IN THE
SUPREME COURT
FOR THE STATE OF FLORIDA

CASE NO. 73,350
DCA-1 BS-398

WARREN FINANCE, INC., a Florida corporation,

Petitioner,

vs.

BARNETT BANK OF JACKSONVILLE, N.A.,
a national banking association,

Respondent.

APPEAL FROM THE DISTRICT COURT OF APPEAL
FOR THE FIRST DISTRICT, STATE OF FLORIDA

REPLY BRIEF OF WARREN FINANCE, INC.

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I. INTRODUCTION: BARNETT ATTEMPTS FIRST TO DISTINGUISH, AND THEN TO BLUR THE DISTINCTION BETWEEN, BANK DEFENSES AND THIRD-PARTY DEFENSES AS A BASIS FOR DISHONORING CASHIER'S CHECKS.

The gravamen of this case is whether Barnett Bank of Jacksonville, N.A. ("Barnett") is entitled to dishonor three cashier's checks (the "Cashier's Checks") presented for payment by Warren Finance, Inc. ("Warren Finance") as endorsee, irrespective of whether or not Warren Finance qualifies as a holder in due course, based on the defenses of the payee of the checks, Redan Engineering, Inc. ("Redan"). Barnett has argued in its Answer Brief that viewing the facts in the light most favorable to Barnett, Warren Finance is not a holder in due course and that Barnett has the right to assert its own defenses and those of Redan against payment of the checks.

In its "Statement of the Case and Facts," Barnett carefully distinguishes between the issuing bank's right to assert its own defenses to the payment of a cashier's check versus those of a payee. Barnett first makes a lame attempt to assert a bank defense based on the circular argument that Barnett does not have a duty to pay Warren Finance by virtue of the fact that it chose to pay Redan instead. Barnett ***goes*** on to obfuscate the issue to be decided in this case by misconstruing decisions allowing banks

to raise their own defenses as legal authority for Barnett's assertion that banks also may rely on the defenses of payees or intervening endorsees. As will be shown in greater detail below, Barnett has failed in its Answer Brief to cite a single case decided under the Uniform Commercial Code which holds that a bank is entitled to dishonor its own cashier's checks based not on its own defenses but on those of third parties, whether such third parties are payees or intervening endorsees.

11. BARNETT HAS NO COLORABLE DEFENSES OF ITS OWN.

Barnett attempts to raise as a bank defense to payment of the Cashier's Checks, the fact that after dishonoring the Cashier's Checks when presented for payment by Warren Finance, Barnett issued replacement checks to Redan. Barnett maintains that Redan could not require payment of the Cashier's Checks from Barnett, having already received replacement checks. Therefore, assuming that Warren Finance is not a holder in due course, Barnett argues that Warren Finance steps into Redan's shoes and has no greater rights to payment from Barnett than does Redan.

This argument is specious. If it were valid, a bank could dispose of conflicting claims to a cashier's check merely by paying one of the claimants. Barnett should not be permitted to argue on the basis of its fait accompli that there has been a failure of consideration for the payment of the Cashier's Checks.

In point of fact, Barnett received full consideration for the issuance of the Cashier's Checks. Barnett should not be allowed to manufacture a bank defense merely on the basis of the fact that through its own negligence it has chosen to pay Redan instead of Warren Finance.

As Barnett has pointed out on Page 3 of its Answer Brief, the question certified by the First District Court of Appeal as one of great public importance, failed to mention the issue of the bank's right to assert its own defenses. This omission stems from the fact that Barnett has failed to allege any colorable defenses of its own. The gist of Barnett's case rests on its allegation that banks are entitled to raise the defenses of payees and intervening endorsees as a basis for dishonoring their own cashier's checks.

III. BARNETT MISLEADINGLY RELIES ON CASES ALLOWING BANK DEFENSES AS THE BASIS FOR ITS CLAIM THAT PAYEE OR ENDORSEE DEFENSES ALSO MAY BE RAISED BY THE ISSUING BANK: BARNETT FAILS TO CITE A SINGLE CASE UNDER THE UCC ALLOWING A BANK TO RELY ON THIRD-PARTY DEFENSES IN ORDER TO AVOID PAYING A CASHIER'S CHECK.

Barnett maintains that it is entitled to raise Redan's disputes with Warren Finance as defenses to the payment of the Cashier's Checks. In Section IV of its Answer Brief, Barnett quotes from a number of cases as authority for its contention that the issuing bank is entitled to countermand a cashier's

check when presented for payment by a non-holder in due course. Answer Brief at 24-32. At one point, Barnett includes over a page of case citations in support of this proposition. However, a reading of the authorities relied upon by Barnett reveals that the excerpted portions have been misleadingly quoted out of context and that none of the cases has allowed a bank to avoid payment on its own cashier's check based on the defenses of any party other than the bank itself.

In short, first Barnett states that a bank may dishonor its own cashier's check on the basis of the bank's **own** defenses but fails to offer any factual basis for the existence of any bank defenses on Barnett's part. Then, Barnett claims that it is entitled to raise the defenses of Redan as payee but offers as authority for this proposition cases which uphold bank defenses but **not** third-party defenses.

For example, on Pages 25-26 of its Answer Brief, Barnett quotes from a Third Circuit Court of Appeals decision as authority for Barnett's position. Pulaski Chase Cooperative v. Kellouu-Citizens National Bank, 386 N.W.2d 510 (Wis. Ct. App. 1986). What Barnett fails to note is that the Pulaski case was limited by its terms to defenses of the bank itself. The Pulaski court ruled that "Kellogg [the bank] may assert its own defenses as a basis for dishonor although it may not **rely** on the defenses of any third party." Id. at 512 (emphasis added). Barnett failed to include this language when it quoted from the Pulaski case.

Similarly, on Pages 26 and 27 of its Answer Brief, Barnett quotes from the Anderson case, a Tenth Circuit Court of Appeals decision, as set forth in the first paragraph below, but neglects to include the underscored paragraph that follows, which appears in the case immediately after the portion excerpted by Barnett:

> No rights of third party holders in due course of the check are involved in the dispute. Under these circumstances "the strong considerations of public policy favoring negotiability and reliability of cashier's checks" are not present. [Citation omitted.] The Bank can therefore assert the defense of fraud against Acco. If fraud was present, the stop order on the cashier's check was justified. [Barnett ended its quoted material here.]
>
> This reasoning is limiting to situations in which a payor bank refuses to honor a cashier's check when Presented by the payee who is not a holder in due course but rather is a party whose fraud induced the bank to issue the check. Thus, a finding of fraud on the part of the payee which (or who) induced the issuance of the check is necessary.

Anderson, Clayton & Co. v. Farmers National Bank of Cordell, 624 F.2d 105, 110 (10th Cir. 1980) (emphasis added).

Barnett neglects to advice the Court that the language it has quoted is limited to situations in which the bank has been induced to issue a cashier's check on the basis of fraudulent misrepresentations made to the bank by the payee.

Virtually all the cases in Barnett's full page of string cites involved the assertion of bank defenses as opposed to third-party defenses. Only two cases cited by Barnett allowed third-party defenses: the Leo Syntax case, the 1965 Ohio trial

court case decided on the basis of pre-Code law which was relied upon by the First District Court of Appeal in the instant case, and a pre-UCC Indiana case which also relied upon Leo Syntax. Leo Syntax Auto Sales, Inc. v. Peoples Bank & Savings Co., 215 N.E.2d 68 (Tuscarawas Co. C. P. 1965); First National Bank of Mishawaka v. Associates Investment Co., 221 N.E.2d 684 (Ind. Ct. App. 1966).

Moreover, two of the cases included by Barnett in its string cites specifically held that the issuing bank is **not** entitled to raise third-party defenses. Both involved the contract defenses of the purchaser of a cashier's check arising out of the underlying transaction for which the check was issued. Louis Falcigno Enterprises, Inc. v. Massachusetts Bank and Trust Co., 436 N.E.2d 993 (Mass. App. Ct. 1982); Moon Over the Mountain, Ltd. v. Marine Midland Bank, 87 Misc. 2d 918, 386 N.Y.S.2d 974 (N.Y. Civ. Ct. 1976).

Barnett has failed to offer a single case decided under the Uniform Commercial Code that allows the issuing bank to assert defenses to payment of its own cashier's check even against one who is not a holder in due course based on the third-party claims of a payee or intervening endorsee. Instead, Barnett relies on selective quotation of favorable language and lengthy citation of cases which it leads us to believe are in its favor. Barnett's misleading quotations and citations seek to obfuscate the fact that if the DCA's decision

in the instant case is upheld, Florida will be the **sole** jurisdiction in the United States to have held that banks are entitled to raise third-party defenses when a cashier's check is presented for payment by one who is not a holder in due course.

The DCA's decision has already begun to draw criticism by virtue of its neglect of precedent and its attempt to create an artificial distinction between purchaser and payee defenses. One commentator has severely criticized the distinction the DCA made between the defenses of Redan as purchaser (which the DCA conceded were not allowed) and the defenses of Redan as payee (which the DCA has permitted Barnett to assert), noting that the distinction was made "without any citation of authority." The commentator emphasized that third-party defenses of any kind are never available:

> The court's distinction is not justified by the case law, which does not give the bank the discretion to dishonor a cashier's check based on any third-party defenses. It is also not justified by the language of the UCC or by sound notions of public policy. Whether the transferor of a cashier's check in payment of an obligation is the original remitter or another party designated as payee, the risk of transferee misbehavior is properly on the transferor's shoulders in the case of a cash equivalent as the means of payment. To allow the bank to stop payment at the request of a favored customer is to undercut the utility of cashier's checks as a substitute for cash in the commercial marketplace.

B. Clark, The Law of Bank Deposits, Collections and Credit Cards, ¶2.6[3][6] (2d ed. Supp. 1988) (emphasis in the original).

"[O]nce a cashier's check is issued, the bank's obligation is substituted for that of the remitter, and any defenses asserted thereafter must be the bank's own and not those of a third party." Id. Florida should not be the sole jurisdiction to have decided under the Code that this rule ought not to apply within its boundaries.

IV. BARNETT'S APPLICATION OF DEFENSES TO PAYMENT ALLOWED UNDER SECTION 3-306 OF THE CODE AGAINST PERSONS WHO ARE NOT HOLDERS IN DUE COURSE WOULD MAKE CASHIER'S CHECKS IDENTICAL TO ORDINARY CHECKS.

Barnett asserts that cashier's checks should be treated like promissory notes and ordinary checks for purposes of Section **3-306** of the Uniform Commercial Code (enacted in Florida as Section **673.306,** Florida Statutes **(1987)).** Section **3-306** enumerates defenses that may be asserted against the holder of an instrument who is not a holder in due course. However, as emphasized above, none of the cases cited by Barnett allowed a bank to assert third-party defenses under Section **3-306.**

If, as Barnett argues, cashier's checks were subject to the same defenses as ordinary checks, there would be no reason whatsoever to have cashier's checks. As pointed out in a Minnesota decision cited by Barnett:

> A cashier's check, drawn on the bank's account rather than the purchaser's, is viewed as more trustworthy than a personal check. It follows that a cashier's check must be less subject to "stop payment."

Seman v. First State Bank of Eden Prarie, 394 N.W.2d 557, 560 (Minn. App. Ct. 1986) (emphasis added).

Bank defenses and, under the circumstances set forth in Section 673.306(4) Florida Statutes, third-party defenses may be asserted against someone who is not a holder in due course of a promissory note or an ordinary check. If a cashier's check is treated no differently than a promissory note or an ordinary check for purposes of Section 3-306, cashier's checks will not be any less subject to stop payment orders than promissory notes or ordinary checks. If such were the case, there would be no reason to use cashier's checks in lieu of ordinary checks. Accordingly, contrary to what Barnett argues, if Barnett's application of Section 3-306 is accepted, the utility of cashier's checks as negotiable instruments in the hands of endorsees will effectively be destroyed.

Moreover, Barnett is wrong in contending that Sections 674.303 and 673.418, Florida Statutes (1987), permit the assertion of third-party defenses under Section 673.306. Contrary to Barnett's allegations, the plain language of 674.303 is not limited to settling conflicting claims to a customer's account. Section 674.303, stating the effect of acceptance, reads in pertinent part as follows:

> Any . . . notice . . . received by, . . . a payor bank, whether or not effective under other rules of law to terminate, suspend or modify the bank's right or duty to pay an item **or** to charge its customer's account for the item, comes too late to *so* terminate, suspend or modify such right or duty if the . . . notice . . . is received . . . after the bank has done any of the following:

(a) Accepted or certified the item . . . .
(Emphasis added.)

Section **673.418** states that @@acceptanceof any instrument is final in favor of a holder in due course." When read together with commentary of the draftsmen of the Code, Section **673.418** "seems addressed to drafts drawn and presented for acceptance by someone other than the drawer himself, not to cashier's checks." Santos v. First National State Bank of New Jersey, **451** A.2d **401, 408** (N.J. Sup. Ct. **1982).** Moreover, even if this were not the case, Section **674.102** specifically provides that in the event of a conflict between Chapter **673** and Chapter **674,** Florida Statutes, the latter shall take precedence.

Barnett has therefore failed to establish that the issuance of a cashier's check does not constitute acceptance under the Code and that the issuing bank should therefore be permitted to assert the claims of third parties under **673.306.**

V. BARNETT'S POLICY ARGUMENTS WGDLD VITIATE THE UTILITY OF CASHIER'S CHECKS AS NEGOTIABLE INSTRUMENTS, CONTRARY TO DECISIONS UNDER THE CODE IN ALL OTHER JURISDICTIONS: THE VERY PURPOSE OF USING CASHIER'S CHECKS IS TO OBTAIN CERTAINTY OF PAYMENT, WHICH WILL NOT BE AVAILABLE IF THERE IS THE POSSIBILITY OF LITIGATION WITH THE DRAWEE BANK.

The only basis for Barnett's argument that the issuing bank should be entitled to rely on the defenses of a payee or endorsee is the policy argument that banks should not be called upon to assist persons who are not holders in due course in avoiding the

claims of the payee or intervening endorsee. To date, no court other than the DCA in the instant case has construed the Uniform Commercial Code on the basis of this policy argument.

As indicated in Barnett's Answer Brief, numerous courts have made a value judgment that a bank should not be required to honor its own cashier's check where the bank itself receives no consideration for the check (whether because of fraud against the bank or otherwise), so long as the check is not in the hands of a holder in due course. This value judgment is based on the fact that banks would be reluctant to do business if the law assisted purchasers of cashier's checks in defrauding banks into issuing cashier's checks for no consideration.(1)

However, given the central importance placed by the draftsmen of the UCC on negotiability, courts have uniformly held under the Code that where the bank has received payment for the issuance of a cashier's check, as occurred in the instant case, the issuing bank should not be entitled to dishonor the check based on the claims of third parties. Without exception, the courts have made the value judgment that society's interest in

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(1) It is worth noting that in the interest of negotiability, some courts even reject bank defenses on the theory that the bank should take steps to ensure that it has received full payment for a cashier's check before issuance. E.g., Kaufman v. Chase Manhattan Bank, 370 F.Supp 276 (S.D.N.Y. 1973); First Financial L.S.L.A. v. First American Bank & Trust Co., 489 So.2d 388 (La. Ct. App. 1986).

negotiability outweighs the bank's interest in accommodating customers who become embroiled in disputes with endorsees of cashier's checks. Where such disputes arise, society's interest in negotiability dictates that the issuing bank refrain from involving itself in the conflict, which is a matter to be settled between the contending parties themselves, as would be the case had cash been used in lieu of cashier's checks. **See**, State ex rel. Chan Siew Lai v. Powell, 536 S.W.2d 14, 16 (Mo. 1976) ("[T]he fraud allegedly practiced on Gunn [the purchaser] by Kin Tak [the payee], if true, afforded him no standing or authority to countermand the Bank's obligation to pay its check on demand; his remedy is by action against Kin Tak [the payee]").

In advancing its policy argument, Barnett has attempted to minimize the effect of the DCA's opinion by contending that it is limited to the narrow circumstances where the holder of a cashier's check is not a holder in due course. As emphasized by Warren Finance in its Initial Brief, this argument overlooks the fact that payees and endorsees seek immediacy and finality of payment through the use of cashier's checks because they do not wish to assume the risk of litigating whether or not they qualify as holders in due course. Cashier's checks are widely utilized precisely because holders do not want to be subjected to the delay and expense of legal challenges to their status as holders in due course, even though in most instances such challenges may ultimately result in a court determination in their favor.

Prior to the DCA's decision, it was taken as a given that once paid for and negotiated, a cashier's check would not be subject to the risk of litigation with the issuing bank. To allow banks to dishonor cashier's checks based on extraneous transactions between the endorsee and third parties would create the possibility of disrupting financial transactions whenever a payee or endorsee steps forward to challenge payment.

> Such a rule would undermine the public confidence in the bank and its checks and thereby deprive the cashier's check of the essential incident which makes it useful. People would no longer be willing to accept it as a substitute for cash if they could not be sure that there would be no difficulty in convertina it to cash.

National Newark & Essex Bank v. Giordano, 268 A.2d 327, 329 (N.J. 1970) (emphasis added). Upholding the DCA's decision would introduce uncertainty in the convertibility of cashier's checks to cash and thereby effectively destroy the predictability of payment of such instruments in the hands of endorsees which has heretofore been relied on so heavily in the commercial world.

CONCLUSION

Even assuming for purposes of this appeal that Warren Finance is not a holder in due course, Barnett does not have any defenses of its own, such as lack of consideration, against the payment of the Cashier's Checks. Even assuming that Warren Finance is not a holder in due course, Barnett is not entitled to raise the third-party defenses of Redan.

Barnett misleadingly cites cases upholding bank defenses as authority for the proposition that a bank is entitled to raise third-Party defenses against the payment of its own cashier's checks. Barnett has failed in its Answer Brief to offer a single decision under the Uniform Commercial Code upholding the assertion of third-party defenses by the issuing bank in the context of cashier's checks. If the DCA's opinion is affirmed by the Court, Florida will be the only state to have authorized such defenses under the Code.

Barnett seeks to avoid the consequences of its own negligence by attempting to rely on defenses asserted by Redan, which are a matter between Warren Finance and Redan. In arguing that Barnett is entitled to raise Redan's defenses under Section 3-306 of the Code, Barnett is effectively asking the Court to obliterate the distinction between ordinary checks, which are subject to defenses when held by persons who are not holders in due course, and cashier's checks, which have been recognized in all other Code cases as cash equivalents not subject to third-party defenses.

The Uniform Commercial Code and the cashier's check decisions rendered under it embody the value judgment that society's interest in negotiability outweighs the bank's interest in accommodating a customer or payee who is involved in a dispute with the endorsee of a cashier's check. Such dispute is a matter for resolution directly between the endorser and the endorsee,

just as would be the case if the endorser had paid the endorsee in cash. All other jurisdictions faced with the same question have correctly recognized that eliminating the distinction between cashier's checks and ordinary checks is too high a price to pay in order to permit banks to raise third-party defenses. Florida should not be the first and only state to fly in the face of the UCC and sound policy and precedent.

For the foregoing reasons, the decision of the First District Court of Appeal should be reversed in the trial court's grant of summary judgment reinstated.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been furnished by U.S. Mail to George L. Hudspeth, Esquire, Post Office Box 4099, Jacksonville, Florida 32201 and James A. Bledsoe, Jr., Esquire, 2501 Independent Square, Jacksonville, Florida 32202, this 1st day of February, 1989.

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