Common Practice

(Industry Standard) - (Commercial Custom)
(Whatever the Banks Want to Call It)
E-Notes are not Legal

*"In its closing brief, Deutsche asserts that the difference between the Original and the versions of the Note attached to the MRS and POC can be explained by the so called **"common practice"** in the mortgage industry of imaging notes and deeds of trust at the time a loan is originated and not updating the electronic file thereafter."*

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF ARIZONA
Case No. 4:09-bk-09703-EWH

"When asked to explain the disparity between the Original and the copies of the Note attached to Deutsche's MRS and POC, Deutsche's witness testified that, when AHMSI's staff reviewed the Note on its "imaging system," the Allonge was not attached and no other assignments appeared on the imaged Note. The witness further testified that when AHMSI acts as an originator of a loan, loan documents are scanned into an imaging system at closing but not thereafter.

841 F.2d 592
UNITED STATES of America, Plaintiff-Appellee,
v.
HIBERNIA NATIONAL BANK, Defendant-Third-Party Plaintiff-Appellant – Cross-Appellee,
v.
Joseph M. RAULT, Jr., Third-Party Defendant - Appellee-Cross-Appellant.
No. 86-3774.
United States Court of Appeals, Fifth Circuit

"Commercial custom does not apply where the U.C.C. provides otherwise. See U.C.C. Sec. 1-103; also U.C.C. Sec. 3-104, Official Comment 2 ("[A] writing cannot be made a negotiable instrument within this Article by contract or by conduct."

Uniform Commercial Code

§ 1-103. Construction of [Uniform Commercial Code] to Promote its Purposes and Policies: Applicability of Supplemental Principles of Law.

(a) [The Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are: (1) to simplify, clarify, and modernize the law governing commercial transactions; (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and (3) to make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.

ORDERED.

Dated: July 29, 2010

EILEEN W. HOLLOWELL
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: ANTHONY TARANTOLA, Debtor.	Chapter 13 Case No. 4:09-bk-09703-EWH
DEUTSCHE BANK NATIONAL TRUST COMPANY, as Trustee in trust for the Certificateholders for Argent Securities Inc., Asset-Backed-Pass-Through Certificates, Series 2004-W8, its assignees and/or successors, Movant, v. ANTHONY TARANTOLA, Debtor; and DIANNE C. KERNS, Chapter 13 Trustee, Respondents.	**MEMORANDUM DECISION**

I. INTRODUCTION

Yet again, the court is called upon to decide whether the purported holder of a note allegedly transferred into a securitized mortgage pool has standing to obtain relief from the automatic stay. Yet again, the movant has failed to demonstrate that it has standing. To make matters worse, the movant filed its motion without evidentiary

support of its claim, attempted to create such evidentiary support after the fact, and only disclosed its "real" evidence on the day of the final evidentiary hearing. The relief will be denied.

II. FACTUAL AND PROCEDURAL HISTORY

On or about November 7, 2003, the Debtor executed and delivered to Argent Mortgage Company, LLC ("Argent Mortgage") an adjustable rate promissory note in the principal sum of $377,600 ("Note") secured by a Deed of Trust ("DOT") on real property located at 11201 East Hashknife Circle, Tucson, Arizona 85749 ("Property").

Shortly after the creation of the instruments, the Note was allegedly placed in a securitized mortgage pool: Asset-Backed Pass-Through Certificates Series 2004-W8, dated May 1, 2004 ("Pool"). (Final Evidentiary Hr'g Tr. 25, 78-79, June 23, 2010, DE #80.)[1] Under the Pooling and Servicing Agreement dated May 1, 2004 ("PSA"), Argent Securities Inc. ("Argent Securities") is listed as the "Depositor," with Ameriquest Mortgage Co. ("Ameriquest") as the "Master Servicer," and Deutsche Bank National Trust Co. ("Deutsche") as the "Trustee" and initial custodian ("Initial Custodian"). (Ex. 6.)

Movant alleges the servicer for the Pool changed twice since its creation. (Tr. 25, 35.) Sometime prior to May 2008, the servicer changed from Ameriquest to Citi

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[1] Any additional citations to a transcript refer to the Final Evidentiary Hearing Transcript dated June 23, 2010 (DE #80). All exhibit numbers refer to exhibits admitted at the hearing.

Residential Servicing Inc. ("Citi Residential"), and then changed again to American Home Mortgage Servicing Inc. ("AHMSI") in May 2008. (Tr. 34.)[2]

As of October 1, 2008, the Debtor was in default on his obligations under the Note. Debtor filed his petition for relief under Chapter 13 of the Bankruptcy Code on March 7, 2009. AHMSI filed a Proof of Claim ("POC") on June 29, 2009. Attached to the POC are the following:

a. The Note. No endorsements appear on the Note. No allonge is attached to the Note.

b. DOT.

c. Assignment of Mortgage/Deed of Trust ("Assignment #1") from Argent Mortgage to AHMSI, executed by Citi Residential as servicer for Argent Mortgage. Assignment #1 was notarized June 25, 2009. No recording information appears on Assignment #1.

Deutsche filed a Motion for Relief from Stay ("MRS") on December 8, 2009, on the grounds that the Debtor was in default, had no equity in the Property, and the Property was not necessary for an effective reorganization. (DE #35.) The MRS also requested adequate protection payments to protect Deutsche's alleged interest in the Property. The MRS represented at paragraph 5 that Deutsche is "now the holder of the Note that is secured by the Deed of Trust and is the real party in interest." Attached to the MRS are the following exhibits:

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[2] Movant provided no documentary evidence to support its allegations regarding changes in servicers.

a. The Note. No endorsements appear on the Note. No allonge is attached to the Note.

b. DOT.

c. Assignment of Mortgage/Deed of Trust ("Assignment #2") from Argent Mortgage to Deutsche, executed by AHMSI as servicer for Argent Mortgage. Assignment #2 was notarized November 12, 2009. No recording information appears on Assignment #2.

On January 5, 2010, Deutsche filed a "Notice of Filing Exhibit and Exhibit in Support of Motion for Relief from Automatic Stay" (DE #39), which attaches, as an exhibit, a copy of the Note and, on a separate piece of paper, an "Allonge to Promissory Note" ("Allonge"), which lists a loan number, the Debtor's name, and the Property's address. The undated Allonge purports to assign the Note from Argent Mortgage to Deutsche.

On January 17, 2010, the Debtor filed a response ("Response") to the MRS challenging Deutsche's standing to seek relief from stay. (DE #40.) The Response also raises a number of other arguments, including a claim that Deutsche was required to provide documentation for every assignment of the Note and DOT, that only certificate holders of the Pool can demonstrate standing and that the Debtor is entitled to credit for any third-party payments made to the Pool's certificate holders. At the preliminary hearing on the MRS, the Movant relied on the Allonge to demonstrate its standing. (Mins. of Prelim. Hr'g for MFR 1, DE #45.) The court set an evidentiary hearing for June 15, 2010, which was later vacated by the court and rescheduled to June 23, 2010.

On June 18, 2010 (DE #68), Deutsche filed a "Supplemental Declaration" consisting of a declaration by Jennifer Ward, in her capacity as an employee of AHMSI, as servicer for Deutsche. The Supplemental Declaration asserts at paragraph 8 that Deutsche became the holder of the Note "when an allonge affixed to the original promissory note transferring the Promissory Note to Movant was executed by Karen [sic] Smith" pursuant to the following documents:

a. corporate resolution appointing Kathy Smith (not Karen) as an Assistant Secretary of AHMSI;

b. corporate resolution appointing all Assistant Secretaries of AHMSI as officers of Citi Residential, electing such officers to be vice presidents and assistant secretaries ("Special Officers") of Citi Residential;

c. list of powers of attorneys, which Special Officers of Citi Residential are authorized to execute; and

d. 2007 Limited Power of Attorney ("LPA") from Argent Mortgage to Citi Residential.

On June 23, 2010, an evidentiary hearing was held on the MRS. At the commencement of the hearing, a motion in limine filed by Deutsche (DE #69) was granted which limited the subject of the hearing to the issue of Deutsche's standing. Deutsche called, as a witness, an employee of AHMSI from its litigation and mediation group who testified that he had brought the original of the Note ("Original") to the hearing. (Ex. 5.) The Original includes two stamped, undated, "without recourse", endorsements (collectively, "Endorsements") which did not appear on any other versions of the Note filed by Deutsche. There is an endorsement from "Argent

Mortgage Company" (not "Argent Mortgage Company LLC") to Ameriquest signed by Wayne Lee "President" and also signed by John R. Grazer "EVP/CFO." The second endorsement is in blank, from Ameriquest, signed by Kirk Langs "President" and also signed by John R. Grazer "EVP/CFO."[3]

When asked to explain the disparity between the Original and the copies of the Note attached to Deutsche's MRS and POC, Deutsche's witness testified that, when AHMSI's staff reviewed the Note on its "imaging system," the Allonge was not attached and no other assignments appeared on the imaged Note. (Tr. 47.) The witness further testified that when AHMSI acts as an originator of a loan, loan documents are scanned into an imaging system at closing but not thereafter. (Tr. 49.)

Deutsche admitted into evidence a copy of the Original, the DOT, an unsigned copy of the PSA with all exhibits, including a "Mortgage Loan Purchase Agreement" ("MLPA"), the corporate resolutions, and the LPA which purportedly permitted Kathy Smith to act on behalf of Argent Mortgage. The Debtor admitted into evidence the Allonge and Assignment #2. The Debtor also offered the testimony of a purported expert on loan securitization and portions of that expert's report. Because the court limited the subject of the hearing to Deutsche's standing, the scope of the expert's testimony was also limited to that subject.

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[3] When Exhibit 5 was first presented, the court expressed concerns overs its late disclosure. The court offered to adjourn the hearing to provide Debtor's counsel more time to review the Original with the Endorsements; however, Debtor's counsel agreed to the admission of the Original as long as the record reflected its late disclosure.

III. ISSUES

Does Deutsche have standing to seek relief from the automatic stay**?**

IV. STATEMENT OF JURISDICTION

Jurisdiction is proper under 28 U. S. C. §§ 1334(a) and 157(b)(2)(G)**.**

V. DISCUSSION

In order to seek relief from the stay, a movant must have a "colorable claim" in the property protected by the automatic stay. In re Weisband, 427 B.R. 13, 18 (Bankr. D. Ariz. 2010) (citing In re Wilhelm, 407 B.R. 392, 400 (Bankr. D. Idaho. 2009); In re Emrich, 2009 WL 3816174, at *1 (Bankr. N.D. Cal. 2009)). Black's Law Dictionary defines a colorable claim as "a claim that is legitimate and that may reasonably be asserted given the facts presented and the current law (or a reasonable and logical extension or modification of the current law)." Black's Law Dictionary 264 (8th ed. 2004). Therefore, in order to have a colorable claim Deutsche must either own the Note or be entitled to enforce the rights provided to the lender in the Note and/or in the DOT.[4]

[4] No separate analysis is required of Deutsche's rights under the DOT because it bases its claim of standing solely on being the holder of the Note under Ariz. Rev. Stat. § 47-3301. (Movant's Closing Br. 4, DE #77.)

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A. Allonge

At the end of the evidentiary hearing, Deutsche asserted it had met its standing burden based on the Allonge and the Endorsements.[5] The Allonge, however, does not demonstrate that Deutsche had standing to seek relief from stay when it filed the MRS or anytime thereafter.

Deutsche's witness admitted that the Allonge was created after the MRS was filed to "get the attorneys the information they needed." (Tr. 36, 47, 73.) Creation of evidence to support a motion for relief from stay, after filing has been found to violate Fed. R. Bankr. P. 9011(b)(3). See In re Maisel, 378 B.R. 19, 22 (Bankr. D. Mass. 2007) ("parties seeking relief from stay must be aware that by presenting a motion to the court, they represent that 'the allegations' and other factual contentions have evidentiary support").

Deutsche's witness also admitted that the Allonge had not been attached to the Original, but to a copy. (Tr. 79.) The Allonge, therefore, was never properly affixed to the Note and could not accomplish a transfer of the Note under ARIZ. REV. STAT. ANN. § 47-3204(A) (2010).

Last, but certainly not least, even if the Allonge had been affixed to the Original, it would have been ineffective to transfer the Note to Deutsche because the party executing the Allonge had no authority to do so. First, while the Allonge is executed by Kathy Smith "as an Assistant Secretary and Vice President" of Argent, the evidence presented by Deutsche demonstrates that she was instead a "Special Officer of Citi

[5] In its closing brief, Deutsche relies exclusively on the Endorsements in arguing that it has standing.

Residential Lending Inc." exercising the LPA. But the LPA only authorized assignments in specific circumstances not present here. The LPA is very similar to limited powers of attorney addressed in two other reported decisions. In re Samuels, 415 B.R. 8, 17 (Bankr. D. Mass. 2009); In re Hayes, 393 B.R. 259, 264 (Bankr. D. Mass. 2008). Both cases also involved Deutsche Bank, Argent Mortgage and Citi Residential. In those cases, as here, the limited powers of attorney in question authorized assignments only in connection with certain events such as a repurchase (#6 of the LPA), pay off or refinancing of a note (#7 of LPA).

In this case, as in Samuels and Hayes, the Allonge was not executed in connection with a repurchase or a refinancing of the Note or any other event set out in the LPA. Accordingly, the LPA did not authorize the transfer in the Allonge. Deutsche not only created the Allonge after it filed its MRS and falsely represented that it was affixed to the Original, but it also relied on the LPA authorizing the transfer of the Note when substantially identical powers of attorney have been held to be ineffective in reported decisions involving Deutsche.

B. Endorsements

Because the Allonge was ineffective (as well as fabricated after the fact), Deutsche's standing depends on the validity of the Endorsements. Deutsche claims that it is the holder of the Note because when the Original was finally produced, it contained an endorsement in blank.

Under Arizona law, when an instrument is endorsed in blank, it becomes a bearer instrument, and may be negotiated by transfer of possession alone. ARIZ. REV. STAT. ANN. § 47-3205(B). Normally, under Fed. R. Evid. 902(9), the Original, as

commercial paper, is entitled to a presumption of authenticity. Furthermore, U.C.C. § 3-307 (ARIZ. REV. STAT ANN. § 47-3307(B) presumes the genuineness of signatures in negotiable instruments. But, under ARIZ. REV. STAT. ANN. § 47-3308, when the validity of an endorsement is challenged, the burden of demonstrating authenticity is on the party asserting it.[6]

In its closing brief, Deutsche asserts that the difference between the Original and the versions of the Note attached to the MRS and POC can be explained by the so-called "common practice" in the mortgage industry of imaging notes and deeds of trust at the time a loan is originated and not updating the electronic file thereafter. However, there is nothing in the record which demonstrates that this was the common practice of Argent Mortgage. In fact, the testimony of Deutsche's witness was based on the practices of AHMSI, which was not the originator of the Note and did not become the servicer until 2008. The witness' explanation as to why the copies of the Note on the "imaging system" did not contain the Endorsements is nothing more than speculation. Therefore, in light of Deutsche's admission that it fabricated the Allonge, and in the absence of any credible explanation for the difference of the Original from other filed versions of the Note, the court will not apply the usual evidentiary presumptions of validity to the Endorsements.

In order to prove the Endorsements' validity, Deutsche must demonstrate that the Endorsements were executed by a party with authority, acting for an entity that owned

[6] In this case, Debtor previously challenged the validity of the signature on the Allonge, but due to the late disclosure of the Original, Debtor was unable to file a written challenge to the Endorsements before the evidentiary hearing. Debtor has challenged the validity of the Endorsements in his closing brief. (Resp't Post Trial Br. 7, DE #78.)

the Note when the Endorsements were executed. Deutsche's witness, however, did not know the identity of the parties who executed the Endorsements or the date the Endorsements were executed.[7]

In the alternative, Deutsche may be able to rely on the PSA and its various exhibits to demonstrate that the Note was transferred to the Pool.[8] In In re Samuels, the court found:

> The PSA itself, in conjunction with the schedule of mortgages deposited through it into the pool trust, served as a written assignment of the designated mortgage loans, including the mortgages themselves.

415 B.R. at 18.

In this case, as in Samuels, the PSA includes requirements for assigning notes and mortgages into the Pool. Section 2.01 of the PSA provides, in relevant part, that all the "Mortgage Loans identified on the Mortgage Loan Schedule" will be delivered to the Pool Trustee ("Deutsche") in the following form:

> The original Mortgage Note, endorsed in blank without recourse, or in the following form: "Pay to the Order of Deutsche Bank National Trust Company, as Trustee under the "applicable agreement, without recourse."

However, the Endorsements do not satisfy Section 2.01 because, even if they are assumed to be valid, there is no endorsement from Argent Mortgage (the originator

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[7] Indeed, the witness did not even know where the Original was maintained by AHMSI. He only knew he received it from the "doc prep" division of AHMSI after requesting it the week of the evidentiary hearing. (Tr. 49-50, 85).

[8] Debtor argues that any assignment of the Note after the "cutoff date" of the PSA would be ineffective because it would violate REMIC and the PSA terms. (Resp't's Resp. to Mot. 2, DE #40.) However, an assignment to the Pool is not necessarily ineffective after the "cutoff date." As noted by the court in Samuels: "Even if this direct assignment were somehow violative of the PSA, giving rise to unfavorable tax, regulatory, contractual, and tort consequences, neither the PSA nor those consequences would render the assignment itself invalid." 415 B.R. at 22.

of the Note) in blank or to Deutsche. Furthermore, the "Mortgage Schedule" referred to Section 2.01 was not offered into evidence by Deutsche, so there is nothing which identifies the Note as having been transferred to the Pool through the PSA.

The transfer of the loans under the PSA could have also occurred under the MLPA. The MLPA lists Argent Securities as the Depositor and Ameriquest Mortgage Co. (the original loan servicer under the PSA) as the Seller. The MLPA provides, in relevant part, as follows:

> Section 4. TRANSFER OF THE MORTGAGE LOANS
>
> (b) DELIVERY OF MORTGAGE LOAN DOCUMENTS. The Seller [Ameriquest] will, on or prior the Closing Date, deliver or cause to be delivered to the Purchaser [Argent Securities] or any assignee, transferee or designee of the Purchaser each of the following documents for each Mortgage Loan:
>
> (i) the original Mortgage Note, endorsed in blank, without recourse, or in the following form: "Pay to the order of Deutsche Bank National Trust Company, as Trustee under the applicable agreement, without recourse,

The Endorsements arguably meet the requirements of MLPA because there is an endorsement from Argent Mortgage (loan originator) to Ameriquest (seller under the MLPA) and an endorsement in blank from Ameriquest, which would satisfy the MLPA's requirement of delivering to the Trustee a "Mortgage Note, endorsed in blank." But, Deutsche did not offer into evidence any document which demonstrates that the Note was, in fact, sold to Deutsche under the MLPA. The MLPA identifies a "Closing Schedule" (Section 2 of the MLPA) which lists all notes and mortgages being sold to Deutsche, but Deutsche did not offer it (or any other document) into evidence which demonstrated that the Note was actually transferred into the Pool. This case, therefore,

is distinguishable from Samuels where the Mortgage Loan Schedule to the PSA and the Closing Schedule to the MLPA, both of which identified the Debtor's loan, were offered into evidence. 415 B.R. at 18.

Frankly, the court is puzzled by Deutsche's inability to offer competent evidence of its standing. Presumably, the PSA places obligations on Deutsche as the Initial Custodian and as Trustee to maintain records, including original notes and mortgages as well as documentation of all assignments of pooled of notes and mortgages. Deutsche and its servicer, therefore, should be able to easily produce the documents needed to prove standing. Instead of doing so, Deutsche, through its servicer and its counsel, filed the MRS without any evidence of standing, thereafter created an ineffective Allonge and falsely represented that it was attached to the Original. It then waited until the last possible moment to obtain the Original, disclosed the existence of the Original through the testimony of a witness, instead of bringing it to the court's attention at the commencement of the evidentiary hearing, and failed to satisfactorily explain the discrepancies between the Original and earlier filed versions of the Note.

Deutsche is not entitled to a *prima facie* evidentiary presumption of the validity of the Endorsements and has not otherwise demonstrated the Endorsements are authentic. Deutsche has also not demonstrated that the Note was transferred to Deutsche under the PSA or the MLPA. It has failed to demonstrate that it has a colorable claim in the Note and, therefore, it is not entitled to relief from the stay.

Deutsche may attempt to address the defects identified in this Memorandum Decision by filing an amended motion. However, because of the tortured history of the filings made by Deutsche, Deutsche, its servicer, and its counsel must be certain that

any future pleadings are filed only after adequate due diligence is undertaken to assure that the pleadings are correct. Given the deficient and misleading nature of Deutsche's filings, the court seriously considered issuing an order to show cause as to why sanctions should not be imposed on Deutsche, its servicer, and its lawyers, especially in light of the fact that sanctions were entered by another court, involving Deutsche, AHMSI and counsel, for conduct similar to the facts in this case. See In re Lee 408 B.R. 893 (Bankr. C.D. Cal. 2009). Because the court is mindful of the stress confronted by all parties in consumer cases, no *sua sponte* sanctions order will be issued. Deutsche, AHMSI and counsel should, however, treat this decision as a warning. If, in the future, the court is confronted with filings as deficient and incorrect as filed in this case, the court will issue an order to show cause and consider imposing sanctions including, but not limited to, an award of fees to debtors' counsel for having to oppose motions filed without proper evidence or worse with improper evidence.

VI. CONCLUSION

Deutsche has failed to satisfy its burden of demonstrating that it is a "party in interest" under 11 U.S.C. §362 (d)(1) entitled to relief from the automatic stay. A separate order denying Deutsche's Motion for Relief from Stay will be issued this date.

Dated and signed above.

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96 A.L.R.Fed. 895, 5 UCC Rep.Serv.2d 1392

UNITED STATES of America, Plaintiff-Appellee,
v.
HIBERNIA NATIONAL BANK, Defendant-Third-Party Plaintiff Appellant-Cross- Appellee,
v.
Joseph M. RAULT, Jr., Third-Party Defendant-Appellee-Cross-Appellant.

No. 86-3774.

**United States Court of Appeals,
Fifth Circuit.**

*April 5, 1988.
Rehearing and Rehearing En Banc Denied May 9, 1988.*

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Joseph M. Rault, Jr., New Orleans, La., pro se.

Virginia Patton Prugh, Robert J. Ashbaugh, Washington, D.C., for U.S.

Appeals from the United States District Court for the Eastern District of Louisiana.

Before CLARK, Chief Judge, REAVLEY, Circuit Judge, and HUNTER,* District Judge.

EDWIN F. HUNTER, Jr., District Judge:

Hibernia National Bank appeals the district court's judgment which held that Hibernia is liable to the United States for $220,000. Cross-appellant Joseph Rault appeals the district court's judgment that he is liable to Hibernia for $110,000. The case was briefed and argued and we now affirm the judgment for the United States against Hibernia, but vacate and remand the judgment for Hibernia against Rault.

I.

During 1982 the United States Army contracted with Rault Center Hotel of New Orleans for the hotel to provide lodging to new Army recruits. In the latter part of that year the hotel billed the Army for $24,844.50 for services rendered pursuant to the contract. On December 23, 1982, the Army issued a Treasury check to the hotel which contained two different figures. In the center or body of the check the amount to be paid is typed: " * * * 24844 DOLLARS/50 CENTS." On the right side of the check appears the amount of "$244844.50." The conflicting figures on the check went undetected by the Army.

On December 27, 1982, a hotel employee presented the check to Hibernia National Bank accompanied by a deposit slip for $24,844.50. Hibernia accepted the deposit and credited the hotel account for the amount listed on the deposit slip. The check was then forwarded for processing to the Hibernia operations center. In the operations center all checks are read by proof operators and are then "magnetic ink computer readable" (MICR) encoded which designates the amount of the check and other routing information. MICR encoding allows the check to be read by high-speed automated readers. The check was handled by Hibernia proof operator Monica Green. She apparently entered both the amount of the deposit ($24,844.50) in the proof machine and the amount of the right hand side of the check ($244844.50). As a result, an out of balance condition was created and the proofing machine signaled a $220,000 error.

Looking only at the deposit slip and the figure on the right side of the check, Monica Green determined that the error was the customer's, and prepared a penciled correction slip

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indicating a $220,000 credit which she sent to the corrections clerk. She did not bring the problem to the attention of a supervisor. Una Poree, the "Corrections Clerk," prepared a typed credit memo from Monica's penciled copy.

The district court found that when hotel employee Herman Taylor received the customer credit notice, he informed a Hibernia employee that the hotel account was credited for $220,000 more than the deposit. James Peterson, Herman Taylor's supervisor, testified that he also advised Hibernia of the overcredit in late December 1982. The overcredit to the hotel account was not adjusted.

Hibernia did not look into the situation despite the initial notification by Taylor and the follow-up telephone call placed by Peterson. Hibernia did not contact the Army, the Treasury Department, or the Federal Reserve Bank, but transferred the Treasury check with an accompanying letter to the New Orleans Branch of the Federal Reserve. Hibernia was given immediate provisional credit by the New Orleans Branch for the $244,844.50 shown on the cash letter. The Treasury check was then transferred to the Federal Reserve Bank of Atlanta where the check was read using an MICR reader. The check, a photo of the check, and the Federal Reserves accounting record of the transaction were then sent to the Treasury for final examination in January 1983.

It generally takes the Treasury six months to reconcile check payment data with drawn checks. Where there is an overpayment on a Treasury check, the Treasury issues an adjustment to the Federal Reserve Bank, which debits the account of the depository bank and sends the depository bank a copy of the adjustment. In the present case, for no known reason, the Treasury did not issue an adjustment.

Hibernia permitted the Rault Hotel to draw against the $244,844.50 deposit almost immediately. By August 31, 1983 the amount on deposit was $102,475.87. In September of 1983 Hibernia permitted Rault to withdraw $100,000 to be used for the purchase of a certificate of deposit in another institution.

In August 1983 the Army Finance Office received notice of a possible overpayment. In February 1984, the Army Finance Office received a copy of the check and noticed the overpayment. The United States demanded repayment of the $220,000 from the hotel and Hibernia; both parties refused these demands.

The United States filed suit alleging that Hibernia National Bank and Rault Petroleum Corporation, which wholly owned Rault Center Hotel, converted the $220,000 overpayment on the Treasury check. Hibernia filed a cross-claim against Rault Petroleum Corporation for fraud and a third-party negligence claim against the United States and the Federal Reserve Bank. Hibernia also filed a third-party claim against Joseph Rault individually alleging that he fraudulently converted the proceeds of the Treasury check. Rault Petroleum Corporation was placed in involuntary bankruptcy and all proceedings against the corporation have been stayed.

The district court held that the Treasury check was a valid $24,844.50 check, and that Hibernia failed to exercise ordinary care by processing the check for $244,844.50. Judgment was entered in favor of the United States and against Hibernia for $220,000.[1] Judgment was also entered for Hibernia and against Joseph Rault for $110,000.

II.

United States v. Hibernia National Bank

Hibernia first contends that the district court erred by applying federal law to the claim against it, insisting that state law rather than federal law controls.

It is well that "[t]he rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law." Clearfield Trust Co. v. United States, 318 U.S. 363, 366-68, 63 S.Ct. 573, 87 L.Ed. 838 (1943). In Bynum v. FMC Corp., 770 F.2d 556, 568 (5th Cir.1985), this Court states that federal common law must be applied where the application of state law would frustrate federal policies or interfere with the United States' duties or authority, the "most obvious example" being "a controversy whose outcome would have an immediate effect on the federal treasury." Because the application of federal law is intended to further federal policies it is immaterial that a particular federal statute is not applicable.

The district court found that Herman Taylor of Rault Center Hotel notified Hibernia of the overpayment in late December 1982, and thus Hibernia had actual notice of the overpayment. Hibernia contends this finding is clearly erroneous because Hibernia employees testified that

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they did not remember Taylor or any other hotel employee advising them of the overcredit, and because of the large amount involved they would have remembered if they had been advised of the overcredit.

A finding is "clearly erroneous" under Fed.R.Civ.P. 52 when "although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 92 L.Ed. 746 (1948). "[W]hen a trial judges' finding is based on his decision to credit the testimony of one of two or more witnesses, each of whom has told a coherent and facially plausible story that is not contradicted by extrinsic evidence, that finding, if not internally inconsistent, can virtually never be clear error." Anderson v. City of Bessemer City, 470 U.S. 564, 575, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985). The district court's finding that the hotel gave actual notice of the over-credit to Hibernia is not clearly erroneous.

Section 4-202(1) of the Uniform Commercial Code (West 1977) imposes on all banks a duty of ordinary care in forwarding checks it accepts for collection. The trial court, after reviewing all the evidence, expressly concluded that Hibernia breached its duty. The rationale for this conclusion is emphasized by the trial court's specific findings. (footnote 1, supra)

Hibernia argues that the routine and customary banking practice is to encode deposited checks for the amount on the right of the check, rather than the amount in the body. They insist that there was no breach of duty on its part because "the check was paid according to the instructions of its maker--the Army--for the amount of $244,844.50." which appeared on the right of the check. Section 3-118(c) of the U.C.C. provides that "[w]ords control figures except that if the words are ambiguous figures control." Though the Treasury check does not state an amount expressed in words, the district court held, and we assuredly agree that the figure in the body of the check, in the place customarily reserved for words, is the controlling amount.[2] H. Bailey & R. Hagedon, Brady on Bank Checks Sec. 3.17 at 3-19 (5th ed. Supp.1986). Hibernia's reliance on commercial custom is misplaced. Commercial custom does not apply where the U.C.C. provides otherwise. See U.C.C. Sec. 1-103; also U.C.C. Sec. 3-104, Official Comment 2 ("[A] writing cannot be made a negotiable instrument within this Article by contract or by conduct.") Moreover, it would be inequitable to apply the banking industry's unilateral "custom" to a maker, such as the Army, that is unaware of or may not recognize such a custom.[3]

Hibernia next asserts that its actions only caused an over-credit to be placed in the hotel's checking account, and that the loss was caused by Joseph Rault's fraudulent depletion of the account which was an intervening superceding cause of the loss and not foreseeable by Hibernia. This argument is spurious. Hibernia's mistake in overcrediting the hotel's account made Rault's depletion of the account possible, thus Rault's use of the funds was not "intervening." Furthermore, it is foreseeable that when a bank overcredits a customer's account, and the customer advises the bank of the overcredit but the bank fails to act, the customer may conceivably deplete the account.

Hibernia contends that the United States was negligent because the Army completed the check with conflicting figures and neither the Federal Reserve or the Treasury noticed the error. They insist that the trial court erred by failing to apply comparative negligence principles and failing to apportion liability. Comparative fault principles are not generally applicable to commercial transactions. See Bradford Trust Co. v. Texas American Bank-Houston, 790 F.2d 407, 409 (5th Cir.1986). The transactional analysis of the U.C.C. places liability on the party that is in the best position to guard against the mistake which gives rise to the loss. United States Fidelity and Guaranty Company v. Federal Reserve Bank of New York, 620 F.Supp. 361, 369-70 & n. 14 (S.D.N.Y.1985), aff'd, 786 F.2d 77 (2d Cir.1986). In the present case the bank was not only in the prime position to remedy the mistake, but by improperly encoding the check was the cause of the mistake. The erroneous encoding made it possible for the overpayment to be made; therefore they should plausibly bear the loss. H. Bailey & R. Hagedon, Brady on Bank Checks Sec. 15.25 at 15-55 (5th ed. 1979). Hibernia asserts that the Government's delay contributed to the loss. However, on this record it cannot be determined to what extent the Government's delay was due to the misencoded check. In that context, we reiterate that Hibernia had immediate notice of the error and failed to act. See United States v. National Bank of Commerce in New Orleans, 438 F.2d 809, 812-13 (5th Cir.), cert. denied, 404 U.S. 828, 92 S.Ct. 64, 30 L.Ed.2d 57 (1971).

Uniform Commercial Code Sec. 4-213(1) provides that "[u]pon final payment ... the payor bank shall be accountable for the amount of the item" Hibernia would have this court to hold that the "final payment" rule prevents the Government's recovery. This position is utterly without support. Under U.C.C. Sec. 4-213(1) the Treasury is accountable for the "amount of

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the item" which is $24,844.50; this sum has been paid and is not at issue. The final payment rule under most circumstances bars recovery on the instrument. The Government's action is for the amount in excess of the instrument. It follows that recovery is not precluded by the final payment rule. This suit is predicated on Hibernia's negligence[4] (by encoding the check for $244,844.50) and breach of quasi-contract, resulting in the conversion of $220,000 of Treasury funds. The Government's suit for return of its Treasury funds is not an action on the instrument. Recovery is not prevented by final payment on the instrument. See e.g. United States v. National Bank of Commerce in New Orleans, 438 F.2d 809.

We affirm the judgment in favor of the United States against Hibernia. This is the end of the matter.III.

Hibernia National Bank v. Joseph Rault

We recognize the difficulties faced by the district judge on this facet of this litigation. We quote from his findings:

11) During the period of December, 1982 until September 1983, Rault Petroleum Corporation, through its representatives, spent the monies comprising the overpayment in the 1111 Operations Account to the detriment of Hibernia.

12) Joseph Rault, Jr. had knowledge of the source of the $220,000 credit and was aware that it was due to an overpayment on the Treasury check. He failed to advise Hibernia of the discrepancy in the 1111 Operations Account though he was regularly advised and, indeed, knew of the excess balance in the account certainly as early as March 4, 1983. The balance in the account on March 31, 1983 was $139,138.18.

13) Notwithstanding his certain knowledge of the overpayment, Joseph Rault, Jr. took no action to escrow, or instruct any of his employees to escrow the funds left in the account as a result of the overpayment. Joseph Rault, Jr. never delegated responsibility to any other officer, or employee of Rault Petroleum Corporation to inform Hibernia of the continuing overcredit but did take action to transfer those funds to other account which accrued to his personal financial benefit." (Record Excerpt, p. 1886)

17) The actions of Rault Petroleum Corporation and Joseph Rault, Jr. in transferring funds comprising the overpayment and depleting the 1111 Operations Account, was the cause in fact of the loss.

22) Fraud is a misrepresentation or a suppression of the truth made with the intention to either obtain an unjust advantage or to cause a loss. A corporate officer's failure to escrow monies which he knows were paid to the corporation by mistake is a non-dischargeable conversion, constituting fraud. Lawrence Freight Lines, Inc. v. Transport Clearings-Midwest, Inc., 16 B.R. 890 (B.C.W.D.Missouri 1979)". (Record Excerpt, p. 1889-1890)

23) Joseph Rault, Jr. is responsible to Hibernia for reimbursement on an amount not yet specifically determined by the Court.

Subsequently, a judgment was signed holding Rault liable to the bank for $110,000 one-half of the overcredit funds and one-half of the judgment cast against the bank of $220,000. Both Hibernia and Rault note that no reasons were noted for the amount of the judgment. There is an absence of any indication of how, why or on what basis the trial court rendered judgment for $110,000. It appears to us that the only theories of law which could explain the one-half award are first, that Rault was personally comparatively half at fault in causing the loss. There are no findings consistent with this theory. Second, that when Rault first had a clear picture of the funds in the account; he had a personal duty to escrow these funds for the bank. Under this theory, the court would have had to conclude that the amount left in the account at that time was $110,000.

Prudence dictates that this Court not endeavor to review the judgment against Rault without knowing what theory, i.e. negligence or fraud, he was held liable under and without knowing the reasons for the amount of the judgment. That task, in the first instance, is best left to district court, which is free to invite additional briefing and/or argument if deemed appropriate, and to alter its findings and conclusions on this facet of the case if deemed appropriate.

The judgment in favor of Hibernia and against Rault is vacated and remanded for further considerations in accordance with this opinion.

AFFIRMED IN PART AND VACATED IN PART AND REMANDED.

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* District Judge of the Western District of Louisiana, sitting by designation

1 The district judge entered specific conclusions as to Hibernia's fault:

3) Hibernia National Bank owes the United States a federal common law duty to exercise good faith and ordinary care in the handling of United States Treasury checks. U.C.C. Sec. 4-103(1); Bullitt County Bank v. Publishers Printing Co., 684 S.W.2d 289 (Ky.Ct.App.1984); Charles Ragusa & Son v. Community State Bank, 360 So.2d 231 (La.App. 1st Cir.1978).

6) Hibernia breached its duty to exercise ordinary care when, presented with a check containing conflicting figures, it failed to contact the payor to ascertain the correct amount before negotiating the check. McCook County National Bank v. Compton, 558 F.2d 871 (8th Cir.), cert. denied, 434 U.S. 905, 98 S.Ct. 302, 54 L.Ed.2d 191 (1977).

7) Hibernia breached its duty to exercise ordinary care by failing to inform the Federal Reserve Bank concerning the discrepancy on the face of the check.

8) Hibernia further breached its duty to exercise ordinary care when it incorrectly IMCR encoded the amount payable on the check. It also breached its duty by failing to follow reasonable instructions of its customer as to the correct amount.

10) Hibernia breached its duty to exercise ordinary care when its proof operator, acting in accordance with Hibernia policy failed to reconcile the amount of the deposit slip with the amount in the body on the instrument once alerted to a discrepancy when the proofing machine went out of balance.

11) Hibernia breached its duty to exercise ordinary care when it failed to investigate the overpayment subsequent to notification by Herman Taylor and James Peterson.

13) Hibernia's failure to exercise ordinary care was the proximate cause of the loss suffered by the United States in the amount of $220,000.00.

16) Since Hibernia's failure to exercise ordinary care was the proximate cause of the loss suffered by the United States, Hibernia is liable for the $220,000.00 overpayment. Hibernia, however, did not act in bad faith with regard to its actions.

2 Hibernia also argues that the district court erred by applying U.C.C. Sec. 3-118(c) because the check does not state an amount in words and the figures are ambiguous. Hibernia's argument is self-defeating. Either the check is a valid $24,844.50 check, or the document is non-negotiable because it does not state a "sum certain." U.C.C. Sec. 3-104(1)(b). In either event Hibernia failed to exercise ordinary care when the item was processed as a $244,844.50 check

3 The district court, without assigning reasons, struck the testimony of Hibernia's expert witness James Stone who testified that banks routinely proof only the figure on the right of the check. Hibernia contends that Stone qualified as a witness and the district court erred. Because the banking industry's unilateral custom is immaterial, the district court's error, if any, in striking Stone's testimony was harmless

4 We emphasize our total agreement with the trial courts conclusion that Hibernia "did not act in bad faith with regard to its actions."

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