

WHETHER UCC ARTICLE 4 IN TEXAS PREEMPTS COMMON LAW FRAUD AND BREACH OF CONTRACT CLAIMS IN THE RELATIONSHIP BETWEEN A BANK AND ITS CUSTOMER

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Am. Dream Team, Inc. v. Citizens State Bank, 481 S.W.3d 725 (Tex. App.—Tyler 2015, pet. denied).

INTRODUCTION

American Dream Team, Inc. (“ADT”) filed suit against Citizens State Bank (“Bank”) alleging that Bank had improperly charged back \$30,000.00 against its account for a provisional credit extended on a counterfeit check.¹ The trial court granted summary judgment to Bank, and ADT appealed.² There are two pertinent issues in this review: (1) whether Uniform Commercial Code Article 4 (the “Code”) preempts a claim of common law fraud when looking at a communication between a bank and its customer;³ and (2) whether the Code preempts common law rules concerning breach of contract.⁴ The Tyler Court of Appeals (the “Court”) held that: (1) if the Code is silent on an issue, common law may supplement the Code;⁵ and (2) the Code preempts common law breach of contract claims.⁶

BACKGROUND

ADT is a real estate brokerage firm specializing in selling properties in the Cedar Creek Lake area of Henderson County, Texas.⁷ On January 23, 2010 ADT received an email from a person named Mr. Yang Hua Lopez (“Lopez”), who alleged he was a Chinese business man searching for a retirement home in Texas.⁸ ADT supplied Lopez with a list of properties and he swiftly decided on a particular property in Lewisville, Texas.⁹ Through multiple email communications, Lopez confirmed his down payment had been sent to ADT, when it, in fact, had not.¹⁰ Lopez was also asked to sign ADT’s representation agreement but failed to do so.¹¹ Via UPS, ADT eventually received a check from Lopez for \$30,000.00 in order to secure the down payment on the property.¹² The check’s drawer was a Canadian insurance company with the payer bank being the Bank of Montreal in Toronto, Ontario.¹³ ADT’s vice president was told by Banks’s branch manager that because the check was drawn on a foreign bank, it could

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¹ Am. Dream Team, Inc. v. Citizens State Bank, 481 S.W.3d 725, 728 (Tex. App.—Tyler 2015, pet. denied).

² *Id.* at 728.

³ *Id.* at 734–36.

⁴ *Id.* at 732.

⁵ *Id.* at 736.

⁶ *Id.* at 732.

⁷ *Id.* at 728.

⁸ *Id.*

⁹ *Id.* at 729.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

take between one and two months for the funds to be collected.¹⁴ As a result, ADT was offered a provisional credit for the check, pending collection.¹⁵ ADT elected to accept this provisional credit, and the funds were immediately available for use under its deposit agreement with Bank.¹⁶

On March 1, ADT was told by a Bank employee, after she had looked on her computer, that, “the funds were there” and “it looks like they’re good.”¹⁷ The following day, an ADT employee told a Bank teller that he wanted to wire \$30,000.00 to a bank in Japan.¹⁸ Before sending the wire, the employee told the teller that he wanted to make sure that the check from Lopez had cleared.¹⁹ He testified that the teller looked at her computer screen and responded “yes.”²⁰ The money was wired to Tokyo that day.²¹ On March 15, Bank and ADT were notified that the check was counterfeit.²² Attempts were made to recover the \$30,000.00 wired to the Tokyo bank, but to no avail.²³ Bank then made a chargeback against ADT’s escrow account for \$30,000.00.²⁴ ADT later filed suit against Bank to recover the \$30,000.00 chargeback. ADT brought actions for:

- I. common law fraud;
- II. breach of contract (the deposit agreement);
- III. negligent misrepresentation and conversion;
- IV. violations of the Deceptive Trade Practices Act (DTPA);
- V. money had and received; and
- VI. promissory estoppel.²⁵

The trial court ruled in favor of Bank on all claims and ADT appealed.²⁶

ANALYSIS

I. Does Code Article 4 Preempt Common Law Fraud Claims?

ADT asserts that its fraud claim, which was based on the statements made by Bank’s two

¹⁴ *Id.* at 729–30.

¹⁵ *Id.* at 730.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

employees during the check settlement process, was not preempted by the Code.²⁷ The trial court granted summary judgment on Bank's affirmative defense reasoning that the Code preempts common law fraud claims.²⁸ Chapter 4 of the Code specifies duties and responsibilities for a bank in the actual check processing procedure.²⁹ However, the Code is silent about the bank's communications with the customer during this period.³⁰ The Court looked to the Official Comments of the Texas Business and Commerce Code to provide guidance on the issue:

The Uniform Commercial Code was drafted against the backdrop of existing bodies of law, including the common law and equity, and relies on those bodies of law to supplement it [sic] provisions. . . . Therefore, while principles of common law and equity may supplement provisions of the Uniform Commercial Code, they may not be used to supplant its provisions, or the purposes and policies those provisions reflect³¹

The Comment supports the contention that common law may supplement but not supplant the Code.³² Moreover, the Code specifically describes fraud as a cause of action that can be used to supplement its provisions.³³ In this instance, the Code provisions did not address alleged misrepresentations about the check settlement process.³⁴ Accordingly, the Court followed a Montana Supreme Court opinion, which held that common law principles apply when a bank communicates with a depositor who has inquired about the check processing procedure.³⁵ This holding reversed the trial court's grant of summary judgment on Bank's affirmative defense of Code preemption as asserted against ADT's common law fraud claim.³⁶

A. *Unjustified Reliance*

ADT argued that Bank made fraudulent statements when communicating whether the fraudulent check had cleared.³⁷ A plaintiff seeking to prevail on a common law fraud claim must prove, among other elements, that the plaintiff suffered an injury by actively and justifiably relying on the fraudulent representation.³⁸ The Texas Supreme Court has held that a person may not justifiably rely upon a representation if there are "red flags" indicating reliance

²⁷ *Id.* at 734–36.

²⁸ *Id.* at 736.

²⁹ *Id.* at 736.

³⁰ *Id.*

³¹ *Id.* at 735 (quoting TEX. BUS. & COM. CODE ANN. § 1.103(b) (West 2009) (emphasis added)).

³² *Am. Dream Team*, 481 S.W.3d at 735.

³³ *Id.* at 736.

³⁴ *Id.*

³⁵ *Id.* (citing *Valley Bank of Ronan v. Hughes*, 147 P.3d 185, 191 (Mont. 2006) (holding because bank communications to the customer in the check processing procedure are not addressed with specificity by the Code, common law and equitable principles supplement the Code and govern the legal rights and responsibilities that apply to a Bank's representations to its customer)).

³⁶ *Am. Dream Team*, 481 S.W.3d at 736.

³⁷ *Id.* at 737–38 (ADT was told by a Bank employee, after being asked if the check had cleared, that "the funds were there" and "it looks like they're good." Another Bank employee also allegedly told ADT the check had cleared when asked the next day).

³⁸ *Id.* at 737 (citing *Exxon Corp. v. Emerald Oil & Gas Co., L.C.*, 348 S.W.3d 194, 217 (Tex. 2011)).

is unwarranted.³⁹ In the instant case, the Court reasoned that ADT disregarded numerous red flags arising from the dealings with Lopez.⁴⁰ ADT appeared to accept the implausible name, conflicting messages, inconsistent numbers on the check, unusual circumstances, and absence of key documents at face value—rather than probing further into these red flags to determine if there was a legitimate transaction.⁴¹ Consequently, the Court found that there was no evidence of justifiable reliance on Bank’s representations and concluded that ADT could not prevail on the common law fraud claim.⁴²

II. Does Code Article 4 Preempt Common Law Breach of Contract Claims?

On the second issue, ADT alleged that Bank’s withdrawal of funds from ADT’s account was a breach of the deposit agreement and, as a result, Bank breached its common law duty to perform.⁴³ In Texas, the Code regulates a bank’s handling of deposits and collections for its customers.⁴⁴ The agreements between a bank and its customer will also, in part, govern the relationship.⁴⁵ However, when the Code applies to this bank-customer relationship, common law rules regarding breach of contract will not be applicable.⁴⁶

In rejecting ADT’s breach of contract argument, the Court reasoned that “[w]here the UCC applies, common law rules regarding breach of contract do not apply”⁴⁷ and “when the UCC applies, *common law claims that conflict with the UCC are precluded.*”⁴⁸ The Court found that in the present case—where a chargeback has occurred—the applicable Code provisions are implicated.⁴⁹

Any cause of action ADT had for breach of contract was preempted by the Code and as a result, when the fraudulent check was determined to be counterfeit, Bank was authorized by the Code to effectuate a chargeback.⁵⁰

III. Other Holdings

ADT also brought an action for promissory estoppel.⁵¹ ADT alleges that Bank consented

³⁹ *Am. Dream Team*, 481 S.W.3d at 740 (citing *Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 923 (Tex. 2010)).

⁴⁰ *Am. Dream Team*, 481 S.W.3d at 740–41.

⁴¹ *Id.* (A Chinese business man (CFO) named “Lopez” who purportedly could only communicate through email due to his poor English, assertions that deposit money had been sent when it had not, the check that had inconsistent numbers spelled out in words compared to the numerals, a check from an insurance company in Canada without explanation, and failure to sign the requested representation agreement were red flags that should have put ADT on alert).

⁴² *Id.* at 741.

⁴³ *Id.* at 732.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* (emphasis added).

⁴⁹ *Id.* (citing TEX. BUS. & COM. CODE ANN. § 4.214(a) (West 2009)).

⁵⁰ *Am. Dream Team*, 481 S.W.3d at 732.

⁵¹ *Id.* at 733.

to inform ADT if the check was not good and was damaged when it relied on Bank employees' statements that the check was good.⁵² The Court promptly affirmed the trial court's holding, reasoning that "if an alleged promise is part of a valid contract [the deposit agreement], the promisee cannot disregard the contract and sue for reliance damages under the doctrine of promissory estoppel."⁵³ Additionally, the Court affirmed the trial court's ruling that ADT's negligent misrepresentation and conversion, as well as their DTPA action, were barred by the statute of limitations.⁵⁴ Furthermore, the Court found that the trial court properly granted summary judgment in favor of Bank on ADT's claim for money had and received.⁵⁵ The Court reasoned that "this common law cause of action has been supplanted by Chapter 4 of the UCC."⁵⁶

CONCLUSION

The Court ultimately affirmed the trial court's judgment.⁵⁷ The Court's holding sustains the established principle in Texas that the Code preempts common law causes of action that attempt to supplant the provisions of the Code. However, common law may still play an important role in supplementing the Code—when appropriate. As a practitioner, it is important to keep in mind that the Code provisions may sometimes be difficult to apply to every factual permutation—such as fraud in the check processing procedure—and in these particular instances, the courts may supplement the Code with common law principles. Still, common law principles inconsistent with the purposes and policies of the Code will not likely be considered by the courts.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.* at 733–34.

⁵⁵ *Id.* at 733.

⁵⁶ *Id.*

⁵⁷ *Id.* at 742.