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IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

CERTIFICATION FROM THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WASHINGTON

TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA, as
Assignee and Subrogee of Skils'Kin,

Plaintiff,

v.

WASHINGTON TRUST BANK,

Defendant.

PLAINTIFF TRAVELERS CASUALTY AND SURETY COMPANY OF
AMERICA'S REPLY BRIEF ON CERTIFIED QUESTIONS

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ARGUMENT

I. The Court Should Answer “No” to Certified Question No. 1 Because § 4-406(f) Imposed No Notice Requirement on Skils’Kin

Certified Question No. 1 asks whether Patterson’s signatures on the backs of the checks imposed on Skils’Kin the notice requirements of § 4-406(f).¹ The Court should answer “no” because (1) the customer notice requirements under § 4-406(f) depend on the nature of the customer’s claim against the bank, and the nature of Travelers’ claim on these checks does not trigger the notice requirement however one categorizes Patterson’s signatures; and (2) Patterson’s signatures on the backs were not unauthorized alterations, indorsements or customer signatures.²

A. Under § 4-406(f), the Basis of Travelers’ Claim Matters

The Bank principally argues that the underlying basis for Travelers’ 4-

¹ This brief refers to Washington’s enactment of the Uniform Commercial Code (“UCC”) by reference to the section number only. For example, “§ 4-406(f)” refers to RCW 62A.4-406(f). When the context requires, the section citation also refers to the uniform version of the UCC. § 4-406 is reprinted in the appendix to this brief.

² For whatever reason, the Bank does not even begin to address Certified Question No. 1 until page 27 of its brief – *after* addressing Question No. 2. Under the certification order, however, if the Court answers “no” to Question No. 1 it need not even address Question No. 2. Moreover, in a grand effort at obfuscation, the Bank devotes substantial portions of its brief to issues that are not before this Court but remain pending for trial in the district court, including: whether the Bank made statements and items available to Skils’Kin through non-electronic means, whether a Bank must act in good faith to raise a § 4-406(f) defense, whether the checks were properly payable to Patterson on the ground that she had authority to cash them, and whether there was any agreement between the Bank and Skils’Kin that allowed Patterson to cash the payees’ checks. (WTB’s Brief, pp. 16-18, 26-27, 29-32, 43-47) The Court should disregard these arguments.

401(a) claim does not matter because, whatever the basis, § 4-406(f) precludes a customer from pursuing “any action premised upon *unauthorized withdrawals*” if the customer does not report an alleged unauthorized indorsement on the item in question – even if the customer’s claim does not require the customer to “assert[] against the bank” (§ 4-406(f)) the alleged unauthorized indorsement. (WTB’s Brief, pp. 32-33, italics added)

The Bank’s phrasing of this argument betrays a conscious effort to avoid the actual statutory language. § 4-406(f) manifestly does not preclude an “action premised upon unauthorized withdrawals” as the Bank argues. (WTB’s Brief, pp. 32-33) It only precludes a customer “from asserting against the bank” an unauthorized alteration, indorsement or customer signature. § 4-406(f). The statute has no preclusion against asserting a claim that a payment (or a “withdrawal”) was improper for any other reason.³

The Bank’s argument is a tortured misreading of § 4-406(f) and, to our knowledge, no court in the country has ever interpreted the statute in this fashion in the fifty-four years since Article 4 was drafted.⁴ Significantly, WTB cites no case anywhere in its brief holding that § 4-406(f) precludes a

³ The transactions in this case were not even “withdrawals,” but check payments. Checks are not withdrawal slips.

⁴ The drafters of the UCC first promulgated Articles 3 and 4 in 1962. These articles were comprehensively revised in 1990. The 1962 version of § 4-406(4) was restyled as § 4-406(f) in 1990, with modified language. For ease of reference, this brief’s reference to “§ 4-406(f)” also refers to the 1962 version of § 4-406(4) unless the context requires otherwise.

customer from pursuing a claim against a bank under § 4-401(a) where the claim does not depend on an unauthorized alteration, indorsement or customer signature.

Courts routinely refuse to apply § 4-406(f) to such claims, even when the customer could have discovered the unauthorized withdrawal by reviewing its bank statements or canceled checks. (Travelers' Opening Brief, pp. 24-25) In each of these cases, it made no difference to the court that the customer could have discovered and reported the "unauthorized withdrawals" (to use WTB's language) by reviewing bank statements and canceled items.

The Bank tries to distinguish *Ford Motor Credit Co. v. United Services Automobile Ass'n*, 11 UCC Rep. Serv. 361, 1972 WL 20865 (N.Y. City Civil Ct. 1972), because the case involved an "isolated incident" and because the customer was not negligent. (WTB's Brief, p. 34) These are false distinctions. The rule applies even when there is a long-term employee embezzlement and when the employer was arguably negligent in failing to catch the embezzlement. *E.g. Smith Barney, Harris Upham & Co. v. Citibank*, 162 A.D.2d 108, 109, 556 N.Y.S.2d 61, 63 (1990). Furthermore, the bank in *Ford Motor Credit Co.* did in fact argue that its customer negligently failed to discover and report the wrongful payment – that is precisely the point of every 4-406(f) defense.

The Bank also argues that "this is not a case about a missing

indorsement.” (WTB’s Brief, p. 34 n.76) Not so – if the payees had indorsed the checks, then the checks would have been negotiated to Patterson, she would have been a person entitled to enforce them, and Travelers would not have filed this lawsuit.⁵

Travelers Indem. Co. v. Scalea, No. 85 Civ. 0400 (WK), 1987 U.S. Dist. LEXIS 11440 (S.D.N.Y. 1987), also exemplifies that § 4-406(f) does not apply when the customer’s claim does not depend on unauthorized alterations, indorsements or customer signatures. In that case, over *eighteen months*, the customer failed to discover from its bank statements that its bank had repeatedly debited its account for unauthorized withdrawals. *Id.* at *3-5. Like WTB, the bank in *Scalea* argued “that the drafters of the U.C.C. could not have intended to discharge a customer from his duty to examine his statement merely upon the absence of any forgery or alteration.” *Id.* at *17. The court rejected this argument as inconsistent with the text of the statute. *Id.* at *17-18 (citing *G & R Corp. v. American Sec. & Trust*, 523 F.2d 1164, 1170 (D.C.

⁵ The Bank refers to a comment under § 3-405 to argue that employers should bear losses from fraudulent employees. (WTB’s Brief, p. 25) The Bank apparently did not read § 3-405 before making this argument. Under § 3-405(c), if an employee with responsibility for a check fraudulently indorses the check, the indorsement is nonetheless effective *but only when the indorsement is in a name “substantially similar” to the name of the payee*. Patterson signed her own name, which was *not* substantially similar to the names of any of the payees. Thus, even if § 3-405 applied, the Bank would bear the entire loss for Patterson’s fraud. § 3-405 demonstrates that the UCC quite intentionally allocates the loss to the bank when the bank throws caution to the wind and transacts checks bearing an obvious mismatch between the payee and the indorser.

Cir. 1975)).

The crooked employee in *Scalea* made only an “oral request” for the wrongful payments (WTB’s Brief, p. 33), but so did Patterson: she *orally* requested the tellers to pay the checks to her rather than to the payees. The checks had no indorsements in the names of the payees purporting to authorize the payments, so the Bank paid the checks “at its peril.” *Smith Barney*, 162 A.D.2d at 109, 556 N.Y.S.2d at 63; *Tonelli v. Chase Manhattan Bank, N.A.*, 41 N.Y.2d 667, 670, 363 N.E.2d 564, 567 (1977).

The Bank also tries to distinguish *DelJack, Inc. v. U.S. Bank Nat’l Ass’n*, 2012 WL 4482049 (D. Idaho 2012), where for at least *three years* the bank had cashed for a customer’s employee 127 checks that the employer had made payable to “cash” even though the customer had restrictively indorsed each check “for deposit only.” But the court rejected the bank’s 4-406 defense and account agreement argument as a matter of law even though the employer never noticed that its monthly bank statements showed the payment of the checks but no corresponding deposit. *Id.* at *11-12.

Like the employer’s claim in *DelJack*, Travelers’ claim is not subject to a 4-406 defense because Travelers claims that the checks were not properly payable to Patterson for a for a reason other than unauthorized alterations, indorsements or customer signatures. The bank in *DelJack* should have paid the employer by complying with the restrictive indorsement rather than paying

the employee, just as WTB should have paid the payees by complying with the payee lines on the checks rather than paying Patterson – whether or not the frauds might have been discovered by reviewing statements or canceled checks.

The Bank cites only one case in an effort to support its argument, *Wetherill v. Putnam Invs.*, 122 F.3d 554 (8th Cir. 1997). The case does not hold, as WTB argues, that all unauthorized withdrawals are subject to § 4-406(f) regardless of whether the customer is asserting against the bank an unauthorized indorsement. *Wetherill* merely holds that § 4-406(f) applies to common law claims against a bank as well as to claims under the UCC. *Id.* at 558. The court stated that the text of § 4-406(f) “bars the bank’s liability *in the relevant circumstances*, regardless of the theory on which the customer is relying.” *Id.* (emphasis added). The “relevant circumstances” in that case were that the bank wrongfully paid checks because they bore *forged drawer-customer signatures*, which are “circumstances” explicitly listed in the statute. *Id.* at 556. *Wetherill* does not even remotely suggest that § 4-406(f) might apply when the customer’s claim is premised on *other* circumstances *not* listed in the text of the statute. “The listing of certain defenses by UCC § 4-406 is to be strictly construed and does not include any defense not specified in that section.” 6C DAVID FRISCH, ANDERSON ON THE COMMERCIAL CODE § 4-406:4 (3d ed.).

As WTB itself points out (WTB's Brief, p. 29), clear statutory language controls. "When the words in a statute are clear and unequivocal, this [C]ourt is required to assume the Legislature meant exactly what it said and apply the statute as written." *In re Recall of Pearsall-Stipek*, 141 Wash.2d 756, 767, 10 P.3d 1034, 1041 (2000) (citation omitted). As written, the statute does not apply to claims like this one, where Travelers is not "asserting against the bank" anything the statute precludes it from asserting. § 4-406(f).

B. Travelers Does Not, and Need Not, Base Its Claim on Unauthorized Indorsements

Alternatively, the Bank devotes a scant three sentences of its brief to arguing that, even if the basis of Travelers' claim determines whether § 4-406(f) applies, the claim must depend on Patterson's authority to sign the backs. (WTB's Brief, pp. 28 & 34) Confusingly, the Bank argues that, if the payees had authorized Patterson to cash their checks, Travelers' claim must depend on whether her signature was authorized. (WTB's Brief, p. 28) This argument is incoherent. To begin with, whether Patterson had authority is an issue awaiting trial and is not before this Court. Even so, if the payees had authorized Patterson to cash the checks, then the checks were arguably properly payable. It makes no sense to say that Travelers' claim depends on facts that arguably disprove the claim. Most fundamentally, the Bank never

explains what any of this has to do with Patterson's signatures. Either the payees authorized Patterson to cash their checks or they did not. The parties dispute whether Patterson had check-cashing authority, not whether she could sign her name on the backs. If Patterson had *never* signed the backs and the Bank had paid her anyway, the dispute would be identical.⁶

The Bank completely misses the point of *Tonelli*. The case illustrates the fundamental principle of commercial paper that a check is not properly payable to a presenter who is not the payee or indorsee. 41 N.Y.2d at 669, 363 N.E.2d at 566. That the court referred to the crook in that case as a "messenger" rather than an "employee" and that the crook was not an agent of the payee has no bearing on this rule of law. (WTB's Brief, at 32).⁷

The Bank cites § 3-401(a) and § 3-402(a) for the proposition that

⁶ A check does not need to have an unauthorized indorsement to be not "properly payable" under § 4-401(a); it only needs to be not authorized by the customer or not in accordance with an agreement between the customer and the bank. § 4-401(a). § 4-401(a) does not even *mention* indorsements.

⁷ The Bank's two other efforts to distinguish *Tonelli* reflect a misunderstanding of the UCC. (WTB's Brief, p. 32) First, the *Tonelli* court indeed noted that the customer had not authorized the messenger to issue checks, but only as a basis for not applying old UCC § 3-405, which was recodified in the 1990 UCC amendments as § 3-404. Whether the Bank has a defense under § 3-404 is still pending before the district court. Furthermore, the Bank has conceded that Patterson was not a holder of the checks (WTB's Brief, p. 35 n.77), which is the benefit of a 3-404 defense in the first place. The Bank also points to the *Tonelli* court's statement that the case did not involve a negligent drawer who contributed to the alteration of a check or the making of an "unauthorized signature." 41 N.Y.2d at 673, 363 N.E.2d at 568. The court made this point to explain why old UCC § 3-406 did not apply. *Id.* In the 1990 amendments to § 3-406, however, "unauthorized signature" was changed to "forged signature." This case does not involve forged signatures, the Bank has never raised a § 3-406 defense, § 3-406 does not apply by its terms, and whether Skils'Kin was negligent is not before this Court.

Travelers' claim "must turn on whether Patterson's signature was authorized on the payees' behalf." (WTB's Brief, p. 28) These UCC sections merely stand for the uncontroversial proposition that a person is not liable on an instrument unless he signed it, either personally or through a representative who would be authorized to do so under the law of contract. This case, however, raises no issue as to whether a person is liable on any instrument. How the Bank perceives some connection between these Code sections and its argument that Travelers' claim "must turn on whether Patterson's signature was authorized on the payees' behalf" (WTB's Brief, p. 28) is nothing short of mystifying.

C. Patterson's Signatures on the Backs Were Not Indorsements

§ 3-204(a) states that a signature on an instrument is an indorsement if the signer signed for one of three purposes of an indorsement listed in the statute. The Bank completely ignores two of these purposes (to restrict the form of payment and to incur indorser's liability). (WTB's Brief, pp. 35-37)

With regard to the third purpose, *i.e.* to negotiate the checks, the Bank apparently does not understand why the very idea that Patterson might have been negotiating the checks to the Bank makes no sense. (WTB's Brief, p. 36 n.79) The entire point of a negotiation is for the *holder* to convey to an *indorsee* the right to enforce the check against the *drawee*. Even if Patterson

signed her name as an agent of the payees, she manifestly and obviously was not doing so to make the Bank an indorsee with the right to enforce the checks. The very idea is absurd – the Bank was itself the drawee and had just paid the checks in cash to Patterson. It obviously was not planning to pay the same checks again, some time in the future, to itself. Indeed, the first certified question states that the checks were “presented for payment” to the Bank, not negotiated to the Bank. Presentment is not negotiation. (Travelers’ Opening Brief, pp. 29-30)

The Bank points to a few checks (which are not part of Travelers’ claim) that were payable to its clients and negotiated (deposited) to the Bank by Skils’Kin for the client’s benefit. (WTB’s Brief, p. 37 & n.80) The Bank does not appreciate that these checks hurt rather than help its argument. Each check was drawn on *another* bank and was *negotiated* (with authority from the payees) to WTB for deposit. Of course Skils’Kin’s stamp on the backs of these checks was an indorsement: the checks were *negotiated* to the Bank as the depository bank rather than *presented* to the Bank as the drawee/payor, and negotiation is one of the three specified purposes of indorsements under § 3-204(a). The checks at issue in this case are fundamentally different because they were all drawn on and paid by WTB without any negotiation requiring an indorsement.

The Bank relies solely on the rebuttable presumption in § 3-204(a) that

a signature on the back of a check is presumed to be an indorsement, but cannot avoid Travelers' argument that the presumption is rebutted under the undisputed facts of this case. A signature is *not* an indorsement when the "circumstances unambiguously indicate that the signature was made for a purpose other than indorsement." § 3-204(a). The first certified question describes the relevant "circumstances" that establish unequivocally that Patterson signed the backs for a purpose other than to indorse.⁸ No other potential purpose is even remotely possible – even the Bank's own expert witness offered no contrary explanation. Furthermore, the Bank's own teller manual lists six categories of indorsements, none of which even arguably apply to Patterson's signatures on the backs. (TEL-202, ECF No. 86-8, App. Ex. 6, pp. A415-A417; ECF No. 86-10, App. Ex. 18, pp. A502-A-503, 49:18-51:8; ECF No. 86-10, App. Ex. 17, pp. A491-A493, 33:14-23, 35:25-37:1) Tellingly, the Bank concedes that the only relevant "circumstance" is that it "understood that Patterson signed each check so she could obtain money on behalf of the client payees" (WTB's Brief, pp. 36-37) Exactly – that is a receipt.⁹

⁸ The checks were "presented for payment" (rather than deposited or otherwise negotiated); the checks bore "no signature in the name of the payee" on the back; and WTB, as the drawee/payor bank, paid the checks "over the counter, in cash" to Patterson. (Certified Question No. 1)

⁹ The Bank argues that we will never have direct evidence of Patterson's intent because she has died, but the statute does not require live testimony of intent. Also, on page 25 of its brief, the Bank misquotes Official Comment 1 to § 3-204.

Finally, the Bank argues that a drawee may return an instrument after presentment for lack of a necessary indorsement. (WTB's Brief, p. 37) *That is precisely what the Bank should have done with these checks!* The checks lacked a necessary indorsement, *i.e.* the indorsements of the payees, so the Bank should have returned them unpaid to Patterson.

II. The Bank Did Not Make the Statements and Checks Available Electronically to Skils'Kin Because Skils'Kin Never Agreed to Accept Them Electronically

If the Court addresses the second certified question, the Court should answer "no" based on the record of this case, which establishes that the Bank did not make the statements and items available to Skils'Kin electronically because Skils'Kin never agreed to review statements and items electronically.

Notably, the Bank does not disagree with Travelers' legal point that a customer must agree to receive and review statements and items electronically before the bank can invoke a defense under Section 4-406 on this ground.

Consistently, the Bank does not even attempt to distinguish *Robinson Motor Xpress, Inc. v. HSBC Bank, USA*, 37 A.D.3d 117, 826 N.Y.S.2d 350 (2006),

The comment actually states: "If the signature is not qualified in any way and appears in the place normally used for indorsements, it may be an indorsement even though the signer intended the signature to be a receipt." § 3-204 Official Cmt. 1. Whether such a signature is a receipt or an indorsement, however, turns on the signer's intent, which "may be determined by words accompanying the signature, the place of signature or *other circumstances*." *Id.* (emphasis added). Under the circumstances of this case, it is simply inconceivable that Patterson could have intended to indorse the checks because none of the three purposes of indorsements even arguably applies.

or *First Citizens Bank of Clayton County v. All-Lift of Georgia*, 251 Ga. App. 484, 555 S.E.2d 1 (2001). Statements are not “available” to the customer under § 4-406 just because the customer happens to have an on-line banking account any more than statements are “available” to the customer just because it happens to have another office to which the bank sent the statements. *See Robinson Motor Xpress, Inc.*, 37 A.D.3d at 120-21, 826 N.Y.S.2d at 353-54. “Availability” depends on whether the bank provides statements and items to the customer by a method that the customer “had designated for that purpose.” *Id.*, 37 A.D.3d at 120, 826 N.Y.S.2d at 354.

Rather than contesting Travelers’ legal point, the Bank argues that Skils’Kin agreed to receive and review statements and items electronically. (WTB’s Brief, pp. 19-20) The Bank is incorrect. The Bank points to the Master Commercial Services Agreement and an addendum thereto. Neither of these documents says anything about Skils’Kin agreeing to receive and review statements and paid items electronically. (ECF No. 90-2)

The Bank argues that Skils’Kin’s enrollment in two banking services, eBusiness Express and Positive Pay, made the checks available to Skils’Kin electronically. However, Skils’Kin signed no eBusiness Express or Positive Pay agreement stating that it agreed to examine statements and items for unauthorized alterations, indorsements or customer signatures through these services.

Even so, according to Janeen Van Slyke, the Bank's Vice President and Director of Risk Management, eBusiness Express provided access to statements *but not canceled checks*. (ECF No. 90, ¶ 8 (stating only that eBusiness Express gave Skils'Kin electronic access to "statements" and not mentioning canceled checks)) The issue in this case hinges on the canceled checks, not the statements. The Bank claims that Patterson's signatures on the backs were unauthorized indorsements that Skils'Kin should have discovered and reported, but the statements did not contain images of the backs.

Positive Pay does not help the Bank either. The Bank's Positive Pay system allowed Skils'Kin to upload to the Bank the data contained in its check register (check number, payee, date and amount of the check). Once checks were presented for payment, the system compared the data on the check as presented with the data uploaded by Skils'Kin. (ECF No. 91-8, p. 59) *See Thompson v. First BankAmericano*, 518 F.3d 128, 135 (2d Cir. 2008) (describing a positive pay system). The system *only* alerted Skils'Kin if there was a discrepancy between the data about a check that Skils'Kin had uploaded and the check as presented. (ECF No. 91-8, p. 59) The record contains no evidence that Positive Pay alerted Skils'Kin to any of the checks at issue, which makes sense because there is no evidence of any discrepancies regarding check numbers, payees, date or amounts. Positive Pay is simply not designed to alert customers to frauds like that this. *See* 1 CLAYTON P.

GILLETTE, DEPOSIT ACCOUNT FRAUD PROTECTION § 2.08[2][a] (LexisNexis Sheshunoff 2014) (“[A] check bearing a forged indorsement is not properly payable from the customer’s account. Nevertheless, that forgery will not be caught by positive pay”).¹⁰

The Bank offers no valid distinction of *Elden v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 2011 WL 1236141 (S.D.N.Y. 2011). The Bank argues that the bank in *Elden* “did not send actual copies of the items to its customer, unlike WTB.” (WTB’s Brief, p. 20) But WTB also did not send copies of the items to Skils’Kin; it only sent images of the *fronts* of the items. Skils’Kin cannot be faulted for not catching allegedly unauthorized indorsements when the Bank never sent images of the backs of the checks, where indorsements are.

The Bank also argues that New York’s version of § 4-401(a) refers to statements “and items” while Washington’s only refers to “statements.” The Bank overlooks, however, that the preclusion at issue in § 4-406(f) requires a bank to make both “statements and items” available to the customer in both Washington and New York. § 4-406(f); N.Y. CLS UCC § 4-406(4). *See also Clemente Bros. Constr. Corp. v. Hafner-Milazzo, N.A.*, 23 N.Y.3d 277, 285-

¹⁰ While a customer apparently could review copies of the backs of the checks within the Positive Pay system, these were made available before payment and thus were not the “items paid” as § 4-406(a) required. (ECF No. 91-8, pp. 58-60) § 4-406(a). Furthermore, Skils’Kin allegedly agreed to review its statements and the partial images of canceled checks that the Bank provided with the statements, but never agreed to use Positive Pay for this purpose.

86, 14 N.E.3d 367, 371-72 (2014) (New York’s version of § 4-406(f) requires the bank to make items as well as statements reasonably available to the customer). The Bank cites *Clemente Bros. Constr. Corp.*, but the case did not address electronic access, and favorably cites *Elden* for the proposition that the bank in *Elden* did not make canceled checks reasonably available by making them available electronically. 23 N.Y.3d at 286, 14 N.E.2d at 371.¹¹

Finally, the Bank asserts that federal banking regulations “provide an entire system of adequate protections for consumers regarding whether a bank can provide paper or electronic copies.” (WTB’s Brief, p. 22) However, the Bank only cites Federal Reserve Board Regulation DD, which was repealed years ago (*see* 12 C.F.R. § 230.6), and Bureau of Consumer Financial Protection Regulation E, which says nothing about paper versus electronic copies of statements. 12 C.F.R. § 1005.9.

III. WTB Failed to Exercise Ordinary Care

A. This Case Presents No Issue Under § 4-406(e)

Preliminarily, the Bank misunderstands the relevance of a holding that

¹¹ The Bank cites other cases that are all inapposite. (WTB’s Brief, pp. 21-22) None of the cases depended on the customer having electronic access to statements and items, because the banks had also made paper versions of the documents available to the customer as agreed. In the present case, where the Bank invokes § 4-406 exclusively on the ground that Skils’Kin should have reported Patterson’s signatures on the backs of the checks, the Bank never included copies of the backs of the checks with Skils’Kin’s statements.

it failed to exercise ordinary care. If Travelers prevails on its claim that the checks are not properly payable, the Bank is strictly liable and ordinary care does not matter. *Travelers Cas. & Sur. Co. of Am. v. Wells Fargo Bank N.A.*, 374 F.3d 521, 525 (7th Cir. 2004) (“ordinarily a bank is strictly liable for charging a customer’s account with an amount that the customer had not authorized the bank to pay” under § 4-401(a)); *Woods v. MONY Legacy Life Ins. Co.*, 84 N.Y.2d 280, 283-84, 641 N.E.2d 1070, 1071 (1994) (“The UCC imposes strict liability on a bank that charges against a customer’s account any item not properly payable”) Whether the Bank failed to exercise ordinary care is only relevant in this case if the Bank has a defense under § 3-404 (which it does not). (Travelers’ Opening Brief, p. 19 n.2)

Contrary to the Bank’s argument (WTB’s Brief, p. 39), there is no “ordinary care” issue under §§ 4-406(d) or (e) under the facts of this case. By their terms, these subsections only potentially apply when a check has an “alteration” or a “customer’s unauthorized signature.” § 4-406(d)(1) & (2) (emphasis added). The Bank concedes that this case does not involve alterations and completely ignores Travelers’ point in its opening brief that Patterson’s signature was not an unauthorized customer signature. When applicable, § 4-406(e) requires a comparative negligence analysis, but it does not apply to checks bearing unauthorized indorsements but no alterations or

unauthorized customer signatures.¹²

B. Patterson Was Not a Non-Holder With the Rights of a Holder

Confusing multiple concepts under the UCC, the Bank argues that Patterson had the right to enforce the checks even though she was not a holder because (1) the Skils’Kin clients were holders, (2) she was the agent of the clients, and thus (3) she was a non-holder with the rights of a holder under § 3-301(ii). (WTB’s Brief, p. 41) This is not an argument as to ordinary care, so it is not clear what the argument has to do with the third certified question. Regardless, the Bank is wrong.

Putting aside for the moment that some of the payees *were not* Skils’Kin clients (so Patterson could not have been an agent of those payees even under the Bank’s reasoning), the Bank’s argument necessarily fails

¹² Confusingly, the Bank argues that “indorsements” are a type of “signature,” Patterson’s signatures on the backs were unauthorized, and thus Patterson’s signatures on the backs were “unauthorized signatures.” (WTB’s Brief, pp. 37-39) But §§ 4-406(c), (d) and (e) do not apply to all checks with “unauthorized signatures.” They only apply to checks where the customer claims the payment was not authorized “because of an alteration of an item or because a purported signature *by or on behalf of the customer* was not authorized.” § 4-406(c) (emphasis added). See *Murray Walter, Inc. v. Marine Midland Bank*, 103 A.D.2d 466, 467-68, 480 N.Y.S.2d 631, 632 (1984) (§ 4-406 “pertains to a customer’s obligation to detect a forgery of his own signature, or other alteration, and does not extend to an instance of a missing indorsement”) (citations omitted); 2 BARKLEY CLARK & BARBARA CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS § 12.02 (LexisNexis A.S. Pratt 2016) (§§ 4-406(c), (d) and (e) do “not apply to the forged indorsement situation, referring only to the ‘unauthorized signature’ of the drawer or ‘any alteration’”). Travelers’ claim that the payments were not properly payable does not depend on alterations or unauthorized signatures of Skils’Kin, so § 4-406(c), and therefore §§ 4-406(d) and (e), do not apply.

because it does not satisfy the elements of § 3-301(ii). § 3-301(ii) applies when someone other than the issuer of an instrument transfers the instrument to a third party with the intention of vesting the third party with rights to enforce it. §3-301(ii).¹³ No one ever transferred the checks to Patterson with the intent of giving her the right to enforce them, and Skils'Kin was the issuer of each check. § 3-301(ii) facilitates the purchase and sale of notes and other instruments by vesting the right to enforce with the purchaser. That has nothing to do with the facts of this case.

C. The Checks Have Missing Signatures of the Payees

The Bank next argues that it exercised ordinary care because the checks did not need signatures of the payees. (WTB's Brief, pp. 43-44) This argument disavows one of the basic rules of the law of commercial paper, that it is "clearly unreasonable" to pay a check to a non-payee when the payee had not indorsed the check over to the non-payee. *Govoni & Sons Constr. Co. v. Mechs. Bank*, 51 Mass. App. Ct. 35, 50-51 & n.34, 742 N.E.2d 1094, 1106 & n.34 (2001).

¹³ *Beacon Place of Coral Springs Condo. Ass'n v. Nationstar Mortg., LLC*, 182 So. 3d 834, 837 (Ct. App. Fla. 2016) (party was not a non-holder in possession with rights of a holder because the note was never assigned to the party); *Zea v. JPMorgan Chase Bank, N.A.*, 77 UCC Rep. Serv. 2d (Callaghan) 166, 2012 U.S. Dist. LEXIS 38866, at *13 (D. Mass. 2012) (elements of being a non-holder in possession with rights of a holder are: the physical transfer of the instrument by a party other than the issuer when the transferor intended to give the transferee the right to enforce); *WBMCT 2006-C29 Office 4250, LLC v. Chestnut Run Investors, LLC*, 87 UCC Rep. Serv. 2d (Callaghan) 279, 2015 Del. Super. LEXIS 383, at *23 (Super. Ct. Del. 2015) (same).

Contrary to the Bank's argument, the "missing signature" cases that Travelers cited are functionally indistinguishable. The Bank argues that the cases involved tellers who inadvertently did not notice a missing indorsement. But the facts of this case are even *more* egregious: WTB tellers handed over cash to Patterson when they *knew* that the payees had not indorsed the checks. Further, the tellers knew that the alleged agreement between Carlson and Patterson to allow these transactions was a "strange agreement," "unusual" and "not a proper agreement," but they cashed the checks anyway. (ECF No. 86-10, App. Ex. 16, pp. A470, A474, 18:15-25, 50:16-21)

Next, the Bank argues that the banks in the cited cases did not inquire about the agency relationship between an indorser and a payee. But WTB made no such inquiry either. WTB never asked any payee whether Patterson was authorized to cash a check and never required a power of attorney, guardianship order or other accepted documentation of authority to cash checks.

Third, the Bank says that this case does not involve a restrictive indorsement. This is a false distinction. See the discussion of *DelJack, Inc.*, *supra* pp. 5-6.

Finally, while the Bank argues that it did not fail to obtain required indorsements, it indeed failed to obtain the *payees'* indorsements. The parties disagree over whether Patterson had authority to cash the checks, but

regardless, the Bank's decision to cash checks for non-payees without any written documentation of such authority (such as an indorsement of the payee, a power of attorney, a guardianship order, etc.) and in violation of its own teller manual falls far over the line of reasonable commercial standards of banking.

Inconsistently, the Bank argues both that it complied with the teller manual and that Branch Manager Debbi Carlson¹⁴ had authority to allow the tellers to disregard the manual. (WTB's Brief, pp. 47-48) The first point defies reality. TEL-203 required that the "payee(s)/presenters must endorse the check exactly as the name(s) appear(s) on the face of the check" and, if the presenter is not the payee, the teller must "ensure the payee's endorsement is on the back of the check" (TEL-203, ECF No. 86-8, App. Ex. 7, p. A419) The tellers obviously did not comply with TEL-203. The Bank points to TEL-206 to argue that Carlson had authority to override the manual, but ignores TEL-207 that requires a manager to document such an override by initializing the face of the check, which never happened. (ECF No. 86, p. 9)

The Bank also argues that it did not fail to exercise ordinary care because Skils'Kin itself was allegedly negligent. (WTB's Brief, pp. 48-49) The facts at trial will be that Skils'Kin was not negligent at all, but the issue is

¹⁴ The Bank fired Carlson in June 2012 for poor job performance because of a separate check-fraud affair that took place under her watch as Branch Manager. (ECF No. 86-10, App. Ex. 20, pp. A515-A517, 25:17-27:14)

not before this Court. Certified Question No. 3 asks whether the Bank, not Skills'Kin, failed to exercise ordinary care.

D. A Bank Cannot Contract Out of Its Obligation to Exercise Ordinary Care

The Bank does not deny that, as a general rule, reasonable commercial standards of banking do not allow a bank to cash checks for someone who is not the payee or indorsee. The Bank nonetheless contends that it acted in a commercially reasonable manner here because Carlson had an alleged oral “agreement” with Patterson that permitted the Bank to cash these checks for Patterson. The parties dispute factually whether such an agreement existed and whether Patterson had authority to enter such an agreement, but those issues are not before this Court.¹⁵ Regardless, the UCC invalidates precisely this type of agreement between a bank and a customer.

First, while parties can vary the “effect” of the UCC by agreement, they cannot vary the terms of the Code itself. § 1-302(a); UCC § 1-302

¹⁵Patterson had no actual or apparent authority to enter such an agreement. See *Smith v. Hanson, Hanson & Johnson, Inc.*, 63 Wn. App. 355, 363-64, 818 P.2d 1127, 1132-33 (Div. 2 1991) (authority requires an “objective manifestation” of authority from the principal to the agent for actual authority and to the third party for apparent authority; “Apparent authority is not created . . . merely because the agent is appointed to or occupies a high position in the principal’s organization”); *Kiniski v. Archway Motel, Inc.*, 21 Wn. App. 555, 563, 586 P.2d 502, 508 (Div. 1 1978) (“The authority of an agent is not ‘apparent’ merely because it looks so to the person with whom he deals”) (internal citations omitted). Apparent authority “cannot be inferred from the acts of the agent,” *State v. French*, 88 Wn. App. 586, 595, 945 P.2d 752, 757 (Div. 2 1997), and an “agent cannot enlarge his actual authority by his own assertions or representations.” *Charette v. American Sur. Co. of N.Y.*, 49 Wn.2d 777, 780, 307 P.2d 252, 253 (1957).

Official Cmt. 1. The alleged agreement between Carlson and Patterson purported to give Patterson the right to enforce the checks for cash, which are the rights of a “holder” under the Code. § 3-301(i). As the Bank concedes, however, Patterson was not a “holder” because she was not a payee in possession of the checks. § 1-201(b)(21)(A). The alleged agreement is thus unenforceable under § 1-302(a) because it purported to transform a non-holder into a holder. *See Becker v. National Bank & Trust Co.*, 284 S.E.2d 793, 795-96 (Va. 1981) (parties cannot make a party a “holder” by agreement when the party is not a “holder” under the statutory definition).

Second, under the UCC, a bank-customer agreement “cannot disclaim a bank’s responsibility for its . . . failure to exercise ordinary care or limit the measure of damages for the lack or failure.” § 4-103(a). *See also* § 1-302(b) (agreement cannot disclaim party’s obligation to act reasonably). The alleged oral agreement between Carlson and Patterson, if it existed at all, was illegal under Section 4-103(a) and Section 1-302(b) because it allegedly allowed the Bank to disregard commercially reasonable standards of banking.¹⁶ If

¹⁶ *See Cumis Ins. Soc’y, Inc. v Girard Bank*, 522 F. Supp. 414, 422 (E.D. Pa. 1981) (bank-customer agreement was invalid under § 4-103 because it would effectively “bar the drawer’s assertion of the bank’s lack of ordinary care” that allowed the embezzlement to occur); *Kaiser Aluminum & Chemical Corp. v. Mellon Bank, N.A.*, 1997 WL 361354, at *5 (W.D. Pa. 1997) (invalidating agreement between customer and the bank under § 4-103); *Mercantile Stores Co. v. Idaho First Nat’l Bank*, 641 P.2d 1007, 1009-10 (Idaho App. 1982) (corporate resolution of customer was manifestly unreasonable and thus unenforceable under § 4-103 because it purported to eliminate the bank’s liability for paying forged checks).

Patterson and Carlson entered this alleged agreement, it is void and unenforceable.

IV. The Bank Misrepresents the Record

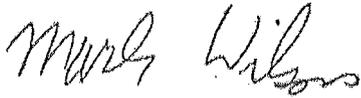
While not relevant to the issues before this Court, several assertions in the Bank's Statement of the Case are either incorrect, misleading, disputed and subject to trial, or constitute legal argument. The most egregious are:

- WTB asserts that its tellers "permitted Patterson to present and cash the Checks provided she indorse the back." (WTB's Brief, p. 8) Whether the signatures were indorsements, however, is a legal question.
- WTB makes assertions about the bank statements (WTB's Brief, p. 9), but for whatever reason, the Bank produced no bank statements in discovery, and only attached a single statement to an early pleading. (ECF No. 107, pp. 7-9, 19) The statements, which underlie the Bank's principal defense against Travelers' claim, are not in the record.
- The parties dispute whether Skils'Kin could have discovered the wrongful payments from the memo lines on the checks (ECF No. 107, p. 73, ¶ 4) and whether Skils'Kin complied with recommendations of its auditors. (ECF No. 107, p. 61, ¶ 3)
- The Bank asserts that Skils'Kin did not notify the Bank of all the particular checks at issue until after Travelers filed suit. (WTB's Brief, p. 12) That is not correct. ECF No. 107, p. 24, ¶ 8)

CONCLUSION

The Court should answer the first certified question “no,” not reach the second certified question, and answer the third certified question “yes.”

Respectfully submitted this 6th day of May, 2016.



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 6th day of May, 2016, I caused the foregoing document to be filed via email with the Washington State Supreme Court at Supreme@courts.wa.gov, and I served a true and correct copy of the foregoing via email and hand delivery to the following:

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APPENDIX

62A.4-406. Customer's duty to discover and report unauthorized signature or alteration.

- (a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid, copies of the items paid, or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment. If the bank does not return the items paid or copies of the items paid, it shall provide in the statement of account the telephone number that the customer may call to request an item or copy of an item pursuant to subsection (b) of this section.
- (b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item. A bank shall provide, upon request and without charge to the customer, at least two items or copies of items with respect to each statement of account sent to the customer. A bank may charge fees for additional items or copies of items in accordance with RCW 30.22.230. Requests for ten items or less shall be processed and completed within ten business days.
- (c) If a bank sends or makes available a statement of account or items pursuant to subsection (a), the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of

the relevant facts.

- (d) If the bank proves that the customer, failed with respect to an item, to comply with the duties imposed on the customer by subsection (c) the customer is precluded from asserting against the bank:
 - (1) The customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and
 - (2) The customer's unauthorized signature or alteration by the same wrong-doer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding thirty days, in which to examine the item or statement of account and notify the bank
- (e) If 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 precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (c) and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) does not apply.
- (f) Without regard to care or lack of care of either the customer or the bank, a natural person whose account is primarily for personal, family, or household purposes who does not within one year, and any other customer who does not within sixty days, from the time the statement and items are made available to the customer (subsection (a)) discover and report the customer's unauthorized signature or any alteration on the face or back of the item or does not within one year from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration. If there is a preclusion under this subsection, the

payor bank may not recover for breach of warranty under RCW 62A.4-208 with respect to the unauthorized signature or alteration to which the preclusion applies.

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Travelers vs. Washington Trust Bank
Supreme Court No. 92483-0
USDC – Eastern District of WA No. CV-13-0409-JLQ

For filing, please find attached Plaintiff's Reply Brief on Certified Questions.

Regards,

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