O/a 5-5-86

CASE NO. 67,777

IN THE SUPREME COURT OF FLORIDA

BARNETT BANK OF WEST FLORIDA,

Petitioner,

v.

W. RICHARD HOOPER,

Respondent.

RESPONDENT'S ANSWER BRIEF

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INTRODUCTION

In this brief the parties will be referred to as they stood in the trial court. The following symbols will be used: (R.) Record on appeal; (T.) Transcript. Unless otherwise stated, any emphasis in this brief is supplied by the respondent/plaintiff.

STATEMENT OF THE FACTS

The facts set forth in petitioner's brief omit the following: When Hosner made the telephone call to Dr. Hooper, Hosner told Dr. Hooper that Dr. Hooper needed to borrow money for his investment, and that he had to do it that day. Hooper v. Barnett Bank of West Florida, 474 So.2d 1253, 1256 n.2, 1259 (Fla. 1st DCA 1985).

ISSUE

I. WHETHER THE DISTRICT COURT OF APPEAL CORRECTLY HELD THAT THE FACTS IN THIS CASE WOULD PERMIT A JURY TO FIND THAT THE BANK'S DUTY OF CONFIDENTIALITY TO HOSNER WAS OUTWEIGHED BY ITS OBLIGATION EITHER TO DISCLOSE MATERIAL FACTS OF FRAUDULENT ACTIVITY TO DR. HOOPER BEFORE MAKING THE LOAN IN QUESTION, OR, TO REFUSE TO MAKE THE LOAN.

SUMMARY OF ARGUMENT

The question in this case is whether a jury could find that the bank had knowledge of material facts concerning this transaction which the bank was under a duty to disclose to Dr. Hooper, or in the alternative, that the bank had a duty to decline to make the loan to Dr. Hooper. As the First District Court of Appeal held, a jury could conclude that the transaction was not a routine, arms-length loan transaction, but instead was one engineered by a bank customer known to be at least seriously delinquent, and very likely also guilty of fraud in his dealings with the bank; and that nothing would have prevented the bank from insisting -- as a condition to approval of the Hosner-arranged loan to Dr. Hooper -- that Hosner disclose to Dr. Hooper the status of his delinquent loans and overdrawn accounts with the bank; and finally, that the bank could have simply declined to make the loan.

On May 14, 1982, the bank had ceased honoring checks on Hosner's accounts in order to protect itself from financial losses. Its self- protective action was not disclosed to Dr. Hooper. The bank knew that there was a substantial likelihood that the proceeds of the $90,000.00 loan to Dr. Hooper would be used by Hosner to cover Hosner's shortages at the bank, to the detriment

of Dr. Hooper. And, the loan proceeds in fact were deposited in Hosner's account.

The First District Court of Appeal specifically recognized the concept of bank confidentiality. The court properly held that the duty of confidentiality must be balanced against a duty to disclose (or a duty not to make a loan which puts another customer at economic risk), when the bank knows of fraudulent activity material to the other customer's loan request. A check-kiting scheme, from which the bank had already begun to protect itself at the time of the loan in question, was a fraudulent activity obviously material to Dr. Hooper's loan request.

Dr. Hooper does not seek to erode the right of bank customers to a reasonable expectation of privacy in their financial affairs with the bank. Nor does he disagree with the contention that exceptions to bank confidentiality should be narrow. In this case, however, the bank cannot hide behind the shield of confidentiality because the bank exposed Dr. Hooper to serious economic risk by making the loan to him while at the same time actively seeking to protect itself from Hosner's fraudulent activity.

The law in Florida should not condone a rule which permits a bank to protect itself from known fraudulent activities of one customer, while permitting other customers

to be unknowingly victimized by the same fraudulent conduct with the bank's acquiescence and to the bank's benefit.

The First District Court of Appeal properly held that bank confidentiality should not as a matter of law prevail to the detriment of Dr. Hooper in this case. A question for the jury was properly presented on the duty of the bank to Dr. Hooper under these circumstances. This Court should approve the decision of the First District Court of Appeal.

ARGUMENT

THE DISTRICT COURT OF APPEAL CORRECTLY HELD THAT THE FACTS IN THIS CASE WOULD PERMIT A JURY TO FIND THAT THE BANK'S DUTY OF CONFIDENTIALITY TO HOSNER WAS OUTWEIGHED BY ITS OBLIGATION EITHER TO DISCLOSE MATERIAL FACTS OF FRAUDULENT ACTIVITY TO DR. HOOPER BEFORE MAKING THE LOAN IN QUESTION, OR, TO REFUSE TO MAKE THE LOAN.

At the time Hosner arranged the loan now in dispute with Barnett Bank, the bank knew:

(a) That Hosner was engaged in a check-kiting scheme (T. 24-36, 86, 146);

(b) That Hosner was delinquent on loans in excess of $700,000.00 (T. 143-152, 155);

(c) That the bank had acted to protect itself from Hosner's check kite by refusing to honor checks totalling more than $291,000.00 (T. 56, 65-66);

(d) That Hosner was being investigated by the I.R.S. for tax fraud (T. 144; Hooper v. Barnett Bank of West Florida, 474 So.2d 1253, 1255 n.1 [Fla. 1st DCA 1985]);

(e) That the bank had instructed Hosner to get money into the bank to cover checks (T. 149);

(f) That Dr. Hooper had been encouraged to make his first investment with Hosner based upon representations

by the bank that the investments were sound and had passed I.R.S. scrutiny (T. 109-110, 115-116);

(g) That Dr. Hooper had come to Barnett Bank because of a special relationship between the bank and doctors at the Medical Center Clinic where Dr. Hooper was employed as a physician (T. 105, 140-141);

(h) That Dr. Hooper had named the bank as trustee of a trust and personal representative of his estate under the terms of his Will (T. 120); and

(i) That there was a substantial likelihood that the proceeds of the $90,000 loan to Dr. Hooper would be used by Hosner to cover Hosner's shortages at the bank.

At the time of the loan in dispute, Dr. Hooper knew only that Hosner had told him Dr. Hooper needed to borrow money for Dr. Hooper's investments with Hosner and that Hosner had told him he (Dr. Hooper) needed to do it that day. Dr. Hooper was confronted with this information by Hosner's demand in a telephone call during a break from surgery. Had Dr. Hooper known the facts known by the bank, Dr. Hooper would not have requested the loan (T. 119-120).

Barnett Bank and Florida Bankers Association rely on Milohnich v. First National Bank of Miami Springs, 224 So.2d 759 (Fla. 3d DCA 1969). However, the district court of appeal was not required to decide in Milohnich

whether a bank would be prohibited from making disclosure if special circumstances in a particular case required disclosure. See id. at 762.

Notwithstanding the special facts recited above and the inferences which can fairly be drawn from them, Barnett Bank claims bank confidentiality required it to permit Dr. Hooper to make loan. This theory has been rejected by the courts of other states as well as by the First District Court of Appeal.

In Richfield Bank & Trust Co. v. Sjogren, 309 Minn. 362 244 N.W.2d 648 (1976), a bank officer who had knowledge of fraudulent activities of one of its customers made a loan to another customer to help out the first customer whose business was in financial difficulty and was in fact insolvent. The Minnesota Supreme Court found that there were special circumstances which required disclosure to the other customer notwithstanding the bank's claim of confidentiality. The court stated:

> The clear implication is that if the bank actually knew that its depositor was insolvent and engaged in fraudulent activity at the time of the transaction, then it would have been under a duty to disclose this fact, since . . .
>
> "* * * There is a moral duty of banks to the community in which they do business to use reasonable care in seeing that

> their depositors are not committing a fraud upon the public."
>
> Thus, the instant case can be distinguished from those cases holding that a bank may not disclose the financial condition of its depositors if it can be shown that Richfield Bank had actual knowledge of the fraudulent activities of its depositor, National Pollution.

Id. at 651.

In affirming a jury verdict setting aside a loan to a customer by the bank, the Minnesota Supreme Court held:

> Therefore, we hold that under the unique and narrow "special circumstances" of this case, in which the bank had actual knowledge of the fraudulent activities of one of its depositors, it had an affirmative duty to disclosure [sic] those facts to the respondents before it engaged in making the loan to respondents which furthered the fraud.

Id. at 652 (emphasis in original) (footnote omitted).

A like holding is found in First National Bank in Lenox v. Brown, 181 N.W.2d 178 (Iowa 1970). In that case the president of the bank became aware of business adversities of one of its customers. He suggested that the customer sell his business. A prospective purchaser was brought to the bank and met the bank preident. The bank agreed to make the loan, but made no mention of an existing mortgage held by the bank, with the bank president

representing that the business was a going business. The court held that the bank had a duty to make disclosure of the true facts to the prospective purchasers and borrowers, and that failure to do so gave rise to the right to avoid the obligation.

In Richfield Bank & Trust Co. v. Sjogren, the Minnesota Supreme Court expressly recognized Milohnich and the qualified duty of bank confidentiality, but held that such duty must be balanced against a higher duty of a bank which has knowledge of fraudulent activities of a customer. The Washington Court of Appeal, in Tokarz v. Frontier Federal Savings & Loan Association, 33 Wash. App. 456, 656 P.2d 1089 (Ct. App. 1983), also recognized Milohnich, but held that the duty of disclosure based on special circumstances must be weighed against the duty of confidentiality. In the case at bar, the First District Court of Appeal also expressly recognized Milohnich, but concluded that the facts of this case permitted a jury to weigh the duty to disclose against the bank's duty of confidentiality to its depositors.

Finally, as the First District Court of Appeal held, and the Minnesota Supreme Court also held in Richfield Bank & Trust Co., the bank had the option to and could have refused to make the loan.

In Florida, one who stands in a confidential or fiduciary relationship with another in a transaction between those parties must disclose material facts. When one party to a transaction has knowledge of the facts superior to that of the other party, and the latter does not have equal opportunity to become apprised of those facts, there is a duty to disclose material facts. Robson Link & Co. v. Leedy Wheeler & Co., 18 So.2d 523 (Fla. 1944); Ramel v. Chasebrook Construction Company, 135 So.2d 876 (Fla. 2d DCA 1961). See generally Quinn v. Phipps, 93 Fla. 805, 113 So. 419, 420 (1927); Hooper v. Barnett Bank of West Florida, 474 So.2d 1253, 1257 (Fla. 1st DCA 1985); 37 Am. Jur. 2d Fraud and Deceit §§ 148-149; 27 Fla. Jur. 2d, Fraud and Deceit, §§ 38-39.

By way of analogy, there is no privilege for lawyers with respect to transactions which constitute the perpetration of a fraud. Kneale v. Williams, 30 So.2d 284 (Fla. 1947). If there is no privilege available to attorneys, there certainly is no privilege available to a bank, which has no statutory privilege, but simply a qualified duty not to disclose information concerning its customers in non-fraud situations.

This Court's recent statement in Johnson v. Davis, 480 So.2d 625 (Fla. 1985), speaks clearly to the bank's

obligation and duty to disclose all the material facts to Dr. Hooper before he made the loan:

> One should not be able to stand behind the impervious shield of caveat emptor and take advantage of another's ignorance. Our courts have taken great strides since the days when the judicial emphasis was on rigid rules and ancient precedents. Modern concepts of justice and fair dealing have given our courts the opportunity and latitude to change legal precepts in order to conform to society's needs. Thus, the tendency of the more recent cases has been to restrict rather than extend the doctrine of caveat emptor. The law appears to be working toward the ultimate conclusion that full disclosure of all materials facts must be made whenever elementary fair conduct demands it.

Id. at 628.

Recognizing that non-disclosure is as devastating as disclosure, this Court noted:

> In theory, the difference between misfeasance and nonfeasance, action and inaction is quite simple and obvious; however, in practice it is not always easy to draw the line and determine whether conduct is active or passive. That is, where failure to disclose a material fact is calculated to induce a false belief, the distinction between concealment and affirmative representations is tenuous. Both proceed from the same motives and are attended with the same consequences; both are violative of the principles of fair dealing and good faith; both are calculated to produce the same result; and, in fact, both essentially have the same effect.

Id.

Thus, although Barnett Bank and Florida Bankers Association rely on Milohnich v. First National Bank of Miami Springs, 224 So.2d 759, that case did not involve fraud. The court in Milohnich was not required to decide whether a bank would be prohibited from making disclosure when, as here, the facts required disclosure. Id. at 762.

Barnett Bank suggests that the if the bank refused to make the loan it would violate the Equal Credit Opportunity Act, 15 United States Code Section 1691 et seq., and its regulations. The Equal Credit Opportunity Act, has as its purpose the prevention of discrimination by lenders against borrowers based on race, color, religion, national origin, sex, marital status or age. Neither the act nor the regulations speak to the bank's option to refuse to make a loan when it has knowledge of fraudulent activities of one of its depositors who arranges the loan in question.

Section 202.9 of the regulations is not applicable to extensions of credit primarily for business or commercial purposes. See 12 C.F.R. § 202.3(e)(2).

The bank's suggestion that the Equal Credit Opportunity Act would have prevented it from refusing to make the loan flies in the face of its loan office Edwin Riffel's statement:

Q. Now, with that knowledge and your feeling that you could not disclose that to Dr. Hooper, you could have simply told Dr. Hooper we are not going to make the loan, isn't that correct?

A. I could have, yes.

(T. 155.)

The Equal Credit Opportunity Act was not written to preclude a bank from denying or refusing to make a loan to one customer when fraudulent activities of another customer are involved. Barnett's reference to the act simply is not relevant to any determination of the important issues now before this Court.

Similarly, the Florida Bankers Association contends that the Fair Credit Reporting Act of 1970 and the Right to Financial Privacy Act of 1978 are applicable. A similar contention was rejected in Tokarz v. Frontier Federal Savings & Loan Association, 33 Wash. App. 456, 656 P.2d 1089 (Ct. App. 1983), which held:

> Frontier contends it therefore had a legal duty not to disclose financial information about Mr. Post to Tokarz by virtue of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681-1681t, and the Financial Privacy Act, 12 U.S.C. §§ 3401-22. The federal legislation is inapplicable since the former act applies only to "consumer reporting agencies" and Frontier does not fit within the definition and the latter applies only to access by a "government authority", and neither party is a government authority. Thus, we must

> weigh the bank's duty not to disclose information about a customer against the duty to disclose which may arise under special circumstances.

656 P.2d at 1092-1093 (emphasis partially supplied).

The Florida Bankers Association suggests that the Right to Financial Privacy Act was enacted in response to United States v. Miller, 425 U.S. 435, 96 S. Ct. 1619, 48 L. ed. 2d 71 (1976). It is interesting to note that the Supreme Court of the United States in Miller stated:

> Even if we direct our attention to the original checks and deposit slips, rather than to the microfilm copies actually viewed and obtained by means of the subpoena, we perceive no legitimate "expectation of privacy" in their contents. The checks are not confidential communications but negotiable instruments to be used in commercial transactions. All of the documents obtained, including financial statements and deposit slips, contain only information voluntarily conveyed to the banks and exposed to their employees in the ordinary course of business. The lack of any legitimate expectation of privacy concerning the information kept in bank records was assumed by Congress in enacting the Bank Secrecy Act, the expressed purpose of which is to require records to be maintained because they "have a high degree of usefulness in criminal, tax, and regulatory investigations and proceedings."

425 U.S. at 442-443 (citation omitted).

Barnett's and the Florida Bankers Association's repeated statements suggesting Dr. Hooper was obligated to inquire whether or not he was being defrauded - even after being advised Hosner's investments were sound - are not supported by the law in Florida as recently firmly stated by this Court in Besett v. Basnett, 389 So.2d 995 (Fla. 1980) and Johnson v. Davis, 480 So.2d 625 (Fla. 1985).

Barnett cites Klein v. First Edina National Bank, 293 Minn. 418, 196 N.W.2d 619 (1972) and Tokarz v. Frontier Federal Savings & Loan Association, 33 Wash. App. 456, 656 P.2d 1089 (Ct. App. 1973) as supporting its position. So did the First District Court of Appeal. Although the facts in those cases were not sufficient to support the claims of the plaintiffs, in each case the court enunciated sound applicable rules of law which the First District Court of Appeal properly followed.

There is not and should not be any right to privacy when fraud is involved. Neither Barnett nor the Florida Bankers Association has cited any decision which affords a right of privacy to fraudulent conduct.

CONCLUSION

This Court should not adopt a rule of law, contrary to the authorities cited in this brief and the First District Court of Appeal's decision, which would permit or require concealment of fraudulent activity.

This Court has an opportunity to hold and should hold that there are special circumstances, as here, in which a bank's qualified duty of nondisclosure must give way to a greater duty to prevent harm to a customer of the bank. This Court also should hold that in Florida a bank which elects not to disclose the fraudulent activities of one customer to another should refrain from making a loan to the other customer. See Richfield Bank & Trust Co. v. Sjogren, 244 N.W.2d 648, 652 n.2 (Minn. 1976); Hooper v. Barnett Bank of West Florida, 474 So.2d at 1258-1259. The decision of the First District Court of Appeal should be approved.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been furnished to Mr. Robert P. Gaines, 7th Floor, Blount Building, Post Office Box 12950, Pensacola, FL 32576 and Mr. James L. Bacchus and Susan V. Wheeler, Post Office Box 231, Orlando, FL 32802, by U. S. Mail delivery, this 18th day of March, 1986.

Donald H. Partington

DONALD H. PARTINGTON