

No. A05-0634

**STATE OF MINNESOTA
IN COURT OF APPEALS**

Lisa L. Bradley, Trustee for the Sally G.
Moore and Robert A. Moore Revocable Living Trust,

Appellant,

v.

First National Bank of Walker, N.A.,

Respondent.

**BRIEF AND APPENDIX OF APPELLANT
LISA L. BRADLEY**

Steven R. Hedges (#43199)
JAMES H. GILBERT LAW GROUP, P.L.L.C.
10159 Wayzata Boulevard, Suite 250
Minnetonka, MN 55305-1504
(952) 960-4200

and

Keith J. Broady (#120972)
Timothy C. Matson (#225423)
ABDO, ABDO, BROADY & SATORIUS, P.A.
710 Northstar West
625 Marquette Avenue
Minneapolis, MN 55402
(612) 333-1526

David R. Marshall (#184457)
Ryan T. Murphy (#311972)
FREDRIKSON & BYRON, P.A.
4000 Pillsbury Center
200 South Sixth Street
Minneapolis, MN 55402
(612) 492-7000
Attorneys for Respondent
First National Bank of Walker, N.A.

Attorneys for Appellant,
Lisa L. Bradley, Trustee for the Sally G.
Moore and Robert A. Moore Revocable
Living Trust

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STATEMENT OF ISSUES

I. May an issue raised for the first time in a party's reply memorandum form the basis for summary judgment?

The Trial Court held: The Trial Court granted summary judgment in favor of Respondent Bank despite the fact that the determinative issue was not raised by Respondent until its Reply Memorandum on the Motion for Summary Judgment.

Apposite Authority:

Minn. Gen. R. Prac. 115.03(d)(1)
Minn. Gen. R. Prac. 115.03(c)
Hebrink v. Farm Bureau Life Insurance Company, 664 N.W.2d 414 (Minn. App. 2003)
Rhee v. Golden Home Builders, Inc., 617 N.W.2d 618 (Minn. App. 2000).

II. Does the UCC 3-year statute of limitations preempt the general 6-year statute of limitations applicable to claims under the Uniform Fiduciaries Act?

The Trial Court held: In the affirmative

Apposite Authority:

McCartney v. Richfield Bank & Trust Co., 2001 WL 436154 (Minn. App.)
Chouteau Auto Mart, Inc. v. First Bank of Missouri, 148 S.W.3d 17, 21-24 (Mo. App. 2004), *rev. denied* (Sept. 28 and Nov. 23, 2004)
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III. Does the Uniform Commercial Code repeal or otherwise preempt claims under the Uniform Fiduciaries Act and other common law theories?

The Trial Court held: In the affirmative

Apposite Authority:

Minn. Stat. §336.10-102 (2004)
Appley v. West, 832 F.2d 1021, 1030-32 (7th Cir. 1987)

STATEMENT OF THE CASE AND FACTS

A. STATEMENT OF THE CASE

Appellant Lisa L. Bradley is the Trustee for the Revocable Living Trust (the “Trust”) established by Robert A. Moore and Sally G. Moore. From September of 1996 until October of 1998, Glenn L. Smith, the Co-Trustee of the Trust, wrote approximately 81 checks to himself from the Trust’s checking account at Respondent First National Bank of Walker, N.A. (“Bank”), in an aggregate amount in excess of \$500,000. When the embezzlement was discovered, Smith resigned as Co-Trustee and ultimately pled guilty to federal criminal charges.

Appellant brought this action against Respondent Bank in Cass County District Court, Ninth Judicial District, based on violations of the Minnesota Uniform Fiduciaries Act, Minn. Stat. §§520.01-.33 (2004), and on negligence and contract theories. The Complaint seeks recovery of unreimbursed losses resulting from Glenn Smith’s actions, which amounted to about \$368,000 as of the time the

action was commenced.¹ Respondent denied liability and alleged that Lisa Bradley was negligent in not discovering the fraud earlier.

Respondent Bank brought a Motion for Summary Judgment, which was heard by the Trial Court on August 12, 2004. The motion was based on Respondent's contention that the Uniform Commercial Code preempted claims under the Uniform Fiduciaries Act and common law theories, and that, under the UCC, unless the Bank had actual knowledge of Glenn Smith's actions, it could have no liability.

Only in its Reply Memorandum, and contrary to General Rules of Practice 115.03(c) and 115.03(d)(1), did Respondent for the first time in this case assert that the UCC 3-year statute of limitations should control in this case over the general 6-year statute of limitations that would otherwise apply to claims under the Uniform Fiduciaries Act. Despite objections made at oral argument to Respondent raising this issue in an untimely and inappropriate manner, and despite the fact that Appellant had not briefed or argued the issue, the Trial Court, the Honorable David Harrington, granted summary judgment, holding that the UCC 3-year statute of limitations controls in this case. Judgment was entered on January 27, 2005. A. 84.

This appeal ensued.

¹ The Trust was reimbursed \$100,000 from the Minnesota Client Security Board, and that amount is not included in the total set forth above. However, under the reimbursement agreement, the Client Security Board does have subrogation rights.

B. STATEMENT OF FACTS

1. Formation of the Trust

Appellant Lisa L. Bradley is the Trustee for the Revocable Living Trust established by Robert A. Moore and Sally G. Moore. She is an Enrolled Agent and provides tax, accounting, and financial services to the general public in the Lake Havasu City, Arizona area. Appellant performed various financial and tax services for Sally G. Moore, who had wintered in Lake Havasu City during the last several years of her life. Complaint ¶¶ 1, 6, A. 2-3.

The Moores established the Trust pursuant to a Trust document executed on June 20, 1990. Under the Trust, the Moores transferred most of their property to the Trust. During their lifetimes, the Moores were the Trustees for the Trust. Three amendments to the Trust were ultimately executed. Complaint ¶¶ 4-6, A. 2-3.

The First Amendment established Lisa L. Bradley as the Successor Trustee of the Trust, to become Trustee upon the death of Sally G. Moore, who was then the surviving Trustor (Robert A. Moore had died on October 2, 1993). Complaint ¶ 6, A. 3.

The Third (and last) amendment to the Trust was dated September 13, 1996, and it appointed Glenn L. Smith as Co-Successor Trustee with Lisa Bradley. Complaint ¶¶ 5, 7, A. 2-3.

The terms of the Trust provided that, after Sally G. Moore's death, \$50,000 was to be disbursed to relatives of Sally G. Moore's deceased spouse. The remaining balance of the Trust was to be paid, after liquidating assets, to four

religious organizations. Complaint ¶ 9, A. 3.

2. Sally Moore's Death and Glenn Smith's Embezzlement

In early to mid-1996 Sally G. Moore was diagnosed with terminal cancer. She returned to Minnesota by June, 1996. She died on September 28, 1996 in the Fargo, North Dakota area, where she had friends. Complaint ¶ 10, A. 3.

Sally G. Moore and/or Robert A. Moore had established bank account No. 329912 for the Trust with Respondent First National Bank of Walker in September of 1990. After the death of Sally G. Moore, Glenn L. Smith, assumed the dominant role in functioning as Trustee of the Trust. He caused the mailing addresses for various of the Trust financial accounts, including the account at Respondent Bank, to be changed to the address of his law office. Complaint ¶¶ 9, 11, A. 3; Affidavit of R. Tiedeman dated March 16, 2004.

Over the period of approximately 25 months from September of 1996 until October of 1998, when Appellant discovered the fraud and demanded that the Bank close the account, Glenn Smith wrote approximately 81 checks to himself from the Trust's checking account at Respondent Bank, in an aggregate amount in excess of \$500,000.² See listing of checks attached as Exhibit "A" to Affidavit of Lisa L. Bradley dated May 14, 2004, A. 111-15.

About 74 of those checks were for \$2,500 or more (with some as high as \$62,000, \$20,000, and \$10,000, and a large number at the \$8,000, \$7,000, and

² Restitution of \$530,000 was ordered by the Judge Magnuson. Complaint ¶ 16, A. 4.

\$6,000 levels). *Id.*³ Almost all of the checks Glenn Smith wrote to himself were deposited in his business account in the Minneapolis area. He did not maintain an account at Respondent Bank in Walker.

In 1997 Appellant began experiencing difficulties in obtaining information from Glenn Smith. He became more difficult to contact and less responsive to requests for information or documents, such as information needed to prepare filings for taxing authorities. However, Mr. Smith ultimately gave plausible excuses and did provide information from time to time.

3. Respondent Bank's Handling of the Account and its Procedures

In 1998 the problems of communications became more pronounced, and it became even more difficult to obtain information from Mr. Smith. Linking fragmentary information, Appellant concluded that Sally G. Moore may have had an account at Respondent Bank, and she placed a call to the Bank. Lisa Bradley testified that, in the phone conversation with one of the Bank's processing personnel, an individual named Debbie Prout, Ms. Prout acknowledged that Bank personnel had examined most of the checks drawn on the Trust Account and almost all of the checks were written to Glenn Smith. Lisa Bradley also testified that Ms. Prout told her that, when she asked her supervisor about the checks Glenn Smith wrote to himself, the supervisor simply told her to pay the checks without

³ It was subsequently determined that the listing contains one typographical error. Check no. 2168 (A. 111) was in the amount of \$2,400 rather than \$24,000.

question or challenge from the Bank.⁴ L. Bradley Deposition transcript, pages 192-95, attached as Exhibit "A" to Affidavit of Steven R. Hedges dated May 18, 2004, A. 120-23.

Respondent Bank has acknowledged that its check processing software contains a function that separates as "large items" all checks of \$2,500 or greater, and that such items are subjected to certain manual processing steps by Bank personnel. However, under the Bank's procedures, the only formal scrutiny of such items is a manual verification to ascertain that the signature was a valid signature for that account and that the check has been endorsed. *See generally* Plaintiff's Supplemental Memorandum of Law dated August 6, 2004, Additional Undisputed Facts at pages 4-5 (¶¶ 12-15), A. 55-56, and references cited therein. In addition, two Bank officers, Richard Tiedeman, its Vice Chairman, and Ms. Charlotte Negen, its Vice President and Cashier, receive the "large item report" each morning, which contains a complete listing of such items from the prior night's processing. Mr. Tiedeman candidly admitted that he spends 1-2 minutes looking at the report, but does not pay attention to any transaction under \$100,000. *Id.*, p. 5 (¶ 13), A. 56, and R. Tiedeman depo. pp. 38-39, attached as part of Exhibit "B" to Hedges Second Affidavit dated August 6, 2004. When asked why the report exists, he acknowledged that he knew of no reason other than that the

⁴ Respondent denies that Ms. Prout said the things that Ms. Bradley claims. In her deposition, Ms. Prout made no such denial, but testified she did not remember. D. Prout deposition, excerpts attached as Exhibit "D" to Second Hedges Affidavit dated August 6, 2004 (submitted with Supplement Memorandum dated August 6, 2004).

Bank's software generated it. *Id.* pp. 39-40. Ms. Negen testified that she reviews the report, but that she never used it to inquire into any of the transactions involved in this case, and that she has never used it to question the propriety of any transactions.⁵ Plaintiff's Supplemental Memorandum of Law dated August 6, 2004, Additional Undisputed Facts at p. 5 (¶ 14), A. 56, and references cited therein.

Under the acknowledged Bank procedures, at least 74 of the 81 checks written by Glenn Smith to himself over a period of 25 months would have been individually scrutinized by Bank employees.

When Lisa Bradley discovered Glenn Smith's fraud, she reported it to appropriate authorities, and Mr. Smith ultimately pled guilty to federal felony charges.

⁵ While it is not specifically material to the issues raised in this appeal, Appellant notes that the Federal Bank Secrecy Act, 31 U.S.C. §5311, *et seq.*, which has been in effect for all periods after April, 1996, requires banks to monitor certain aspects of their customers' account activity, and, in appropriate cases, file "Suspicious Activity Reports" ("SARs") with federal bank regulators. As part of the official reporting form (which was in effect during the period of 1996-98), suspicious activities include "embezzlement," "false statement," and "misuse of position or self-dealing." Exhibit B to R. Solarz Affidavit.

As part of Appellant's submissions in opposition to the Summary Judgment Motion, the Affidavit of Richard Solarz, dated August 3, 2004 was submitted. Mr. Solarz is a banker with more than 40 years of experience, mostly with banks in greater Minnesota. In his affidavit he offered his opinion that the failure of the Bank to submit a SAR with respect to Mr. Smith's activities amounted to bad faith. The Affidavit presented the further opinion that, in view of the fact that at least 75 of the 81 checks Mr. Smith wrote to himself would have been included on the Bank's daily Large Item Reports, Respondent had "actual knowledge" of Mr. Smith's wrongdoing. Actual knowledge and bad faith are the two criteria identified by the Minnesota Uniform Fiduciaries Act, Minn. Stat. §§520.01-.33 (2004) for holding a bank liable.

4. This Litigation and the Summary Judgment Motion

This litigation was commenced by Appellant's Complaint dated July 25, 2003. Complaint, A. 1-7. By Notice of Motion and Motion dated March 23, 2004, Respondent brought its Motion for Summary Judgment. A. 14. Its 15-page Memorandum did not comply with Minn. Gen. R. Prac. 115.03(d) relating to summary judgment motions in that it did not contain the required statement of issues (115.03(d)(1)), a statement of documents comprising the record (115.03(d)(2)), and a statement of undisputed facts (115.03(d)(3)). A. 15-29.

Respondent's Argument section of its memorandum presented two arguments:

"I. THE MINNESOTA COMMERCIAL CODE DISPLACES BRADLEY'S CLAIMS OF NEGLIGENCE AND BREACH OF CONTRACT."

"II. THE MINNESOTA COMMERCIAL CODE, NOT THE UNIFORM FIDUCIARIES ACT, CONTROLS AND FIRST NATIONAL IS NOT LIABLE BECAUSE IT DID NOT HAVE ACTUAL KNOWLEDGE OF SMITH'S BREACH OF FIDUCIARY DUTY."

A. 11, 12.

Appellant's Memorandum in opposition was served on May 18, 2004. A. 32-42. Respondent's Reply Memorandum was dated August 4, 2004. A. 43-51. In the Reply Memorandum (at p. 3, A. 45), Respondent's second point of argument read as follows:

"II. THE MINNESOTA COMMERCIAL CODE, NOT THE UNIFORM FIDUCIARIES ACT, CONTROLS AND FIRST NATIONAL IS NOT LIABLE BECAUSE IT DID NOT

HAVE ACTUAL KNOWLEDGE OF SMITH'S
BREACHES OF FIDUCIARY DUTY.”

Its fifth subheading under that argument introduced the statute of limitation argument for the first time (at p. 5, A. 47):

“E. Bradley’s Claims Are Barred By The Statute Of Limitation”

This was followed by half a page of argument as to why the UCC statute of limitations should control.

At the August 12, 2004 hearing on the Summary Judgment Motion, counsel for the Bank argued the statute of limitations issues to the Trial Court. Transcript of Hearing at p. 12, A. 99. Counsel for Appellant objected to the statute of limitations issues being presented, stating:

“I would vigorously oppose anything that is raised for the first time in the reply memorandum and then at oral argument as somehow being a basis for determination of the Summary Judgment Motion on that issue when it hasn’t been presented.”

Id. at pp. 30-31, A. 102-103 (quote from A. 103). Appellant had not briefed and did not argue the merits of the statute of limitations issue.⁶

⁶ The submissions to the Trial Court with respect to this motion included supplemental memoranda in addition to the typical Memorandum, Memorandum in Opposition, and Reply Memorandum. Appellant submitted a Supplemental Memorandum dated August 6 (six days in advance of the hearing) (A. 52-68) and a Second Supplemental Memorandum dated October 1, 2004. A. 69-77. Respondent submitted a Supplemental Reply Memorandum dated October 11, 2004. A. 78-82.

The first Supplemental Memorandum came about because discovery was still taking place prior to the hearing on the motion. The transcripts from one set of depositions were not delivered until a week prior to the August 6 submission and about two weeks prior to the hearing date.

In addition, there were further ongoing disputes about discovery.

The District Court's Order dated January 12, 2005, granted Respondent's Motion for Summary Judgment on the UCC statute of limitations issue, and judgment was entered accordingly on January 27, 2005, from which this appeal has been taken.

ARGUMENT

I. THE STANDARD OF REVIEW

On appeal from a judgment entered pursuant to a motion for summary judgment, factual issues will be reviewed using the "genuine issue of material fact" criterion of Minn. R. Civ. Proc. 56.03. A reviewing court asks whether there are any genuine issues of material fact and whether the trial court erred in its application of the law. *State by Cooper v. French*, 460 N.W.2d 2, 4 (Minn. 1990). Also, the reviewing court views "the evidence in the light most favorable to the

Respondent had refused to permit depositions of some of its employees. Also, while Appellant had produced more than 500 pages of documents as of the date of the hearing (subsequently that number rose to 784 pages), Respondent had not produced any documents in response to the November 17, 2003 document requests until June 17, 2004, at which time it produced five documents consisting of 11 pages total. See Affidavit of Steven R. Hedges dated July 14, 2004, in support of Plaintiff's Motion to Compel, ¶ 11.

As a consequent, a Motion to Compel had been noted for the August 12, 2004 hearing date. Ultimately, Respondent agreed to additional depositions, and it did provide some additional documents on September 21, 2004, and Appellant submitted its Second Supplemental Memorandum on October 1, 2004. At the hearing on the motions on August 12, 2004, it had been agreed that supplemental memoranda could be submitted when the additional discovery was completed. Hearing Transcript at pp. 2-4, A. 95-97.

In any event, the supplemental memoranda addressed only additional factual material that emerged from the additional depositions and document production. They did not address the statute of limitations issues that had been untimely and improperly raised by Respondent.

party against whom judgment was granted.” *Fabio v. Bellomo*, 504 N.W.2d 758, 761 (Minn. 1993) (citation omitted).

Construction of a statute of limitations is a question of law to be reviewed *de novo* by the reviewing court. *Jensen-Re Partnership v. Superior Shores Lakehome Association*, 681 N.W.2d 42, 44 (Minn. App. 2004), *rev. denied* (Minn. Sept. 21, 2004).

II. AN ISSUE RAISED FOR THE FIRST TIME IN A PARTY’S REPLY MEMORANDUM MAY NOT FORM THE BASIS FOR SUMMARY JUDGMENT.

Respondent Bank first raised the statute of limitations issue in its Reply Memorandum of Law dated August 4, 2004, eight days before the August 12 hearing on the Summary Judgment motion. That, coupled with other procedural shortcomings, excludes that issue from Respondent’s motion and invalidates the Trial Court’s Order.

A. Failure to Comply with Minn. Gen. R. Prac. 115.03(d)

Respondent’s Motion generally failed to comply with the procedural requirements of Minn. Gen. R. Prac. 115. Specifically, Respondent’s 15-page Memorandum did not comply with Minn. Gen. R. Prac. 115.03(d) relating to summary judgment motions in that it did not contain the required statement of issues (115.03(d)(1)), a statement of documents comprising the record (115.03(d)(2)), and a statement of undisputed facts (115.03(d)(3)). A. 15-29.

These rules have been in effect for some time, and compliance should not be optional. One consequence of compliance in a case such as this is that the

moving party must designate what issues are involved in its summary judgment motion.

B. Violation of Minn. R. Gen. Prac. 115.03(c) Relating to New Issues in Reply Memorandum

Minn. R. Gen. Prac. 115.03(c) requires that a reply memorandum be “limited to new legal or factual matters raised by an opposing party’s response to a motion” No mention of the statute of limitations issue was made in Respondent’s Memorandum of Law in support of its motion, and certainly not in Appellant’s Memorandum of Law in opposition to the motion for summary judgment.

As a consequence, the first mention of the statute of limitations as an issue was made eight days before the August 12 hearing on the motion. Also, as noted above, at the argument on the Summary Judgment Motion counsel for Appellant objected to the statute of limitations issues being presented, stating:

“I would vigorously oppose anything that is raised for the first time in the reply memorandum and then at oral argument as somehow being a basis for determination of the Summary Judgment Motion on that issue when it hasn’t been presented.”

Hearing Transcript at pp. 31, A. 103. Appellant had not briefed and did not argue the merits of the statute of limitations issue.

C. The Party Responding to a Summary Judgment Motion Must be Given a Meaningful Opportunity to Oppose Summary Judgment

The Minnesota Court of Appeals has addressed these issues. For example, in *Hebrink v. Farm Bureau Life Insurance Company*, 664 N.W.2d 414 (Minn.

App. 2003), the Court considered a situation in which a party had brought a motion designated as a motion in limine seeking to bar the appellant in that case from presenting evidence on particular issues in a case. The trial court granted the motion and granted summary judgment *sua sponte*.

On appeal, the Court of Appeals held that the motion in limine functioned as a summary judgment motion, and that it failed to meet the formal requirements of Minn. R. Civ. P. 56.03 and Minn. Gen. R. Prac. 115. 664 N.W.2d at 419. Noting that the motion had been brought only seven days before the trial date, the Court held that the notice did not comply with the unequivocal requirement of Rule 56.03 that no less than 10 days notice in a summary judgment setting. *Id.*

Addressing the contention that the trial court's *sua sponte* ruling was not subject to Rule 56.03 and Rule 115, and addressing the conditions under which such rulings may be made generally, the Court in *Hebrink* stated:

The district court, however, must afford the adverse party a meaningful opportunity to oppose such an action. *Fed. Land Bank of St. Paul v. Obermoller*, 429 N.W.2d 251, 255 (Minn. App. 1988), review denied (Minn. Oct. 26, 1988).

664 N.W.2d at 419. Concluding that the trial court had failed to give appellant a “meaningful opportunity to oppose summary judgment,” the Court of Appeals concluded that the appellant had been prejudiced, regardless of the characterization of the ruling as *sua sponte*. 664 N.W.2d at 419-20.

Similar factors were present in the case of *Rhee v. Golden Home Builders, Inc.*, 617 N.W.2d 618 (Minn. App. 2000). There homeowners sued their

contractor over water leakage, who in turn impleaded a subcontractor. The subcontractor – but not the contractor – had raised the statute of limitations defense. Both the contractor and the subcontractor moved for summary judgment, and at the motion hearing the contractor made an oral motion to amend its answer to assert the statute of limitations defense. The district court permitted the amendment and then granted summary judgment in favor of both the contractor and the subcontractor on the statute of limitations defense. 617 N.W.2d at 620.

In reversing, the Court of Appeals noted that the statute of limitations is an affirmative defense which “must be pleaded specifically and the failure to do so results in a waiver of the defense.” *Rhee*, 617 N.W.2d at 621. The Court of Appeals held that it was error to allow the contractor to “ignore the rules altogether,” that appellants had been unfairly prejudiced by the action, and that there had been an abuse of discretion. *Id.*

In this case the first notice that Appellant received of Respondent’s attempt to base its summary judgment motion on the statute of limitations defense was in Respondent’s Reply Memorandum, submitted eight days before the motion hearing.⁷ In view of Respondent’s failure to comply with notice requirements, as

⁷ Prior to that time, Respondent had never provided any notice of its claim that the 3-year UCC statute of limitations (Minn. Stat. §336.6-118(g)(2004)), applies. While it had claimed in Defense No. 7 of its Answer that certain claims were “barred by statute” (A. 11), Respondent refused to answer Appellant’s Interrogatory 16 which asked Respondent Bank to identify “any and all statutes referred to in Defense No. 7 of your Answer. . . .” (The text of the interrogatory is found in Respondent’s Answers dated December 23, 2003 at page 10, Exhibit B to the Affidavit of Steven R. Hedges dated July 14, 2004, in support of Plaintiff’s

well as Respondent's four other violations of court rules (discussed in the preceding two sections), Appellant did not have a "meaningful opportunity to oppose summary judgment," and the judgment should be reversed on those grounds.

III. THE UCC 3-YEAR STATUTE OF LIMITATIONS DOES NOT PREEMPT THE GENERAL 6-YEAR STATUTE OF LIMITATIONS APPLICABLE TO CLAIMS UNDER THE UNIFORM FIDUCIARIES ACT.

A. The Trial Court Holding

Should the Court, nevertheless, determine that Respondent's raising of the statute of limitations defense for the first time in its Reply Memorandum is permissible, the appropriate limitations period for the Court to apply is the 6-year statute of limitations applicable to claims arising under the Uniform Fiduciaries Act ("UFA") and common law, not the 3-year time period for claims governed solely by the Uniform Commercial Code ("UCC").

In its Order granting summary judgment, the Trial Court stated that the latest date on which the limitations period for Appellant's claims began to run would be July 13, 2000. Memorandum at p. 8, A. 90. The Trial Court determined, however, that a conflict existed between the UCC's 3-year statute of limitations and the 6-year limitations period applicable to claims under the UFA.

Motion to Compel that was also heard at the motion hearing on August 12, 2004.) Respondent's answer asserted that "Interrogatory No. 16 calls for a legal analysis, which is not the appropriate subject of an interrogatory." *Id.*

Id. at pp. 7-8, A. 89-90.⁸ Believing that the UCC repealed all provisions of law inconsistent with the Code, and reasoning that the UCC was more recently enacted than the UFA, the Court ruled that the UCC's 3-year provision controlled, barring Appellant's claims.

B. The Uniform Fiduciaries Act

The Minnesota Uniform Fiduciaries Act was adopted by the Legislature in 1945. Minnesota is one of 25 states (plus the District of Columbia) that have adopted the UFA. See 31 Minnesota Statutes Annotated, Chapter 520 Table of Jurisdictions.

The general working and purpose of the UFA is described in the opinion of the Eighth Circuit (involving the Missouri version of the UFA) in the case of *In re Lauer*, 98 F.3d 378, 382-83 (8th Cir. 1996), *reh. denied* (Dec. 20, 1996) (citations omitted):

The Uniform Fiduciaries [Act] modifies the common law with respect to the duties of parties who deal with fiduciaries. . . . In particular, the [UFA] relieves banks of their common law duty of inquiring into the propriety of each transaction conducted by a fiduciary. . . . The [UFA] provides that banks and others who typically deal with fiduciaries may not be held liable for a fiduciary's breach of duty absent either (1) "actual knowledge" of the breach or (2) knowledge of sufficient facts to constitute "bad faith."

Thus it is important to note that the UFA is not in the nature of a "punitive" law, but rather was intended to relieve banks of certain burdens so long as they meet

⁸ Because the UFA has no pertinent statute of limitations itself, the 6-year general statute of limitations of Minn. Stat. §541.05 (2004), applies to actions arising under the UFA. See *Chouteau Auto Mart, Inc. v. First Bank of Missouri*, 148 S.W.3d 17, 21 (Mo. App. 2004, *rev. denied* (Sept. 28 and Nov. 23, 2004)).

statutory thresholds of due care.

C. The “Bad Faith” Threshold of the UFA

As noted, the UFA establishes a “bad faith” threshold for a bank’s liability. In particular, in this case, Appellant relies on Minn. Stat. §520.08, which provides that: “If a check is drawn upon the account of the principal [the Trust] in a bank [Respondent] by a fiduciary [Glenn Smith] who is empowered to draw checks upon the principal’s account, the bank [Respondent] is authorized to pay such check without being liable to the principal [the Trust], unless the bank [Respondent] pays the check . . . *with knowledge of such facts that its action in paying the check amounts to bad faith*” (emphasis added).

While the Trial Court based its holding on its perceived conflict between the UCC statute of limitations and the UFA statute of limitations, it is important to understand the working of the UFA “bad faith” liability standard.

Contrary to the contentions of Respondent Bank to the effect that actual knowledge is required to find bad faith, courts in Minnesota and elsewhere have found bad faith to exist under circumstances far short of “actual knowledge.” For example, the Court of Appeals recently applied the Uniform Fiduciaries Act in a case that has significant similarities to this case. *See McCartney v. Richfield Bank & Trust Co.*, 2001 WL 436154 (Minn. App. May 1, 2001) (NO. CX-00-1466, C1-00-1467), *rev. denied* (Minn. Jun 27, 2001) (a copy of unpublished opinion is contained in the Appendix at A. 124-29 in compliance with Minn. Stat. §480A.08, subd. 3). *McCartney* involved claims asserted by trust beneficiaries against a bank

for losses resulting from the illegal activities of the attorney who had misappropriated their funds and who had maintained a trust account at the bank. The Court of Appeals reversed the trial court's summary judgment order dismissing the claims against the bank.

In *McCartney* the Court of Appeals begins by noting that the parties were all in agreement that the Uniform Fiduciaries Act applied. See *McCartney*, 2001 WL 436154 at *3. The key inquiry of the Court of Appeals was whether the bank had acted in bad faith. 2001 WL 436154 at *4. As set forth above, the key provisions of the Uniform Fiduciaries Act contain language that a bank may be held liable under the Act if it acts with actual knowledge that the fiduciary is committing a breach of an obligation or "with knowledge of such facts that its action in paying the check amounts to bad faith." Minn. Stat. §520.08.

Rejecting the reasoning of the trial court and the arguments of the bank, the Court of Appeals quotes with approval language from several decisions from other jurisdictions. *Id.* and n. 2, quoting and citing *County of Macon v. Edgcomb*, 654 N.E.2d 598, 601 (Ill. App. Ct. 1995) ("An example of bad faith is where the taker suspects that the fiduciary is acting improperly and deliberately refrains from investigating in order that he may avoid knowledge that the fiduciary is acting improperly. (citation omitted)"); *Home Sav. of Am., FSB*, 661 N.Y.S.2d at 638 ("[N]either a large bank nor a small bank may urge that it is ignorant of facts clearly disclosed in the transactions of its customers with the bank[.]" (quotation omitted)); *New Jersey Title Ins. Co. v. Caputo*, 748 A.2d 507, 514 (N.J. 2000)

(holding bad faith denotes a reckless disregard or purposeful obliviousness of the known facts suggesting impropriety by the fiduciary); *Broadview Lumber Co., Inc. v. Southwest Mo. Bank of Carthage*, 118 F.3d 1246, 1251 (8th Cir. 1997) (providing that “bad faith” can be found when the person disregards circumstances that are suggestive of a breach and sufficiently obvious such that it is in bad faith to remain passive (citations omitted)); *Trenton Trust Co. v. Western Sur. Co.*, 599 S.W.2d 481, 492 (Mo. 1980) (“Where circumstances suggestive of the fiduciary’s breach become sufficiently obvious it is ‘bad faith’ to remain passive.” (citations omitted)). Based on that authority from other states (see Section H *infra*), the Court of Appeals reversed the dismissal of the case against the bank.

Suffice it to say that the facts and circumstances of this case would establish “genuine issues of material fact” as to the existence of bad faith.

D. Minn. Stat. §520.08 was Not Repealed by Nor is it in Conflict With the UCC

When the Legislature adopted the UCC in 1965, it repealed only certain, specifically-enumerated sections of the UFA, and not the UFA as a whole. Specifically, Minn. Stat. §336.10-102 repealed Minn. Stat. §§520.04-.06 (dating from the enactment of the UCC in Minnesota in 1965). The remaining provisions remained in effect.

The thrust of Respondent’s argument below seems to be that the rest of the UFA has been repealed by implication. Clearly the Legislature was aware of the Uniform Fiduciaries Act, in that it repealed certain sections and left the remaining

sections in force. In view of the fact that the Legislature selectively repealed parts of the Act, that argument fails totally. *Accord Coeur d'Alene Mining Company v. First National Bank of North Idaho*, 118 Idaho 812, 818, 800 P.2d 1026, 1032 (1990).

E. There is no Conflict between Minn. Stat. §520.08 and any UCC Provision

As noted above, Appellant relies upon Section 8 of the UFA, Minn. Stat. §520.08, which applies to checks “drawn upon the account of the principal [the Trust] in a bank [Respondent] by a fiduciary [Glenn Smith]” and prescribes when “the bank [Respondent] is authorized to pay such check without being liable to the principal [the Trust]” (in the absence of actual knowledge or bad faith).

The only UCC provision cited by Respondent Bank or by the Trial Court, Minn. Stat. §336.3-307(b), applies to a situation in which “an instrument is *taken* from a fiduciary for payment or collection or for value” (emphasis added). It applies to the “taker” of such an instrument.

This fact was recognized implicitly by Respondent in its Reply Memorandum below when it stated that (Reply Memorandum at p. 4, A. 46, emphasis by Respondent):

[T]he official comment to §336.3-307 specifically provides that a “taker” includes a depository [*sic*] bank such as First National:

The basic scenario is one in which the fiduciary in effect embezzles money of the represented person by applying the proceeds of an instrument that belongs to the represented person to the personal use of the fiduciary. **The person dealing with the fiduciary may be a depository [*sic*] bank that takes the instrument for collection** or

bank or other person that pays value for the instrument.

However, Respondent's claim that it is a "depository bank" is simply wrong. The UCC definition of "depository bank" (along with "payor bank") is found in Minn. Stat. §336.4-105:

(2) "Depository bank" means the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter.

(3) "Payor bank" means a bank that is the drawee of a draft.

As noted by the Trial Court, the checks that Glenn Smith wrote to himself were deposited at Americana Bank and Excel Bank. Memorandum at p. 3, A. 85. Thus, they would be the "depository banks" in the transactions. Respondent Bank is the payor bank.

Also, as noted above, Section 6 of the UFA, Minn. Stat. §520.06, was repealed in 1965 when the UCC was enacted. As with UCC §3-307, that section dealt with "takers" or "transferees" of checks or other instruments. Specifically, the operative language of Minn. Stat. §520.06 (repealed in 1965) read as follows (emphasis added):

If a check . . . is drawn by a fiduciary as such, . . . payable to the fiduciary personally, . . . and is thereafter *transferred* by the fiduciary, . . . the *transferee* is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in transferring the instrument [absent actual knowledge or bad faith].

It is clear that the provisions of UFA §6 would have conflicted with the provisions of UCC §3-307. The drafters of the UCC thus repealed UFA §6.

However, Respondent Bank is not a transferee of the checks. It was the

“payor bank” and received the checks for collection. Accordingly, Minn. Stat. §520.08, which remained in effect since its original enactment, controls.

F. The UCC Statute of Limitations is Not Applicable

Since the UCC is not applicable, it follows that its statute of limitations is not applicable.

Without citing a statute, the Trial Court noted that the Uniform Fiduciaries Act has a 6-year statute of limitations. Memorandum at p. 8, A. 90. Respondent Bank, in its Reply Memorandum (at p. 8, A. 50), has acknowledged that the general 6-year statute of limitations, Minn. Stat. §541.05 (2004), would otherwise apply.

G. Other Courts Have Held that there is No Conflict Between the UCC and the UFA Statutes of Limitations

Courts in other states have considered the issue of whether there is a conflict between the UFA statute of limitations and the UCC (or other) statutes of limitations. For example, in a case against a payor bank involving the embezzlement of funds by a fiduciary who deposited checks of the principal into her own account, the Missouri Court of Appeals held that the principal’s claims were governed by Missouri’s equivalent of the UFA, not the UCC. As a result, the court applied the state’s 5-year general statute of limitations rather than the UCC’s 3-year statute of limitations. *Chouteau, supra*, 148 S.W.3d 17. The Seventh Circuit Court of Appeals issued a similar ruling in *Appley v. West*, 832 F.2d 1021, 1029-32 (7th Cir. 1987) (holding that UFA and common law claims were distinct

from UCC claims and were, therefore, not governed by the UCC's statute of limitations).

Because Appellant asserts no claims under the UCC, the UCC's 3-year statute of limitations does not apply to the present case. The appropriate statute of limitations is the general 6-year limitations period applicable to claims arising under the UFA. This provision has neither been repealed by, nor does it conflict with, the UCC.

H. UFA Cases Decided in Other States are to be Given Great Weight in Minnesota Cases

Minn. Stat. §645.22 (2004) provides:

Laws uniform with those of other states shall be interpreted and construed to effect their general purpose to make uniform the laws of those states which enact them.

The Minnesota Supreme Court has held that great weight will be given to other states' interpretations of a uniform law. *Johnson v. Murray*, 648 N.W.2d 664 (2002).

Accordingly, the cases cited in this matter from other states are to be accorded significant weight.

IV. THE UCC HAS NOT PREEMPTED THE COMMON LAW THEORIES BROUGHT IN THIS CASE

The Trial Court concluded that the UCC §3-307 had displaced Appellant's common law claims (negligence and contract). Memorandum at p. 9, A. 91.

Respondent had argued that theory based in part on the case of *Hedged Investment Partners v. Norwest Bank*, 578 N.W.2d 765 (Minn. App. 1998). In that

case, which dealt with the interpretation of Article 4A of the UCC, the Court of Appeals reversed (in part) the trial court's holding. The Court of Appeal's Syllabus reads in part as follows:

The exclusivity of Article 4A does not prevent application of common law principles specifically provided for within the act or common law actions that do not conflict with the provisions and remedies of Article 4A.

As set forth above, UCC §3-307 applies to transferees of the checks or instruments, not to the drawee or payor bank. Therefore, the UCC does not have applicability to this case. Accordingly, there is no conflict with the UCC. To the extent that common law theories are otherwise applicable, they have not been displaced by adoption of the UCC. *See Appley, supra*, 832 F.2d at 1029-32.

CONCLUSION

Respondent Bank's Summary Judgment Motion was defective in various regards, most particularly in that it sought to raise the statute of limitations issue for the first time in its Reply Memorandum, contrary to procedural rules, since Appellant never had a meaningful opportunity to respond to the argument. As a consequence, the judgment entered on the summary judgment must be reversed.

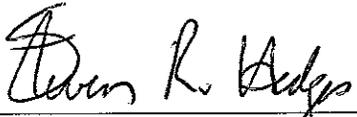
Furthermore, the Trial Court's Order was fatally flawed in that its core premise – that the UCC applies to this case and that it preempts the Uniform Fiduciaries Act – is contrary to the clear wording of UCC §3-307 and to directly applicable cases from other jurisdictions interpreting the same uniform laws.

Accordingly, Appellant respectfully requests that the District Court Judgment be vacated, and that its Order be reversed and the case remanded.

Respectfully submitted,

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JAMES H. GILBERT LAW GROUP, P.L.L.C.

By 
Steven R. Hedges (I.D. No. 43199)
10159 Wayzata Boulevard, Suite 250
Minnetonka, MN 55305
(952) 960-4200

ABDO, ABDO, BROADY &
SATORIUS, P.A.
Keith J. Broady (I.D. 120972)
Timothy C. Matson (225423)
710 Northstar West
625 Marquette Avenue
Minneapolis, MN 55402
(612) 333-1526
Attorneys for Appellant

The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).