

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 28, 1994, on Motion for Summary Judgment filed by Norwest Bank Anaconda-Butte, N.A. Appearing on behalf of Western Iowa Farms Co. was Victor Lich of Lich, Herold & Mackiewicz, Omaha, Nebraska. Appearing on behalf of First Savings Bank was Frederick Stehlik of Schmid, Mooney & Frederick, P.C., of Omaha, Nebraska, and Richard Seaton of Everett, Seaton, Miller & Bell, Manhattan, Kansas. Appearing on behalf of Norwest Bank was Thomas Flaherty of Fraser, Stryker, Vaughn, Meusey, 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 not a core proceeding as defined by 28 U.S.C. § 157, but is a proceeding related to a case under title 11. All parties have consented in writing to the bankruptcy judge entering judgment, subject to review under 28 U.S.C. § 158, as permitted by 28 U.S.C. § 157(c)(2).

Background

The plaintiff, Western Iowa Farms (Western Iowa), operated a business that financed cattle purchased by others. During 1989 and part of 1990, the plaintiff maintained a business account at the defendant, Norwest Bank Anaconda-Butte, N.A. (Norwest). The plaintiff authorized Leonard Russell and his son Mike Russell, who were independent livestock dealers, to issue checks on Western Iowa's account at Norwest. Mike and Leonard Russell were given blank checks by Western Iowa to buy cattle drawn on Western Iowa's account at Norwest.

Between November 9, 1989 and January 2, 1990, Leonard Russell signed eight checks and Mike Russell signed two checks that were drawn on the Norwest account and were payable to either Walter L. Johns, David Wullschleger, or Steven J. Blumer. The checks were made out and signed as follows:

<u>Exhibit</u>	<u>Check no. &amp; date</u>	<u>Signer</u>	<u>Payee</u>	<u>Amount</u>
1	56849 11/09/89	Leonard	Wullschleger	\$47,642.37
2	56855 11/16/89	Leonard	Johns	\$27,409.67
3	57015 11/28/89	Leonard	Wullschleger	\$10,551.04
4	57016 11/30/89	Leonard	Johns	\$36,295.40
5	57021 12/01/89	Leonard	Johns	\$39,488.40
6	57020 12/04/89	Leonard	Johns	\$ 7,840.12
7	57031 12/19/89	Leonard	Wullschleger	\$40,548.05
8	56896 12/23/89	Mike	Johns	\$34,065.12
9	56897 12/23/89	Mike	Johns	\$12,442.11
10	57034 01/01/90	Leonard	Blumer	<u>\$18,709.60</u>
			TOTAL	\$274,991.88

None of the payees received or deposited these checks. Instead, all of the checks were deposited by Brad Russell, son of Leonard and brother of Mike, into two bank accounts that were controlled by the Russells and in which Western Iowa had no interest. Both accounts were located at First Savings National Bank of Manhattan, Kansas (First Savings). When First Savings accepted the checks from Brad for deposit, the payee's indorsement had been forged by Brad. Brad also wrote the words "For Deposit Only" and the Russell account number on the back of the check.

First Savings presented all ten checks to Norwest for collection. Norwest charged Western Iowa's account and paid First Savings.

In the ordinary course of business between the Russells and Western Iowa, the Russells purchased cattle with Western Iowa checks, resold the cattle to a third party, received payment for the sale, and repaid Western Iowa the amount of the original checks plus a fee. However, these ten checks do not represent actual cattle purchases. The Russells issued checks to the payees, forged their indorsements, and deposited the proceeds into their own accounts. Since no cattle were purchased, no cattle could be sold

to generate funds to repay Western Iowa. Apparently Western Iowa has not been able to recover sufficient funds from Russell to cover its losses.

Western Iowa filed this adversary complaint against Norwest and First Savings to recover \$277,991.88, the total amount of the forged checks. Norwest and Western Iowa agree that any liability on the part of Norwest will be determined under the law that was in effect in Montana during the period of time that the checks were paid, which in this case occurred before the 1991 revisions to Articles 3 and 4 to the Uniform Commercial Code were adopted by the Montana Legislature. See MONT. CODE ANN. § 30-4-102(2)(1990) ("The liability of the bank for action or nonaction with respect to any item handled by it for purposes of presentment, payment, or collection is governed by the law of the place where the bank is located.").<sup>1</sup>

Western Iowa alleged in its complaint that Norwest may only charge against Western Iowa's account those checks which are properly payable under Montana Uniform Commercial Code Section 4-401, and it breached this duty when it paid the ten checks which bore forged indorsements. MONT. CODE ANN. § 30-4-401(1)(1990).<sup>2</sup> Norwest has moved for summary judgment. Norwest alleges that this situation is excepted from Section 4-401 of the Montana Uniform Commercial Code because the indorsements are effective and are, therefore, deemed not to be forgeries under Section 3-405(1)(b) and (c) of the Uniform Commercial Code. MONT. CODE ANN. § 30-3-405(1)(b) & (c)(1990).<sup>3</sup>

### Discussion and Decision

#### A. Standard for Summary Judgment

Motions for summary judgment are filed pursuant to Fed. Bankr. R. 7056, which incorporates Fed. R. Civ. P. 56. A summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of

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<sup>1</sup> The substantive law of Section 4-102 was not altered by the revised section. See generally MONT. CODE ANN. § 30-4-102(b)(1993).

<sup>2</sup> See infra p. 4 for the text of Section 4-401. See also MONT. CODE ANN. § 30-4-401 (1993) for the revised version of this U.C.C. section.

<sup>3</sup> See infra p. 5 for the text of Section 3-405(1)(b) and (c). Montana adopted the Revised Article 3 Section 3-405 to the Uniform Commercial Code in 1991. See MONT. CODE ANN. § 30-3-405(1993).

law." Fed. Bankr. R. 7056(c); Fed. R. Civ. P. 56(c); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986).

While state law governs the substantive issues in this case, the procedural standards of law applicable to this summary judgment motion are determined by federal law. Erie Railroad Co. v. Tompkins, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 2d 1188 (1938). The burden is on Norwest to establish both that there is no genuine issue as to any material fact and that it is entitled to judgment as a matter of law. United States Gypsum Co. v. Greif Bros. Cooperage Corp., 389 F.2d 252 (8th Cir. 1968). The materials submitted on a motion for summary judgment are viewed in a light most favorable to the party opposing the motion, and that party should be given the benefit of all inferences reasonably deducible from the evidence. Adickes v. S.H. Kress & Co., 398 U.S. 144, 90 S. Ct. 1598, 26 L. Ed. 2d 142 (1970).

"[T]he burden on the moving party may be discharged by "showing" ... that there is an absence of evidence to support the nonmoving party's case." Celotex Corp. v. Catrett, 477 U.S. 317, 325, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986). In addition, a failure by the nonmoving party to submit evidence to support its claims will result in summary judgment being entered against him. Metro North State Bank v. Gaskin, No. 93-2850, 1994 U.S. App. LEXIS 22174 (8th Cir. August 19, 1994) (refusing to overturn the entry of summary judgments by a district court in situation where nonmoving party failed to submit evidence in support of its claim).

Any deposition testimony that would be admissible at trial may be considered when determining a summary judgment motion. 6 JAMES W. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 56.11[1.--3], at 56-100 (2d ed. 1994). Even though deposition testimony is better than affidavit testimony because the deponent is subject to cross-examination, it still suffers from one weakness, which is that the demeanor of the deponent is not observable by the Court. Id.

#### B. Applicable Law

The general rule that Norwest must follow is set forth in the pre-revision Article 4 at Section 4-401(1), which states:

As against its customer, a bank may charge against his account any item which is otherwise properly payable from that account even though the charge creates an overdraft.

MONT. CODE ANN. § 30-4-401(1)(1990). A drawee bank is obligated to credit a customer's account after paying an order indorsed by forgery because under the pre-revision Articles 3 and 4, Section 3-404 renders the indorsement inoperative as the payee's signature, and therefore, a bank is in violation of its customer's directive

to pay to the order of the payee. MONT. CODE ANN. § 30-3-404(1) (1990); BARKLEY CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS, AND CREDIT CARDS ¶ 8.04[2], at 8-71 (3rd ed. 1990). Thus, "forged indorsements are ineffective to pass title or authorize a drawee to pay." Western Casualty and Surety Co. v. Citizens Bank, 676 F.2d 1344, 1345 (10th Cir. 1982) (quoting J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 16-8, at 631 (2d ed. 1988)).<sup>4</sup>

Norwest takes the position that it is exempted from this general rule because the indorsements in this case are "effective" pursuant to Section 3-405(1)(b) and (c) of the Montana Uniform Commercial Code, and therefore, the checks were properly payable. Section 3-405(1)(b) and (c) states:

(1) An indorsement by any person in the name of a named payee is effective if: (b) a person signing as or on behalf of a maker or drawer intends the payee to have no interest in the instrument; or (c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.

MONT. CODE ANN. § 30-3-405(1)(b) & (c)(1990).

This exception, which is often referred to as the "fictitious payee rule" in subsection (b) cases or the "padded payroll case" under subsection (c) cases, applies in this case. "In certain factual situations, [Section 3-405(1)] treats anyone's indorsement in the name of the payee as effective to pass title to the instrument, leaving the drawer liable on the instrument despite the forged indorsement." Western Casualty, 676 F.2d at 1345.

The question raised in this summary judgment motion is whether Brad Russell's forged indorsements are effective because Leonard Russell intended that the named payees on the eight checks that Leonard issued would not have any interest in the checks and because Leonard Russell caused Mike Russell to issue two checks payable to Walter Johns with the intent that Mr. Johns would not have any interest in the checks. Leonard Russell died in 1990, and therefore, there is no direct testimony from Leonard as to what his intent was.

### C. Undisputed Facts

1. Leonard Russell and Mike Russell were authorized by Western Iowa to issue checks on Western Iowa's account at Norwest,

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<sup>4</sup> Neither Montana state or federal courts nor the Ninth Circuit have addressed forged indorsements in the context of Section 3-405(1)(b) and (c).

and Western Iowa gave Leonard and Mike blank checks to carry out this authorization. Filing no. 1, Adversary Complaint ¶ 7.

2. Leonard Russell issued three checks payable to David Wullschleger, four checks payable to Walter Johns, and one check payable to Steven Blumer. In addition, Leonard Russell directed Mike Russell to issue two checks payable to Walter Johns. See generally Exhibits 2-5 and attached exhibits.

3. Leonard Russell gave all of the checks to Brad Russell and instructed Brad Russell to deposit the checks into accounts controlled by the Russells. Exhibit 6.

4. Brad Russell forged all of the names of the payees on all ten checks and deposited the check proceeds into bank accounts controlled exclusively by the Russells. The checks were not delivered at any time to the payees. Exhibit 6.

5. At the time the checks were issued, David Wullschleger was not owed any money by Western Iowa or the Russells. Mr. Wullschleger's only livestock transactions with Leonard Russell occurred in 1988, long prior to the issuance of the forged checks. Mr. Wullschleger's only other business transaction with the Russells during the period of time that the checks were issued concerned a bond that Mr. Wullschleger held on one of the Russell's sale barns. The Russells paid any resulting obligation from the bond in full, separate from the checks issued in November and December 1989. Mr. Wullschleger has not had a business relationship with Western Iowa at any time.

No transaction took place prior to or after the issuance of the checks which would cause any money owed by Western Iowa or the Russells to be paid to Mr. Wullschleger. The checks issued by Leonard Russell and payable to Mr. Wullschleger were not issued for the purpose of paying Mr. Wullschleger for any business transaction. See Exhibit 3, attached exhibits 1, 3, & 7.

6. Brad Russell was not authorized to sign David Wullschleger's name on the back of any of the three checks which were payable to Mr. Wullschleger. See Exhibit 3, attached exhibits 1, 3, & 7. Brad Russell was not authorized by Mr. Wullschleger to deposit the checks into the Russell's account at First Savings.

7. At the time the checks were issued, Steven Blumer did not owe money to and was not owed any money by Western Iowa or the Russells. Mr. Blumer never engaged in any transaction concerning livestock or otherwise with the Russell's or Western Iowa which would cause Leonard Russell to issue a check to Mr. Blumer. Therefore, the check issued by Leonard and payable to Mr. Blumer was not issued for the purpose of paying Mr. Blumer for any obligation, outstanding or otherwise. See Exhibit 4, attached exhibit 10.

8. Steven Blumer did not sign the back of the check which was issued as payable to him. Brad Russell forged Mr. Blumer's name without his knowledge or authorization and deposited it into an account controlled by the Russells without Mr. Blumer's knowledge or authorization. See Exhibit 4.

9. Walter Johns did engage in numerous livestock transactions with the Russells during the period of time that the forged checks were issued. Walter Johns routinely purchased cattle for the Russells, and the Russells used Western Iowa checks to pay for the cattle. However, Mr. Johns did not have any knowledge of the four checks issued by Leonard and the two checks issued by Mike on the Western Iowa account. See Exhibit 2, attached exhibits 2, 4, 5, 6, 8 & 9. All livestock transactions between Mr. Johns and the Russells were paid in full with checks other than the ones at issue in this case. As far as Mr. Johns recalls, Leonard Russell always paid Mr. Johns within the next business day after each transaction took place.

10. Walter Johns did not authorize Brad Russell to indorse the six checks which are payable to Mr. Johns. Mr. Johns did not authorize Brad Russell or any of the Russells to deposit the checks into an account controlled by the Russells.

#### D. Conclusions and Discussion

The only reasonable inference from the undisputed facts recited above is that Leonard Russell did not intend for the payees to have an interest in the checks. Leonard Russell is dead. His intent must be inferred from the circumstances.

The circumstances in this case show the following. Leonard issued checks payable to Mr. Johns, Mr. Blumer and Mr. Wullschleger, and he instructed Mike Russell to issue checks payable to Mr. Johns. None of the payees had any knowledge about the checks, nor did the payees have any reason to believe that the Russells would issue such a check. Mr. Wullschleger did not engage in any business transactions with the Russells or Western Iowa at the time the checks were issued to cause Leonard to issue a check to him. Mr. Blumer had never engaged in any business transaction with the Russells or with Western Iowa. Mr. Johns engaged in several livestock transactions with Mike and Leonard during the period of time that the checks were issued, but he accounted for all such transactions and was paid in full by the Russells with checks different from those at issue in this case.

The logical inference from the facts is that only an intent to deny the payees any interest in the checks could cause Leonard Russell to direct Brad Russell to forge the payee's signatures and to deposit the proceeds into the Russell accounts.

Western Iowa has not submitted any evidence to counter the evidence of Norwest that shows that Leonard intended to deny Mr. Wullschleger any interest in the checks. Western Iowa's defense is that certain statements by Brad and Mike, which concern their

impression of their Dad's intent, is hearsay, and since that evidence is arguably not admissible, there is no factual basis for determining Leonard's intent. However, the finding above that Leonard Russell intended that the payees would not have any interest in the check was made without considering the statements made by Brad and Mike concerning their father's intent. The objectionable testimony is not necessary to reach a conclusion in this motion for summary judgment.

Once the moving party, Norwest, has shown that no genuine issue of material fact exists, the burden is on Western Iowa to present evidence on the issue of Leonard's intent concerning denying the payees any interest in the checks. Western Iowa has not come forward with any such evidence, and in this situation, the Court finds that there are no reasonable inferences from the testimony that would support Western Iowa's position.

The payees, Mr. Wullschleger, Mr. Johns, and Mr. Blumer, are all disinterested parties to this lawsuit. There is no reason to question the veracity of their testimony. Brad and Mike Russell are interested parties, but their testimony is also credible because the testimony is to a certain extent an admission against their own interests. For example, Brad's testimony concerning the forged indorsements subjects him to civil, and perhaps criminal, liability. Therefore, there are no genuine issues of material fact in this case.

Under Section 3-405 of the Montana Uniform Commercial Code, Brad's indorsements in the names of the payees are effective as to the checks signed by Leonard because Leonard did not intend for the payees to have any interest in the checks. MONT. CODE ANN. § 30-3-405(1)(b)(1990). Brad's forged indorsements on the two checks signed by Mike are also effective because Leonard provided Mike, an authorized agent of Western Iowa, with the names of the payees, but Leonard did not intend for the payees to receive any interest in the checks. MONT. CODE ANN. § 30-3-405(1)(c)(1990). Norwest charged against Western Iowa's account an item that was properly payable pursuant to Section 4-401(1), and, therefore, is not required to credit Western Iowa's account for the checks. Summary judgment is granted.

Separate journal entry to be entered.

DATED: October 4, 1994

BY THE COURT:

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

Copies faxed by the Court to:

LICH JR, VICTOR	397-1254
STEHLIK, FREDERICK	493-7005

FLAHERTY, THOMAS

341-8290

Copies mailed by the Court to:

United States Trustee

Richard Seaton, P.O. Box 816, Manhattan, KS 66502

Movant (\*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

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	)	DATE: October 4, 1994
KANSAS and NORWEST BANK	)	HEARING DATE: July
ANACONDA-BUTTE, N.A.,	)	28, 1994
Defendant	)	

JOURNAL ENTRY

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion for Summary Judgment filed by Norwest Bank Anaconda-Butte, N.A.

APPEARANCES

Victor Lich, Attorney for debtor  
Frederick Stehlik, Attorney for First Savings Bank  
Richard Seaton, Attorney for First Savings Bank  
Thomas Flaherty, Attorney for Norwest Bank

IT IS ORDERED:

Motion for Summary Judgment filed by Norwest Bank Anaconda-Butte, N.A., is granted. Judgment is entered in favor of Norwest Bank Anaconda-Butte, N.A., and against plaintiff.

BY THE COURT:

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

Copies faxed by the Court to:

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STEHLIK, FREDERICK	493-7005
FLAHERTY, THOMAS	341-8290

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