until at least 18 months after receipt of the first account statement and copies of checks, Plaintiffs are statutorily precluded from asserting any claim against Belen.

b. There is no genuine issue of material fact in dispute as to whether Plaintiffs received monthly account statements with copies of the checks

Plaintiffs also argue that there is an issue of fact as to whether the Bank made the account statements available to plaintiffs because Jennifer Grano picked up the statements at the Bank. Plaintiffs cite no authority in support of that argument. In addition, Plaintiffs ignore the fact that they were aware that Grano was the employee who picked up the statements at the Bank because it was one of her job duties. Furthermore, Grier admitted that either he or his daughter, Idamay Romero, reviewed the monthly statements, including the photocopies of cancelled checks, and used them to reconcile those statements with the corporate records. (RP 218-219, 221).

Courts have long held that the information contained in an account statement is imputed to an employer who allows its employee to both handle checks and receive bank statements. *Credit Control Services, Inc. v. Greate bay Hotel and Casino, Inc.*, 1994 WL 483454, at *4 (E.D.Pa. Sept. 7, 1994); *Screenland Magazine Inc. v. Nat'l City Bank,* 42 N.Y.S.2d 286 (N.Y.Sup.Ct.1943); *Parent Teacher Ass'n*, 524 N.Y.S.2d at 338-339; *Kiernan v. Union Bank,* 127 Cal.Rptr. 441, 445 (Cal. Ct.App. 1976); *Globe Motor Car Co. v. First Fidelity Bank, N.A.*, 641 A.2d 1136 (N.J.Super. Law Div. 1993); *Menichini v. Grant*, 995 F.2d 1224, 1234-35 (3rd Cir. 1993).

Plaintiffs cite no authorities in support of their argument that delivery of the account statements to Plaintiffs' employee who, unknown to Plaintiffs and Belen, was embezzling money from Plaintiffs, is not delivery to the Plaintiff corporations. In its letter decision, the District Court correctly found that "Plaintiff does not establish any reason or basis upon which the Bank should be charged with knowledge, or even suspicion, of Ms. Grano's misconduct, nor any other basis upon which the Bank's providing copies of the statements to one of Plaintiff's employees was improper." (RP 360).

c. There is no evidence of bad faith and/or lack of ordinary care

In an attempt to avoid the statutory bar of Section 55-4-406, Plaintiffs argue that the "same wrongdoer" rule in Section 55-4-406(d)(2) does not apply to this

case because Belen acted negligently and in bad faith. After considering the evidence and arguments presented on summary judgment the District Court correctly found that Plaintiffs did not establish any misconduct or bad faith on the part of Belen. (RP 360-362). When opposing a summary judgment motion, Plaintiffs must produce admissible evidence in support of their claim. Section 55-4-406 explicitly establishes that the customer has the burden of establishing a lack of ordinary care by the bank:

> "[i]f Subsection (d) applies and the **customer proves** that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer [...] and the bank."

NMSA 1978, Section 55-4-406(e) (emphasis added). The burden to prove bad faith is also on the party asserting it. *Canfield v. Bank One, Texas, N.A.*, 51 S.W.3d 828, 837 (Tex.App. 2001) ("A party who alleges that acts are done in bad faith, or for a dishonest or fraudulent purpose, takes the burden of proving such bad faith."); *see also Roswell State Bank v. Lawrence Walker Cotton Co.*, 56 N.M. 107, 111, 240 P.2d 1143, 1145 (1952) (the "burden of proof according to law is upon the [customer] to show bad faith on the part of the [bank].").

Plaintiffs argue on appeal that they "have alleged facts which demonstrate, at the very least, bad faith." (BIC 27). Allegations are not evidence. The purported "evidence" Plaintiffs presented to the District Court was nothing more than the conclusory and self-serving statements of Grier, the owner and CEO of

Plaintiffs, contained in his affidavit prepared in response to Belen's summary judgment motion, which states:

> "The bank's negligence in this case is clear. Initially we were told that the bank would not accept corporate checks made out to "cash" unless an officer of the corporation presented the check. This representation was false. Ms. Grano presented checks well over $1,000.00 made out to "cash" and it was well known that Ms. Grano was not a corporate officer. The other components of negligence of the bank include the following. The checks were written out to cash and were repeatedly presented to the bank by a bookkeeper who had no signature authority. The checks for cash were only presented by Jennifer Grano and she started the pattern of presenting the checks outside Plaintiffs' ordinary banking routine. The signatures were different between the signature cards and the checks and/or the endorsement. The checks were brought into the bank signed, even though they were made to cash. The check amounts exceeded teller limits and were often cashed without supervisor approval. Idamay Romero's name is spelled out on the signature that is on the signature card, yet the signature on the forgery only shows a straight line for the name "Romero." Secondly, it is very evident that the signatures of my name did not match, since I was not a signer on one of the accounts." (ROA 348-349).

Plaintiff's factual and legal conclusions are not admissible evidence. Plaintiffs also contend that:

> "in support of their negligence argument, Enchantment presented evidence that Kenneth J. Carson Jr., the president of the Bank, admitted some fault for the unauthorized payments and he admitted there were improper banking procedures in the payment of some of the checks. [RP 345-346] Further, the Albuquerque Branch manager also admitted there was misuse of the check cashing procedures of the tellers of the Bank because quite a few of the checks were cashed over the tellers' limit without a required supervisor's signature. *Id.*"

(BIC 5). There is no such evidence in the record. The only place in the record where these statements appear is in Grier's combined answers to Belen's interrogatories, which were not sworn to, or even signed, by Grier or any other representative of the Plaintiffs. (RP 345-346). Those statements are not evidence. Plaintiffs could have deposed the individuals needed to substantiate these claims, but did not do so. Thus, the District Court correctly noted that "[m]ere allegations are not sufficient to create such a question of fact," (ROA 360), and "there is nothing in the record tending to establish misconduct or lack of good faith on the part of the Bank [...]." (RP 361).

In addition, § 55-4-406 requires that a bank exercise "ordinary care" in paying an item as determined by reasonable commercial standards. *See* NMSA 1978, Section 55-4-406(e). Plaintiffs p resented no evidence of the applicable reasonable commercial standards. Thus, Plaintiffs' own failure to produce evidence in support of their claims justifies the District Court's ruling that no showing of misconduct or bad faith had been made.

d. The District Court's decision was not based upon the Account Agreement

Plaintiffs further attempt to avoid the clear statutory language of Section 55-4-406 by arguing that Belen relied on the Account Agreement to shorten the statutory periods of time in § 55-4-406; that the Account Agreement was not admissible in evidence; and that "it is not clear if the District Court relied on it".

This issue is improperly raised on appeal. In its motion for summary judgment, Belen argued that the Account Agreement between the parties shortened the statutory timeframes in which Plaintiffs had to report the forgeries, as allowed by NMSA 1978, Section 55-4-103(a). When it became evident that the only available copy of the Account Agreement was dated after the events occurring in this case, Belen withdrew that argument. (RP 358). Furthermore, in its letter ruling the District Court referred only to the statutory time limits. Thus, contrary to Plaintiffs' argument, it is clear that the District Court did not consider the Account Agreement or any argument that the statutory time limits were shortened by that Agreement.

Because Belen withdrew any argument based on the Account Agreement in its Summary Judgment Reply Brief, it did not argue that the statutory time limits were shortened at the summary judgment stage and likewise does not make that argument on appeal. Thus, Plaintiffs' argument in this regard is irrelevant and should be disregarded.

CONCLUSION

Because Plaintiffs failed to promptly review their account statements and copies of cancelled checks and discover and report the forged checks to Belen, Plaintiffs cannot recover from Belen the amount embezzled from Plaintiffs by their own employee. All of the "facts" Plaintiffs now contend should impose liability

on Belen were known to the Plaintiffs. The account statements and copies of cancelled checks were reviewed each month by either Michael Grier or Idamay Romero, who were better able to detect forgeries of their own signatures than were employees of Belen. Likewise, Plaintiffs were better able to detect a "pattern of presenting checks outside Plaintiffs' ordinary banking routine". Plaintiffs were also better able to detect an unusual number of checks drawn on their accounts payable either to Grano or to cash. Finally, Plaintiffs were better able to detect the fact that almost $300,000.00 was missing from their accounts.

Because Plaintiffs did not report any forgeries to Belen until some 18 months after they received and reviewed the first account statements containing copies of forged checks, NMSA 55-4-406 prohibits Plaintiffs from making any claim against Belen.

Because 55-4-406 displaces other causes of action or theories of recovery, it provides the exclusive remedy and Plaintiffs' negligence based causes of action were properly dismissed. Because Count II of Plaintiffs' Second Amended Complaint failed to allege four of the five essential elements required to state a cause of action for fraud, it was properly dismissed. Furthermore, because that dismissal was without prejudice and Plaintiffs failed to request leave to amend their Complaint, they cannot seek reversal of that Order on appeal.

WHEREFORE, for the above and foregoing reasons, Defendant Bank of Belen respectfully requests this Court affirm the District Court's Orders dismissing Plaintiffs' common law claims, dismissing Plaintiffs' fraud claim, and granting summary judgment in favor of the Bank on Plaintiffs' UCC claim for paying forged checks drawn on Plaintiffs' accounts.

REQUEST FOR ORAL ARGUMENT

Pursuant to Rules 12-214(B)(1) and 12-213(A)(6) NMRA, Belen respectfully requests oral argument. The matter before this Court is one of first impression regarding effect of NMSA 1978, Section 55-4-406. In addition, because the issues before this Court are numerous and complex, oral argument would aid in the resolution of this appeal.

Dated this 18th day of August, 2011.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that I have served a true and correct copy of the above and foregoing **APPELLEE'S ANSWER BRIEF** on counsel of record by:

(**XX**) placing the same in the U.S. mail, postage prepaid,
(__) placing the same in Federal Express Overnight,
(__) facsimile, or
(__) hand delivery,

on this, the 19th day of August, 2011 to:

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