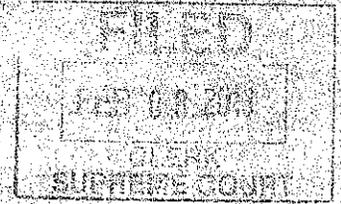


COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
2012-SC-000267-D
(2010-CA-002152)



MARK D. DEAN, P.S.C.

APPELLANT

v.

APPEAL FROM THE SHELBY CIRCUIT COURT
ACTION NO. 09-CI-00050

COMMONWEALTH BANK &
TRUST COMPANY

APPELLEE

BRIEF FOR APPELLANT MARK D. DEAN, P.S.C.

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CR 76.12(6) CERTIFICATE

The undersigned does hereby certify that copies of this brief were served by U.S. Mail, First Class, postage pre-paid, this 8 day of February 2013, upon the following: Hon. John T. McGarvey, Hon. Eric M. Jensen, and Hon. Bradley S. Salyer, Morgan & Pottinger, P.S.C., 601 W. Main St., Louisville, KY 40202; the Hon. Charles R. Hickman, Chief Circuit Judge, 501 Main Street, Suite 15, Shelbyville, KY 40065.; and Lowry S. Miller, Clerk, Shelby Circuit Court, 401 Main Street, Suite 101, Shelbyville, KY 40065. Appellant did not withdraw the record on appeal.

Counsel for Appellant

INTRODUCTION

Appellant Mark D. Dean, P.S.C. appeals from two summary judgment orders dismissing his claims against Commonwealth Bank & Trust Company relating to its unsafe banking practice of issuing pre-printed and blank counter checks to a non-account holder which were utilized in a check-kiting scheme resulting in over \$800,000.00 in losses to Dean. The Court of Appeals erred when it issued an opinion affirming summary judgments on grounds not presented to the Court of Appeals, made impermissible findings of fact, and erroneously applied a UCC statute of repose to unrelated common law claims.

STATEMENT CONCERNING ORAL ARGUMENT

Appellant desires oral arguments and believes such argument would aid the Court in its examination of several complex issues, which will have significant impact upon the rights of Kentucky bank depositors.

STATEMENT OF POINTS AND AUTHORITIES

INTRODUCTION..... i

STATEMENT CONCERNING ORAL ARGUMENT ii

STATEMENT OF POINTS AND AUTHORITIES iii-vi

STANDARD OF REVIEW 1

Scifres v. Kraft, 916 S.W.2d 779, 781 (Ky. App. 1996).....1

Lewis v. B & R Corp., 56 S.W.3d 432, 436 (Ky. App. 2001).....1

STATEMENT OF THE CASE..... 1-6

 K.R.S. § 355.3-118(7).....4

 K.R.S. § 355.4-1114

 K.R.S. § 355.4-4066

ARGUMENT..... 6-28

I. THE COURT OF APPEALS ERRED IN DECIDING THIS MATTER UPON AN ISSUE NOT WITHIN THE SCOPE OF THE APPEAL TAKEN..... 6-10

 KRS 355.4-1117

 KRS 355.4-4067, 8, 10

Brown v. Louisville Jefferson County Redevelopment Authority, Inc., 310 S.W.3d 221 (Ky. App. 2010)8, 9

Com. v. Maricle, 15 S.W.3d 376 (Ky. 2000)8

Regional Jail Auth. v. Tackett, 770 S.W.2d 225 (Ky. 1989)8

II. THE COURT OF APPEALS ERRED IN CONCLUDING THAT KRS 355.4-406 BARRED DEAN’S UCC AND COMMON LAW CLAIMS AGAINST CBT 10-21

A. Dean Only Has a Duty to Report Those Signatures That It Could Determine from the Statements or Items Provided Were “Unauthorized” 10-11

KRS 355.4-406(3).....10

Steevest, Inc. v. Scansteel Service Center, Inc., 807 S.W.2d 476, 480 (Ky. 1991)11

R.T. Vanderbilt Co., Inc. v. Franklin, 290 S.W.3d 654 (Ky. App. 2009).....11

KRS 355.4-40611

B. The Court of Appeals Impermissibly Weighed Facts and Construed the Record Against Dean in Deciding that KRS 355.4-406 Acts as a Bar to Recovery 12-17

James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co., 814 S.W.2d 273, 276 (Ky. 1991).....12,13

Steevest, Inc. v. Scansteel Service Center, Inc., 807 S.W.2d 476 (Ky. 1991).....12, 14

KRS 355.4-406(6).....12

R.T. Vanderbilt Co., Inc. v. Franklin, 290 S.W.3d 654 (Ky. App. 2009).....12

Davis v. Howard, 276 S.W.2d 460 (Ky. App. 1955).....12

Com. v. Thomas Heavy Hauling, Inc., 889 S.W.2d 807 (Ky. 1994).....12, 14

UNIFORM COMMERCIAL CODE § 4-406 cmt.....13

KRS 355.4-40614, 16

KRS 355.4-406(3).....15

Lynn Min. Co. v. Kelly, 394 S.W.2d 755 (Ky. 1965)17

C. The Duty to Report is Inapplicable or, Alternatively, Was Fulfilled as a Matter of Law Where the Bank Has Actual Knowledge of Unauthorized Signatures18

KRS 355.4-40618

D. Even if KRS 355.4-406 Applies to Dean’s UCC Claim, It Does Not Act as a Bar to Dean’s Common Law Claims 18-21

KRS 355.4-40618, 19, 20, 21

City Nat. Bank v. Strickland, 273 S.W.2d 667 (Tex. App. 1954)..... 18-19, 21

Long v. Watkins, 271 F.Supp. 630 (D.C. Ky. 1967).....19

Bullitt County Bank v. Publishers Printing Co., 684 S.W.2d 289
(Ky. App. 1984)(disc. review denied)..... 19-20

III. THE SHELBY CIRCUIT COURT ERRED IN GRANTING SUMMARY JUDGMENT ON DEAN’S UCC AND COMMON LAW CLAIMS 22-28

A. The Trial Court Improperly Resolved Issues of Fact and Construed the Record Against Dean in Finding that Its UCC Claim Was Barred by the Statute of Limitations 22-24

KRS 355.3-118(7).....22

KRS 355.4-11122

R.T. Vanderbilt Company, Inc. v. Franklin, 290 S.W.3d 654 (Ky. App. 2009)22

Bradley v. National City Bank of Kentucky, 2004 WL 3017297
(Ky. App. Dec. 30, 2004)23

Steelvest, Inc. v. Scansteel Service Center, Inc., 807 S.W.2d 476 (Ky. 1991)23

Munday v. Mayfair Diagnostic Laboratory, 832 S.W.2d 912 (Ky. 1992)23

B. The Trial Court Impermissibly Weighed Facts in Granting Summary Judgment Against Dean with Respect to Its Common Law Claims..... 24-28

i. There are genuine issues of fact that preclude entry of summary judgment on Dean’s negligence claim..... 24-25

Grayson Fraternal Order of Eagles v. Claywell, 736 S.W.2d 328 (Ky. 1987).....24

Bullitt County Bank v. Publishers Printing Co., Inc., 684 S.W.2d 289
(Ky. App. 1984)24, 25

Lee v. Farmer’s Rural Elec. Co-op. Corp., 245 S.W.3d 209 (Ky. App. 2007).....24

12 C.F.R. 353.3(a)(2).....25

ii. There are genuine issues of fact that preclude entry of summary judgment on Dean’s aiding and abetting claim	25-26
Restatement Second, Torts § 876.....	25-26
iii. There are genuine issues of fact that preclude entry of summary judgment on Dean’s breach of duty of good faith and fair dealing claim	27
<i>Ranier v. Mount Sterling National Bank</i> , 812 S.W.2d 154 (Ky. 1991).....	27
iv. Dean’s claim for punitive damages should not be dismissed...	27, 28
KRS 411.184.....	27
<i>Phelps v. Louisville Water Co.</i> , 103 S.W.3d 46 (Ky. 2003).....	27
<i>McDonald’s Corp. v. Ogborn</i> , 309 S.W.3d 274 (Ky. App. 2009)	27
CONCLUSION	28
APPENDIX.....	29

STANDARD OF REVIEW

On appeal of a grant of summary judgment, the standard of review is “whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law.” *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky. App. 1996). This Court is not bound to give any deference to the trial court’s or Court of Appeals’ decisions and reviews the issues *de novo*. *Lewis v. B & R Corp.*, 56 S.W.3d 432, 436 (Ky. App. 2001). In this action the trial court and Court of Appeals improperly construed the facts of this case and erred in their application of the law to those facts. Therefore, this Court should reverse the decisions of the trial court and Court of Appeals and remand to allow this matter to proceed to trial.

STATEMENT OF THE CASE

Appellant Mark Dean, P.S.C. (“Dean”) is a law firm in Shelbyville, Kentucky. Attorney Mark Dean is the sole owner of Mark D. Dean, P.S.C. *R. at 191-92, Affidavit of M. Dean*. Dean’s primary area of practice is real estate law, including the performance of real estate closings. *R. at 135-192, Response to Motion for Summary Judgment*.

Dean maintained a bank account at Commonwealth Bank and Trust Company (“CBT”) in Shelbyville. Dean’s former secretary, Jody Wills (“Wills”) was an authorized signatory on Dean’s account at CBT, but had no ownership interest in the account. *R. at 266, Signature Card; R. at 423-439, Response to Renewed Motion for Summary Judgment*. Contrary to the course of normal business and to the principles of safe banking practice, CBT provided Wills, on numerous occasions, with counter checks (blank checks upon which a bank teller fills in the account number). *R. at 423-439, Response to Renewed Motion for Summary Judgment*. Belinda Nichols, Shelby County

Market President of CBT, testified that counter checks are intended to be “temporary”, allowing a customer to write a check “while their checks are being ordered or if they’ve ran [sic] out of checks.” *Nichols Depo.*, p. 37-38. CBT, however, provided Wills with counterchecks on a frequent and continued basis.

Additionally, CBT allowed Wills to obtain pre-printed checks tied directly to Dean’s account. *R. at 423-439, Response to Renewed Motion for Summary Judgment.* In doing so, CBT granted Wills unfettered access to Dean’s account. Providing checks to an account holder’s employees, whether counter or pre-printed, is a dangerous banking practice, which was not in the normal course of business for Dean or CBT. *Id.*

Between late 2003 and March 2005, Wills unlawfully diverted over \$800,000.00 in funds from Dean. *R. at 135-192, Response to Motion for Summary Judgment.* Wills was able to accomplish such a significant diversion of funds through the use of the counter checks and pre-printed checks that she obtained directly from CBT. *Id.*

At some point, CBT became aware that there was suspicious or irregular activity occurring in Dean’s account. CBT, however, did not report this suspicious activity to Dean. *R. at 191-92, Affidavit of M. Dean.* Moreover, though federal law and CBT corporate policies provide procedures for reporting such concerns, CBT did not file a Suspicious Activity Report with federal authorities, which would have alerted these authorities to Wills’ check-kiting activity. *Evans Depo.*, p. 17; *Nichols Depo.*, p. 74.

In September 2008, Dean learned that the FBI was investigating an alleged check-kiting scheme carried out by Wills and involving Dean’s bank accounts. *R. at 191-92, Affidavit of M. Dean.* Wills would deposit a large amount into Dean’s CBT account and then, using the counter checks or pre-printed checks she obtained directly from CBT,

Wills would immediately write a check payable to Dean. *R. at 135-192, Response to Motion for Summary Judgment.* Wills cycled the money between accounts at CBT and Citizens Union Bank. *Id.* Wills stole over \$800,000.00 from Dean's account before her fraud was discovered. *Id.*

The check-kiting scheme was very difficult to discover. First, Wills diverted bank statements arriving from CBT so that Dean was unable to review them. *R. at 191-92, Affidavit of M. Dean.* Even if Dean had received such statements, however, it would not have been possible to detect Wills' scheme from such statements. *Id.* Dean's primary area of practice is in real estate law, including specifically the handling of real estate closings. As such, there are often numerous large deposits and withdrawals occurring within its accounts. Because of the manner in which Wills' theft was carried out, Dean's account balances never indicated that money was missing or stolen. *R. at 135-192, Response to Motion for Summary Judgment.* Nate Evans, a CPA and an auditor for CBT, testified that even with his expertise, it would have taken hours to determine from the documents produced by CBT whether check kiting or suspicious activity was occurring. *Id.; Evans Depo. at 37-39.* If Evans, a bank employee and professional auditor, would have required significant time and resources to determine the existence of suspicious activity, then Dean cannot be expected to decipher the same information without such expertise. Indeed, even the FBI relied upon forensic accounting experts to decipher CBT's records and bank statements in order to be able to determine that fraud had occurred. *R. at 191-92, Affidavit of M. Dean.*

Dean first learned of lost funds in September 2008 as part of the FBI investigation. *R. at 135-192, Response to Motion for Summary Judgment.* Four months

later, on January 23, 2009, Dean filed a Complaint against CBT, asserting common law claims of aiding and abetting fraud and illegal activity, breach of duty of ordinary care, negligence, breach of contract, and breach of the duty of good faith and fair dealing. *R. at 1-9, Complaint.* Dean also asserted claims under the Uniform Commercial Code (“UCC”). *Id.*

On November 9, 2009, CBT filed a Motion for Summary Judgment arguing that all of Dean’s claims, even his common law claims, were governed by the UCC and its three-year statute of limitations under K.R.S. § 355.3-118(7) and K.R.S. §355.4-111. *R. at 17-116.* Additionally, even though Dean had filed its Complaint within four months of learning of the fraud and its injuries resulting therefrom, CBT argued that Dean’s cause of action accrued years before when the checks were negotiated. *Id.*

Dean set forth evidence showing that its cause of action did not accrue until much later, in the fall of 2008, when it learned of the check-kiting scheme and the losses it had incurred as a result. *R. at 135-192, Response to Motion for Summary Judgment.* Alternatively, Dean argued that the discovery rule would toll its statute of limitations. *Id.* Additionally, Dean’s common law claims have longer statute of limitations than its UCC claim and were timely filed. *Id.*

The Shelby Circuit Court granted summary judgment, in part, and dismissed Dean’s UCC claim as barred by the applicable statute of limitations. *R. at 226-234, February 17, 2010 Opinion and Order.* The Shelby Circuit Court held, based upon an Illinois case, that the discovery rule was inapplicable to Dean’s UCC claim. *Id.* It further found that Dean was “informed” of a check-kiting scheme as early as 2005. *Id.* In so deciding, the trial court improperly weighed the parties’ conflicting proffered evidence

and failed to view the record in the light most favorable to Dean, the non-movant to the summary judgment motion.

CBT claims that it fully disclosed the check-kiting scheme to Dean in February 2005. Mark Dean, however, has affirmatively testified, by sworn affidavit, that he was not informed of Wills' activity by CBT. *Compare, R. at 17-116, Motion for Summary Judgment, with R. at 135-192, Response to Motion for Summary Judgment, including Affidavit of M. Dean.* As such, there was a genuine issue of material fact as to whether Dean was informed of the check-kiting scheme by CBT and when Dean had such knowledge.

CBT filed a Renewed Motion for Summary Judgment on April 15, 2010, challenging the validity and sufficiency of Dean's common law claims. *R. at 238-422, Renewed Motion for Summary Judgment.* The Court improperly determined that there were no genuine issues of material fact as to Dean's claims for negligence, aiding and abetting fraud or illegal activity, or breach of duty of good faith and fair dealing. *R. at 446-452, November 5, 2010 Opinion and Order.*

Dean appealed both the February 17, 2010 and November 5, 2010 Opinions and Orders to the Court of Appeals, seeking reversal and a remand to the trial court. *R. at 453-470.* The Court of Appeals did not address issues identified by the parties or upon which the Shelby Circuit Court had issued its decision. *Opinion Affirming, Appendix at I.* Instead, the Court of Appeals *sua sponte* raised and analyzed an entirely separate issue

and affirmed the decisions of the Shelby Circuit Court on those grounds – without the benefit of briefing from either party or oral argument.¹ *Id.*

The Court of Appeals determined that KRS 355.4-406, a provision of Kentucky’s Uniform Commercial Code, imposes a “duty on a customer to examine their bank statements in a prompt and reasonable fashion” for transactions including an “unauthorized signature” and that compliance with KRS 355.4-406 was a “precondition of a customer’s lawsuit against a bank.” *Id.* The Court of Appeals noted that there is an exception which provides that a customer is not precluded from bringing suit where the customer “should not reasonably have discovered the unauthorized payment.” *Id.*

Instead of remanding the matter to the trial court for proceedings to determine whether Dean should reasonably have determined that there were “unauthorized signatures” being made on its account, the Court of Appeals took it upon itself to weigh the conflicting evidence of this case and make its own factual determination as to whether, under the circumstances, Dean “should not reasonably have discovered the unauthorized payment.” *Id.* The Court of Appeals ultimately concluded that it believed Dean should have known of the check-kiting scheme and therefore, that, Dean’s claims – including his common law claims – were barred by a UCC statute of repose. *Id.*

ARGUMENT

I. THE COURT OF APPEALS ERRED IN DECIDING THIS MATTER UPON AN ISSUE NOT WITHIN THE SCOPE OF THE APPEAL TAKEN

The issues to be examined and reviewed by the Court of Appeals in the instant appeal were:

¹ Though the Court of Appeals originally scheduled oral arguments in this matter, on September 13, 2011, it issued an order cancelling these arguments and decided the appeal on the parties’ briefs. *Order Canceling Oral Argument, Appendix at 2.*

(1) whether the trial court erred in its February 17, 2010 Order regarding the statute of limitations applicable to Dean's Uniform Commercial Code claim and the determination not to employ the discovery rule; and

(2) whether the trial court erred in finding that there were no material issues of fact as to Dean's claims for breach of contract, breach of duty of good faith and fair dealing, common law negligence, and aiding and abetting Wills' fraud and illegal activity.

Appellant's Prehearing Statement, Appendix at 3.

The Court of Appeals, however, wholly ignored the issues raised by the parties. It did not review the Shelby Circuit Court's analysis of this matter for error, but instead decided this matter on a theory not addressed by the trial court nor appealed by the parties:

Dean argues that KRS 355.4-111, a three-year statute of limitations, combined with the discovery rule, allows it to pursue its Code and non-Code claims against Commonwealth. We disagree and conclude that a rule of substantive law, KRS 355.4-406, and not a statute of limitations, prohibits the pursuit of these claims.

Opinion Affirming, Appendix at 1, p. 5-6.

The Court of Appeals' consideration of KRS 355.4-406's applicability to this matter was a complete departure from the scope of the appeal taken. Neither Appellant nor Appellee indicated in their pre-hearing statements that KRS 355.4-406 was relevant to this appeal.

Prehearing Statements, Appendix at 3.

Indeed, the trial court had previously rejected the idea that KRS 355.4-406 was applicable to this case. The statute requires the timely reporting of an "unauthorized signature", but Wills was an "authorized signatory on the account, so Dean [was not asserting] that the Bank paid a check over an unauthorized signature." *R. at 226-234, February 17, 2010 Opinion and Order.* Neither the February 17, 2010 Opinion and Order nor the November 5, 2010 Opinion and Order granting summary judgment turned

on application of KRS 355.4-406. *R. at 226-234, February 17, 2010 Opinion and Order; R. at 446-452, November 5, 2010 Opinion and Order.*

The Court of Appeals' action in deciding this matter on a theory not explored by the trial court and which was not appealed by the parties was error. In *Brown v. Louisville Jefferson County Redevelopment Authority, Inc.*, 310 S.W.3d 221, 225 (Ky. App. 2010), the Court of Appeals reversed a portion of the trial court's summary judgment, giving rise to other issues including applicability of the Statute of Frauds and governmental immunity law. These were issues "never addressed by the trial court" and, as such, the Court declined to "devote any additional consideration to these issues as it is unlikely we have authority to do so." *Id.* (citing *Com. w. Maricle*, 15 S.W.3d 376 (Ky. 2000)(court is limited to review of those issues raised and ruled on by the trial court); *Regional Jail Auth. v. Tackett*, 770 S.W.2d 225 (Ky. 1989)("The Court of Appeals is without authority to review issues not raised in or decided by the trial court.")). As such, the Court remanded the matter to the trial court for further proceedings. Even if the Court had authority to so decide the issues, it believed the task was "best reserved for the trial court as it is in the best position to consider any additional arguments presented to it on remand and to address these arguments with appropriate findings." *Id.* at 225-26.

There are sound policy reasons for restricting the Court of Appeals' review to those issues actually ruled on by the trial court and appealed by the parties. To allow otherwise creates a substantial risk that the decision will be rendered on incomplete evidence, denies the parties due process, and undermines the appellate process.

When the Court of Appeals decides a case on an argument which has not been fully explored at the trial court level or appealed by the parties, there is a substantial risk

that the decision will be based on an incomplete or insufficient record. On appeal, parties face practical limitations on the scope of facts, law, and argument that they can present in their briefs and at oral argument. There may be facts or law known to parties but not presented to the Court of Appeals because they were not relevant to the issues actually appealed, but which would have been relevant to the theory adopted by the Court of Appeals. In such a case, the Court of Appeals decision runs a substantial risk of being incorrectly premised on an incomplete record.

Additionally, where the Court of Appeals decides a case on a new theory, the parties essentially lose the matter-of-right review that they would have otherwise enjoyed if the trial court had rendered the same decision. A party's only opportunity for review of the decision would be the Kentucky Supreme Court, which of course, does not provide review as a matter-of-right but chooses a limited number of cases to consider for discretionary review. As such, where the Court of Appeals decides a case on grounds never argued or advanced by the parties, it denies the litigants a level of review to which they might otherwise be entitled.

As such, where the Court of Appeals has found the trial court's actual reasoning behind a decision to be in error, but believes that there are other issue which may be determinative or relevant to the case which have not been fully explored by the trial court, the proper action by the Court of Appeals would be to remand the matter back to the trial court, with express instruction or suggestion to review the issue identified by the Court of Appeals. *See, Brown v. Louisville Jefferson County Redevelopment Authority, Inc.*, 310 S.W.3d 221 (Ky. App. 2010). This is the action which should have been taken in the instant appeal, but was not.

The Court of Appeals avoided review of the Shelby Circuit's actual reasoning set forth in its opinions and orders, as written. Instead, it *sua sponte*, and without benefit of presentation of facts or law relevant to the particular issue either through briefing or oral argument, affirmed the Shelby Circuit Court's holding on grounds rejected by the trial court and not raised by the parties on appeal. The Court of Appeals should have affirmed or reversed the trial court on the grounds advanced by the parties. Upon finding that the trial court's order, as written, was erroneous, the Court of Appeals should have remanded this matter to the trial court with instructions to explore KRS 344.4-406's applicability to the matter.

II. THE COURT OF APPEALS ERRED IN CONCLUDING THAT KRS 355.4-406 BARRED DEAN'S UCC AND COMMON LAW CLAIMS AGAINST CBT

A. Dean Only Has a Duty To Report Those Signatures That It Could Determine From the Statements or Items Provided Were "Unauthorized"

A customer only has a duty to report "unauthorized" signatures on its account as can be determined from the statements or items provided by its bank pursuant to KRS 355.4-406(3) which provides, "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." (Emphasis added). Mark Dean has testified, by sworn affidavit, that even if Dean had actually received statements from CBT, he "would not have been able to decipher fraud without expert intervention." *R. at 191-92, Affidavit of M. Dean.*

Pursuant to the Court of Appeals' analysis, it is the fraud that renders Wills signatures "unauthorized". *Opinion Affirming, Appendix at 1.* Dean's inability to

decipher fraud from the statements means it would have been impossible for Dean to determine, from the statements alone, that Wills' signature on any particular transaction was "unauthorized". Because Dean could not determine from the statements and items provided that fraud and check-kiting were occurring, it could not determine that Wills was exceeding her actual authority, and therefore, could not know what signatures, if any, were "unauthorized".

For purposes of this motion, Dean's testimony that he could not decipher the CBT bank statements must be taken as true. *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 480 (Ky. 1991). Additionally, the testimony of Nathan Evans, Director of Risk Management and Credit Policy at CBT, supports that it would have been unreasonable that Dean would have been able, from the statements, to determine that fraud was occurring and that Wills' signature was "unauthorized". *Evans Depo.*, p. 35-39.

A jury will have to determine, ultimately, whether it finds this testimony credible and whether Dean "should reasonably have discovered" from the bank statements that Wills' signature was "unauthorized". "Reasonableness" is a question of fact, to be determined by the jury. *R.T. Vanderbilt Co., Inc. v. Franklin*, 290 S.W.3d 654 (Ky. App. 2009). The jury will be able to see for itself whether the average person could reasonably have determined from the statements that fraud was occurring such that Wills' signature could be determined to be "unauthorized". If Dean could not have reasonably determined as much from the statements, it had no duty to report such signatures as "unauthorized" to CBT pursuant to KRS 355.4-406 and is not barred by this statute from pursuing its UCC claim.

B. The Court of Appeals Impermissibly Weighed Facts and Construed the Record Against Dean in Deciding that KRS 355.4-406 Acts as a Bar to Recovery

“The only duty of the court on a motion for summary judgment is to determine whether there are genuine issues to be tried and not to resolve them.” *James Graham Brown Found., Inc.*, at 276. It is error for the trial court, or the reviewing appellate court, to act as a finder of fact and, where the Court of Appeals has usurped the jury’s role in this regard, the Court of Appeals must be reversed. *Id.* Even though a court “may believe the party opposing the motion may not succeed at trial, it should not render a summary judgment if there is any issue of material fact.” *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky. 1991). The Court of Appeals overstepped the bounds of its review in this matter and impermissibly weighed facts in resolving this matter.

The Court of Appeals’ decision in the instant case turns on a question of reasonableness:

The Legislature clearly intended that courts consider the customer’s individual circumstances and allow a claim despite the bar of KRS 355.4-406(6), provided those circumstances make it **unreasonable** to expect that the customer should have discovered the unauthorized payment.

Opinion Affirming, Appendix at 1, p. 9-10 (Emphasis added).

Whether something is “reasonable” is a question of fact. *R.T. Vanderbilt Co., Inc. v. Franklin*, 290 S.W.3d 654 (Ky. App. 2009)(“[I]f there is a factual dispute regarding the reasonable diligence of the plaintiff, the question is properly submitted to the jury for resolution.”); *Davis v. Howard*, 276 S.W.2d 460 (Ky. App. 1955)(“[W]hat constitutes a ‘reasonable time’ is a question of fact.”); *Com. v. Thomas Heavy Hauling, Inc.*, 889 S.W.2d 807 (Ky. 1994)(finding summary judgment inappropriate as “what is a

reasonable fee is a question of fact.”). Indeed, the Official Commentary to the UCC recognizes that analysis under KRS 355.4-406 is inherently fact based and should be undertaken on a “case-by-case basis.” UNIFORM COMMERCIAL CODE § 4-406 cmt.

It is well-established that at the summary judgment phase a court is merely to decide whether an issue of fact exists, not to determine the issue of fact. *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 276 (Ky. 1991). The Court of Appeals gave lip-service to the summary judgment standard, claiming that it was resolving the issue on “uncontroverted facts.” *Opinion Affirming, Appendix at 1, p. 10*. It is evident, however, that the facts are indeed in controversy and that the Court of Appeals impermissibly resolved issues of fact by weighing the evidence *against*, not in favor, of Dean, the non-movant.

First, in departing from the issues appealed, the Court of Appeals may be operating without benefit of full knowledge of all relevant facts. As discussed above, parties to an appeal face practical limitations on the number of facts and arguments which they may present to the Court of Appeals. As such, parties often take great care in tailoring the facts presented to the issues actually raised, excluding other facts which may be pertinent to the case at whole, but not relevant to any particular issue on appeal. It is difficult for the Court of Appeals then, to say with any confidence, that it has reviewed all the facts of the present matter and determined that there are no material issues in dispute. The facts at the Court of Appeals’ disposal are necessarily limited and, in the instant matter, because the parties could not have expected that the Court of Appeals would decide this appeal on an issue not explored by the trial court or appealed by the parties,

the parties did not have full opportunity to present facts specifically relevant to any considerations under KRS 355.4-406.

Even from the record before the Court, though, it is clear that genuine issues of material fact exist which bear on the issue of Dean's "reasonableness". There is a question of fact as to when Dean first learned of fraudulent activity in its account. CBT alleges that it informed Dean of suspicious activity in 2005. In direct contrast to CBT's allegations, Mark Dean has submitted a sworn affidavit testifying that (1) CBT never reported suspicious activity by Wills to him and (2) that he first learned of the fraudulent activity after it was brought to his attention by law enforcement. *R. at 191-92, Affidavit of M. Dean*. There is a dispute then, as to when Dean became informed of the check-kiting scheme and unauthorized signatures on its account.

Furthermore, even if the facts in this case were not in dispute, summary judgment would not have been appropriate. This Court has held that, where the question is one of "reasonableness", even if there is no dispute as to material fact, summary judgment is still inappropriate "if there is a dispute as to conclusions to be draw from the facts of the case." *Com. v. Thomas Heavy Hauling, Inc.*, 889 S.W.2d 807, 808 (Ky. 1994). At the summary judgment phase, the record must be construed in the non-movant's favor. *Steelvest, Inc. v. Scansteel Ser. Center, Inc.*, 807 S.W.2d 476, 480 (Ky. 1991). Based on the record before the Court, there is sufficient evidence from which a jury could find in Dean's favor.

In the case at bar, the evidence of whether Dean should have "reasonably" discovered the unauthorized payments must be determined only from affidavits and deposition testimony because there has been no trial. The relevant facts include:

- That Jody Wills intercepted bank statements before they could be reviewed by Dean, *R. at 191-92, Affidavit of M. Dean, para. 3*;
- That CBT never reported any suspicious activity by Wills to Dean, *R. at 191-92, Affidavit of M. Dean, para. 4*;
- That Dean first learned of fraudulent activity after it was brought to its attention by law enforcement, *R. at 191-92, Affidavit of M. Dean, para. 5*;
- That, upon information learned from law enforcement, they could not determine fraud without expert intervention, *R. at 191-92, Affidavit of M. Dean, para. 6-7*;
- That even if Dean had received the bank statements in question, it would not have been able to decipher that fraud was occurring without expert assistance, *R. at 191-92, Affidavit of M. Dean, para. 8*; and
- That Nate Evans, a CPA and an auditor for CBT, testified that even with his expertise, it would have taken hours to determine from the documents produced by CBT whether check kiting or suspicious activity was occurring. *R. at 135-192, Response to Motion for Summary Judgment; Evans Depo. at 37-39.*

From these facts, a jury could find in favor of Dean that it was unreasonable to expect it, under the circumstances, to have determined that Wills' signature would be "unauthorized" such that it could report these facts to CBT.

The Court of Appeals ignored these facts, however, and instead construed the record evidence and drew inferences *against* Dean. The Court of Appeals concluded that Wills' signature was an "unauthorized signature that Dean would have discovered if it had complied with its duty under KRS 355.4-406(3) to examine the bank statements." *Opinion Affirming, Appendix at 1, p. 7.* However, Mark Dean affirmatively testified by sworn affidavit that "even if I had received any bank statements, . . . I would not have been able to decipher fraud without expert intervention." *R. at 191-92, Affidavit of M. Dean, para. 8.* The Court of Appeals rejected Dean's sworn testimony, claiming that it

was “not persuaded by that argument.” *Opinion Affirming, Appendix at 1, p. 10*. The Court of Appeals then further states, without any citation to the record to indicate where such evidence exists, that “Mark effectively acknowledges that when, finally, he did look at the bank statements, he *was* alerted to Jody’s curious accounting and check-writing practices, such as using counter checks and preprinted checks, and making checks payable to the bank in unusual amounts.” *Id. at 10-11*. This is directly contrary to Mark Dean’s affidavit, in which he testified that, “Even if I had received any bank statements, . . . I would not have been able to decipher fraud without expert intervention.” *R. at 191-92, Affidavit of M. Dean, para. 8*.

In improperly construing the record against Dean, the Court of Appeals lost itself its own circuitous logic. It holds that KRS 355.4-406 is applicable to the matter at hand because Wills’ signature would be “unauthorized” as defined in the UCC. *Opinion Affirming, Appendix at 1*. Wills was an authorized signatory on the account (indeed, the trial court found KRS 355.4-406 inapplicable to this case on the basis that Wills was an authorized signatory). *R. at 226-234, February 17, 2010 Opinion and Order*. The Court of Appeals held that “unauthorized” signatures include those “made by one exceeding actual or apparent authority” and found that Wills “exceeded her authority when she engaged in the check-kiting scheme.” *Opinion Affirming, Appendix at 1*. In order to determine that Wills’ signature was “unauthorized”, one would first have to know then that Wills was check-kiting to know that she had exceeded her authority. The Court of Appeals, however, faults Dean, in its opinion, for not having reported the signatures as “unauthorized” even though it had no knowledge at the time of a check-kiting scheme or that Wills had exceeded the authority granted her.

The Court of Appeals, unlike Dean, had the benefit of hindsight, in determining that Wills' signatures were "unauthorized." Unlike in many instances of "unauthorized signature" transactions, there was nothing on the face of these transactions to indicate a problem, such as a clear forgery or alteration. Indeed, Wills was an authorized signatory and even CBT has argued that Wills' signature could not be considered "unauthorized". *See, R. at 238-422, Renewed Motion for Summary Judgment* ("Because Wills was an authorized signer on the Account, Plaintiff cannot allege that the Checks were issued with an unauthorized signature.").

When Dean knew, or should reasonably have known, that Wills' signatures were "unauthorized" is a question of fact. The parties have set forth competing testimony as to when Dean learned that fraud had occurred on the account and the question of when it should "reasonably" have known of the existence of unauthorized signatures is a question of fact. Where there are facts in dispute or when differing inferences can be drawn from undisputed facts, the question must be submitted to the jury. Rather than weigh the evidence and impermissibly construe evidence against Dean, if the Court of Appeals determined that KRS 355.4-406 was the operative statute upon which this case will be resolved, it should then have remanded this matter back to the trial court for further proceedings with respect to this issue. *See, Lynn Min. Co. v. Kelly*, 394 S.W.2d 755, 759 (Ky. 1965)(holding that where "there is a factual issue upon which the application of the statute depends, it is proper to submit the question to the jury.").

C. The Duty to Report is Inapplicable or, Alternatively, Was Fulfilled as a Matter of Law Where the Bank Has Actual Knowledge of Unauthorized Signatures

The purpose of KRS 355.4-406 is not to lay a trap for bank customers who, through no fault of their own, are unable to determine that authorized transactions are occurring; the purpose is to require bank customers who know of suspicious activity to bring this to the attention of their bank. If the bank already knows of the suspicious activity, the purpose of KRS 355.4-406 has been achieved.

CBT had actual knowledge of suspicious activity on the account. An October 18, 2005 email from Nathan Evans, the Director of Risk Management and Credit Policy at CBT, identifies Dean's account as the one having "the suspected kiting". *Evans Depo.*, p. 9-10. If CBT was already aware of all facts supporting that the signatures were "unauthorized", then there was nothing Mark Dean could have done to put the Bank on notice. In light of the Bank's actual knowledge, KRS 355.4-406 is either inapplicable in the instant matter or its reporting requirements should be considered fulfilled as a matter of law.

D. Even if KRS 355.4-406 Applies to Dean's UCC Claim, It Does Not Act as a Bar to Dean's Common Law Claims

KRS 355.4-406 does not bar all common law claims against a bank. The trial court correctly stated that it was "not clear that KRS 355.4-406 applies to the factual circumstances at issue." *R. at 226-234, February 17, 2010 Opinion and Order*. KRS 355.4-406 simply does not apply to the common law claims brought in this case.

"Before the statute [of repose] will be held applicable, it must appear that the cause of action was based upon the unauthorized check." *City Nat. Bank v. Strickland*, 273 S.W.2d 667 (Tex. App. 1954)(Emphasis added). As such, in *City National Bank*, the

Texas Court of Appeals held that the statute of repose requiring bank customers to timely review statements and report unauthorized signatures would not bar a customer's common law claims where the basis of the depositor's claims did not rest upon the fact that there had been an unauthorized withdrawal of her account by the bank vice-president, but instead was founded on the fact that the vice-president had misrepresented the purpose for which the check had been drawn and the use which had been made of the check funds.

KRS 355.4-406 is limited to "facts in which a customer has received a bank 'statement of accounts' and fails to point out any error shown by the statement." *Long v. Watkins*, 271 F.Supp. 630, 635 (D.C. Ky. 1967). Such did not occur here. Dean's common law claims are not based upon negligence in paying an unauthorized check, but arise from actions CBT took which violated safe banking practices in providing pre-printed and counter checks to a non-account holder and in failing to inform the account holder or authorities about suspicious or irregular activity on the account. *R. at 1-9, Complaint.*

Although not factually identical, the case at bar is most like *Bullitt County Bank v. Publishers Printing Company.*, 684 S.W.2d 289 (Ky. App. 1984)(*disc. review denied*), which found that the bank breached its duty of good faith and ordinary care when it allowed an employee authorized to deposit checks to present a check with a request that the bank exchange the check for a cashier check made payable to another bank. *Id at 291.*

There is little doubt, given the law and the facts involved, but that the Bank violated its duty of ordinary care. No employee of the Bank ever notified [Plaintiff] of [Plaintiff's employee's] strange departure from his

regular banking duties following 1975. The tellers' deposition testimony indicates that they simply assumed he was acting on behalf of [Plaintiff].

Id. at 292.

Just as in *Bullitt County Bank*, CBT never questioned Wills' practice of seeking counterchecks and moving large sums of money, violating the duty of ordinary care. In the *Bullitt County Bank* case, the bank argued that KRS 355.4-406 bars the action; the Court of Appeals ruled otherwise: it bars actions based on unauthorized signatures only.

The Kentucky Court of Appeals failed to evaluate on a claim-by-claim basis whether the common law claims presented by Dean were based on an "unauthorized signature". Instead, it merely held that, wholesale, Dean's common law claims would be barred by the application of KRS 355.4-406. *Opinion Affirming, Appendix at 1.*

Dean's claim for Aiding and Abetting Fraud and Illegal Activity and Breach of Duty of Ordinary Care, for example, asserts that the bank failed to notify Dean regarding the provision of counter-checks to a non-account holder and that such activity was in violation of the duty of care. *R. at 1-9, Complaint.*

Likewise, Dean's Breach of Contract and Breach of Duty of Good Faith and Fair Dealing claim is premised on CBT's breach of its contractual obligations to conduct business in accordance with commercially reasonable banking practices when it provided counter checks to a non-account holder and when it failed to notify Dean or federal authorities of suspected improper activity. *Id.* Nichols, CBT's Shelby County Market President, recognized that counter checks are only to be used on a "temporary" basis, in the rare event that a customer has run out of checks or is awaiting arrival of ordered checks. *Nichols Depo., p. 37-38.* CBT, however, regularly provided such checks to Wills.

Dean's claim for negligence indicates that the Bank's breach of duty was its failure to abide by the duty of care by "not having or not following policies and procedures concerning requests for counter checks." *Id.* Dean's claim for punitive damages indicates that CBT acted with gross negligence, reckless disregard for the rights of Dean, and with malice and oppression in its actions towards Dean. *Id.*

KRS 355.4-406 will bar only those common law claims based on an "unauthorized signature". None of these common law claims are based on an "unauthorized signature" or the negotiability of a check instrument. Instead, the focus of Dean's common law claims is the impropriety of CBT's actions in providing a non-account holder with counterchecks and preprinted checks without first notifying and receiving approval from the account holder and its failure to provide notice, to either Dean or federal authorities, of suspicious activity on the account. *R. at 1-9, Complaint.*

Nothing in the UCC relates to or governs the provision of checks to customers or non-account holder signatories. Dean's common law claims relate to banking practices such as providing blank counterchecks and pre-printed checks to a non-account holder, failing to notify an account holder of dangerous banking activity, and failing to report suspicious activity to appropriate authorities. As in *City National Bank*, these claims do not implicate the propriety of the negotiation of the actual instrument, but instead relate to general banking practices not within the scope of the UCC. These claims are not precluded by KRS 355.4-406, and the Court of Appeals' ruling to the contrary is clearly erroneous.

III. THE SHELBY CIRCUIT COURT ERRED IN GRANTING SUMMARY JUDGMENT ON DEAN'S UCC AND COMMON LAW CLAIMS

A. The Trial Court Improperly Resolved Issues of Fact and Construed the Record Against Dean in Finding that Its UCC Claim was Barred by a Statute of Limitations

In its February 17, 2010 Opinion and Order, the Shelby Circuit Court granted summary judgment, on Dean's UCC claim, on the grounds that such claim was allegedly barred by the statute of limitations. *R. at 226-234*. The parties agree that the UCC claim would be governed by the statute of limitations set forth in KRS 355.3-118(7) and KRS 355.4-111, which provide a statute of limitations of three years from the date the cause of action accrued. A cause of action "will not accrue . . . until the plaintiff discovers or in the exercise of reasonable diligence should have discovered not only that he has been injured but also that his injury may have been caused by the defendant's conduct." *R.T. Vanderbilt Company, Inc. v. Franklin*, 290 S.W.3d 654, 659 (Ky. App. 2009).

The trial court impermissibly construed the record against Dean in making a finding of fact that Dean's cause of action accrued on February 1, 2005. The trial court found that it was "undisputed" that "[o]n February 1, 2005, Commonwealth's Shelby County Market President Belinda Nichols had a meeting with Mark Dean wherein she reviewed the account history in the escrow account with him and Nichols informed him that there was suspected kiting activity in the account." *R. at 226-234, February 17, 2010 Opinion and Order*. This fact, however, is not undisputed. Mark Dean's affidavit specifically states, at Paragraph 4, "CBT never reported to me the suspicious activity by Ms. Wills" and that he first learned of the check-kiting scheme and his losses thereunder much later, from law enforcement authorities. *R. at 191-92, Affidavit of M. Dean*. There is then, a fact issue, of whether CBT ever reported suspicious activity to Dean, whether

the alleged February 1, 2005 meeting even occurred, and if so, what was discussed and whether Dean could have reasonably determined from information provided not only that it had suffered injury, but also, that its injury was likely caused by CBT.

Furthermore, even if Dean's UCC cause of action accrued in 2005, the discovery rule would toll this statute of limitations. The trial court again impermissibly resolved an issue of fact and construed the record against Dean in concluding that the discovery rule would not apply to Dean's claims. There is no published decision determining whether the discovery rule applies to UCC claims. The sole unpublished case on the subject, *Bradley v. National City Bank of Kentucky*, 2004 WL 3017297 (Ky. App. Dec. 30, 2004) allows the discovery rule to be employed where there has been fraudulent concealment by a bank. There is evidence from which a jury could find in Dean's favor that CBT fraudulently concealed its wrongful actions from Dean. Dean's testimony, by sworn affidavit, that "CBT never reported to me the suspicious activity by Ms. Wills" must be taken as true for purposes of this motion. *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky. 1991).

Furthermore, though both federal law and CBT's internal policies provide for the reporting of suspicious activity, CBT did not contact Dean to let it know that CBT had been providing numerous counter checks to Wills, or make a Suspicious Activity Report to banking authorities, as would be done under safe banking practices. *R. at 191-92, Affidavit of M. Dean; Evans Depo., p. 17; Nichols Depo., p. 74.* This Court has recognized that "where the law imposes a duty of disclosure, a failure to disclose may constitute concealment" *Munday v. Mayfair Diagnostic Laboratory*, 832 S.W.2d 912, 915 (Ky. 1992). CBT provided the pre-printed and counter checks to Wills that

allowed her to carry out her scheme. A reasonable jury could infer from these facts that CBT recognized that its own actions assisted and aided Wills in achieving her check-kiting scheme and concealed this information to avoid discovery of its unsafe banking practices which led to substantial injury to its depositor.

B. The Trial Court Impermissibly Weighed Facts in Granting Summary Judgment Against Dean with Respect to Its Common Law Claims

i. There are genuine issues of fact that preclude entry of summary judgment on Dean's negligence claim

Kentucky courts have recognized a "universal duty of care, providing that 'every person owes a duty to every other person to exercise ordinary care in his activities to prevent foreseeable injury.'" *Grayson Fraternal Order of Eagles v. Claywell*, 736 S.W.2d 328, 332 (Ky. 1987). CBT owed Dean a duty to exercise ordinary care to prevent foreseeable injury in its business dealings with Dean. *Bullitt County Bank v. Publishers Printing Co., Inc.*, 684 S.W.2d 289 (Ky. App. 1984).

The trial court dismissed Dean's negligence claim on the grounds that "Dean PSC has failed to establish that Commonwealth has breached any duty owed to Dean PSC or that any action or any inaction on their part violated any banking standard." *R. at 446-52, November 5, 2010 Opinion and Order*. Breach, however, is a "question of fact for the jury to decide." *Lee v. Farmer's Rural Elec. Co-op. Corp*, 245 S.W.3d 209 (Ky. App. 2007).

Dean has presented facts from which a jury could decide that CBT breached the duties of care that it owed to Dean. Among other things, CBT provided pre-printed and counter checks to the account holder's employee. *R. at 191-92, Affidavit of M. Dean*. CBT recognized that such counter checks are to be used only on a temporary basis, when

a customer is otherwise without their normal checks. *Nichols Depo.*, p. 37-38. Despite this, CBT regularly provided counter checks to Wills, which counter checks Wills utilized in her embezzlement scheme.

Furthermore, though CBT had duties under federal law and its own internal policies to report suspicious activity on a customer account, CBT failed to inform Dean or federal authorities of Wills' suspicious banking activity. Regulations promulgated under the Bank Secrecy Act require that a Suspicious Activity Report be filed with the Financial Crimes Enforcement Network if there is suspicion of money laundering or other money crimes. 12 C.F.R. 353.3(a)(2). Additionally, CBT had internal policies governing the reporting of suspicious activity. *Nichols Depo.*, Exhibits 8-10. Despite this, CBT made no report to either Dean or the federal authorities. *R. at 191-92, Affidavit of M. Dean; Evans Depo.*, p. 17; *Nichols Depo.*, p. 74. In *Bullitt County Bank v. Publishers Printing Co, Inc.*, the Kentucky Court of Appeals cited, as evidence of breach of the duty of ordinary care, a bank's failure to notify a business client of its employee's departure from regular banking duties.

These facts, taken in the light most favorable to Dean, are sufficient to allow a jury to find that CBT breached duties of care owed to Dean. The trial court erred in construing the record against Dean and entering summary judgment on Dean's claim for negligence.

ii. There are genuine issues of fact that preclude entry of summary judgment on Dean's aiding and abetting claims

Pursuant to the Restatement Second, Torts § 876, "For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he . . . knows that the other's conduct constitutes a breach of duty and gives substantial assistance or

encouragement to the other so to conduct himself or . . . gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.” The trial court dismissed Dean’s claim for aiding and abetting on the grounds that “Dean PSC has failed to establish that Commonwealth has breached a duty owed to Dean PSC or that any action or inaction on their part violated any banking standard.” *R. at 446-52, November 5, 2010 Opinion and Order.*

There are facts from which a jury could conclude that CBT gave “substantial assistance” to Wills in committing her check-kiting scheme. CBT provided Wills, who was not the holder of the account, pre-printed checks and counter checks. *R. at 191-92, Affidavit of M. Dean.* Such action violates safe banking practices and contributed to the difficulty of detecting Wills’ illegal activities. Such checks should only be issued when a customer is temporarily without access to checks on their account. *Nichols Depo., p. 37-38.* CBT, however, provided Wills with such checks frequently and on a continued basis.

Additionally, though CBT had evidence of check kiting and knew that it was providing Wills with counter checks, it failed to so inform Dean and it failed to file a Suspicious Activity Report. *R. at 191-92, Affidavit of M. Dean; Evans Depo., p. 17; Nichols Depo., p. 74.* Had CBT notified either Dean or federal authorities of its concerns and suspicions, it would have allowed for early detection of Wills’ embezzlement. A jury could infer from CBT’s failure to report this suspicious activity to either Dean or the federal authorities that CBT was attempting to avoid discovery of its own improper and unsafe practice of providing Wills with counter checks and pre-printed checks, the very means by which she carried out her fraud.

iii. There are genuine issues of fact that preclude entry of summary judgment on Dean's breach of duty of good faith and fair dealing claim

In Kentucky, "there is an implied covenant of good faith and fair dealing." *Ranier v. Mount Sterling National Bank*, 812 S.W.2d 154 (Ky. 1991). "[C]ontracts impose on the parties thereto a duty to do everything necessary to carry them out." *Id.* at 156. The trial court, however, ignored the existence of such a duty.

CBT was required to act in a commercially reasonable banking manner in its relationship with Dean. There is evidence that such a duty was breached. CBT provided counterchecks and pre-printed checks to someone other than the account holder. *R. at 191-92, Affidavit of M. Dean*. Additionally, it failed to take reasonable steps to deter Wills' fraudulent scheme, either by reporting suspicious activity to Dean directly or to the federal authorities. *R. at 191-92, Affidavit of M. Dean; Evans Depo., p. 17; Nichols Depo., p. 74*. CBT gave Wills the instrumentality needed to perpetuate her scheme and, by its failure to report suspicious activity, allowed the scheme to remain undetected for some time. There is sufficient evidence from which a jury could find in Dean's favor that CBT breached the duty of good faith and fair dealing that it owed to Dean as its customer.

iv. Dean's claim for punitive damages should not be dismissed

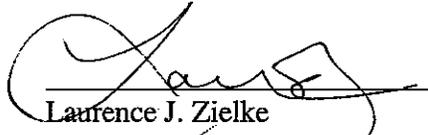
Dean's punitive damages claim was dismissed by the trial court in conjunction with the dismissal of the negligence and aiding and abetting claims. *R. at 446-452, November 5, 2010 Opinion and Order*. Punitive damages are allowable under both claims. KRS 411.184; *Phelps v. Louisville Water Co.*, 103 S.W.3d 46 (Ky. 2003); *McDonald's Corp. v. Ogborn*, 309 S.W.3d 274 (Ky. App. 2009). It is error to dismiss a

claim for punitive damages when there is a viable claim for either negligence or aiding and abetting. The dismissal of this claim should be reversed in conjunction with the reversal of the dismissal of Dean's negligence and aiding and abetting claims.

CONCLUSION

For the foregoing reasons, the Court of Appeals' Order Affirming should be reversed. The Shelby Circuit Court's orders granting summary judgment should be reversed as to all claims, whether arising from the Uniform Commercial Code or common law, and this matter should be remanded to the trial court for trial on all issues of fact.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Laurence J. Zielke', is written over a horizontal line. The signature is stylized and cursive.

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APPENDIX

<u>TAB</u>	<u>DOCUMENT</u>
1	Opinion Affirming
2	Order Canceling Oral Arguments
3	Prehearing Statements of Appellant and Appellee