IN THE

PENNSYLVANIA SUPREME COURT

No. 53 EAP 2003

PIONEER COMMERCIAL FUNDING CORPORATION, et al.,

v.

AMERICAN FINANCIAL MORTGAGE CORPORATION, THOMAS F. FLATLEY, NORWEST FUNDING, INC., AND CORESTATES BANK, N.A.

ON APPEAL FROM THE SUPERIOR COURT OF PENNSYLVANIA

BRIEF ON THE MERITS OF APPELLEE PIONEER COMMERCIAL FUNDING CORPORATION

Ronald J. Mann
727 E. Dean Keeton Street
Austin, TX 78705
(512) 232-1357

FREY, PETRAKIS, DEEB, BLUM,
BRIGGS & MITTS, P.C.
Maurice R. Mitts
Frank G. Murphy
1601 Market Street, Twenty-Sixth Floor
Philadelphia, PA 19103
(215) 563-0500

Howard J. Bashman
1250 Virginia Drive
Suite 1000
Fort Washington, PA 19034
(267) 419-1230

Attorneys For Plaintiff/Appellee
PIONEER COMMERCIAL FUNDING CORPORATION

TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

STATEMENT OF FACTS AND PROCEEDINGS BELOW 1

SUMMARY OF ARGUMENT 10

ARGUMENT 13

1. THE BANK'S SETOFF WRONGFULLY CONVERTED PIONEER'S FUNDS 13

a. Pennsylvania Law Limits a Bank's Right of Setoff to Funds Owned by the Bank's Customers 14

b. UCC Article 4A Does Not Authorize the Bank to Take Funds That Are Not Owned by Its Customers 18

(i) Pennsylvania courts are skeptical of claims that the UCC rejects common-law rules 19

(ii) Section 4A-502's plain language cannot support the Bank's unprecedented argument 20

(iii) The structure and drafting history of § 4A-502 underscore the intention of the drafters to recognize a traditional, limited right of setoff 21

(iv) The Eleventh Circuit's decision in *Regions Bank* supports Pioneer's position 25

(v) Summary 28

c. The Passage of Months Before the Bank Set Off the Funds Makes It Irrelevant That the Funds Originally Reached the Bank by Wire Transfer 29

d. Liability in this Case Is Consistent with the Basic Structure of Article 4A 34

(i) Liability on these facts will not burden routine banking transactions 34

(ii) Article 4A does not preempt Pioneer's claim 35

(iii) The views of the Federal Reserve Banks do not justify reversal....................40

e. The Bank Would Not Have Had Priority Even if AFMC Had Owned the Funds and Pioneer Had Only a Security Interest in the Funds....................42

2. PIONEER'S INTEREST IN THE FUNDS WAS VALID....................43

3. BANKING CODE § 606 DOES NOT PROTECT A BANK THAT SETS OFF FUNDS AGAINST A CLAIM OF A THIRD PARTY IF THE BANK'S PURPORTED DEPOSITOR DISCLAIMS ANY INTEREST IN THE FUNDS....................47

a. Pioneer's Claim Is Not Adverse to the Purported Depositor Because the Purported Depositor Disclaimed Any Interest in the Funds....................48

b. Bank Protection Statutes Do Not Protect Banks That Take Funds by Setoff....................50

c. Summary....................52

4. THE AWARD OF COMPENSATORY DAMAGES WAS APPROPRIATE IN THIS CASE....................53

a. Pennsylvania Law Awards Compensatory Damages for the Tort of Conversion....................53

b. UCC Article 4A Does Not Limit the Damages Available in Nonstatutory Tort Actions....................56

5. PENNSYLVANIA LAW AUTHORIZES AN AWARD OF PUNITIVE DAMAGES BASED ON THE PERSISTENTLY MALICIOUS AND WILLFUL MISCONDUCT PROVEN IN THIS CASE....................57

CONCLUSION....................64

TABLE OF AUTHORITIES

Page(s)

Cases

Aarons v. Public Serv. Bldg. & Loan Ass'n, 318 Pa. 113, 178 A. 141 (1935) 31-33

Adolph Bergman Bldg. & Loan Ass'n v. Blaul, 318 Pa. 126, 178 A. 140 (1935)..............33

Allen v. Chase Manhattan Bank, 267 N.Y.S.2d 620 (N.Y. 1966) 51-52

Arizona Bank v. Wells Fargo Bank, 713 P.2d 337 (Ariz. Ct. App. 1985) 47-51

Banque Worms v. Bank America Int'l, 570 N.E. 2d 189 (N.Y. 1991)...............................28

Barnett Bank of Jacksonville, N.A. v. Jacksonville Nat'l Bank,
457 So.2d 535 (Fla. Dist. Ct. App. 1984) 48, 50

Bean v. Agard, 252 F. 3d 113 (2d Cir. 2001)..45

Bell v. Citizens Nat'l Bank, 9 S.E. 2d 143 (W. Va. 1940) 53

BMW of North America, Inc v. Gore, 517 U.S. 559 (1996)...58

Burnett v. Griffith, 769 S.W. 2d 780 (Mo. 1989)...58

Caban v. Dep't of Public Welfare, 431 A.2d 1163 (Pa. Commw. 1981) 50

In re Caplan Estate, 48 Pa. D&C.2d 117, 1968 WL 6871 (Ct. Com. Pl. 1968)................19

Carl v. Republic Security Bank, 282 F. Supp. 2d 358 (S.D. Fla. 2003)............................38

Century Indem. Co. v. Bank of Gowanda, 35 N.Y.S.2d 396 (N.Y. 1941).........................15

Citizens Bank of Maryland v. Strumpf, 516 U.S. 16 (1995) 30, 33

Collins v. First Financial Services, Inc., 815 P.2d 411 (Ariz. Ct. App. 1991)..................55

Commonwealth v. Lurie, 524 Pa. 56, 569 A.2d 329 (1990) 20

Commonwealth v. Miller, 469 Pa. 27, 364 A.2d 886 (1976)...19

Commonwealth v. Patton, 546 Pa. 562, 686 A.2d 1302 (1997) 7

Commonwealth v. Revtai, 516 Pa. 53, 532 A.2d 1 (1987)....................20

Community Bank, FSB v. Stevens Fin. Corp., 966 F. Supp. 775 (N.D. Ind. 1997)...........38

Cooper Indus., Inc. v. Leatherman Indus., Inc., 532 U.S. 424 (2001)....................58

Daly v. Atl. Bank, 614 N.Y.S.2d 418 (N.Y. App. Div. 1994)....................39

Dartt v. Browning-Ferris Indus., Inc., 691 N.E. 2d 526 (Mass. 1998)....................58

Delahanty v. First Pennsylvania Bank, N.A., 318 Pa. Super. 90, 464 A.2d 1243 (1983)....................53, 59

Domain Indus., Inc. v. First Security Bank & Trust Co., 230 N.W.2d 165 (Iowa 1975)....................48, 51

E.F. Houghton & Co. v. Doe, 427 Pa. Super. 303, 628 A.2d 1172 (1993)............43, 50-52

FDIC v. Golden Imports, Inc., 859 S.W. 2d 635 (Tex. Ct. App. 1993)....................15

Feld v. Merriam, 506 Pa. 383, 485 A.2d 742 (1984).................... 57-59

Firstar Eagan Bank v. Marquette Bank Minneapolis, 466 N.W.2d 8 (Minn. Ct. App. 1991)....................39

First Bank of Whiting v. Samocki Bros. Trucking Co., 509 N.E.2d 187 (Ind. Ct. App. 1987).................... 47-49, 51

In re Garofalo's Finer Foods, Inc., 164 B.R. 955 (Bankr. N.D. Ill. 1994)....................39

Gendler v. Sibley State Bank, 62 F. Supp. 805 (N.D. Iowa 1945)....................49

General Elec. Credit Corp. v. Tarr, 457 F. Supp. 935 (W.D. Pa. 1978).................... 33-34

Goldstein v. Riggs Nat'l Bank, 459 F.2d 1161 (D.C. Cir. 1972)....................49

In re Gordon, 319 Pa. 367, 179 A. 592 (1935)....................17

Hansman v. Imlay City State Bank, 328 N.W. 2d 653 (Mich. Ct. App. 1982)....................15

Hollock v. Erie Ins. Exch., No. 298 MDA 2002, 2004 WL 100468 (Pa. Super. Ct. Jan. 22, 2004)....................62

Housing Authority v. Civil Service Comm'n, 556 Pa. 621, 730 A.2d 935 (1999)............19

Ingram v. Hocking Valley Bank, 708 N.E.2d 232 (Ohio Ct. App. 1997)....................51

Iola State Bank v. Bolan, 679 P.2d 720 (Iowa 1984)................................15, 39, 58, 60, 63

Kirkbride v. Lisbon Contractors, Inc., 521 Pa. 97, 555 A.2d 800 (1989) 59

LFG, LLC v. Navarre, No. 01C9451, 2002 WL 1379112 (N.D. Ill. June 26, 2002).........15

LTV Steel Co. v. W.C.A.B. (Mozena), 562 Pa. 205, 754 A.2d 666 (2000).........................20

Loyal Christian Benefit Ass'n v. Bender, 342 Pa. Super. 614,
493 A.2d 760 (1985) 56

Luxonomy Cars, Inc. v. Citibank, 408 N.Y.S.2d 951 (N.Y. App. Div. 1978) 15

In re McConville, 110 F.3d 47 (9th Cir. 1997) 45

McKeeman v. CoreStates Bank, N.A., 2000 Pa. Super. 117,
751 A.2d 655 (Pa. Super. 2000)...15

Middle Atl. Credit Corp. v. First Pennsylvania Banking & Trust Co.,
199 Pa. Super. 456, 185 A.2d 818 (1962)..19, 42, 43

Mitzelfelt v. Kamrin, 526 Pa. 54, 584 A.2d 888 (1990) 1, 40

Montgomery County Bank v. Reese, 26 Pa. 143 (1856)...54

Moorhead v. Crozer Chester Med. Ctr., 564 Pa. 156, 765 A.3d 786 (2001)................... 54

Nat'l Bank v. Ins. Co., 104 U.S. (14 Otto) 55 (1881) 15

Neuman v. Corn Exchange Nat'l Bank & Trust, Co., 356 Pa. 442,
51 A.2d 759 (1947) 54

In re Nomination Papers of Lahr, No. 765 MAL 2003, 2004 WL 304331
(Pa. Feb. 17, 2004) 22

O'Donnell v. Bank of Vermont, 692 A.2d 1212 (Vt. 1997) 39

Pennsylvania Nat'l Bank & Trust Co. v. CCNB Bank, 446 Pa. Super. 625,
667 A.2d 1151 (1995) 31, 43

Phelps v. Louisville Water Co., 103 S.W. 3d 46 (Ky. 2003) 58

Pittsburgh Nat'l Bank v. United States, 657 F.2d 36 (3d Cir. 1981)........................... 31-33

Regions Bank v. Provident Bank, Inc., 345 F.3d 1267 (11th Cir. 2003) 1, 25-28, 36

Rizzo v. Haines, 520 Pa. 484, 555 A.2d 58 (1989) 57

Royal Bank v. Selig, 434 Pa. Super. 537, 644 A.2d 741 (1994) 31

Ryan Bros. v. Curwensville State Bank, 382 Pa. 248, 114 A.2d 178 (1955) 16

Schenkel v. Flaster, 49 UCC Rep. Sev. 2d 1274, 2002 WL 31831555
(3d Cir. Dec. 18, 2002) 38

Sheerbonnet, Ltd. American Express Bank, Ltd., 991 F. Supp. 403
(S.D. N.Y. 1995) 37, 38

Sherts v. Fulton Nat'l Bank, 342 Pa. 337, 21 A.2d 18 (1941) 15-16, 17, 52

Shonberger v. Oswell, 365 Pa. Super. 481, 530 A.2d 112 (1987) 14

SHV Coal, Inc. v. Cont'l Grain Co., 526 Pa. 489, 587 A.2d 702 (1991)..................... 57-59

South Central Livestock Dealers, Inc. v. Security State Bank,
551 F.2d 1346 (5th Cir. 1977) 19

Southern Elec. Supply Co. v. Raleigh County Nat'l Bank,
320 S.E. 2d 515 (W. Va. 1984)..15

State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408,
123 S.Ct. 1513 (2003)...58

Steuart v. McChesney, 498 Pa. 45, 444 A.2d 659 (1982) 6

Stevenson v. Economy Bank of Ambridge, 413 Pa. 442, 197 A.2d 721 (1964) 14

Stevenson v. First Nat'l Bank of Washington, 395 A.2d 21 (D.C. Ct. App. 1978)............51

Straus v. Tradesman's Nat'l Bank, 25 N.E. 372 (N.Y. 1890) 15

United States v. Lam, 338 F.2d 868 (8th Cir. 2003) 27

Utica Sheet Metal Corp. v. J.E. Schecter Corp., 278 N.Y.S.2d 345 (N.Y. 1967).............15

Walter v. Nat'l Bank, 330 N.E. 2d 425, 427-29 (Ohio 1975) 15

Witherow v. Weaver, 337 Pa. 488, 12 A.2d 92 (1940) 16

Statutes

Pennsylvania Statutes

Act of June 16, 1836, formerly codified at 12 P.S. § 2113 31

1 PA. CONS. STAT. ANN. §1903 .... 21, 25

1 PA. CONS. STAT. ANN. § 1921(5) 19-20

1 PA. CONS. STAT. ANN. § 1922 18

1 PA. CONS. STAT. ANN. § 1928 (a) 19

PA STAT. ANN., tit. 7, § 606 (1965) 12, 47, 52

PA STAT. ANN., tit. 7, § 606(a)(1) (1965) 48

Uniform Commercial Code

UCC § 1-103 23

UCC § 1-201 3

UCC § 3-201 3

UCC § 3-201, comment 1 3

UCC § 3-205(b) 3

UCC § 3-301 3

UCC § 3-302(a)(2) 28

UCC § 4-303(a) 22

UCC § 4-402 49

UCC § 4A-102 37

UCC § 4A-103(a)(1) 20

UCC § 4A-109(8) (Proposed March 1987 draft) 38

UCC § 4A-109(8) (Proposed Nov. 1986 draft) 38

UCC § 4A-109 comment 7 (Proposed Nov. 1986 draft) 38

UCC § 4A-205 36

UCC § 4A-208 (Proposed Aug. 1987 draft) 22

UCC § 4A-209 27

UCC § 4A-211 36

UCC § 4A-301(9) (Proposed March 1987 draft) 38

UCC § 4A-305 37

UCC § 4A-404 37

UCC § 4A-404(a) 24

UCC § 4A-405 ....10, 25, 37, 41

UCC § 4A-405 (Proposed Feb. 1989 draft) 25

UCC § 4A-405 (Proposed Apri1 1989 draft) 25

UCC § 4A-405(a) 24

UCC § 4A-405(a)(ii) 24

UCC § 4A-405 comment 1 24

UCC § 4A-406(a) 24

UCC § 4A-502 ....10-11, 13-14, 16, 18, 20-21, 23-25, 29-30, 34, 41

UCC § 4A-502 (Proposed Feb. 1989 draft) 25

UCC § 4A-502 (Proposed April 1989 draft) 25

UCC § 4A-502(b) 22

UCC § 4A-502(c) 22

UCC § 4A-502(c)(1) 24, 31

UCC § 4A-502(c)(2) 22

UCC § 4A-502(c)(3) 22

UCC § 4A-502 comment 2 ....22, 24

UCC § 9-203(1) 44

UCC § 9-203(1)(a) 44

UCC § 9-203(1)(b) 44

UCC § 9-203(1)(c) 44

UCC § 9-203 comment 3 44

UCC § 9-306(4)(d) 19

Rev. UCC § 9-203 comment 4 44

Rev. UCC § 9-203(b)(3)(B) 44

Rev. UCC § 9-340 comment 2 43

Federal Statutes

11 U.S.C.A. § 364(c) 45

11 U.S.C.A. § 549(a)(2)(B) 45

11 U.S.C.A. § 549(d) 46

11 U.S.C.A. § 552(a) 44

Statutes of Other States

OHIO STAT. § 2913.51 27

Secondary Sources

10 AM. JUR. 2D BANKS AND FINANCIAL INSTITUTIONS 39, 48-49, 63

B. Clark & B. Clark, *The Law of Bank Deposits, Collections & Credit Cards*...........39, 42

Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT L. REV. 963 (1999)................... 42

C.C. Marvel, Annotation, *Construction, Application and Effect of Statute Relating to Notice to Bank of Adverse Claim to Deposit*, 62 A.L.R. 2d 1116 (1995).......47

5A MICHIE ON BANKS AND BANKING (M. Divine & G. Legner eds. 1994).......................39

Fred H. Miller & Alvin C. Harrell, THE LAW OF MODERN PAYMENT SYSTEMS AND NOTES (Practitioner's Edition 2002)..28

2 PATON'S DIGEST (1942)... 47, 49

RESTATEMENT (SECOND) OF CONTRACTS (1981) 54-55

RESTATEMENT (SECOND) OF TORTS (1965)... 46, 54, 57-58

B.C. Ricketts, Annotation*, Bank's Right to Apply Third Persons' Funds, Deposited in Debtor's Name, on Debtor's Obligation*, 8 A.L.R.3d 235 (1966) 16, 39

James J. White & Robert S. Summers, UNIFORM COMMERCIAL CODE, 22-8 (5th ed. 2000) 44

STATEMENT OF FACTS AND PROCEEDINGS BELOW

This case presents this Court with two starkly differing perspectives on the responsibility that banks bear for their conduct. Appellant Corestates Bank, N.A. (the "Bank") articulates the view that the interest in ensuring that banks can cheaply and profitably provide services to the community justifies special rules that insulate banks from responsibility for their wrongful acts. Our view is that theft is wrong, and that tortious conversion should be remedied even when a bank is the tortfeasor. As we explain below, it is not seriously disputed that the conduct that the jury, trial court, and Superior Court condemned is wrongful under the common-law doctrines that this Court has articulated. It also is plain that no court previously has recognized the startling exemption from liability that the Bank finds in the simple language of the Uniform Commercial Code. The only court that has considered the question expressly (the United States Court of Appeals for the Eleventh Circuit, in *Regions Bank v. Provident Bank, Inc.*, 345 F.3d 1267 (11th Cir. 2003)) firmly rejected the Bank's view of the matter. The Bank's arguments offer no reason for departing from the straightforward application of existing law to the facts of this dispute.

The Bank's brief violates the cardinal rule that the facts must be viewed in the light most favorable to the party in whose favor a verdict was rendered. *Mitzelfelt v. Kamrin*, 526 Pa. 54, 584 A.2d 888 (1990). Accordingly, Pioneer now sets forth an accurate statement of the facts and proceedings below.

1. The relevant transactions start from a business arrangement between Appellee Pioneer Commercial Funding Corporation ("Pioneer"), a company in the business of lending money to mortgage bankers, and RNG Mortgage Services, Inc. ("RNG"), a California mortgage banker in the business of making mortgage loans to consumers. Under that arrangement, Pioneer

would provide the funds for the consumer mortgage loans that RNG originated. When the transactions closed, RNG would indorse and assign the homeowners' promissory notes in blank and deliver them to Pioneer. Pioneer, in turn, would deliver the promissory notes to its own lender, Bank One Texas, N.A. ("Bank One"), as collateral for Pioneer's credit line from Bank One. Bank One would store the notes in its vault and would release them when they were purchased by a secondary-market investor. Super. Ct. Op. 2.

Those affairs were complicated when RNG filed for bankruptcy in 1997. Shortly thereafter, a Pennsylvania mortgage banker named American Financial Mortgage Corporation ("AFMC") began negotiations to acquire RNG. To keep RNG operating while those negotiations continued, AFMC needed to ensure that RNG could continue to originate mortgage loans. To that end, AFMC and its principal Thomas Flatley entered into agreements with Pioneer to induce Pioneer to continue funding RNG loans despite RNG's bankruptcy. Pursuant to those agreements, AFMC arranged for Norwest Funding, Inc. ("Norwest") to purchase from RNG the consumer mortgage notes that RNG continued to originate. As is typical in such transactions, Norwest sought a guarantee of performance by the homeowners in the underlying mortgage transactions. In this case, it sought the guarantee from AFMC, its existing customer. To implement that aspect of the arrangement, the parties agreed that Bank One would send the mortgage notes with a bailee letter to AFMC and that AFMC in turn would forward the notes and bailee letters to Norwest. The bailee letters provided that the funds for those transactions were to be sent from Norwest to Pioneer's account at Bank One. Super. Ct. Op. 3.

A central point of dispute is the nature of AFMC's role in those transactions. The Bank includes in its statement of "undisputed" facts a characterization of the transactions as a sale of the mortgages from RNG to AFMC, followed by a second sale from AFMC to Norwest. *See*

CoreStates Br. 6-9, 35-42. Pioneer has contended, however, that AFMC never acquired title to the notes. Rather, AFMC's role was simply to provide a guarantee of the obligations of the underlying homeowners. The notes were sent to AFMC, under a bailee letter, solely to obtain the indorsement that was the vehicle for AFMC's providing that guarantee. AFMC then sent the notes and the bailee letter to Norwest. Because AFMC did not own those notes,[1] it did not own the money that Norwest paid for them. Consistent with Pioneer's understanding, and rejecting the Bank's version of the facts, the jury specifically found that AFMC did not own that money and that the Bank was liable for conversion of the funds in question. *See* Super. Ct. Op. 10

---

[1] The Bank asserts (CoreStates Br. 6-7) that the parties agreed that AFMC would be the "holder" of the notes. There are three basic problems with that assertion. First, the important question in this case is whether the Bank's depositor owned the notes. The relevant provisions of the Uniform Commercial Code (UCC §§ 1-201, 3-201, and 3-301) deal only with the status of a party as a holder of an instrument; status as an owner is something quite different. Among other things, it is clear that a party that acquires possession of a note under circumstances that would not make it an owner (a thief, for example), nevertheless becomes a holder. *See* UCC § 3-201 comment 1. So the Bank's argument that the particular character of the indorsements provides something useful for its claim of AFMC's ownership is incorrect. At most it could establish a status as holder, which is perfectly consistent with the claim of conversion accepted by the jury and lower courts.

Second, as a factual matter, the record does not support the Bank's assertion that the parties intended for AFMC to hold the notes. The testimony of Glenda Klein on which the Bank relies concludes on the page that the Bank cites with an unqualified assertion by Ms. Klein that the structure of the transactions did not involve a transfer to AFMC, but that the notes were simply sent to AFMC to get them to Norwest. R. 1244a.

Finally, as a matter of the law of negotiable instruments it is plain that the Bank is wrong in asserting that AFMC somehow became a holder. RNG indorsed the notes in blank (that is, indorsed them without indicating a particular party to whom it was indorsing them, *see* UCC § 3-205(b)), but that does not mean that any party that later had possession of the notes was a holder. As we explained to the Superior Court, AFMC took possession of the notes under the terms of the bailee letters, holding them in *trust* for Bank One and Pioneer. In that circumstance, AFMC had possession only as an agent, not as a holder (or owner) in its own right. See UCC § 3-201 comment 1 (discussing the significance of possession as an agent); Pioneer Super. Ct. Br. 18 & n.4.

(discussing that finding)[2]; R. 2376a-2377a. Immediately after receiving that verdict, the trial court interpreted it on the record as a finding that the money belonged to Pioneer. R. 2383a ("The jury has stated unequivocal[l]ly and found as a matter of fact that Pioneer * * * owned those funds that were in that account."). The Bank did not object at that time to the trial court's contemporaneous understanding of the verdict.

The trial court's opinion summarized the most important evidence and concluded that the finding was supported by the record. Ct. Comm. Pl. Op. 6-8 (noting that the "record in this case is heavy with testimonial and demonstrative evidence tending to show by a strong preponderance that Pioneer owned the notes"). The Superior Court reviewed the trial court's determination and also found that "there was sufficient evidence to support the jury's determination that Pioneer owned the [funds]." Super. Ct. Op. 10-11.

Nor does the Bank's heated presentation establish any substantial reason to think that the concurrent conclusions of the jury, the trial court, and the Superior Court erred on that heavily contested factual point. The Bank did not ask this Court to review that wholly factual question, which suggests that much of the Bank's complex factual presentation is not relevant to this Court's deliberations. In any event, almost all of the evidence on which the Bank relies tends to establish only that the parties wanted the notes to pass through the hands of AFMC and wanted AFMC to indorse them[3] or that the funds went to AFMC because AFMC was Norwest's

---

[2] The Bank asserts (CoreStates Br. 35 & n.22) that the interrogatories put to the jury did not ask for a finding about AFMC's interest in the funds. The record does not support the Bank's assertion. Read in context of the entire instructions, there can be little doubt that the jury was asked to decide if AFMC had an ownership interest in the fund, and that the jury concluded that AFMC did not have such an interest. *See* R. 2355a (quoted in Super. Ct. Op. 17). ("The other condition [of a valid setoff] is that the money must belong to AFMC. * * * That's a jury issue that you're going to answer: Was it AFMC's money * * * ?").

[3] That explanation applies to the following testimony on which the Bank relies:

customer.[4] None of that evidence is inconsistent with the view that the jury and the courts below have taken of the transactions – that AFMC's role was limited to a guarantor to Norwest of the underlying obligations of the homeowners. Moreover, it is fundamentally inconsistent with the Bank's view of the transactions as a purchase and resale by AFMC that the transaction was not structured to involve a payment by AFMC for the notes. R. 1442a (AFMC admits that fact). Even on the Bank's theory of the case (which the jury rejected), the relevant funds passed through AFMC's hands only as a matter of convenience in making a payment intended to run from Norwest to Pioneer and RNG. CoreStates Br. 7-8. That certainly was the view that the Bank's executives took at the time. R. 4238a (email between CoreStates executives dated Dec.

- Melanie Hotz (RNG): R. 1343a, 1391a-1392a, 1397a-98a, 1402a (cited at CoreStates Br. 6, 38) (suggesting that Norwest questioned RNG's net worth and that it was necessary for American Financial to become "responsible for those loans"). For further testimony consistent with our understanding, *see* R. 290b-291b.

- Glenda Klein (Pioneer): R. 1109a, 1242a-1245a, 1254a-1256a (cited at CoreStates Br. 36) (statements that "we needed to make sure that American Financial endorsed those notes" and unambiguous assertion that AFMC never owned the notes, see CoreStates Br. 36 n.23).

- Howard Seidman (AFMC): R. 1440a, 1445a, 1496a-1499a, 1511a-1512a (cited at CoreStates Br. 37) (statements that the loans "would come back to our company" "if there was a problem with one of these loans later").

The only testimony in support of the Bank's view is self-serving assertions by some AFMC employees. That testimony can bear little weight, given the plain testimony by Howard Seidman, executive vice president of AFMC and the person most involved in structuring the transactions, that AFMC was trying only to facilitate the sales and was not trying to take any interest or profit from the transactions. R. 1442a-1459a. The testimony of Thomas F. Flatley in particular is dubious given his frequent invocation of the Fifth Amendment, *see* R. 294b-312b, a fact that the jury was instructed that it could take into account in this civil case, R. 294b.

[4] That is true of the testimony of James Lovelace and Kevin Hannon, both employed by Norwest. *See* R. 2045a-2046a, 2054a (Lovelace testimony cited at CoreStates Br. 38) (statements that money had to go back to AFMC because AFMC "was our customer"); R. 1979a (Hannon testimony cited at CoreStates Br. 39) (statements that funds had to go back to AFMC because AFMC was "our customer").

12, 1997, a month after the funds arrive, before the setoff) ("This is a payment on a very convoluted transaction involving acompany in bankruptcy in California thatsold a portfolio of loans to Norwest. Go Figure how the funds got here.") (spacing and capitalization as in original).

Looking at the documentation for the transaction, the Bank can identify no document that even purports to involve a "purchase" by or a "sale" to AFMC.[5] On the premise that the best way to understand commercial transactions is to look at the documents that the parties use to implement them (*Steuart v. McChesney*, 498 Pa. 45, 48-49, 444 A.2d 659, 661 (1982) ("[T]he intent of the parties to a written contract is to be regarded as embodied in the writing itself.")), the absence of any such document is a notable "dog that does not bark" in the Bank's presentation. Looking at what the documents do affirmatively say, the message is distinctly unambiguous. As discussed above, the notes were sent to AFMC from Bank One under cover of bailee letters addressed to AFMC, which stated that the notes were

> being delivered to you for a purchase under the existing take out commitment [from Norwest] * * * Either payment in full for the collateral or the collateral itself must be received within 45 days after the date of this letter. **Until that time you are deemed to be holding the collateral in trust, subject to the security interest [of Bank One]. No property interest in the [notes] is transferred to you until [Bank One] receives [full payment, which never happened here.]**

Super. Ct. Op. 4 n.4 (emphasis added).[6] Because the bailee letters are the formal documents under which the mortgage notes were sent to AFMC, they are the most pertinent indicator of the

---

[5] The best that the Bank can do is to claim that a document identifies AFMC as a seller to Norwest. *See* CoreStates Br. 39-40. That document, however, is a general agreement governing transactions between AFMC and Norwest; it was not prepared for the transactions at issue here. R. 3202a. The documents we discuss – prepared and executed specifically for these transactions – answer the relevant factual question in Pioneer's favor directly and without ambiguity.

[6] The Bank asserts (CoreStates Br. 7 & n.4) that the Superior Court's description of the bailee letters is incorrect, claiming that the bailee letters were not forwarded to Norwest. Again, the record does not support the Bank's assertion. Norwest's own loan intake documents expressly acknowledge receipt of the bailee letter and note the date the bailment commenced

interest AFMC was to acquire. These documents provide in the most unqualified way that AFMC did not obtain title to the notes.[7] It is therefore difficult to give significant weight to the Bank's persistently contrary explanations of the transactions, which overlooks pertinent evidence, the jury's findings, and the Superior Court's affirmance of those findings.[8] "It is axiomatic that an appellate court should not substitute its judgment for that of the jury on an issue of fact; such a determination is solely within the province of the jury which had the exclusive opportunity to weigh the expert and lay testimony, observe the witnesses, and to form opinions on credibility." *Commonwealth v. Patton*, 546 Pa. 562, 568, 686 A.2d 1302, 1305 (1997).

2. Pursuant to the agreements discussed above, Norwest purchased two separate groups of mortgage notes. The first purchase took place in early November and proceeded as planned, except that Norwest wired the funds to AFMC's account[9] at the Bank instead of

---

(which is the date on the bailee letter). *See, e.g.,* R. 3619a, 3635a; *see also* R. 1140a-1141a (testimony of Glenda Klein, CFO of Pioneer, reporting that Howard Seidman of AFMC advised her that the bailee letters had been forwarded to Norwest).

[7] None of the sources on which the Bank relies in its discussion of bailee letters (CoreStates Br. 40-41) provide any support for ignoring the plain language of the letters. On the contrary, those sources simply describe a variety of common uses of the letters, many of which are distinct from their use in this case.

[8] The Bank asserts (CoreStates Br. 51) that the trial court erred in treating the question of ownership as a question of fact rather than a question of law. That question, however, was not presented on appeal to the Superior Court and thus is not properly before this Court. In any event, if AFMC's role is to be determined based solely on the documentation for the transaction (as the Bank suggests), then the bailee letters discussed above resolve the matter conclusively in Pioneer's favor, in accordance with the conclusions of the jury, the trial court, and the Superior Court.

[9] The Bank asserts (CoreStates Br. 4) that the account was covered by a "zero balance account agreement," under which funds automatically would be swept from the account periodically. The record does not support that assertion. Among other things, the record establishes that the account in fact did not operate as a zero-balance account, because it

Pioneer's account at Bank One. Upon request from AFMC, CoreStates promptly forwarded all of the funds to Pioneer within a couple of hours. Super. Ct. Op. 3-4.

This case involves Norwest's second purchase of loans from RNG, which occurred during the second week of November 1997. Because of the error in sending the funds for the first purchase, representatives of RNG, Pioneer, and AFMC contacted Norwest jointly to ensure that the funds for the second purchase would be sent directly to Pioneer's account at Bank One. Notwithstanding those joint instructions, AFMC unilaterally sent later instructions to Norwest asking that the funds be wired to AFMC instead of Pioneer. Super. Ct. Op. 5.[10] Norwest followed those instructions and sent the funds to AFMC's account at CoreStates; the funds were sent in three different transfers on November 12, 13, and 19, totaling $1,779,519.99. Super. Ct. Op. 5.

By the time the wire transfers were received for the second transaction, the Bank already had become concerned about AFMC's ability to repay $4 million of losses resulting from AFMC's two years of check-kiting activity.[11] Accordingly, the Bank had imposed a debit

---

maintained a positive balance throughout the time in question. R. 4025a. Moreover, the agreement to which the Bank refers is found nowhere in the record. The reason, as it happens, is that when the Bank attempted to introduce the agreement at trial, the trial court excluded it because it did not relate to this account and was not executed by the specific Bank entity that held the accounts at issue in this case. R. 323b-326b.

[10] The Bank asserts (CoreStates Br. 7, 32, 39) that the Superior Court's description is incorrect, claiming that AFMC instructed Norwest to wire payment to AFMC "[w]ith Pioneer's approval." The record does not support that assertion. *See* R. 1141a-1143a (testimony of Glenda Klein, CFO of Pioneer, that she never consented to having the funds sent to any destination other than to Pioneer's account at Bank One). Because Pioneer in fact did not consent to the funds being wired to AFMC, the Bank and its *amici* miss the mark when they argue that Pioneer should have required AFMC to establish a special account to ensure that Pioneer would receive the funds. CoreStates Br. 32-33; Penn. Bankers Br. 15-16.

[11] The Bank's assertion (CoreStates Br. 9) that it "had no notice that any party other than its depositor, AFMC, claimed or could claim any right in those funds" is inconsistent with its

restraint on all of AFMC's accounts, preventing any transfers of funds out of the account. Thus, when the parties (including AFMC) asked the Bank to forward the funds from AFMC's settlement account for the second transaction to Bank One, the Bank refused. Super. Ct. Op. 5-6. More than a month later, on December 19, 1997, the Bank removed the funds from the account into which they were wired. Moreover, other Bank documents establish that some or all of the funds remained in AFMC accounts until at least early February of the following year. R. 4075a (balance transferred from the account that received the wire remained in sweep account as of Feb. 2, 1998); *see also* R. 4093a ¶ 24 (Bank's RICO complaint against AFMC, discussing setoff on Jan. 20, 1998).

3. Because the Bank refused to return the funds, Pioneer commenced this suit, claiming that the Bank's actions constituted conversion. After a two-month jury trial, the jury returned a verdict in favor of Pioneer in the amount of $1,779,519.99 (direct damages), $13.5 million (consequential damages), and $337.5 million (punitive damages). In response to post-trial motions by the Bank, the trial court affirmed the liability findings and actual damages, Ct. Comm. Pl. Op. 6-30, but remitted the punitive damages to $40.5 million, resulting in a judgment in favor of Pioneer in the amount of $55,858,374.28, Ct. Comm. Pl. Op. 30-34.

4. Pioneer did not appeal the remittitur, but the Bank appealed to the Superior Court presenting five separate challenges to the trial court's decision. The Superior Court issued a lengthy opinion rejecting all of the Bank's challenges to the judgment and to the award of compensatory damages. Super. Ct. Op. 9-31. Judge Beck dissented in part, arguing that the

---

decision, before the funds arrived, to impose a restraint on the account. *See* CoreStates Br. 8 (emphasizing the information that caused the Bank to take that action before the funds arrived). Because the decision to impose the restraint rested on a concern about check-kiting, it necessarily reflected a concern by the Bank that funds that AFMC was purporting to deposit might in fact not belong to AFMC.

Bank's setoff was not invalid. Super. Ct. Op. 39-41. Finally, the Superior Court vacated the punitive damages award and remanded the case for a new trial on the amount of punitive damages. Super. Ct. Op. 31-38.

5. The Bank filed an application for reargument and reargument *en banc*, raising five separate challenges to the Superior Court's disposition. The application was denied; no judge of the Superior Court noted a dissent from the denial of the application.

6. The Bank then filed a petition for allowance of appeal in this Court, which this Court granted on December 2, 2003.

SUMMARY OF ARGUMENT

1. An action in tort to recover funds that a bank converts by a wrongful setoff has a distinguished tradition in the decisions of this Court. The Uniform Commercial Code ("UCC") did not eviscerate that cause of action for funds that are deposited into an account by wire transfer. The Bank urges a rule that would entrust banks with unconstrained authority to resolve their own financial difficulties at the expense of utterly innocent third parties. If a statute as sensible and carefully drafted as the UCC intended to give banks such an unprecedented blank check, it would have done so explicitly. In fact, the UCC says no such thing.

Rather, UCC § 4A-502 simply mentions the bank's right to set off as one method by which a bank can accept a wire transfer and pay the recipient. The provision explicitly cross-references UCC § 4A-405, which indicates that the right in question is limited to cases in which the setoff is "lawful." Here, as a factual matter, the Bank did not accept the wire transfer by setting off the funds. Moreover, the setoff was not lawful because the funds in question did not belong to the Bank's customer.

The Bank's right to accept a wire transfer by setoff under UCC § 4A-502 cannot be dispositive in this particular case, because the Bank did not use that provision to accept the funds and pay the beneficiary. Rather, it waited *months* after it received the funds before it removed them from its customer's accounts. Whatever the breadth of the right in UCC § 4A-502, it is a right to exercise a set off in connection with the receipt and processing of a wire transfer. It does not permanently impress some special character on the funds sent by wire that leaves them forever subject to treatment that would be tortious if the funds had been received in some other manner. The right to challenge the Bank's action is particularly plain when the claimant, as in this case, was not even a party to the transfer, and thus does not have access to the provisions of UCC Article 4A that apply to mistakes in the wire-transfer process.

2. The Bank's second argument is that Pioneer could not support a claim for conversion because defects in the approval of RNG's transactions during its bankruptcy proceeding defeat Pioneer's claim. That argument fails for four separate reasons. First, the Bank's argument that Pioneer did not acquire a security interest ignores the indisputably consensual pledge of the notes from RNG to Pioneer, which suffices to create a security interest. Second, to the extent the Bank is raising a complaint about the lack of bankruptcy court approval, the Bank – which had no claim of any kind in the RNG bankruptcy – has no standing to complain about any defect in the approval. Moreover, even if the Bank's argument about the lack of approval were valid, it would at most make Pioneer's interest subject to an avoidance action by the trustee; because the interest had not been avoided at any time, the possibility of such an action would not vitiate Pioneer's claim for conversion. In any event, the statute of limitations prevents the Bank from raising this contention at this time. Finally, even if the Bank were correct that federal bankruptcy law invalidated Pioneer's security interest in the funds,

Pioneer's right to possess the funds – arising from the bailee letters – is enough for Pioneer to maintain a conversion action against the Bank, which knowingly took money that its depositor did not own.

3. The Bank's third argument is an attempt to shift the blame for its wrongful conduct to Pioneer. Specifically, the Bank claims that Pioneer should have posted a bond and complied with the procedures set forth in Pennsylvania's adverse claims statute, PA. STAT. ANN., tit. 7, § 606 (1965). That argument is wrong for two separate reasons. First, the statute applies only to a claim that is adverse to the right of the purported depositor. This case did not involve such a claim because the supposed depositor, AFMC, disclaimed any interest in the funds and advised the Bank that the funds belonged to Pioneer. Second, the statute applies only to protect banks from harm if they choose between other claimants competing for funds deposited in the bank. It does not protect a bank that ignores a single uncontested third-party claim and instead takes such funds for itself. The purpose of the statute is to ensure that a bank that holds funds while a third-party claim that the depositor contests is resolved will not be subjected to liability for maintaining the status quo; the statute provides protection to a bank by requiring that the adverse claimant post a bond to protect the bank from any claim of the purported depositor. There is no need for a bond in a case like this one, where the depositor has waived any such claim and where the challenged action is a bank's own self-appropriation of the funds.

4. The Bank's fourth argument is that Pennsylvania law does not award compensatory damages for the tort of conversion when committed by a bank. That argument ignores fundamental principles of tort law, adopted by this Court, which indicate that the purpose of tort damages is to provide full compensation to the victim. The Bank's related argument that Article 4A implicitly precludes the usual full measure of compensatory damages is incorrect for

the same reason that UCC Article 4A does not preempt the cause of action for conversion: this case does not challenge the wire transfer or seek its reversal; the tortious conduct here was in fact unrelated to the receipt or processing of the transfer (it occurred months later); and the claimant (Pioneer) was not a party to the transfer.

5. The Bank's final argument challenges the propriety of punitive damages in this case. The Bank challenges both the standard by which those damages are imposed and its application to this case. First, the Bank claims that the United States Constitution prevents Pennsylvania courts from imposing punitive damages for willful and malicious tortious conduct because application of that standard unfairly surprised the Bank. The Bank's argument ignores long-settled Pennsylvania law governing the award of punitive damages, which made it entirely predictable that the Bank's conduct would be judged by that standard.

On the facts of this particular case, the Bank argues that punitive damages were inappropriate because it relied on the advice of its counsel. That defense cannot prevail, however, because the Bank and its lawyers ignored the actual facts known to the Bank, and because much of the wrongful conduct involved recalcitrance in the subsequent months and years that the relevant advice did not require.

ARGUMENT

1. The Bank's Setoff Wrongfully Converted Pioneer's Funds.

The first question on which this Court granted review is the Superior Court's determination (Super. Ct. Op. 9-19) that the Bank committed the tort of conversion. Our analysis of that question proceeds in five steps. First, we explain the longstanding Pennsylvania common-law rules that condemn the Bank's conduct. Second, we explain that UCC § 4A-502 does not create an exception to those rules. Third, we show that the Bank's conduct in this

particular case cannot be justified even under the Bank's view of UCC § 4A-502, because the Bank in fact did not implement a setoff under UCC § 4A-502 when it finally took Pioneer's money. Fourth, we rebut the Bank's claim that our analysis is inconsistent with the general framework of UCC Article 4A. Finally, we discuss the Bank's irrelevant claim that its alleged right of setoff would have been superior to the rights of a secured creditor of its depositor AFMC.

a. Pennsylvania Law Limits a Bank's Right of Setoff to Funds Owned by the Bank's Customers.

Pioneer's basic claim is that the Bank committed conversion by using a setoff to take money that the Bank knew belonged to Pioneer rather than AFMC. It is common ground under Pennsylvania law that the tort of conversion includes "deprivation of another's right of property in, or use or possession of, a chattel, without the owner's consent and without lawful justification." *Stevenson v. Economy Bank of Ambridge*, 413 Pa. 442, 451, 197 A.2d 721, 726 (1964) (internal quotation marks omitted); *see* Super. Ct. Op. 9 (same) (quoting *Shonberger v. Oswell*, 365 Pa. Super. 481, 484, 530 A.2d 112, 114 (1987)). Money qualifies as a chattel for purposes of the cause of action for conversion. *See Stevenson* (considering a cause of action for conversion by a bank of funds in a safety deposit box); Super. Ct. Op. 10 (citing *Shonberger*, 530 A.2d at 114).

The Bank suggests for the first time (CoreStates Br. 51-52) that conversion is not an appropriate remedy for a deposit account. *See also* Penn. Bankers Br. 33-35.[12] That argument was not presented to the Superior Court and is not embraced by the questions on which this

[12] The Bank's *amici* Pennsylvania Bankers Association also argues (Penn. Bankers Br. 32-34) that the conversion remedy was inappropriate because the bank was in lawful possession of the funds. That argument rests on the express assumption, rebutted below, that the setoff occurred automatically as a matter of law.

Court granted review. Accordingly, it is not properly before this Court. In any event, there is no basis in Pennsylvania law for the argument. Indeed, existing caselaw involving the activities of CoreStates plainly supports such a cause of action. *McKeeman v. Corestates Bank, N.A.*, 751 A.2d 655, 659 (Pa. Super. 2000) ("[O]nly Corestates, the bank where the account was held, had access to the account and the subsequent ability to 'deprive' [plaintiff] of her rights to it, as is required to show conversion."). The Bank relies here on a stray sentence in a 1978 decision of a lower court in New York. *Luxonomy Cars, Inc. v. Citibank*, 408 N.Y.S.2d 951 (N.Y. App. Div. 1978). The great weight of authority, however, recognizes a cause of action for conversion of a bank account. Indeed, despite frequent statements such as the quotation from *Luxonomy*, there are no cases that have absolved a bank for liability when it retained funds in the face of a claim to ownership by a third party that the bank knew to be valid. That is true both in the jurisdiction in which *Luxonomy* was decided[13] and also in the other states in which similar disputes have occurred.[14] Even the United States Supreme Court has adopted that perspective. *Nat'l Bank v. Ins. Co.*, 104 U.S. (14 Otto) 54, 63 (1881) (case interpreting general federal common-law). Furthermore, in some cases banks are held responsible under an "equitable" exception even without knowledge that a competing claim is valid. *E.g.*, *Sherts v. Fulton Nat'l Bank*, 342 Pa. 337, 340-41, 21 A.2d 18, 20 (1941); *FDIC v. Golden Imports, Inc.*, 859 S.W.2d 635, 640-41 (Tex. Ct. App. 1993).

---

[13] *Straus v. Tradesmen's Nat'l Bank*, 25 N.E. 372, 372-73 (N.Y. 1890); *Century Indem., Co. v. Bank of Gowanda*, 35 N.Y.S.2d 396, 397-98 (N.Y. 1941); *see also Utica Sheet Metal Corp. v. J.E. Schecter Corp.*, 278 N.Y.S.2d 345, 348 (N.Y. 1967) (discussing that rule).

[14] *Iola State Bank v. Bolan*, 679 P.2d 720, 731-32 (Kan. 1984); *Walter v. Nat'l City Bank*, 330 N.E.2d 425, 427-29 (Ohio 1975); *Southern Electrical Supply Co. v. Raleigh County Nat'l Bank*, 320 S.E.2d 515, 518-21 (W. Va. 1984); *Hansman v. Imlay City State Bank*, 328 N.W.2d 653, 655-56 (Mich. Ct. App. 1982); *LFG, LLC v. Navarre*, No. 01C9451, 2002 WL 1379112 (N.D. Ill. June 26, 2002).

Finally, as a policy matter, such an exception would be senseless, because money is an asset on which we depend more heavily than on most other types of personal property. If the purpose of tort law is to remedy intentional invasions of serious interests, it makes no sense to exclude from the tort of conversion the intentional takings that are *most* likely to impose significant harm on victims.

The lower courts correctly understood (Super. Ct. Op. 16; Ct. Comm. Pl. Op. 11) that the Bank's view of UCC § 4A-502 conflicts with the basic common-law principle that a bank has no right of setoff against funds that the bank knows do not belong to its depositor. This Court has repeatedly articulated that common-law rule in broad and unqualified language. *See Ryan Bros. v. Curwensville State Bank*, 382 Pa. 248, 253-54, 114 A.2d 178, 181 (1955) ("All the authorities agree that if a bank has knowledge, or notice of facts enough to put it upon inquiry, that the funds in a depositor's account actually belong to a third person, it may not apply such funds to a debt owed to it by the depositor individually.") (quoting *Sherts v. Fulton Nat'l Bank*, 342 Pa. 337, 339, 21 A.2d 18, 19 (1941)); *Witherow v. Weaver*, 337 Pa. 488, 491-92, 12 A.2d 92, 94 (1940) ("[A] bank with knowledge that a deposit is held for the benefit of a third party cannot appropriate such moneys to the payment of an individual debt of the depositor."). This aspect of Pennsylvania law accords with the views of other states. *See* B.C. Ricketts, Annotation, *Bank's Right to Apply Third Persons' Funds, Deposited in Debtor's Name, on Debtor's Obligation*, 8 A.L.R.3d 235, 239 (1966) ("It has universally been held that knowledge upon the part of a bank that deposits made by a debtor in his own name belong to a third person absolutely precludes the bank from applying such funds to the individual indebtedness of the depositor to it.").

Indeed, this Court has gone even further, adopting a broader "equitable" rule under which

> a bank, even though without knowledge or notice of facts putting it upon inquiry that another than the depositor has an interest in the funds deposited in his name, cannot appropriate such funds to the depositor's indebtedness to the bank, at least where there has not been any change in the bank's position in reliance on the apparent ownership of the funds so as to raise superior equities in its favor.

Sherts, 342 Pa. at 340-41, 21 A.2d at 20; *see also In re Gordon*, 319 Pa. 367, 371, 179 A. 592, 593 (1935) (bank not entitled to setoff even if it does not have knowledge of the third party's claim if the bank has not relied adversely on the presence of the funds in the account). Here, the Bank did not and could not rely on the wholly fortuitous and mistaken misdirection of funds to AFMC's account when the Bank earlier allowed AFMC to engage in check-kiting that amassed a multi-million dollar debt to the Bank. *See* R. 4093a (RICO complaint against AFMC).

Thus, the central fact of importance to this litigation is the ownership of the funds in question. Even the Bank acknowledges (CoreStates Br. 34) that the Bank's common-law setoff right depended on the rights of its depositor to the funds. As we have discussed above (pp. 5-8), it must be taken as given by this point in the litigation that AFMC in fact had no ownership interest in the funds in question. Super. Ct. Op. 10-11; Ct. Comm. Pl. Op. 6-8. The Bank's claimed right of setoff therefore fails under Pennsylvania common-law.

This Court's holding in *Sherts* provides an even broader basis for defeating the Bank's claimed right of setoff. As the undisputed facts indicate, the Bank did not rely on the funds in allowing AFMC to become indebted to the Bank. Rather, the Bank had blocked AFMC's accounts because of AFMC's check kiting activity **before** Pioneer's funds reached the account. The Bank was not a party to the underlying transactions and thus had no financial exposure in those transactions. Indeed, the Bank's own internal discussions recognized that any right to retain the funds would amount to a fortuitous windfall for the Bank. R. 4238a (email between

CoreStates executives) ("This is a payment on a very convoluted transaction involving acompany in bankruptcy in California thatsold a portfolio of loans to Norwest. Go Figure how the funds got here.") (spacing and capitalization as in original).

b. UCC Article 4A Does Not Authorize the Bank to Take Funds That Are Not Owned by Its Customers.

The Bank tries to avoid the significance of the common-law rules by arguing that UCC § 4A-502 grants a free-standing right of setoff untrammeled by traditional common-law limitations on a bank's setoff rights. To put it bluntly, the Bank argues that the UCC generally permits a bank knowingly to take money that belongs to innocent third parties as a way to collect unsecured loans that the bank has made to its depositor. The consequences of that view are astounding – and go conspicuously unexplored in the Bank's brief. For example, a thief could defraud an innocent victim into wiring money to the thief's bank account. Even if the thief's bank had full knowledge of the scheme when the funds arrived, the bank would be able – under the view of the Bank in this case – to capture the funds and use them to offset any obligations the thief might have to the Bank at that time. *See* CoreStates Br. 25-26 (arguing that adverse claims are cut off when funds are sent through wire-transfer system).

The Superior Court recognized the incongruity: "[I]f the ownership requirement were eliminated, it would lead to the absurd consequence whereby a Bank could effectuate an automatic setoff even where funds are mistakenly or inadvertently wired or deposited to the wrong account." Super. Ct. Op. 16. Statutory construction is governed by the presumption that "the General Assembly does not intend a result that is absurd, impossible of execution or unreasonable." 1 Pa. Cons. Stat. Ann. § 1922 (1972). Thus, "[t]he first principle of statutory construction is that courts will not interpret legislative enactments in a manner which imputes

absurdity to the legislative enactment." *Housing Authority v. Civil Service Comm'n*, 556 Pa. 621, 642, 730 A.2d 935, 947 (1999).

(i) Pennsylvania courts are skeptical of claims that the UCC rejects common-law rules.

Because our law ordinarily has not accorded banks the right to profit from unlawful or tortious activity, this Court should expect that any provision of the Uniform Commercial Code granting banks such power would do so in no uncertain terms. Although Pennsylvania no longer applies the principle that statutes in derogation of the common law should be strictly construed, 1 PA. CONS. STAT. ANN. § 1928(a) (1972), this Court has explained that "statutes are not presumed to make changes in the rules and principles of the common law or prior existing law beyond what is expressly declared in their provisions." *Commonwealth v. Miller*, 469 Pa. 24, 27-28, 364 A.2d 886, 887 (1976). Pennsylvania courts have been particularly reluctant to construe the Uniform Commercial Code as rejecting common-sense common-law limitations on the right of setoff. *See Middle Atl. Credit Corp. v. First Pennsylvania Banking & Trust Co.*, 199 Pa. Super. 456, 458, 185 A.2d 818, 820 (1962) (holding that the right of setoff granted by old UCC § 9-306(4)(d) did not preempt common-law limitations on the right of setoff); *see also In re Caplan Estate*, 48 Pa. D. & C.2d 117, 127, 1968 WL 6871, at *7 (Ct. Com. Pl. 1968) (relying on *Middle Atlantic* to conclude that Article 3 of the Uniform Commercial Code preserves traditional rules of set-off with regard to negotiable instruments).[15] Those decisions accord with customary rules of statutory construction in the Commonwealth. *See* 1 PA. CONS. STAT. ANN. § 1921(5)

[15] *Cf. South Central Livestock Dealers, Inc. v. Security State Bank*, 551 F.2d 1346, 1349-50 (5th Cir. 1977) (holding that UCC Article 3 did not nullify Texas rule that bank cannot set off funds of a third party against its depositor's indebtedness).

(1972) ("When the words of the statute are not explicit, the intention of the General Assembly may be ascertained by considering, among other matters[,] * * * [t]he former law, if any.").

(ii) Section 4A-502's plain language cannot support the Bank's unprecedented argument.

It is not in the least bit plausible to think that Section 4A-502 has the broad effect the Bank attributes to it.[16] The Bank's argument essentially lifts a single phrase out of the statute and insists that the Court should decide the case by looking only at that phrase without any attention at all to the surrounding words and context. This Court, by contrast, consistently has counseled that statutory provisions "are not to be isolated and read out of the context of the entire statute." *Commonwealth v. Lurie*, 524 Pa. 56, 60, 569 A.2d 329, 331 (1990). As the Court explained more generally: "Statutes do not exist sentence by sentence. Their sections and sentences comprise a composite of their stated purpose. All sections and sentences that address that purpose are subsumed in each other and in the entire context of the statute." *Commonwealth v. Revtai*, 516 Pa. 53, 63, 532 A.2d 1, 5-6 (1987); *see LTV Steel Co. v. W.C.A.B. (Mozena)*, 562 Pa. 205, 221-222, 754 A.2d 666, 674-675 (2000).

Article 4A of the Uniform Commercial Code provides a general statutory regime for wire transfers. Among other things, the statute provides rules that govern "payment orders" (the individual steps in wire-transfer transactions). *See* UCC § 4A-103(a)(1) (defining "[p]ayment order"). Those rules clarify such things as when payment orders are final and when they can be retracted. Within that set of rules, Section 4A-502 deals comprehensively with the attempts of creditors to reach funds sent by wire transfer. Logically, that problem can arise in three different contexts, governed by the three substantive subsections of Section 4A-502. Subsection (b) deals

---

[16] For the convenience of the Court, Attachment A to this brief sets out the entire text of UCC § 4A-502 as adopted in Pennsylvania, together with the official comments.

with creditors of a sender of a payment order trying to reach funds before they are transferred from the sender's account. At the end of the section, subsection (d) adopts a general rule that a creditor of the beneficiary cannot intercept the funds before they reach the beneficiary's bank.

Between those two provisions is subsection (c), the provision at issue in this case. Subsection (c) addresses a contest in which a beneficiary's bank receiving funds for its customer *and* a creditor of the beneficiary *both* wish to take those funds to satisfy some debt of the beneficiary. The Bank's arguments rest on a phrase in that provision indicating that the bank has an option to accept or pay the wire transfer by setting off the incoming funds against an obligation of the beneficiary. Nothing in the provision itself or the comments to the provision indicates that the provision does anything more than recognize setoff as one possible approach the bank might take to accept or pay a wire transfer. More specifically, nothing in the provision suggests any intention to grant a statutory right of setoff or to validate setoffs that would not be permissible at common law. Indeed, because this case does not involve creditor process as defined in subsection (a), it is not obvious that the section applies at all. An understanding of the structure and purpose of the whole section makes it plain that the statute simply was not designed to provide any guidance on the questions involved in this case.

(iii) The structure and drafting history of § 4A-502 underscore the intention of the drafters to recognize a traditional, limited right of setoff.

A broader look at the statute and its history provides further support for our view that the drafters understood that the right of setoff they recognized was a traditional one, subject to traditional limitations, not some newfangled unconstrained right to take funds of third parties without consequence. *See* 1 Pa. Cons. Stat. Ann. § 1903 (1972) ("Words and phrases shall be construed * * * according to their common and approved usage; but technical words and phrases

and such others as have acquired a peculiar and appropriate meaning * * * shall be construed according to such peculiar and appropriate meaning or definition."); *In re Nomination Papers of Lahr*, No. 765 MAL 2003, 2004 WL 304331 (Pa. Feb. 17, 2004) (applying that statute).

The issue that preoccupied the drafters of UCC § 4A-502(c) was the extent to which a bank receiving a funds transfer for its customer could prevent a creditor of the customer from obtaining those funds. The perspective of the drafters was that a bank might be motivated by its relationship with its customer to take the customer's side in an effort to stymie the creditor's collection efforts. The three paragraphs of UCC § 4A-502(c) address three different scenarios. One possibility is that the bank would attempt to put the funds beyond the reach of the creditor by rejecting the wire transfer, so that the funds would be returned to the originator. Early drafts of the statute viewed that as an acceptable response by the beneficiary's bank. Proposed UCC § 4A-208 (Aug. 1987 draft).[17] Eventually, however, the drafters adopted a blanket rule forbidding that course of action. UCC § 4A-502(c)(3) & comment 2 ¶ 2. Another possibility is that the bank might let its customer withdraw the funds instead of delivering them to the creditor. On that point, the drafters followed the lead of provisions in the existing Article 4 (relating to checks); the statute allows the bank to release the funds unless the creditor acts soon enough to "affor[d] the bank a reasonable opportunity to act to prevent withdrawal." UCC § 4A-502(c)(2); *compare* the similar rules in UCC § 4A-502(b) & 4-303(a).

---

[17] All references to drafts of Article 4A are based on materials obtained from the Biddle Law Library at the University of Pennsylvania Law School. That library is the official repository of the archives of the Uniform Commercial Code. *See* www.nccusl.org → NCCUSL Archives at the University of Pennsylvania → NCCUSL Archives. For the Court's convenience, we are filing an application to lodge with the Court copies of all of the materials cited from those archives.

The final possibility (the one at issue here) is that the bank might take the funds for itself to satisfy a debt that the beneficiary owes to the bank. On that point, the statute states that the bank may take one of two courses of action: the bank can allow the creditor to take the funds or the bank can take the funds for itself by "set[ting them] off against an obligation owed by the beneficiary or to the bank." Two things about the details of that provision are important for the present controversy.

For one thing, the statute does not even attempt to resolve the priority conflict between the bank and the third-party creditor. The Bank here favors a reading that the grant of a right to setoff was intended to give a bank priority over all claims of competing creditors. As discussed below, however,[18] the bank's right of setoff is inferior in priority to the claim of a secured creditor of the beneficiary. Is it plausible to think that the language of § 4A-502 was intended to resolve that conflict in the bank's favor? If so, the secured creditor's collateral would be at risk of disappearing if the funds were wired to its borrower's bank, but protected if the funds were transferred by check or in the form of cash. Surely a more plausible reading is that the statute left the resolution of that priority conflict to other law. *See* UCC § 1-103 ("Unless displaced by the particular provisions of the [Uniform Commercial Code], the principles of law and equity * * * supplement its provisions.").

Another conspicuous aspect of the provision is the absence of any definition of the boundaries of the bank's right of setoff. The Bank in this case leaps from the spare language of the statute to the conclusion that the drafters intended to grant a broad right of setoff unconstrained by the traditional common-sense limits articulated by this Court and other common-law courts around the country. A reading that credits the drafters with common sense

---

[18] *See infra* pp. 42-43.

is more plausible. Under that reading, the reference to setoff is merely a statement that a setoff is one of the things a bank might do when the money arrives, parallel to releasing it to the beneficiary (under paragraph (2)) or sending it back (under paragraph (3)). On that reading, the statute creates no unprecedented and unconstrained right of setoff, but merely allows the bank to exercise an otherwise lawful right of setoff within the framework of UCC Article 4A.

That reading is bolstered by the interplay of § 4A-502 with related provisions of the statute. As comment 2 explains, § 4A-502 is designed to dovetail with the Code's provisions about acceptance and payment of a payment order. Acceptance of a payment order by a beneficiary's bank is important in the structure of UCC Article 4A, because that is the point in time at which the transfer satisfies the underlying obligation of the originator to the beneficiary. UCC § 4A-406(a). Acceptance of a payment order also obligates the beneficiary's bank to pay the amount of the payment order to its customer, the beneficiary. UCC § 4A-404(a). As the comments to § 4A-502 point out, the drafters understood that the beneficiary's bank can both accept the order and satisfy its obligation by the single action of setting the incoming funds off against an obligation of the beneficiary. *See* UCC § 4A-502 comment 2 ¶ 1. The comments explain the reference to setoff in § 4A-502(c)(1) by a specific reference to § 4A-405(a), under which payment occurs if the credit is applied to a debt of the beneficiary. But § 4A-405(a) makes clear what is left implicit in § 4A-502(c)(1), stating that payment occurs only if "the bank **lawfully** applies the credit to a debt of the beneficiary." UCC § 4A-405(a)(ii) (emphasis added).[19] Because the UCC offers no guidance as to what might make it lawful or unlawful to

---

[19] The comments to that provision make it clear that UCC § 4A-405(a)(ii) was written with a view to UCC § 4A-502(c)(1). "The two principal cases in which payment will occur in this manner are setoff by the beneficiary's bank and payment of the proceeds of the payment order to a garnishing creditor of the beneficiary. These cases are discussed in Comment 2 to Section 4A-502." UCC § 4A-405 comment 1. Further evidence of the integration between §§

apply the credit, it is necessary to resort to the common law of setoff to resolve that question. A setoff, like the one in this case, that does not comply with common law is not a setoff contemplated by UCC § 4A-502 as a method of acceptance or payment of the payment order. *See* 1 PA. CONS. STAT. ANN. § 1903 (statutory language should be interpreted in light of existing usage), 1932 (statutes *in pari materia* should be construed together).

(iv) The Eleventh Circuit's decision in *Regions Bank* supports Pioneer's position.

The absurdity of the Bank's claim is underscored by its inability to identify any previous decision that adopts the broad reading of the UCC that the Bank proffers. The only decision to examine the question was handed down by the Eleventh Circuit last summer, while this case was awaiting review by this Court. *Regions Bank v. Provident Bank, Inc.*, 345 F.3d 1267 (11th Cir. 2003). That case squarely rejected the Bank's understanding of UCC § 4A-502 with a vigor that warrants extended quotation:

> Article 4A is silent with regard to claims based on the theory that the beneficiary bank accepted funds when it knew or should have known that the funds were fraudulently obtained. Therefore, a provision of state law that requires a receiving or beneficiary bank to disgorge funds that it knew or should have known were obtained illegally when it accepted a wire transfer is not inconsistent with the goals or provisions of Article 4A. * * * [W]e are mindful that, if possible, a court should avoid construing a statute in a way that produces absurd results. Interpreting Article 4A in a manner that would allow a beneficiary bank to accept funds when it knows or should know that they were fraudulently obtained, would allow banks to use Article 4A as a shield for fraudulent activity. It could hardly have been the intent of the drafters to enable a party to succeed in

---

4A-405 and 4A-502 comes from the timing of the changes most important to this case. The April 1989 draft was the first draft that included the reference to "lawful" setoff in § 4A-405 (*compare* Proposed UCC § 4A-405 (February 1989 draft) *with* Proposed UCC § 4A-405 (April 1989 draft)) and also the first draft to explicitly refer to § 4A-405 in the comments to § 4A-502 (*compare* Proposed UCC § 4A-502 (February 1989 draft) *with* Proposed UCC § 4A-502 (April 1989 draft)).

> engaging in fraudulent activity, so long as it complied with the provisions of Article 4A.

345 F.3d at 1275-76 (brackets and citations omitted).

Oddly enough, the Bank contends (CoreStates Br. 27-30)[20] that *Regions Bank* supports its position, largely because the Eleventh Circuit in *Regions Bank* on other grounds absolved the beneficiary's bank of responsibility. But the Eleventh Circuit's analysis of the merits of that case is not instructive here for several reasons. First, as the opinion makes abundantly clear, the decision rests on the finding that the beneficiary's bank in *Regions Bank* did not act in bad faith. 345 F.3d at 1276-78; *see also* 345 F.3d at 1279 (rejecting claim for conversion because "one acting in good faith may obtain title to money from a thief"). In our case, by contrast, a jury has concluded, in a verdict that has survived post-trial review by the trial court and appellate review by the Superior Court, that the Bank in this case acted with sufficient bad faith and malice to warrant the imposition of punitive damages.

The Eleventh Circuit proceeded to conclude that under Ohio law a claim for conversion could be made out only based on events that occurred before the transfer. The most important thing about that line of reasoning is that it is flatly inconsistent with the Bank's position in this case, which is that a bank is free to take money from an incoming wire transfer without any regard at all to the circumstances – *even if the bank had actual knowledge at the time of the transfer that the funds were stolen*. *See* CoreStates Br. 18 ("Article 4A authorized CoreStates to set off the funds against AFMC's debt, notwithstanding any third-party claim of ownership or security interests that might be asserted after receipt of the payment order and its proper crediting to AFMC's account.").

---

[20] The Federal Reserve also relies on *Regions Bank*. Fed. Res. Br. 18-19.

Furthermore, contrary to the Bank's arguments, the Eleventh Circuit's reasoning does not suggest any error in the reasoning of the lower courts here. For one thing, the Eleventh Circuit's ruling rested directly on the words of the Ohio statute at issue in *Regions Bank*. *See* 345 F.3d at 1277-79 (quoting OHIO REV. CODE ANN. § 2913.51). Because the cause of action in this case – common-law conversion – does not rest on any such statute, the Eleventh Circuit's interpretation of Ohio's criminal code is not in any way instructive, much less binding, on how this Court should interpret its cases about the common law of Pennsylvania. Moreover, even if this Court wished to limit its common-law cases about conversion to the narrow confines the Eleventh Circuit discerned in Ohio criminal law,[21] that would not pose a problem for Pioneer. Here, the Bank had actual knowledge of a problem when the funds first reached the Bank and were accepted under UCC § 4A-209. Indeed, the reason that the funds were not disbursed promptly in our case is that the Bank had imposed a debit restraint a week *before* the wires arrived because the Bank knew that its customer was check-kiting. *Regions Bank* holds that a bank that had "known or had reason to know that the funds it received * * * were obtained by fraud * * * could not have obtained title to the funds upon acceptance of the wire transfer * * * because it would have acted in bad faith," 345 F.3d at 1276. Because the Bank in this case had reason to know that AFMC had obtained the funds by fraud, even the *Regions Bank* interpretation of Ohio law would support a judgment for conversion here. *Compare*, *e.g.*, *United States v. Lam*, 338 F.3d 868, 872 (8th Cir. 2003) (allegations of check kiting are enough to state a claim for criminal bank fraud).

[21] Because the depositor in *Regions Bank* claimed ownership of the funds and specifically authorized the receiving bank to apply the funds to the depositor's debt, the court in that case had no occasion to consider the common law of setoff at issue in this case.

The Bank also relies (CoreStates Br. 25-26) on the statement in *Regions Bank* to the effect that "title [to wired funds] passes to the beneficiary's bank" when it accepts a wire transfer.[22] As *Regions Bank* itself demonstrates, that unadorned statement is far too broad. In the context of *Regions Bank*, for example, the court concludes that Ohio law permits title to pass only if the funds have been received in good faith, a qualification not satisfied here. None of the authorities on which the Bank relies in that discussion suggests that Article 4A protects a bank that maliciously converts funds that do not belong to its depositor.[23] To the extent that those cases consider the possible effect of misconduct, it is clear (as *Regions Bank* makes explicit) that the transfer does not eradicate the rights of claimants (like Pioneer) that are not parties to the transfer. *E.g.*, *Banque Worms v. BankAmerica Int'l.*, 570 N.E.2d 189 (N.Y. 1991) (limiting its rule to cases in which a beneficiary "receives money to which it is entitled and has no knowledge that the money was erroneously wired").

(v) Summary.

As the Superior Court correctly determined, the absence of any definition of "setoff" from the Uniform Commercial Code means that it is necessary to look to common-law rules to give content to that term. Thus, read fairly, the provision is innocuous: a bank that has a right to set off the incoming funds – with the existence of that right to be determined under standard

[22] The Bank's reference (CoreStates Br. 26 n.14) to Fred H. Miller & Alvin C. Harrell, THE LAW OF MODERN PAYMENT SYSTEMS AND NOTES (Practitioner's Edition 2002) is wholly inapposite. In context, the cited passage (Miller & Harrell, *supra*, at 490-91) simply states the general rule that a bank's right of setoff extends to general accounts, but not to special accounts. Elsewhere, the same text recognizes the rule at issue here: "If the banking institution has actual knowledge that the account does not belong to the debtor, setoff generally is not permitted." Miller & Harrell, *supra*, at 515.

[23] The same is true of the holder-in-due-course doctrine, on which the Bank relies (CoreStates Br. 30) in the same passage. *See* UCC § 3-302(a)(2) (barring holder in due course status for parties that took with notice of problems).

principles of common law – can use that right as a vehicle for accepting the transfer and paying the beneficiary. The long tradition of common-law rules that restrict the setoff rights of banks supports the Superior Court's decision to read that section as describing the effect of a setoff that is proper under standard common-law rules.

The Bank's extravagant suggestion – that the section creates a new and completely unqualified right to take funds that belong neither to the Bank nor any of its customers – finds no support in any previous judicial decision, the UCC, or the writings of any previous commentator. *See* Super. Ct. Op. 16 ("Nothing in the language of § 4A-502 or in Pennsylvania case law indicates or mandates that a Bank should not determine whether the funds belong to a depositor before setoff is exercised."). Given the years of attention to the drafting of Article 4A, and the intervening decade of cases interpreting that statute, it is difficult to believe that such an important departure from the common law would have passed entirely unnoticed until the Bank's willfully reprehensible conduct provided a reason to test the boundaries the statute places on the actions of banks that receive payment orders.

c. The Passage of Months Before the Bank Set Off the Funds Makes It Irrelevant That the Funds Originally Reached the Bank by Wire Transfer.

Without regard to the merits of our reading of § 4A-502, the Bank's reliance on that provision cannot be reconciled with the relevant historical facts. The Bank did not actually set the funds off for more than a month after it received them. As the record at trial shows, the funds remained in AFMC's Settlement Account for a month, and were not removed from the account to which they were wired until December 19, 1997. R. 4025a-4026a, 4074a-4075a (internal Bank record showing that the Bank implemented a "sweep" removing the funds in mid-December). Moreover, other documents in the record make it clear that some or all of the funds

remained in AFMC accounts until at least early February of the following year. R. 4075a (balance in sweep account as of Feb. 2, 1998); *see also* R. 4093a ¶ 24 (RICO complaint against AFMC, discussing setoff on Jan. 20, 1998). Whatever the meaning of UCC § 4A-502, it cannot apply to authorize the Bank to remove funds from an account weeks or months after the funds were received. That reading of § 4A-502 would contemplate a rule under which funds commingled in a deposit account would be distinguishable based on the manner in which they originally were received – with different rules for setoff against funds originally deposited in cash, by check, or by wire transfer.

The Bank ignores (CoreStates Br. 19) the undisputed historical fact that the Bank did not remove the funds from AFMC's accounts until long after it received them, arguing instead that the funds technically should be treated as having been removed on the date of the transfer.[24] The Bank supports that treatment by reference to what the Bank describes as a Pennsylvania doctrine of "automatic setoff." *See also* Penn. Bankers Br. 12-14 (similar argument). One problem with application of that supposed doctrine in this case is that the Bank relies on UCC § 4A-502. The statement in § 4A-502 that a bank "may" set off funds shows that no automatic setoff would be consistent with any right of setoff under UCC Article 4A.[25]

---

[24] The Bank also argues (CoreStates Br. 19 n.10) that the existence of a debit restraint at the time the wires were received somehow renders it irrelevant that the Bank as a matter of historical fact did not set the funds off when they arrived. Because the debit restraint did not constrain the Bank in any way, we can discern no logical connection between the existence of a debit restraint and the date when the Bank in fact set off the funds. *See*, *e.g.*, *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 19-21 (1995) (imposition of administrative hold on deposit account did not violate the automatic stay because it did not amount to a setoff against the account).

[25] As discussed above, UCC § 4A-502 relies on common-law rules to resolve priority contests between a bank that wishes to take incoming funds and a creditor that has served third-party process on the receiving bank. If the Bank's reading of the provision were correct, banks always would prevail in those contests, a receiving bank always would take the funds by

Moreover, despite the wealth of decisions of this Court addressing the doctrine of setoff under Pennsylvania law, the Bank can identify nothing in the opinions of this Court to support that doctrine. Rather, the doctrine rests entirely upon language in a decision of the United States Court of Appeals for the Third Circuit, *Pittsburgh Nat'l Bank v. United States*, 657 F.2d 36, 38 (3d Cir. 1981), which has been quoted in two opinions of the Superior Court, *Royal Bank v. Selig*, 434 Pa. Super. 537, 545, 644 A.2d 741, 744 (1994); and *Pennsylvania Nat'l Bank & Trust Co. v. CCNB Bank*, 446 Pa. Super. 625, 631, 667 A.2d 1151, 1154 (1995), but never in any decision of this Court.

Those opinions rest on the Third Circuit's misunderstanding of this Court's decision in *Aarons v. Public Serv. Bldg. & Loan Ass'n*, 318 Pa. 113, 178 A. 141 (1935). *Aarons* involved a dispute between a garnishing creditor and a bank, both of which had claims against a customer of the bank. The point of *Aarons* is to determine which creditor has priority, not to determine the point in time at which a setoff in fact occurs. This Court began by pointing out that at common law a judgment creditor could not take funds in a deposit account by execution; a judgment creditor could acquire the capacity to reach such funds only through a statute derogating from the common law. 318 Pa. at 115, 178 A. at 141-42. The Court then identified the Act of June 16, 1836 (then codified at 12 Pa. Stat. § 2113) as having granted judgment creditors the right to take "deposits of money in any bank" and "debts due to him, * * * subject nevertheless to all lawful claims thereupon of such * * * person." 318 Pa. at 115, 178 A. at 142. The Court went on to explain that the statute generally had been interpreted to allow the garnishee (that is, the bank) to

---

automatic setoff, and there never would be an occasion for the funds to be taken by the third-party creditor. That understanding effectively reads the closing clause of § 4A-502(c)(1) out of the statute.

"plead anything against the plaintiff [the judgment creditor] that he could plead against his own original creditor [the depositor]." 318 Pa. at 115-16, 178 A. at 142.

At that point, the *Aarons* Court faced the question whether the bank could interpose its own claim to the funds in the account as a defense against the claim of the judgment creditor. The Court explained:

> The answer must be in the affirmative. The statute did not increase the liabilities of the bank. It merely required the garnishee to respond to the process of one standing in the depositor's place. Plaintiff must conform to the statute conferring the right. When he demands his judgment out of "deposits of money in any bank," or of "debts due to him" by the bank, he must show that there is a debt "belonging to" defendant; the right to execution on debts, or deposits of money, is expressly limited to be "subject, nevertheless, to all lawful claims thereupon, of" the bank.

318 Pa. at 116, 178 A. at 142 (inner citations omitted).

Notwithstanding those preexisting rules, the lower court in *Aarons* had concluded that the garnishing judgment creditor had priority over the setoff claim of the bank because the bank "could not make the appropriation [of the funds] after service of the writ of attachment." 318 Pa. at 117, 178 A. at 142 (quoting lower court opinion). This Court rejected that reasoning, explaining that the bank "may make the same defense to the attachment by evidence of set-off or of other equities that he might have made if sued by his original creditor." 318 Pa. at 117, 178 A. at 142. Because the bank held a demand note from the depositor at the time that it received the writ of attachment, the bank was entitled to set off its claim under that note against the funds in the account. 318 Pa. at 117-18, 178 A. at 143.

This Court's decision in *Aarons* makes it clear that the discussion of "automatic setoff" by the Third Circuit in *Pittsburgh Nat'l Bank* (and the cases that follow it) is fundamentally incorrect. Neither *Aarons* nor any other reported decision of a Pennsylvania court that predates

the Third Circuit's decision in *Pittsburgh Nat'l Bank* uses the term "automatic" to describe the setoff rights of a bank with respect to funds in a deposit account. Indeed, the *Pittsburgh Nat'l Bank* opinion was the first appearance of the term in any reported decision of an American court. As explained above, *Aarons* states only that the bank's right of setoff is superior to the claim of a garnishing creditor *even if* the bank has not yet made the relevant book entries at the time it is served with process by the garnishing creditor. It does not say – or even suggest – that setoff occurs automatically at the moment that the funds arrive. *See Aarons*, 318 Pa. at 116, 178 A. at 142 (explaining that the bank "was not required first [that is, before being served] to make book entries charging one account and crediting the other before asserting its right to priority"); *see also Adolph Bergman Bldg. & Loan Ass'n v. Blaul*, 318 Pa. 126, 128, 178 A. 140, 140 (1935) (following that understanding of *Aarons*); *General Elec. Credit Corp. v. Tarr*, 457 F. Supp. 935, 938 (W.D. Pa. 1978) (citing *Adolph Bergman* and following that understanding of *Aarons*).[26]

Moreover, it should be clear that application of the automatic-setoff doctrine would wreak havoc with customary banking practices. For example, consider the case of a depositor that has an account at a bank from which the depositor has borrowed money that is payable on demand. Under the Bank's understanding of the doctrine, all funds that were deposited to the account – by wire or otherwise – automatically would be swept from the account and applied to the debt. In practice, of course, that is not how banks operate in Pennsylvania or elsewhere. The reason is that it would be absurd for setoffs to occur automatically in such cases.

---

[26] We note that the purported doctrine of automatic setoff is not consistent with the concept of a setoff as it typically is understood. *See Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 19-21 (1995) (holding as a matter of bankruptcy law that a setoff does not occur at the time that a bank imposes an administrative hold on an account bur rather when the bank "purport[s] permanently to reduce [its customer]'s account balance by the amount of the [customer's obligation to the bank]").

The automatic-setoff doctrine as the Bank envisions it simply does not exist. The Bank on the facts of this case did not have a claim to the funds that would have been superior to Pioneer's if only the Bank had enforced its claim before Pioneer's entitlement to the funds became known to the Bank. This case, instead, is one in which the Bank for its own reasons – most obviously its doubts about the lawfulness of its conduct – did not promptly exercise a setoff. Thus, because the Bank in fact did not use its alleged right of setoff under § 4A-502 to remove the funds in question from the account to which they were wired, § 4A-502 can provide no justification for the Bank's action. Accordingly, that provision would not afford a basis for reversal in this case even if the Bank were correct in its self-serving argument that § 4A-502 generally grants such a right.

d. Liability in this Case Is Consistent with the Basic Structure of Article 4A.

In addition to its arguments about UCC § 4A-502 itself, the Bank also argues more broadly (CoreStates Br. 20-22, 31-33) that it is improper to interpret Article 4A against the backdrop of common-law rules because the Uniform Commercial Code includes its own framework for addressing mistaken transfers. That argument includes three general points: an empirical claim that our view has catastrophic practical implications, a related doctrinal claim that UCC Article 4A preempts our claim, and an emotional claim that the decision below gives inadequate deference to the views of the Federal Reserve. None of those claims has merit.

(i) Liability on these facts will not burden routine banking transactions.

First, the Bank (CoreStates Br. 27) and its *amici* (Penn. Bankers Br. 17-19) argue that liability in this case will unduly clog the millions of routine wire transactions that occur every day by imposing some undue burden on the beneficiary's bank. That argument ignores the basic

facts at issue. Pioneer's suit is not based on the Bank's failure to reverse the transaction. Pioneer's suit, indeed, is not based on any conduct that is connected with the wire transfer in any temporal or logical way. Pioneer was not a party to the wire transfer, and the setoff occurred months after the wire transfer. The wire-transfer system is related to this case solely because the funds happen to have arrived by wire instead of some other method. That circumstance cannot stamp the funds with some permanent character that distinguishes them for all time from other deposits.

It also bears emphasis that the conduct that gives rise to liability in this case is not routine conduct that occurs millions of times each day. The conduct is not the acceptance of the wire transfer or the credit to AFMC's accounts. Nor is it the routine and consensual application of funds from a deposit account to repay an acknowledged obligation. Rather, the conduct is the Bank's considered decision, after months of internal deliberation, to appropriate and retain funds in the face of a claim – known to the Bank at the time of the decision – that the funds did not belong to the Bank or the Bank's customer. That is not the type of routine, snap-judgment decision described in the Bank's arguments. On the contrary, it is the type of willful and deliberate tortious action properly remedied by a cause of action for conversion.

(ii) Article 4A does not preempt Pioneer's claim.

Nor is there any substance to the argument (CoreStates Br. 21-33; Fed. Res. Br. 13-15; Penn. Bankers Br. 17-32) that Article 4A directly preempts the claim in this case. That argument is wrong for two general reasons. First, the Bank identifies nothing express in Article 4A that is inconsistent with our claim. Second, even if Article 4A were construed to cast some penumbra of preemption beyond its specific language, the range of preemption could not extend to a case like this one – a challenge by a person that was not a party to the transfer – against conduct that

is not logically or temporally related to the transfer.

On the first point, much of the Bank's argument rests on the false assertion (CoreStates Br. 20, 23-25, 27) that this case "requires a bank to unwind a setoff and reverse a wire transfer." Pioneer is not demanding that the money be returned to Norwest – the consequences of a reversal of the transfer. Pioneer is asking only that the money be delivered to its lawful owner, a request that Article 4A does not address in any way.

The provisions of Article 4A that the Bank discusses are simply not relevant to this dispute. Those rules govern the ability of a sender of a wire to recover a mistaken payment order and, quite properly, limit that recovery to narrowly delineated circumstances. *E.g.*, UCC §§ 4A-205, 4A-211. This case involves the quite different context of a bank that has taken funds that do not belong to its depositor and the related question of the true owner's ability to recover the funds from the bank that takes them. Not a word in Article 4A (or in any of the materials on which the Bank relies) suggests that a bank is entitled to take such an action.[27] Accordingly, the cause of action asserted here is in no way inconsistent with Article 4A. *See Regions Bank*, 345 F.3d at 1275-76 (holding that Article 4A does not preempt a cause of action for conversion).

On the broader point of the precise bounds of the preemptive effect of Article 4A, the courts have struggled since the earliest days of Article 4A to determine the precise scope of the preemptive effect of Article 4A. As the United States District Court for the Southern District of New York has noted, the exclusivity of the statute "is deliberately restricted to 'any situation

---

[27] The Bank also argues (CoreStates Br. 22-23) that Article 4A implicitly absolves the Bank of any duty to inquire about the ownership of funds that it receives by wire transfer. That argument is irrelevant here, however, because by the time that the setoff occurred the Bank had been advised by its depositor that it did not own the funds. Moreover, when the funds arrived the Bank had notice of a problem, as evidenced by the decision of the Bank to restrain transfers out of the account.

covered by particular provisions of the Article.'" *Sheerbonnet, Ltd. v. American Express Bank, Ltd.*, 951 F. Supp. 403, 408 (S.D.N.Y. 1995) (quoting UCC § 4A-102 comment). Beyond those situations, the statute necessarily contemplates reliance on common-law remedies like the remedy for conversion at issue here. 951 F. Supp. at 408 ("The Article itself is replete with references to common law remedies."). As that court put it:

> [W]here the provisions do not venture, the claimant need not turn back; he or she may seek other guides, statutory or judicial.
>
> * * *
>
> [D]espite its exhaustive aspirations, Article 4A has not completely filled the area of law surrounding wire transfers. Common law and equitable principles, where they compl[e]ment the important policy considerations of the Article and are not inconsistent with any of its specific provisions, can and should be used to resolve conflicts between parties to this type of transaction.

951 F. Supp. at 408, 410.

The discussion above illustrates quite plainly that this case does not present a "situation covered by [any] particular provisio[n] of the Article." The conduct of which Pioneer complains has nothing to do with the wire transfer. It is not Pioneer's contention that the Bank failed in any of its obligations to execute the order under UCC § 4A-305, to give notice to the beneficiary under § 4A-404, or to pay the beneficiary under § 4A-405. Pioneer contends that the Bank should have released the funds when its depositor disclaimed any interest in them and it was clear that they belonged to Pioneer. That contention is simply not concerned with the circumstances and the propriety of the wire transfer, which was completed weeks, if not months and years before the wrongful conduct by which we are aggrieved. Indeed, this is a much easier case than *Sheerbonnet*, in which the Southern District of New York recognized common-law

liability for a wrongful acceptance of a wire transfer. This case is much farther removed from the wire-transfer system than that one.

Furthermore, it is important that Pioneer was not a party to the wire transfer in any way. Thus, for example, the case would be entirely different if the plaintiff had been the originator or the originator's bank (here, Norwest) that sent the transfer. Courts faced with such cases on occasion have found that Article 4A preempts the claim. *Schenkel v. Flaster*, 49 UCC Rep. Serv. 2d 1274, 2002 WL 31831555 (3d Cir. Dec. 18, 2002) (unpublished decision); *Carl v. Republic Security Bank*, 282 F. Supp. 2d 1358 (S.D. Fla. 2003); *Community Bank, FSB v. Stevens Fin. Corp.*, 966 F. Supp. 775 (N.D. Ind. 1997). Those cases make sense, because a cause of action by an originator against a beneficiary's bank directly challenges the statutory scheme for resolving disputes internal to the transfer system itself.

At bottom, the Bank's argument is that Article 4A should give it a free pass, for all time, for any misconduct related to funds that it received by wire. The drafting history of the statute strongly undercuts the Bank's argument, because the drafters considered – and rejected – a provision that would have included a broad exemption from liability resembling the rule that the Bank seeks here.[28]

---

[28] The November 1986 Draft added to what was then § 4A-109 ("Effect of Acceptance of Transfer Order") a statement at the end of subsection (8) as follows: "The obligations of banks with respect to transfer orders stated in this Article are the only obligations of those banks, and liability on the basis of other legal theories is precluded." The comment emphasized the point: "Subsection (8) makes clear that Article 4A states all of the obligations of receivers, and that a court could not impose additional liabilities on those banks on some extra-Article 4A theory such as negligence." Proposed 4A-109 comment 7 (Nov. 1986 Draft). When that section was transferred to § 4A-301 ("Obligations and Liabilities Created by Acceptance of Transfer Order") in the March 1987 Draft, the bulk of what had been § 4A-109(8) appeared as § 4A-301(9). The last sentence (the one quoted above), and the comment explaining that provision, were deleted. The final statute includes only the more measured statement that we discuss above from the comment to § 4A-102, which bars any remedy that is "inconsistent" with the Article.

Senior Judge Beck expressed a separate concern (Super. Ct. Op. 40-41) that the decision of the Superior Court might undermine uniformity in the interpretation of the UCC by leaving Article 4A subject to the vagaries of local rules about setoff. Nothing could be further from the truth. The rule on which we rely here – that a bank cannot set off funds that it knows do not belong to its depositor – appears to be the rule in every state that has addressed the question.[29] Accordingly, there is little risk that banks would be permitted to take such funds in some states,

---

[29] For recent decisions, *see, e.g.*, *In re Garofalo's Finer Foods, Inc.*, 164 B.R. 955, 974 (Bankr. N.D. Ill. 1994), *aff'd in part and rev'd in part on other grounds*, 186 B.R. 414 (N.D. Ill. 1995) ("Where * * * a bank has knowledge of a third person's interest in deposited funds, or notice of facts sufficient to put it upon inquiry as to the true character of the deposit, the debtor-creditor relationship is altered and the bank's right of setoff is subject to the rights of such third party."); *Iola State Bank v. Bolan*, 679 P.2d 720, 732 (Iowa 1984) ("Where a bank knows sums deposited in the account of one of its depositors belongs [*sic*] to a third party, it does not act in good faith when it applies such funds of the third party against the depositor's debts to the bank. Under such circumstances the third party has an action directly against the bank for conversion of the third party's funds from the debtor's accounts."); *Firstar Eagan Bank v. Marquette Bank Minneapolis*, 466 N.W.2d 8, 12 (Minn. Ct. App. 1991) ("The bank improperly exercises setoff if the deposit account does not belong to the debtor as an unencumbered fund or if the bank knows that the account really belongs to someone other than the debtor"); *Daly v. Atl. Bank*, 614 N.Y.S. 2d 418, 419 (N.Y. App. Div. 1994) ("[W]hen a bank is on notice that funds in a depositor's account are owned by a third party, the bank cannot appropriate those funds in order to set them off against a debt of the depositor."); *O'Donnell v. Bank of Vermont*, 692 A.2d 1212, 1215 (Vt. 1997) ("The right to setoff is not absolute. We [have] recognized * * * that if a bank knows that a deposit is owned by a third party and not by the depositor, the bank may not apply the funds as payment for the depositor's debts.").

For similar views by commentators, see B. CLARK & B. CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS, AND CREDIT CARDS ¶ 18.06[1], at 18-22 ("If the bank *knows* that the account really belongs to someone other than the debtor, setoff is improper. The cases are uniform on this point.") (emphasis in original); 5A MICHIE ON BANKS AND BANKING §§ 132, 141, at 542, 560 (M. Divine & G. Legner eds. 1994); 10 AM. JUR. 2D *Banks and Financial Institutions* § 887 & n.43 ("It is universally held or conceded that knowledge upon the part of a bank that deposits made by a debtor of the bank in his own name belong to a third person absolutely precludes the bank from applying such funds to the individual indebtedness of the depositor to it."); B.C. Ricketts, Annotation, *Bank's Right to Apply Third Persons' Funds, Deposited in Debtor's Name, on Debtor's Obligation*, 8 A.L.R.3d 235, 239 (1966) ("It has universally been held that knowledge upon the part of a bank that deposits made by a debtor in his own name belong to a third person absolutely precludes the bank from applying such funds to the individual indebtedness of the depositor to it.").

but not others. The conduct condemned by the courts below is lawless in all American jurisdictions. Thus, the Bank's proposed rule would lead to an even more perverse lack of uniformity, one in which banks are permitted to take the funds of innocent third parties if the funds originally are deposited by wire transfer, but not if the funds originally are deposited by check or currency.

(iii) The views of the Federal Reserve Banks do not justify reversal.

Finally, striving to dramatize the dispute, the Bank argues (CoreStates Br. 17-20) that the decision of the Superior Court pays inadequate deference to the views of the Federal Reserve. But the brief of the Federal Reserve in fact says quite little about the questions actually at issue here. For one thing, that brief assumes the Bank's premise – that the funds in question were owned by AFMC. *See* Fed. Reserve Br. 4 ("Norwest purchased a group of mortgage obligations from AFMC.").[30] As we have demonstrated above, that premise is incorrect – Pioneer claims not as a creditor of AFMC but as the bailor and trust beneficiary of the funds. Hence, the Federal Reserve had no occasion to grapple with the actual facts that the case presents to this Court.

Moreover, for the most part, the Federal Reserve simply repeats arguments that we have rebutted in detail above. For example, the Federal Reserve asserts (Fed. Res. Br. 10-14) that our argument rests on "the erroneous assumption that [the Bank] was obliged to reverse its

[30] The Bank asserts (CoreStates Br. 20 n.11) that the Federal Reserve brief filed in the Superior Court did not rely on the Bank's version of the facts. The reliance on the Bank's version of the facts is even clearer in the brief filed in this Court, because the Federal Reserve notes that the "parties * * * disagree at several points about the transaction" and indicates that the brief's factual statement "will only briefly set out those facts relevant to [Article 4A's] application." Fed. Res. Br. 4 n.2. Because the sentence that follows that footnote is the sentence that accepts the Bank's version of the facts – the version rejected by the jury, the trial court, and the Superior Court – the Federal Reserve's analysis has at best dubious significance. It is well-established that the facts must be viewed in a light most favorable to the verdict winner. *Mitzelfelt v. Kamrin*, 526 Pa. 54, 584 A.2d 888 (Pa. 1990), and there is no special exception from that rule for the benefit of *amici*.

acceptance of the * * * transfers." As we explained above, reversal of the transfers could have been accomplished only by Norwest, the sender. Pioneer does not seek reversal; Pioneer sought disgorgement of money that belonged to it, an entirely separate remedy that is neither duplicative of nor inconsistent with anything that Article 4A provides.

The Federal Reserve goes on to repeat (Fed. Res. Br. 13-15) the argument that UCC § 4A-502 preempts Pioneer's claim for conversion. The only new point that the Federal Reserve presents is its brief assertion (Fed. Res. Br. 14 n.8) that § 4A-405 preempts the cause of action here by granting a right of recovery to a beneficiary for an unlawful setoff. That argument ignores, however, the difference between this case and the case governed by § 4A-405. This is a claim by a third party with no role in the wire transfer at all. That section governs a claim by a beneficiary against its bank, arguing that its bank has failed to fulfill its obligation under 4A-405 to pay over to the beneficiary the funds that the bank received on the beneficiary's behalf. As discussed above, our cause of action is brought by a stranger to the wire transfer and challenges conduct that has no relation to the wire transfer except for the fortuity that the funds were delivered by wire transfer rather than check, money order, or currency. There is no reason to think that Article 4A should preempt it.

In sum, this Court cannot be sure that the Federal Reserve (given the correct facts) would even disagree with the judgment of the Superior Court, much less that it would find the decision catastrophic, as the Bank suggests. The views of the Federal Reserve accordingly cannot justify reversal by this Court.

e. The Bank Would Not Have Had Priority even if AFMC Had Owned the Funds and Pioneer Had only a Security Interest in the Funds.

The Bank relies heavily (CoreStates Br. 33-34) on its assertion that a bank's right of setoff is superior to the claim of a secured creditor to funds of one of the bank's depositors. That assertion is fundamentally misleading. It portrays the dispute as one between two creditors of AFMC: the Bank with its claim of setoff and Pioneer claiming as a secured creditor holding an interest in the funds granted to it by AFMC. But this case does not involve that fact situation. Rather, it involves a situation in which Pioneer's claim to the funds is antecedent to AFMC's and – according to the jury, the trial court, and the Superior Court – superior to AFMC's. Accordingly, understanding how courts would have resolved a priority dispute between the Bank and a creditor of AFMC is immaterial.

Nevertheless, it is clear that the Bank would have lost such a dispute. The reason is that Pennsylvania common-law rules (like those of most American jurisdictions) grant the secured creditor priority over a bank's claim to setoff against a demand-deposit account. *See Middle Atl. Credit Corp. v. First Pennsylvania Banking & Trust Co.*, 199 Pa. Super. 456, 459-61, 185 A.2d 818, 820-21 (1962); *see also* Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT L. REV. 963, 1006 (1999) ("Under current law, a secured party with a perfected proceeds interest in a deposit account generally defeats a depositary bank's set-off rights."); B. Clark & B. Clark, THE LAW OF BANK DEPOSITS, COLLECTIONS & CREDIT CARDS ¶ 18.07, at p. 18-38 (summarizing the cases as "not * * * very protective of set-off when it is in competition with a perfected security interest in proceeds under Article 9"). The clarity of that rule is shown by the specificity with which the

drafters of the UCC acted when they recently departed from that rule. *See* UCC § 9-340 comment 2.[31]

The Bank's contrary contention that a bank's setoff claim has priority over the claim of a secured party to the account (CoreStates Br. 33-34) is incorrect. The Bank's claim rests entirely on *Pennsylvania Nat'l Bank & Trust Co. v. CCNB Bank*, 446 Pa. Super. 625, 667 A.2d 1151 (1995). That case is not persuasive here for several reasons. First, its analysis of the priority question is dictum. Because the bank in that case (unlike the Bank in this case) apparently had relied on the presence of the funds, the bank should have had priority even in a jurisdiction that recognizes priority of a security interest over a setoff claim. *Cf. E.F. Houghton & Co. v. Doe*, 427 Pa. Super. 303, 309 n.6, 628 A.2d 1172, 1175 n.6 (1993) (noting the importance, to the holding in *Middle Atlantic* that the claim of a secured creditor had priority over a bank's right to setoff against a deposit account, of the fact that the bank there "did not make its loan to the depositor on the strength of the deposited funds as collateral"). In any event, because *CCNB* involved a certificate of deposit, there is no apparent reason to rely on that case rather than *Middle Atlantic* (which, like this case, involved a demand deposit account).

2. Pioneer's Interest in the Funds Was Valid.

The Bank next argues (CoreStates Br. 42-45) that Pioneer's failure to obtain consent for its loan transactions from the court supervising RNG's bankruptcy justifies a judgment in the Bank's favor. That argument is meritless for several reasons.

First, to the extent that the Bank is contending that Pioneer never acquired a valid security interest, the Bank ignores the undisputed and wholly consensual transfer of physical

[31] Because that provision was adopted after the events of this case, it has no application here.

possession of the notes from RNG to Pioneer. R. 280b-287b. Whatever effect Bankruptcy Code 11 U.S.C.A. § 552(a) might have on the prepetition security agreement, the postpetition pledge of the notes is adequate without any written security agreement to give Pioneer a security interest under UCC § 9-203(1). Under UCC § 9-203(1), a security interest attaches when the three conditions set out in the subparagraphs of § 9-203(1) are satisfied. The last two subparagraphs are easily satisfied: Pioneer plainly gave value by funding the transactions (*see* UCC § 9-203(1)(b)); RNG plainly had rights in the mortgage notes when it received them at the closings where they were created (UCC 9-203(1)(c)). The first subparagraph (UCC 9-203(1)(a)) ordinarily requires a written agreement, but sets out a special rule dispensing with a written agreement where the collateral is in the possession of the secured party. All that is required is that the secured party actually has the debtor's agreement that it take possession. There is no need for a formal security agreement. The consensual transactions here plainly satisfy that requirement. As the relevant comment explains: "Where the collateral is in the possession of the secured party, the evidentiary need for a written record is much less than where the collateral is in the debtor's possession; * * * in this Article as at common law, the writing is not a formal requisite."). UCC § 9-203(1) comment 3.[32]

To the extent the Bank is complaining about the lack of bankruptcy court approval, the Bank has no standing to complain because the Bank is not a creditor in RNG's bankruptcy. On

[32] We cite to the statute in effect at the time of these transactions. The same rule appears in the current version of Article 9 at 9-203(b)(3)(B). *See* Revised UCC § 9-203 comment 4 ("Under paragraph (3)(B), the secured party's possession substitutes for the debtor's authentication under paragraph (3)(A) if the secured party's possession is 'pursuant to the debtor's security agreement.' That phrase refers to the debtor's agreement to the secured party's possession for the purpose of creating a security interest"); James J. White & Robert S. Summers, UNIFORM COMMERCIAL CODE 22-8, at 769 (5th ed. 2000) ("Section 9-203(b)(3)(B) also renders the security agreement of a possessing creditor enforceable even though there is no signed writing or other authenticated record.").

that point, as the Superior Court recognized, the Bank does not suggest that any court has allowed a party that was not a creditor in a bankruptcy proceeding to invalidate a security interest without bringing a challenge directly in the bankruptcy proceeding itself. Super. Ct. Op. 14. As a matter of basic bankruptcy policy, there is no plausible reason to permit a party that has no interest in the financial health of RNG to step in years after the fact and benefit from the invalidation of a transaction that went unchallenged at the time by RNG's shareholders, creditors, the trustee, or the bankruptcy court.[33] That is particularly true here, where the Bank would benefit at the expense of the party (Pioneer) that funded the transaction for the benefit of the bankrupt debtor.

Moreover, contrary to the suggestion of the Bank, no technical failure to comply with the Bankruptcy Code, 11 U.S.C.A. § 364(c) (the rules for post-filing authorization of credit transactions) would make Pioneer's interest void. Rather, the interest *at worst* would have been subject to invalidation in the discretion of the bankruptcy court based on the relevant circumstances. *See* Bankruptcy Code, 11 U.S.C.A. § 549(a)(2)(B) ("[T]he trustee **may** avoid a transfer of property of the estate * * * that is not authorized under this title or by the court."). If the trustee had brought an avoidance action, the key question would have been whether the transaction involved a bona fide extension of funds for the benefit of the estate. *See Thompson v. Margen* (*In re McConville*), 110 F.3d 47, 49 (9th Cir. 1997); *see also Bean v. Agard*, 252 F.3d 113 (2d Cir. 2001) (dismissing as a "gross abuse of discretion" an action by a trustee to invalidate an unauthorized post-petition sale of assets, because the sales proceeds already had been delivered to the bankruptcy trustee).

[33] Even the Bank does not suggest that the transactions were conducted in any clandestine or hidden way. The transactions were public, lawful and immediately apparent to any party following RNG's financial affairs.

As discussed above, it is plain that the transaction was conducted for the benefit of the estate and in the ordinary course of the debtor's business. In light of the relevant authorities, it is improbable that the bankruptcy court would have avoided the transaction. In any event, whatever the merits that such a challenge would have had if it had been brought, what is most clear is that the transactions had not been avoided at the time of the events of this case.

Furthermore, it is plain that even a party with standing could no longer bring such an avoidance action, even if the bankruptcy proceeding still were pending. The Bankruptcy Code imposes a statute of limitations of two years for such claims. 11 U.S.C.A § 549(d) (two-year statute of limitations for such claims). The passage of more than six years since the transactions in question puts them far beyond challenge.

Finally, even if the Bank's argument otherwise had merit, the most that it could establish is that Pioneer's security interest is invalid. But even complete invalidation of Pioneer's security interest would not be enough to justify the Bank's misconduct. As we have explained repeatedly above, the basic problem with what the Bank did is that it knowingly took money that its depositor did not own. It is enough for Pioneer to pursue its action for conversion that Pioneer had a present entitlement to the funds in question. RESTATEMENT (SECOND) OF TORTS (1965) § 225 & comment a (common-law action for conversion can be pursued by the person entitled to "immediate possession of the chattel"). Because the bailee letters under which the notes were transmitted to AFMC unquestionably preserved Pioneer's right to possession, arguments about Pioneer's relations with RNG under federal bankruptcy law cannot provide any basis for justifying the Bank's conduct or reversing the decision of the Superior Court.

3. Banking Code, § 606 Does Not Protect a Bank That Sets off Funds Against a Claim of a Third Party if the Bank's Purported Depositor Disclaims Any Interest in the Funds.

The Bank next argues (CoreStates Br. 46-50) that the decision of the Superior Court is inconsistent with Banking Code, PA. STAT. ANN., tit. 7, § 606 (1965). *See also* Penn. Bankers Br. 25-31 (asserting a similar argument). The Bank offers no substantial analysis of the relevant language of the statute or the substantial body of law interpreting similar statutes in this and other jurisdictions.[34] Careful examination of the relevant materials shows that the Bank's claim fails for two separate reasons.[35] First, the statute does not apply when the purported depositor

---

[34] The statute, like similar statutes adopted by most states, is based on a model statute recommended by the American Bankers Association. 2 PATON'S DIGEST § 6:3, at 1657-58 (1942) (quoting the model ABA statute and citing early examples, including 1933 Pa. Laws 624 (codified at PA. STAT. ANN. tit. 7, § 819-905 (1965)); *see* Pennsylvania Bankers Br. 26 (discussing the model statute). For the convenience of the Court, Attachment B to this brief sets out the entire text of Pennsylvania's Adverse Claim Statute, PA. STAT. ANN., tit. 7, § 606 (1965).

Because the statutes have "closely similar language, or [language] to similar effect," C.C. Marvel, Annotation, *Construction, Application, and Effect of Statute Relating to Notice to Bank of Adverse Claim to Deposit*, 62 A.L.R.2d 1116, 1117 (1958), courts frequently rely on decisions of other states interpreting these statutes. *E.g.*, *Arizona Bank v. Wells Fargo Bank, N.A.*, 713 P.2d 337, 339 (Ariz. Ct. App. 1985) (relying on decisions from Iowa, New York, Oklahoma; explaining that "[t]his uniform adverse claims statute has been adopted by a majority of states, including Arizona"); *First Bank of Whiting v. Samocki Bros. Trucking Co.*, 509 N.E.2d 187, 194-95 (Ind. Ct. App. 1987) (relying on decisions from California, the District of Columbia, Iowa, Mississippi, New Mexico, New York, Oklahoma, Oregon, and Pennsylvania). We follow the lead of those courts in offering this Court guidance from the broader case law regarding those statutes.

[35] Like much of the Bank's discussion of the first question presented, the Bank's discussion of this question continues to assume the accuracy of the Bank's assertion that the money belonged to AFMC and that Pioneer was a mere creditor of AFMC. See CoreStates Br. 49 (criticizing a "system that empowered the depositor to overcome the rules of priority by choosing which of its creditors it prefers to pay first"); *see also* Pennsylvania Bankers Br. 30-31 (presenting a similar argument). As we explain above at pages 5-8, it is far too late in the course of this litigation for any credence to be given to the Bank's claim that Pioneer was a creditor of AFMC rather than the bailor/trust beneficiary of the funds in question.

has waived its claim to the funds. Second, the statute protects banks against claims for wrongful recognition of third-party claims; it does not protect a bank that takes funds for its own account.

a. Pioneer's claim is not adverse to the purported depositor because the purported depositor disclaimed any interest in the funds.

The most obvious weakness in the Bank's argument is evident from the language of the statute. The statute by its own terms provides protections for "adverse claims," defined as claims prejudicial to the claim of the "customer in whose name the account or property is held by the institution." PA. STAT. ANN., tit. 7, § 606(a)(1). This case did not involve such a claim, because AFMC – in a written letter from its counsel – promptly disclaimed any right or ownership to the funds in question. Accordingly, as the Superior Court explained, the statute does not apply because "Pioneer's claim to the Fund is not adverse to the depositor, AFMC." Super. Ct. Op. 22; T-1000 (R. 4175a).

The view that this type of claim is not covered by the statute follows not just from the statute's reference to claims that are "adverse," but also from the general policy that motivates the statute. As courts widely recognize, the basic purpose of statutes like this one (usually referred to as bank protection statutes) is to prevent a bank from being forced to decide "at its peril" between the competing claims of others to funds deposited with the bank.[36] Thus, in the

---

[36] *Arizona Bank v. Wells Fargo Bank*, 713 P.2d 337, 339 (Ariz. Ct. App. 1985) ("The statute was aimed at saving banks from having to decide at their own peril which of two or more claimants is entitled to funds deposited with it."); *Barnett Bank of Jacksonville, N.A. v. Jacksonville Nat'l Bank*, 457 So. 2d 535, 538 (Fla. Dist. Ct. App. 1984) ("The evident purpose of the statute is to relieve the bank from having to decide at its peril whether the adverse claim is valid * * *."); *see First Bank of Whiting v. Samocki Bros. Trucking Co.*, 509 N.E.2d 187, 194 (Ind. Ct. App. 1987) ("It is clear that Indiana's adverse claim statute was intended to protect banks and similar financial institutions from having to choose between claimants to deposits in their keeping."); *Domain Indus., Inc. v. First Security Bank & Trust Co.*, 230 N.W.2d 165, 169 (Iowa 1975) ("The purpose of the statute is to protect a bank from this kind of dilemma."); 10 AM. JUR. 2D *Banks and Financial Institutions* § 773, at 638-39 (1997) ("The purpose of such a

core fact situation a bank is presented with a check drawn by one person on funds claimed by another. Early in this century, several cases held that a bank is liable to the third-party claimant if it honors the check drawn by its depositor after receiving notice of the third party's claim. *See Arizona Bank v. Wells Fargo Bank*, 713 P.2d 337, 339 (Ariz. Ct. App. 1985); *Gendler v. Sibley State Bank*, 62 F. Supp. 805, 810 (N.D. Iowa 1945); *see also* 2 PATON'S DIGEST § 6:2, at 1656-57 (1942) (citing cases); 10 AM. JUR. 2D *Banks and Financial Institutions* § 773, at 638 (1997) (citing cases). At the same time, a bank that refused to honor the check drawn by its depositor would face liability for wrongful dishonor[37] if the claim ultimately is held invalid. Because the interplay of those two rules left banks in "the precarious situation of being vulnerable to a law suit whichever course of action it took," bank protection statutes followed in most American jurisdictions. *Goldstein v. Riggs Nat'l Bank*, 459 F.2d 1161, 1163 (D.C. Cir. 1972); *see Arizona Bank*, 713 P.2d at 337; *First Bank of Whiting v. Samocki Bros. Trucking Co.*, 509 N.E.2d 187, 194 (Ind. Ct. App. 1987).

In a case like this one, however, the bank has no need of such a statute, because the depositor has disclaimed any interest in the funds. Accordingly, the bank in this case had no fear whatsoever that it would be subjected to liability for wrongful dishonor if it recognized Pioneer's claim. We have found no case in which a court has held a bank protected under a bank protection statute when the purported depositor had disclaimed any interest in the funds. The closest case is a Florida case, in which the court interpreted its statute as we urge, recognizing that a bank would not be protected under its statute if the purported depositor acknowledged that

---

statute is to afford the bank protection, when an adverse claim to a deposit is made, against the hazard of double liability * * *.").

[37] The modern rule for wrongful dishonor appears at UCC § 4-402.

it had no claim to the funds in question. *Barnett Bank of Jacksonville, N.A. v. Jacksonville Nat'l Bank*, 457 So. 2d 535, 539 (Fla. Dist. Ct. App. 1984) ("Had Perfecta [the depositor] acknowledged the validity of JNB's claim when advised of it by Barnett [the depositary bank], that claim would have ceased to be 'adverse' within the meaning of the statute * * *.").

The Bank asserts (CoreStates Br. 48 n.27) that this argument is inconsistent with the judgment in *Houghton*, contending that at the time of the setoff there "all parties knew that the funds had been embezzled from Houghton, and the depositor (like AFMC) asserted no claim to the funds." The Bank does not identify any basis for that contention; nothing in the *Houghton* opinion suggests that the depositors in that case (like AFMC in this case) previously had advised the bank in that case that they waived any claim to the funds. Accordingly, this argument is perfectly consistent with the outcome in *Houghton*.[38]

In sum, the language of the statute, the policy behind its enactment, and the reasoning of previous courts all coincide in supporting affirmance of the Superior Court.

b. Bank Protection Statutes Do Not Protect Banks That Take Funds by Setoff.

The policy of the statute also supports a more general basis for affirmance of the decisions of the lower courts. As discussed above, bank protection statutes generally are designed to prevent a bank from being forced to decide at its peril between competing claims to funds deposited with the bank. The general point is to give banks a chance to freeze the situation for long enough to assess the validity of the claims against the account. *Arizona Bank*, 713 P.2d

[38] *Amici* Pennsylvania Bankers Association suggests (Penn. Bankers Br. 30-31) that our argument is inconsistent with *Caban v. Dep't. of Public Welfare*, 431 A.2d 1163 (Pa. Commw. 1981). That case, however, did not involve an adverse claims statute. It merely recites (in the context of a dispute over welfare eligibility) a general presumption that funds belong to the named depositor.

at 341 ("The majority rule is that when a bank receives notice of an adverse claim it may preserve the situation by freezing the accounts * * *." (internal quotation marks omitted); *Stevenson v. First Nat'l Bank of Washington*, 395 A.2d 21, 24 (D.C. Ct. App. 1978) ("[W]hen a * * * banking institution receives notice of an adverse claim to a deposit, said institution may freeze that deposit for a brief, reasonable period of time * * *.").

The need to freeze the situation does not in any way justify a decision to set the funds off and keep them for the bank's own account. The bank needs protection only if it decides to dispose of the funds by giving them to one of the two claimants instead of another. Thus, courts in other states regularly have denied protection to banks in situations like this one, reasoning that the statutes do not validate improper setoffs. *See First Bank of Whiting*, 509 N.E.2d at 197 ("The statute was designed to save a bank from deciding at its peril which contesting claimant is entitled to the proceeds of an account it holds for one of them. *It was not intended to afford a bank the opportunity to improve its own position* to the disadvantage of one or both." (emphasis by court)); *Domain Indus., Inc.*, 230 N.W.2d 165, 169 (permitting an action for conversion despite the plaintiff's failure to post a bond under the Iowa adverse claims statute, explaining: "The statute was designed to save a bank from deciding at its peril which contesting claimant is entitled to the proceeds of an account it holds for one of them. It was not intended to afford a bank the opportunity to improve its own position to the disadvantage of one or both. * * * The question is, rather, could defendant then disregard a lien of which it had notice and apply the encumbered account to its own advantage."); *Ingram v. Hocking Valley Bank*, 708 N.E.2d 232, 238 (Ohio Ct. App. 1997) ("The risk that the bank would appropriate the account was not a risk of which [the claimant] was given notice by the language of the bank protection statutes."); *see also Allen v. Chase Manhattan Bank*, 267 N.Y.S.2d 620, 623 (N.Y. 1966) (explaining that bank

protection statute "does not immunize a bank from liability for conduct which might constitute negligence or conversion").

We acknowledge that our argument on this point rejects a portion of the reasoning of the Superior Court in *E.F. Houghton & Co. v. Doe*, 427 Pa. Super. 303, 628 A.2d 1172 (1993). As the Superior Court explained when ruling in Pioneer's favor, the court in *Houghton* offered a number of rationales for its decision. It was enough for the Superior Court in this case to accept the portion of the *Houghton* reasoning that a claim was not covered by the statute if the purported depositor was not "adverse" to the claimant. 797 A.2d at 285-86 (¶ 30) (following *Houghton*'s understanding of "adverse" claims). If this Court agrees with that line of reasoning (which we have explained above), then it need not address the setoff argument presented in this section. If it does address that argument, however, we believe for the reasons discussed above that it should reject the portion of *Houghton* that applies the statute to protect a bank that has taken funds for its own account. That decision applies the statute beyond the reach of the policies that motivate it and puts Pennsylvania out of line with the jurisprudence of other states considering similar statutes. Thus, we agree with the dissenting judge in *Houghton*, who relied on *Sherts* to argue that the statute does not apply

> where [the bank's] own claim to funds held by it was at issue rather than [the bank]'s being a mere stakeholder and a disinterested party. * * * I would find that § 606 is not applicable where a bank attaches deposits in furtherance of its own claims to the funds, as opposed to protection of itself from competing third-party claimants.

Houghton, 427 Pa. Super. at 311-12, 628 A.2d at 1176-77 (Cavanaugh, J., dissenting).

c. Summary.

In sum, the decision below reflects the most natural reading of the statute, as well as a reasonable accommodation of the paramount authority of this Court's decision in *Sherts*. As

both of the lower courts recognized, it makes much more sense to follow the plain language and policy of the statute, and thus limit its application to claims that are adverse to the claims of the depositor, and to cases in which the bank disburses funds to third parties. The statute has no sensible application in a case in which the bank takes funds for itself. That is particularly true in a case in which the Bank had every reason to know when it received the funds that something was awry.[39]

4. The Award of Compensatory Damages Was Appropriate in This Case.

The next question that the Bank presents (CoreStates Br. 50-57) involves two distinct challenges to the award of consequential damages in this case. First, the Bank argues (CoreStates Br. 50-53) that consequential damages are entirely unavailable as a remedy for a wrongful setoff by a bank. Second, the Bank argues (CoreStates Br. 53-57) that the provisions of UCC Article 4A implicitly bar the award of damages in this tort case. Neither of these arguments is sound.

a. Pennsylvania Law Awards Compensatory Damages for the Tort of Conversion.

As both of the lower courts understood, the Bank's first argument is in substantial tension with the general rule that damages for the tort of conversion should compensate a party entirely for the harm caused by the tort. *See* Super. Ct. Op. 28 (citing *Delahanty v. First Pennsylvania Bank, N.A.*, 318 Pa. Super. 90, 119-21, 464 A.2d 1243, 1258-59 (1983)) ("Pennsylvania law * * * provides in tort actions in which business losses and/or lost profits are alleged to have

---

[39] On that point, see *Bell v. Citizens Nat'l Bank*, 9 S.E.2d 143, 145 (W. Va. 1940) (holding that statute "protects only banks which are not at fault" because "an essential condition precedent for the operation of the statute is that the bank shall be in rightful possession of the controverted deposit").

indirectly resulted from the misconduct, consequential damages are recoverable."); Ct. Comm. Pl. Op. 27-28.

The Bank understandably cites no case supporting its argument for an exception to that general principle. The decisions of this Court, for example, consistently have emphasized that principle, explaining that "[t]he paramount rule in assessing damages is that every person unjustly deprived of his rights should at least be fully compensated for the injury he sustained. * * * [C]ompensation being the true purpose of the law, it is obvious that the means employed, in other words, the evidence to ascertain compensation, must be such as truly reaches this end." *Neuman v. Corn Exchange Nat'l Bank & Trust Co.*, 356 Pa. 442, 456, 51 A.2d 759, 766 (1947) (quoting *Montgomery County Bank v. Reese*, 26 Pa. 143, 146 (1856)). The "theories of fair compensation reflected in Pennsylvania case law * * * seek to put the injured person in a position as nearly as possible equivalent to his or her position prior to the tort." *Moorhead v. Crozer Chester Med. Ctr.*, 564 Pa. 156, 163-64, 765 A.3d 786, 790 (2001).

There is nothing surprising about this. It is consistent with fundamental principles of tort law. *See* RESTATEMENT (SECOND) OF TORTS § 927(2)(b) (damages for conversion include not only the value of the converted asset but also "any further pecuniary loss of which the deprivation has been a legal cause"). Indeed, a contrary rule essentially would encourage banks to take funds in all cases of doubt, because the worst consequence of being caught in the most flagrant taking would merely be an order to return the stolen property.

More fundamentally, the Bank's phrasing of the question as a challenge to Pioneer's entitlement to "consequential" damages is itself misguided. The concept of consequential damages is a concept of contract law, not tort law, the purpose of which is to limit unforeseeable damages for breach of contract. *See* RESTATEMENT (SECOND) OF CONTRACTS § 351 & comment

b (1981) ((discussing the role of foreseeability in limiting contract damages, including consequential damages); *Collins v. First Fin. Servs., Inc.*, 815 P.2d 411, 413 (Ariz. Ct. App. 1991) ("[T]he measure of conversion damages includes not only the value of the property taken, but also other damage suffered because of the wrongful detention or deprivation of the property * * *."). Because the harm at issue here flowed directly from the misconduct, Pioneer is entitled to compensation for it.

Thus, it is not surprising that the principal basis for the Bank's argument here is to challenge the availability of a tort remedy here as "tortification" of something the Bank regards as a contract dispute. CoreStates Br. 52; *see* Penn. Bankers Br. 35-37 (similar argument). That argument has no force here, however, because there is no contractual relation of any kind between Pioneer and the Bank.

Because this case involves a claim for tort, the only important question is whether the damages compensate for actual harm. In this case, as the lower courts recognized, the jury's finding resolves that question in Pioneer's favor. Super. Ct. Op. 28-29; Ct. Comm. Pl. Op. 28-29.[40] The matter should end there.

---

[40] The Bank argues briefly (CoreStates Br. 54-55) that the evidence was insufficient to support the award of consequential damages. That argument, of course, is difficult to credit in the face of the contrary jury findings affirmed by the trial court and the appellate court.

The Bank also argues (CoreStates Br. 56-57) that Pioneer failed to mitigate its damages. As the Superior Court explained, Pioneer introduced substantial evidence of its efforts to mitigate, including testimony that one of its shareholders invested millions of dollars in an ultimately unsuccessful attempt to keep Pioneer afloat in the face of the Bank's misconduct. Super. Ct. Op. 29 ("The evidence also showed that Pioneer attempted to mitigate its losses."). Although it did not present this argument to the Superior Court, the Bank now argues that Pioneer's efforts should be discounted because Pioneer did not choose to post a bond and pursue a claim under the adverse claim statute. As discussed in our response to the Bank's third question presented, that statute does not apply to this dispute. Furthermore, Pennsylvania law does not obligate the injured party to pursue any and every speculative course of action that appellate counsel of the tortfeasor can devise with the benefit of hindsight. That is particularly

b. UCC Article 4A Does Not Limit the Damages Available in Nonstatutory Tort Actions.

The Bank also argues (CoreStates Br. 53-55) that the provisions of UCC Article 4A that limit the availability of consequential damages in actions under Article 4A implicitly preclude the availability of damages in this case.[41] That argument substantially duplicates the argument we addressed above. First, the claims about "chilling effects" on routine transactions (CoreStates Br. 54) ignore the inherently nonroutine nature of a setoff like the one in this case, which occurred months after the transfer, after careful and considered deliberation. *See* CoreStates Br. 61-63 (the Bank's account of its deliberative process).

Furthermore, with respect to the claim that damages in this case somehow infringe upon the territory staked out by Article 4A (CoreStates Br. 53-54), we have explained above that this dispute does not relate to Article 4A in any cognizable way. Pioneer is not complaining that the Bank improperly refused to cancel the wire transfer or that the Bank improperly failed to pay the beneficiary of the wire transfer. Pioneer is a complete stranger to the wire-transfer transaction bringing a cause of action for conversion under Pennsylvania common law based on conduct that

---

true when the tortfeasor itself is in an equal position to mitigate damages. *See Loyal Christian Benefit Ass'n v. Bender*, 342 Pa. Super. 614, 620, 493 A.2d 760, 763 (1985) ("The injured party is not obligated to mitigate damages where both he and the liable party have an equal opportunity to reduce damages."). Here, of course, the Bank could have mitigated all the damages by the simple expedient of returning the funds once it discovered in late November that the funds in fact did not belong to its depositor.

[41] The references to consequential damages in UCC Article 4A illustrate our point that the concept of consequential damages has no application in a tort case like this one. Those references appear in provisions in which it is natural to expect contractual arrangements between the parties, so that the damages provided by the statute arise in the context of a contractual relationship. In that context, the statute simply implements the normal expectation in such a relationship that there will be no consequential damages except as provided in a written agreement among the parties. UCC § 4A-305(c) & comment 2. Pioneer, of course, was not a party to any contractual agreement with the Bank.

has no logical or temporal relation to the wire transfer. Pioneer would bring the same cause of action if the funds had reached AFMC's account through a check or a deposit of currency; the method by which the funds entered the account is entirely irrelevant. So long as that cause of action does not provide a recovery for any conduct validated by Article 4A – and it does not, for the reasons discussed above with respect to the first question that the Bank presents – there is no reason to think that Article 4A would deprive the plaintiff of an entitlement to full compensatory damages or to punitive damages in an appropriate case.

5. Pennsylvania Law Authorizes an Award of Punitive Damages Based on the Persistently Malicious and Willful Misconduct Proven in This Case.

By remanding for a new trial on punitive damages, instead of reversing the punitive damages award, the Superior Court upheld the unanimous jury and the trial court's conclusion that the Bank's conduct was sufficiently reprehensible to warrant punitive damages. *See* Ct. Comm. Pl. Op. 33 ("[T]he jury under the facts of this case had every reason to punish the defendant CoreStates having found essentially that the bank took what belonged to the plaintiff, refused to return it to the plaintiff when properly notified, and as a result drove the plaintiff's business into the ground.").

The Bank's final argument (CoreStates Br. 57-65) challenges the decision of the Superior Court on that point. Pennsylvania law permits an award of punitive damages for conduct that "is malicious, wanton, reckless, willful, or oppressive." *Feld v. Merriam*, 506 Pa. 383, 395, 485 A.2d 742, 747-48 (1984) (internal quotation marks omitted). Among other things, that permits an award for conduct that shows "reckless indifference to the rights of others." *Rizzo v. Haines*, 520 Pa. 484, 507, 555 A.2d 58, 69 (1989) (quoting Restatement (Second) of Torts § 908(2) (1977)); *see SHV Coal, Inc. v. Cont'l Grain Co.*, 526 Pa. 489, 493, 587 A.2d 702, 704 (1991)

(holding the same). This Court's decisions are in line with the decisions of other courts. They reflect a conscious adoption of the rule articulated in Section 908 of the Restatement (Second) Of Torts, which several other states also have adopted. *E.g.*, *Phelps v. Louisville Water Co.*, 103 S.W.3d 46, 52 (Ky. 2003); *Dartt v. Browning-Ferris Indus., Inc*, 691 N.E.2d 526, 537 (Mass. 1998); *Burnett v. Griffith*, 769 S.W.2d 780, 789-90 (Mo. 1989) (*en banc*).

The question before the Court does not present any substantial question of federal law. Although the United States Supreme Court has decided a number of cases about punitive damages, the issue in those cases has been the amount of the punitive damages award, not the underlying question whether punitive damages are appropriate. *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 123 S. Ct. 1513 (2003); *Cooper Indus., Inc. v. Leatherman Indus., Inc.*, 532 U.S. 424 (2001); *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996). For example, the Court explained in *Campbell* that the "States possess discretion over the imposition of punitive damages," but went on to discuss constitutional limitations that the Due Process Clause imposes on "grossly excessive" awards, 123 S. Ct. at 1519.

The Bank suggests (CoreStates Br. 57) that the Superior Court's decision "disregard[s] the constitutionally based principle that a defendant must have fair notice that its conduct is subject to punishment." The Bank does not, however, offer any reason to doubt that the Due Process Clause permits Pennsylvania to impose punitive damages upon a finding that satisfies the standard articulated by this Court in *Feld*.[42] That standard has been the law in this Commonwealth for twenty years. Despite the Bank's implausible complaints that it could not

---

[42] The Bank does suggest that "as far as we know" punitive damages have never been imposed against a bank for wrongful setoff. The Bank errs in contending that the outcome here is unprecedented. *See Iola State Bank v. Bolan*, 679 P.2d 720, 734 (Kan. 1984) (affirming a punitive damages award of 5.6 times the compensatory damages on a cause of action for conversion).

have anticipated that it would be liable in punitive damages for its conduct in this case (CoreStates Br. 64), application of the *Feld* standard to the Bank's conduct in this case hardly amounts to unfair surprise.

The question whether the record supports allowing a jury to assess punitive damages in a particular case is a factual one determined under typical standards for sufficiency of evidence. *See SHV Coal*, 526 Pa. at 495, 587 A.2d at 705 ("The determination of whether a person's actions arise to outrageous conduct lies within the sound discretion of the fact-finder and will not be disturbed by an appellate court so long as that discretion has not been abused."); *Kirkbride v. Lisbon Contractors, Inc.*, 521 Pa. 97, 100, 555 A.2d 800, 802 (1989) (noting that the appellate court should not "substitut[e its] own judgment for that of the jury in evaluating the [relevant] factors"); *Feld*, 506 Pa. at 395-96, 485 A.2d at 747-48 (applying that standard of review to a determination that punitive damages were appropriate); *see Delahanty*, *supra*, 318 Pa. Super. at 129, 464 A.2d at 1263 ("It is well settled law in Pennsylvania that the decision of whether to award punitive damages * * * [is] within the discretion of the fact finder.").

Thus, in the end, all that is left is a factual argument that the Bank's conduct was reasonable. The Bank's sole basis for that argument is the contention (CoreStates Br. 62-63) that the Bank's conduct was consistent with the views of its attorney at the time, and with the views later offered by Senior Judge Beck on the Superior Court and the Federal Reserve. The basic difficulty with that argument is that the description that the Bank offers is yet another example of the Bank's studied unwillingness to come to grips with the actual record at trial. On this particular point, it is fair to say that the Bank's position ignores entirely the record of its own malicious and outrageous behavior.

In the first place, at the time in question – when the Bank initially refused to release the funds to their apparent owner – the Bank in fact was not relying on the legal opinion that it cites now with such pride (CoreStates Br. 61), because that opinion was not even prepared until January 8, 1998, three weeks after the Bank removed the funds from the account into which they were originally wired. R. 4151a. Moreover, the Bank conveniently ignores the contrary information that it did have when it made up its mind – not only the plain terms of the bailee letters, but also specific written notice from AFMC's attorney disclaiming ownership in the funds, and repeated contemporaneous efforts by Norwest to retract the wires as mistaken. R. 3832a; R. 4188 – 4198a.

Nor does the Bank mention the most telling point of all, the internal evidence indicating that the Bank at that time already knew the accuracy of Pioneer's understanding of the transactions and the inaccuracy of the factual account on which its counsel based the advice in question, the same inaccurate factual account that the Bank would present to the trial court, the Superior Court, and this Court. R. 4238a (email between CoreStates executives) ("This is a payment on a very convoluted transaction involving acompany in bankruptcy in California thatsold a portfolio of loans to Norwest. Go Figure how the funds got here.") (spacing and capitalization as in original). In those circumstances, it is not plausible to credit the advice of counsel defense on which the Bank relies. *See Iola State Bank v. Bolan*, 679 P.2d 720, 734 (Kan. 1984) (rejecting advice of counsel defense to punitive damages where attorney had not been apprised of the facts that made conduct reprehensible).

Moreover, as discussed above, the Bank's vigorous litigating strategy should not obscure the fact that the conduct that the Bank defends in this Court was indisputably wrongful under the common law of every American jurisdiction. As the date of the Weir memorandum on which

the Bank relies indicates, there is no reason to think that the Bank's position is anything other than a post hoc justification for conduct that was motivated by malice or recklessness at the time it occurred. The Bank's internal documentation that is contemporaneous with the initial decision to retain the funds strongly supports that view. *See*, *e.g.*, R. 4237a-4239a (Dec. 12, 1997 email between CoreStates executives describing transactions as a sale from RNG to Norwest (rather than AFMC) and asking "go figure how the funds got here"); *see also* R. 4233a-4236a (Jan. 30, 1998 email between CoreStates executives indicating that the Bank should "shoot and ask questions later").

The inference that the conduct was malicious in the first instance draws powerful support from the way in which the Bank has handled the dispute in the months and years that have followed. That subsequent conduct can draw no support from the justifications that the Bank offers to support its initial decision to retain the money and thus is particularly important to a complete understanding of the case. The basic point, as the opinions below illustrate, is that the Bank engaged in a protracted and calculated effort to prevent Pioneer from learning the facts about the Bank's conduct. That conduct started with concerted and repeated efforts to coerce AFMC's president, Thomas Flatley, into renouncing his original statement that the funds belonged to Pioneer. Eventually, the Bank forced Flatley to capitulate and say that the Bank could keep Pioneer's money. The Bank succeeded at this coercion by threats of RICO actions against Flatley and his companies. *See* R. 1562a-1570a (description of RICO threat by AFMC's principal); R. 1658a-1659a (testimony of CoreStates executive that he threatened AFMC's principal with the RICO complaint unless he acquiesced in the Bank's demands); 1692a–1694a (testimony of CoreStates executive regarding decision to report AFMC activities to federal authorities when AFMC did not immediately accede to the Bank's demands).

In order to buy more time to keep the pressure on Flatley to change his story and to reach a deal with him, the Bank delayed a pending grand jury proceeding by failing to respond to repeated grand jury subpoenas – despite threats by the U.S. Attorney's office that the Bank would be investigated before the grand jury for its refusal to produce its records. R. 4142-49a. The Bank was ultimately successful in delaying the criminal investigation so that it could conclude its deal with Flatley. R. 4239-40a. This delay strategy was denied by Bank witness Weir, but later proven by one of the withheld emails that the Bank produced a month into the trial. The email directly contradicted Weir's testimony before the jury that the Bank had done nothing to delay the criminal investigation of Flatley. R. 1932-38a; 1956-61a.

Nor did the Bank's efforts to stonewall Pioneer's claim cease when the matter reached the judicial system and was turned over to the Bank's legal representatives. As both of the lower courts have explained, the Bank's recalcitrance in discovery was extraordinary. *See* Ct. Comm. Pl. Op. 21 ("[T]o resist proof of [Pioneer's] theory the defendants tried by every means possible to keep [relevant] evidence * * * out of the record. There were an unheard of seven discovery orders entered against CoreStates."); Super. Ct. Op. 25 (characterizing the Bank's "discovery violations" as "willful, repeated and persistent"). The conduct persists to this day, as evidenced by the substantial number of direct misstatements in the Bank's brief.

In sum, the Bank's arguments that it acted innocently when it retained Pioneer's money are implausible with respect to the conduct that they do address and do nothing to justify the entirety of the Bank's wrongful conduct. *See Hollock v. Erie Ins. Exch.*, No. 298 MDA 2002, 2004 WL 100468 (Pa. Super. Ct. Jan. 22, 2004) (upholding finding of bad faith based in part on litigation misconduct). There can be no doubt that the entire course of conduct is sufficient to permit a jury to find that the Bank acted with intentional malice and impose *some* amount of

punitive damages. The Bank's blinkered effort to justify a small part of that conduct should not obscure from this Court what the jury and both of the lower courts saw so clearly. *See*, *e.g.*, *Iola State Bank*, 679 P.2d at 734-35 (upholding punitive damages award for wrongful setoff because bank's knowledge of the true facts made its decision to set off "willful" and "wanton").[43]

(intentionally left blank)

---

[43] *See also* 10 AM. JUR. 2D *Banks and Financial Institutions* § 873, at 707 (1997) ("[W]hen the bank knows that the funds in the account of its depositor represent the funds of a third person, it is liable to such third person for conversion if it sets off against such funds * * * and the bank also, under such circumstances, may be liable for punitive damages.").

CONCLUSION

For all the foregoing reasons, this Court should affirm the judgment of the Superior Court.

Respectfully Submitted,

____

Maurice R. Mitts,
Frank G. Murphy
FREY, PETRAKIS, DEEB, BLUM,
BRIGGS & MITTS, P.C.
1601 Market Street, Twenty-Sixth Floor
Philadelphia, PA 19103
(215) 563-0500

Ronald J. Mann
727 E. Dean Keeton Street
Austin, TX 78705
(512) 232-1357

Howard J. Bashman
1250 Virginia Drive
Suite 1000
Fort Washington, PA 19034
(267) 419-1230

Attorneys for Plaintiff/Appellee
Pioneer Commercial Funding Corporation

PROOF OF SERVICE

I, Maurice R. Mitts, hereby certify that on this 10th day of March, 2004, I caused a true and correct copy of Brief on the Merits of Appellee Pioneer Commercial Funding Corporation to be served in the manner indicated upon the following in accordance with Rule 121(d) of the Pennsylvania Rules of Appellate Procedure:

By Hand Delivery:

Ralph G. Wellington, Esquire
Schnader, Harrison, Segal & Lewis, LLP
1600 Market Street, Suite 3600
Philadelphia, PA 19103-7286

David R. Moffitt
Saul, Ewing, Remick & Saul, LLP
Centre Square West
1500 Market Street – 38th Floor
Philadelphia, PA 19102

John J. Brennan, Esquire
Dechert
4000 Bell Atlantic Tower
1717 Arch Street
Philadelphia, PA 19103-2793

Edward M. Mahon, Esquire
Federal Reserve Bank of Philadelphia
Ten Independence Mall
Philadelphia, PA 19106

Marc J. Sonnenfeld, Esquire
Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921

By U. S. Mail:

William H. Lamb, Esquire
24 East Market Street
Post Office Box 565
West Chester, PA 19381-0565

Louise Alexandra Rynd, Esquire
Pennsylvania Bankers Association
3897 North Front Street
Post Office Box 152
Harrisburg, PA 17108

Andrew L. Frey, Esquire
Mayer, Brown & Platt
1909 K Street, N.W.
Washington, D.C. 20006-1101

Nolan N. Atkinson
Duane, Morris & Heckscher LLP
One Liberty Place, Suite 4200
Philadelphia, PA 19103

____

Maurice R. Mitts
Attorney for Plaintiff/Appellee
Pioneer Commercial Funding Corporation

March 10, 2004