UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
WESTERN IOWA FARMS CO.,	)	CASE NO. BK91-82008
	)	
DEBTOR	)	A93-8025
	)	
WESTERN IOWA FARMS CO.,	)	
	)	CH. 11
Plaintiff	)	
vs.	)	
	)	
FIRST SAVINGS BANK, MANHATTAN KANSAS AND NORWEST BANK ANACONDA-BUTTE, N.A.,	)	
	)	
Defendant	)	

MEMORANDUM

Hearing was held on July 20, 1993, on a motion to dismiss by First Savings Bank of Manhattan, Kansas. Appearing on behalf of debtor was Victor Lich of Lich, Herold & Mackiewicz, Omaha, Nebraska. Appearing on behalf of Norwest Bank Anaconda-Butte, N.A., was Robert Yates of Fraser, Stryker, Vaughn, Meusey, Olson, Boyer & Bloch, P.C., Omaha, Nebraska. Appearing on behalf of First Savings Bank, Manhattan, Kansas, were Chris Curzon and David Crawford of Schmid, Mooney & Frederick, P.C., Omaha, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A).

Background

Leonard Russell and Mike Russell are independent livestock dealers authorized by the Plaintiff Western Iowa Farms Co. (Western Iowa) to issue checks on Western Iowa's account at Norwest Bank Anaconda-Butte, N.A. (Norwest). Between November 9, 1989 and January 2, 1990, Leonard and Mike signed ten checks drawn on Western Iowa's Norwest account. The checks were deposited into Defendant First Savings National Bank of Manhattan, Kansas, (First Savings) by Brad Russell, son and brother of Leonard and Mike. Brad forged the names of the payees onto the checks and deposited the checks into business accounts

that Brad maintained at First Savings. First Savings presented the checks to Norwest for collection. Norwest charged Western Iowa's account and paid First Savings. Western Iowa filed an adversary complaint, A93-8025, against Norwest and First Savings to recover $274,991.88, the amount of the forged checks.

Western Iowa has asserted two causes of action against First Savings in the complaint: (1) there exists an action in conversion against First Savings for accepting the forged indorsements from Brad Russell; (2) First Savings failed to exercise ordinary care, act in good faith, and adhere to reasonable commercial standards in the banking industry by paying Brad Russell the amount of the checks (Filing No. 1). In the Answer, First Savings stated that Western Iowa has failed to state a claim upon which relief may be granted (Filing No. 11). In support of this allegation, First Savings filed a Motion To Dismiss on the grounds that Western Iowa has not stated a cause of action upon which relief may be granted under Fed. R. Civ. P. 12 (b)(6) (Filing No. 22, 24). See Fed. R. Civ. P. 12(b)(6). In the Motion To Dismiss, First Savings argued that Western Iowa may only recover from Norwest in conversion and may not recover from a depository bank and that as owners of the checks the payees are the only parties who have a cause of action against First Savings for conversion. First Savings did not address Western Iowa's second cause of action.

This memorandum will address whether First Savings' Motion To Dismiss may be granted. First, the memorandum will address whether Western Iowa's complaint may be dismissed if First Savings requests dismissal of the conversion action, but does not address the second cause of action. Second, the memorandum will address whether Kansas law recognizes an action in conversion.

Discussion

Under Rule 12(b)(6), Western Iowa's complaint should not be dismissed for failure to state a claim unless it is clear beyond a doubt that Western Iowa cannot prove any set of facts that would entitle Western Iowa to relief. Conley v. Gibson, 355 U.S. 41, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957); Hishon v. King & Spalding, 467 U.S. 69, 81 L. Ed. 2d 59, 104 S. Ct. 2229 (1984). Western Iowa's cause of action for conversion is considered in "the light most favorable to the plaintiff", and the complaint should only be dismissed if it is clear on the face of the complaint that Western Iowa is absolutely barred to any relief. Fusco v. Xerox Corp., 676 F.2d 332, 334 (8th Cir. 1982); Jackson Sawmill Co. v. United States, 580 F.2d 302, 306 (8th Cir. 1978), cert. denied, 439 U.S. 1070 (1979).

In determining whether to dismiss Western Iowa's entire complaint, the court may not dismiss Western Iowa's cause of action solely because the allegations do not support the

particular legal theory Western Iowa is advancing for "the court is under a duty to examine the complaint to determine if the allegations provide for relief on any possible theory." Bowers v. Hardwick, 478 U.S. 186, 201-02, 92 L. Ed. 2d 140, 106 S. Ct., 2841, 2849 (1986) (Blackmun, J., dissenting on other grounds) (quoting Bramlett v. Wilson, 495 F.2d 714, 716 (8th Cir. 1974)). Defendant First Savings must meet this high standard because the federal courts view Fed. R. Civ. P. 12(b)(6) Motions To Dismiss with disfavor; courts prefer to dispose of the merits after the submission of proof. Leimer v. State Mut. Life Assur. Co., 108 F.2d 302, 305 (8th Cir. 1940).

A. A MOTION TO DISMISS MAY BE GRANTED TO DISMISS ONE CAUSE OF ACTION; HOWEVER, THE REMAINING CAUSE OF ACTION WILL SURVIVE.

Defendant First Savings' Motion To Dismiss states that Plaintiff Western Iowa's complaint should be dismissed on the grounds that an action in conversion against First Savings fails to state a valid claim upon which relief may be granted (Filing Nos. 22 and 24). First Savings does not address Plaintiff Western Iowa's second cause of action which alleges that First Savings failed to use reasonable care in examining the checks for forgery at the time the checks were presented to First Savings by Brad Russell; that First Savings did not act in good faith by accepting the forged checks; and that First Savings failed to observe reasonable commercial standards that prevail in the banking industry for examining checks for forgeries. (See Complaint, Filing No. 1). First Savings requested that the court only consider the Motion To Dismiss for the cause of action based on conversion. (See Hearing, July 20, 1993). The court must consider whether the second cause of action will survive if the conversion claim is dismissed or if the Motion must fail for failing to address both legal theories.

First Savings' request for dismissal of one cause of action, while leaving the other cause of action alive is permissible. Courts examine complaints to determine if the allegations provide for relief under any possible theory. Bowers, at 201; Bramlet, at 716; Alshire v. Darnell, 508 F.2d 526 (8th Cir. 1974); Lada v. Wilke, 250 F.2d 211 (8th Cir. 1957). Because the legal theory of reasonable care and good faith is not addressed in the Motion To Dismiss, Western Iowa's second cause of action will not be dismissed. Decker v. Massey-Ferguson, Ltd., 681 F.2d 111 (2nd Cir. 1982) (holding that a Fed. R. Civ. P. 12(b)(6) motion may be granted as to part of the complaint and denied to the remainder of the complaint). It is inappropriate for the court to dismiss all of Western Iowa's Complaint because First Savings has not addressed the second cause of action, but the court may dismiss the cause of action regarding conversion if it finds that Western Iowa has not stated a cognizable legal theory. Westland v. Sero, Inc., 601 F. Supp. 163, 165 (N.D.Il. 1985) (dismissing only the

cause of action that the defendant addressed in its motion and leaving other potential causes of action alive); Edmond v. U.S. Postal Serv. Gen. Counsel, 949 F.2d 415, 431 (D.C. Cir. 1991), rehearing denied 953 F.2d 1398 (D.C. Cir. 1992) (holding a motion to dismiss that was granted for one legal theory did not preclude the plaintiff from going forward with two legal theories that were not addressed in the motion).

B. FIRST SAVINGS' MOTION TO DISMISS SHOULD BE DENIED BECAUSE THE PLAINTIFF HAS STATED A COGNIZABLE LEGAL THEORY UNDER KANSAS LAW.

Failing to state a cause of action under state law is grounds for a dismissal under Fed. R. Civ. P. 12(b)(6). Ross v. Creighton Univ., 957 F.2d 410 (7th Cir. 1992) (holding that causes of action not recognized under state law are subject to dismissal); Ward v. Connor, 495 F. Supp 434 (D.C. Va. 1980), reversed on other grounds, 657 F.2d 45 (4th Cir. 1981), cert. denied, 455 U.S. 907, 71 L. Ed. 2d 445, 102 S. Ct. 1253 (1982) (holding that a complaint based on a cause of action not recognized by state law survived dismissal because other theories of recovery existed). Therefore, Western Iowa's cause of action based on conversion will be dismissed if Kansas law does not recognize conversion as a theory for relief. First Savings is correct in its assertion that Kansas law is the applicable substantive law to be applied to this issue. (See Brief in Support of Defendant First Savings' Motion To Dismiss, filed April 16, 1993, p. 2, quoting Kan. Stat. Ann. § 84-4-102 (1990)).

In 1992, Kansas adopted the revised Article 3 of the UCC, and the section that addresses conversion is § 84-3-420, which is titled "Conversion of Instrument." Kan. Stat. Ann. § 84-3-420 (1992). However, Kansas followed the previous Article 3 at the time the alleged conversion of Western Iowa's check occurred; therefore, Western Iowa's cause of action falls under § 84-3-419, the section on conversion in effect at the time of the act which led to this adversary action. Kan. Stat. Ann. § 84-3-419 (1990). Both Western Iowa and First Savings have cited to § 84-3-419 in their briefs and pleadings; therefore, there is an agreement that the applicable law to use is the law in effect during the period of time that the alleged conversion took place.

Section 3-419 states "(1) An instrument is converted when it is paid on a forged indorsement." Kan. Stat. Ann. § 84-3-419(1)(c) (1990). Post-UCC case law in Kansas recognizes an action in conversion under § 84-3-419. The Kansas Appeals court dealt with the issue of conversion for a forged indorsement in Aetna Casualty and Surety Co. v. Hepler State Bank, 6 Kan. App. 2d 543, 630 P.2d 721 (1981). Under the Kansas Rules Relating To Supreme Court, Court of Appeals and Appellate Practice, all appeals go directly to the Kansas Appeals Court except for certain statutory exceptions. Kan. Stat. Ann. S. Ct. Rule 2.01

(1987). Published opinions of the Court of Appeals must satisfy one of a list of requirements laid out in Supreme Court Rule 7.04 to establish the importance of the opinion before the opinions are published. Kan. Stat. Ann. S. Ct. Rule 7.04 (1987). Only unpublished appellate opinions are forbidden from being used as authority of Kansas law. State v. Bryan, 12 Kan. App. 2d 206, 210, 738 P.2d 463 (1987). For these reasons, the decision of the Kansas Appeals Court in Aetna will be considered as stating the Kansas law on this issue.

In Aetna, the court found the depository bank liable for paying checks that contained indorsements that were forged by an employee of the payee. 6 Kan. App. 2d at 544-555, 630 P.2d at 724. The court stated "Receiving the funds without a proper indorsement and crediting the funds to one not entitled thereto constitutes a conversion of the funds." Id. at 547, 725. Therefore, Kansas recognizes an action in conversion for a forged indorsement under the U.C.C.

First Savings' argument that Western Iowa must be a holder to recover under § 3-419(1)(c) is without merit. Section 3-419 does not require that the party seeking to recover must be a holder of the instrument. See Kan. Stat. Ann. § 84-3-419 (1990). In addressing § 3-419(1)(c), the comments state,

> [(1)(c)] adopts the prevailing view of decisions holding that payment on a forged indorsement is not an acceptance, but that even though made in good faith it is an exercise of dominion and control over the instrument inconsistent with the rights of the owner, and results in liability for conversion.

U.C.C. § 3-419, comment 3 (1990). Section 84-3-419(3) also supports Western Iowa's position that a depository bank is liable to the owner of the check by providing a defense for a depository institution against the owner of the instrument. Kan. Stat. Ann. § 84-3-419(3) (1990).

Because the payees named in the checks issued by the Russells are not holders, Western Iowa is the true owner of the instrument. To be holders, the payees would have to be in possession of the checks. Kan. Stat. Ann. § 84-1-201(20) (1990). Section 84-3-202 states that a payee cannot become a holder until the instrument is negotiated by "delivery with any necessary indorsement." Kan. Stat. Ann. § 84-3-202(1) (1990). Thus, the payee "without indorsement of an order instrument is not a holder and so is not aided by the presumption that he is entitled to recover on the instrument. . . ." U.C.C. § 3-201, comment 8 (1990). The checks were not delivered to the payees, but apparently were interrupted, indorsements forged, and payment made prior to possession by the payee. Western Iowa, at the time

of the payment on the checks, was the owner of the checks. Because Western Iowa retained its ownership interest in the checks, Western Iowa may sue First Savings for conversion.

In Aetna, the Kansas Court of Appeals addressed the fact pattern of a payee suing a collecting bank for conversion under § 3-419(1)(c), but Aetna did not limit itself to apply only to payees. See generally Aetna, 6 Kan. App. 2d 543, 630 P.2d 721. In addition to the Aetna authority, the United States District Court for the District of Kansas in Hanover Ins. Co. v. Brotherhood State Bank, 482 F. Supp. 501 (D. Ks. 1979), construing Kansas law, held that a payor may sue a depository bank. In Hanover, an employee of the payor forged indorsements before the checks were delivered to the payees. Id. at 503-04.

Although the theory of recovery in Hanover was negligence rather than conversion, the case provides guidance because the District Court based its finding of negligence on the part of the bank under the Kansas common law maximum: "where one of two innocent persons must suffer by reason of the fraud or misconduct of a third, he by whose act, omission, or negligence, such third party was enable to consummate the fraud, ought to bear the loss." Wichita Savings Bank v. Atchison, Topeka & Santa Fe R.R. Co., 20 Kan. 519, 526 (1878). The District Court found that Article 3 of the U.C.C. is based on this fundamental theory of liability and found the depository bank was liable to the payor because the depository bank is in the best position to stop the fraudulent conduct by the forger. Hanover, 482 F. Supp. at 510.

Since Kansas law apparently permits a suit for conversion under facts as exist in this case, Western Iowa should be allowed to sue First Savings for conversion because at the time of the forgery Kansas followed the line of cases under the U.C.C. that try to place liability on the party who last dealt with the wrongdoer.

Separate journal entry to be entered.

(X) Movant to give immediate notice of the Court's ruling to all parties in interest.

DATED: August 23, 1993.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: MOVANT

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
WESTERN IOWA FARMS CO.,	)	CASE NO. BK91-82008
	)	A93-8025
DEBTOR(S)	)	
	)	CH. 11
WESTERN IOWA FARMS CO.,	)	Filing No.
Plaintiff(s)	)	
vs.	)	JOURNAL ENTRY
	)	
FIRST SAVINGS BANK, MANHATTAN	)	
KANSAS AND NORWEST BANK	)	
ANACONDA-BUTTE, N.A.,	)	
	)	DATE: August 23, 1993
Defendant(s)	)	HEARING DATE: July 20, 1993

Before a United States Bankruptcy Judge for the District of Nebraska regarding motions to dismiss by First Savings Bank of Manhattan, Kansas.

APPEARANCES

Victor Lich, Attorney for debtor
Robert Yates, Attorney for Norwest Bank
Chris Curzon, Attorney for First Savings Bank
David Crawford, Attorney for First Savings Bank

IT IS ORDERED:

Motion to dismiss the first claim for relief in the complaint filed by plaintiff is denied. See memorandum this date.

(X) Movant to give immediate notice of the Court's ruling to all parties in interest.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: MOVANT

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
WESTERN IOWA FARMS CO.,	)	CASE NO. BK91-82008
	)	A93-8025
DEBTOR(S)	)	
	)	CH. 11
WESTERN IOWA FARMS CO.,	)	Filing No. 24, 35
Plaintiff(s)	)	
vs.	)	JOURNAL ENTRY
	)	
FIRST SAVINGS BANK, MANHATTAN	)	
KANSAS AND NORWEST BANK	)	
ANACONDA-BUTTE, N.A.,	)	
	)	DATE: August 23, 1993
Defendant(s)	)	HEARING DATE: July 20, 1993

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion to Dismiss by First Savings Bank, Manhattan, Kansas; and Resistance of Norwest Bank.

APPEARANCES

Victor Lich, Attorney for debtor
Robert Yates, Attorney for Norwest Bank Anaconda-Butte, N.A.
Chris Curzon, Attorney for First Savings Bank, Manhattan, Kansas
David Crawford, Attorney for First Savings Bank, Manhattan, Kansas

IT IS ORDERED:

First Savings Bank, Manhattan, Kansas, as cross-defendant, has moved to dismiss the cross petition filed by Norwest Bank Anaconda-Butte, N.A. Hearing was held on July 20, 1993.

The motion alleges that the cross petition should be dismissed pursuant to Fed. R. Civ. P. 12(b)(6) because the statute of limitations has run.

At the hearing, the issue of when the statute of limitations began to run, whether it was tolled until Norwest Bank Anaconda-Butte, N.A., was put on notice of a claim by the plaintiff and other matters concerning the statute of limitation issue were discussed. There did not seem to be agreement on any of the factual or legal issues concerning the statute of limitations.

The Court finds that evidence will be required to be submitted concerning not only the date various checks were paid

by Norwest, but the date that Norwest did or should have known that it had a claim against First Savings Bank, Manhattan, Kansas. Generally, on a motion to dismiss, the Court should be reluctant to erect the statute of limitations as an insurmountable barrier where the determination turns on circumstances and intentions of parties not readily ascertainable from facts. See Argo Comm. Corp., 134 Bankr. 776 (Bankr. S.D.N.Y. 1991).

Therefore, the motion to dismiss directed at the cross-petition filed by Norwest is denied.

(X) Movant to give immediate notice of the Court's ruling to all parties in interest.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: MOVANT