STATE OF WISCONSIN
SUPREME COURT

KOSS CORPORATION,

Plaintiff-Appellant,

v.

PARK BANK,

Appeal No. 2016AP000636

Defendant-Third-Party Plaintiff-
Respondent-Cross Appellant,

v.

MICHAEL J. KOSS,

Third-Party Defendant-Appellant-
Cross-Respondent,

and

GRANT THORNTON LLP,

Third-Party Defendant-Cross
Respondent.

BRIEF OF WISCONSIN BANKERS ASSOCIATION AND THE AMERICAN BANKERS ASSOCIATION AS *AMICUS CURIAE*

Dated: April 27, 2018.

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Page**

Statutes

INTRODUCTION

The Wisconsin Bankers Association ("WBA") and American Bankers Association ("ABA") appear in this appeal to urge the Wisconsin Supreme Court to uphold the decision of the Court of Appeals, *Koss Corp. v. Park Bank*, 2018 WI App. 1, 379 Wis.2d 629, 907 N.W.2d 447 ("Decision"). The Court of Appeals correctly decided that the alleged actions by Respondent Park Bank ("Bank") and its employees' in handling Koss' deposit accounts and withdrawals, even if true, and even if negligent, do not rise to the level of "bad faith" under §112.01(9) of the Wisconsin Uniform Fiduciaries Act ("UFA"). The WBA and ABA agree with the Decision.

Prior to UFA, common law imposed a duty on banks to help ensure that depositors' funds were not being transferred by the depositors' fiduciaries (such as a corporate officer with check signing authority) for improper purposes. *See e.g. National Cas. Co. v. Caswell*, 317 Ill. App. 66, 69, 45 N.E.2d 698, 699-700 (1942); *Central Nat'l Bank v. Connecticut Mut. Ins. Co.*, 104 U.S. 54, 68-69 (1881); *Colby v. Riggs Nat'l Bank*, 92 F.2d 183, 186 (D.C. Cir. 1937). Consequently, banks were expected to monitor the activities of the fiduciaries of their depositors and identify misconduct.

This standard clearly is unworkable in a world of complex business organizations conducting high numbers of transactions, often through multiple fiduciaries. In response, UFA was approved by the National Conference of Commissioners on Uniform State Laws and the American Bar Association in 1922, and signed into law in Wisconsin in 1925. In the Decision, the Court of Appeals correctly recognized that UFA "was specifically intended to relax the common law standard of care owed by banks to principals and third parties when dealing with fiduciary accounts" (*Koss Corp.*, 2018 WI App 1 at ¶51, quoted source omitted).

The case involves a massive embezzlement over a period of many years by a highly placed senior executive of the Koss Corporation, a large publicly held corporation ("Koss"). Koss seeks to shift to the Bank the losses caused by its own high level executive's criminal conduct by urging the Court to find that a bank's alleged negligence in dealing with a depositor's fiduciary constitutes "bad faith" under UFA. This is not the current law in Wisconsin, nor is it the way in which UFA is interpreted in other jurisdictions. Changing the law as proposed by Koss would impose again on banks the duty to make sure that fiduciaries are appropriately applying depositor funds, to the detriment of the economy and in direct

contravention of the legislature's intentions in passing UFA. The WBA and ABA urge this Court to uphold the Decision.

INTEREST OF THE *AMICUS CURIAE*

WBA is an organization of state and national banks, savings banks and savings and loan associations with offices in Wisconsin. WBA regularly represents the interests of its membership in significant judicial proceedings, including by appearing as *amicus curiae* in appeals before the Wisconsin Supreme Court. ABA is the principal national trade association of the financial services industry in the United States. Founded in 1875, the ABA is the voice for the nation's $13 trillion banking industry and its million employees. ABA members are located in each of the fifty States and the District of Columbia, and include financial institutions of all sizes and types. The ABA, whose members hold a substantial majority of domestic assets of the banking industry of the United States and are leaders in all forms of consumer financial services, often appears as *amicus curiae* in litigation that affects the banking industry.

The issues raised in this appeal are highly relevant and of statewide and nationwide concern to the banking industry. All FDIC-insured banks hold customer deposits. The standards under which Wisconsin courts will

determine whether the actions of banks and their employees in handling customer deposits and accounts constitute "bad faith" under UFA is of great importance to Wisconsin banks. Because UFA is to be "interpreted and construed as to effectuate its general purpose to make uniform the law of those states which enact it," *Wis. Stat.* §112.01(14), the Court's interpretation of UFA in this case is also likely to influence courts, and affect banks, in other jurisdictions. For the reasons stated below, the Court should reject the analysis proposed by Koss and refuse to change the UFA standard articulated by the Court of Appeals. The Court should uphold the Decision.

STATEMENT OF THE CASE

A high level executive of Koss embezzled *$34 million* from her employer over a 9+ year period, without her employer noticing. The oversight by the employer was so lax that the SEC filed a lawsuit (and obtained a judgment) against Koss and its CEO alleging, among other claims, that the company's failure to maintain adequate internal controls to reasonably assure reliable financial reporting allowed the executive to hide her embezzlement. Much of the embezzlement occurred through Koss accounts held at the Bank. Koss cites to a variety of actions by the Bank

and its employees that Koss claims constituted "bad faith" under UFA. These alleged actions are detailed in the Decision and Koss' Petition and Brief to this Court, and include a litany of alleged failures of the Bank in connection with various cashier's check, wire transfer and petty cash transactions.

In support of its motion for summary judgment, the Bank provided evidence that we believe important in evaluating whether the Bank's actions constituted "bad faith." The cashier's checks and wire transfers the Bank undertook for Koss were a very small portion of all of the Bank's cashier's check and wire transfer transactions for its customers during the same period. Almost 50 different Bank employees were involved with issuing the cashier's checks. The Bank provided Koss with monthly statements detailing the account activity, including the transactions that were part of the executive's theft. Until the executive was caught, no one from Koss ever told the Bank that Koss had concerns about the executive's fiduciary transactions, or that she was no longer permitted to withdraw funds from Koss accounts. Michael Koss testified that Koss did not prohibit its employees from using cashier's checks, and acknowledged that the company did not have any written policy or procedure about their use. A

Bank employee testified that it was not unusual for a corporate depositor to request cashier's checks to pay credit card debt. A former Koss employee testified that she did not believe there was anything suspicious about how Koss was using petty cash, the amount of petty cash being obtained, Koss' use of cashier's checks, or that she personally was asked to go to the Bank to obtain the petty cash and cashier's checks. She also testified that no one at the Bank gave her the impression that they thought there was something suspicious about those transactions. The Court of Appeals also agreed with the trial court that because the wire transfers at issue involved transferring funds to other Koss accounts, the wire transfers are immaterial in this case because from the Bank's perspective the funds remained in Koss' control after the transfer.

The Court of Appeals examined cases from outside Wisconsin to determine the proper standard for §112.01(9) of Wisconsin's UFA, which is appropriate particularly given UFA's stated goal of judicial consistency in interpretation. The Court concluded that "bad faith" under UFA requires proof of two elements:

1. circumstances that are suspicious enough to place a bank on notice of improper conduct by the fiduciary; and

2. a deliberate failure to investigate the suspicious circumstances because of a belief or fear that such inquiry would disclose a defect in the transaction at issue.

With the standard identified, the Court of Appeals then concluded that:

> "[a]lthough the transactions Sachdeva engaged in may appear suspicious or odd in hindsight, Koss has not cited any evidence to indicate that, in the larger context of Koss's banking practices and the banking practices of Park Bank's other corporate clients, the transactions were suspicious enough to put Park Bank on notice of Sachdeva's misconduct. Koss also fails to cite any evidence indicating that Park Bank deliberately declined to investigate Sachdeva's transactions due to a fear that further inquiry would disclose defects in them."

The WBA and ABA agree with the standard for "bad faith" laid out by the Court of Appeals. They agree that the allegations against the Bank do not meet the required standard. They agree that even if the allegations against the Bank constitute negligence, mere negligence is not enough to support a finding of "bad faith" under UFA. They believe that if this Court finds that the Bank's alleged failings constitute "bad faith", the Court will be interpreting UFA in a manner inconsistent with other states (in contravention of UFA's explicit call for uniformity), but more importantly,

will be imposing again on Wisconsin banks the requirement that they attempt to affirmatively monitor the propriety of fiduciary deposit transactions. In today's economy – where millions of financial transactions rapidly move money in and out of bank accounts annually – this would be impossible. It is this reality that gave rise to UFA in the first place.

ARGUMENT AND POLICY CONCERNS

First, WBA and ABA ask this Court to clarify that for claims involving a bank's dealings with a depositor's fiduciaries, UFA abrogates state common law negligence claims. Here, Koss initially brought both negligence and UFA claims against the Bank, but voluntarily dismissed the negligence claim. Therefore, this question was not directly before the Court of Appeals, but is important to provide certainty to banks, depositors, fiduciaries and third parties going forward. The language of UFA itself implies that it is to supersede common law claims: "In any case not provided for in this section the rules of law and equity . . . shall continue to apply." *Wis. Stat.* §112.01(13). Courts in other states have found that UFA abrogates common law negligence claims. *See e.g., Pargas, Inc. v. Taylor's Estate*, 416 So.2d 1358, 1361 (La. Ct. App. 1982); *Dean v. Centerre Bank of North Kansas City*, 684 S.W.2d 373, 374 (Mo. Ct. App.

1984); *Lawyers Title Ins. Corp. v. Dearborn Title Corp.*, 904 F. Supp. 818, 820 (N.D. Ill. 1995). In Wisconsin, "[t]o abrogate the common law, the intent of the legislature must be clearly expressed, either in specific language or in a manner that leaves no reasonable doubt of the legislature's purpose." *Gibson v. Overnite Transp. Co*, 2003 WI App. 210, ¶16, 267 Wis.2d 429, 671 N.W.2d 388, *review dismissed*, 2004 WI 20, 269 Wis.2d 202, 675 N.W.2d 808 (Wis. Jan. 29, 2004). UFA did away with the common law standard for liability in failing to investigate the purpose for which a fiduciary uses the principal's funds, and substituted the new standards of "actual knowledge" and "bad faith". Allowing for negligence claims in these cases would nullify UFA's standard and purpose, and render irrelevant *Wis. Stat.* §112.01(13). There is no reasonable doubt that abrogating common law negligence claims in these situations was the legislature's purpose. UFA was enacted to "place on the principal the burden of employing honest fiduciaries," *Bolger v. Merrill Lynch Ready Assets Tr.*, 143 Wis.2d 766, 775, 423 N.W.2d 173 (Ct. App. 1988) (quoting *Johnson v. Citizens Nat'l Bank,* 334 N.E.2d 295, 300 (Ill. App. Ct. 1975)), which is necessary in the modern economy. If UFA is not found to abrogate state common law negligence claims, then the law will not

accomplish its goal of "relax[ing] the standards of care owed by banks to principals and third parties when dealing with fiduciary accounts," *Guild v. First Nat'l Bank of Nev.*, 553 P.2d 955, 958 (Nev. 1976), or "provide relief from the dire consequences of the common law rule." *Bolger*, 143 Wis.2d 766 at 774.

Second, the WBA and ABA ask this Court to confirm the "bad faith" standard found by the Court of Appeals. We agree with the Court of Appeals' analysis of the cases from other states interpreting UFA, and believe that the two-element standard articulated by the Court satisfies both goals of UFA – shifting the burden to monitor fiduciary accounts away from banks for the good of the economy, and interpretive uniformity between the states.

Third, we ask this Court to confirm that the actions of the Bank in dealing with the Koss fiduciary accounts do not constitute "bad faith" under UFA. Koss's allegations, even if true, do not reveal a bank that had been put on notice that the executive was embezzling funds, or that deliberately closed its eyes to the misconduct because it thought that investigating the situation would reveal a defect in the transactions. The Bank may have not scrupulously followed its own policies. It may have had policies and

procedures that, in hindsight, were not rigorous enough. But to prevail on a claim under UFA, the conduct must rise to the standard of "bad faith" articulated by the Court of Appeals. For the reasons stated in the Decision, these alleged deficiencies in the Bank's policies and procedures do not constitute "bad faith". The Bank did what an authorized executive officer of Koss instructed it to do – nothing more or less.

The other "evidence" pointed to by Koss – the total dollar amount of checks and petty cash transactions was large; the embezzlement involved a lot of checks; the checks were made out to companies with odd names – also do not demonstrate "bad faith." In fact, they highlight the exact reason for UFA. It is bad policy, and makes no sense, to require a bank to actively analyze all banking activities of all of its corporate depositors. The Bank was not in a position to determine, out of the 60,000 cashier's checks it facilitated during the same period, whether the 359 cashier's checks requested by the executive were improper. The Bank could not assess whether the seven Koss wire transfers, out of the tens of thousands requested by Bank customers, and which moved funds to other *Koss* accounts at another bank, constituted theft. It is not for the Bank to judge how a customer chooses to use its petty cash, or whether the name of a

specific payee on a check is unusually weird. At least forty-nine different Bank employees were involved with the various check transactions. Aggregating those persons together and imputing their collective observations to the Bank is misleading. A bank cannot gather its employees into constant meetings for the purpose of having the employees analyze and dissect as a group all the various transactions of hundreds or thousands of bank customers to look for possible malfeasance.

By contrast, Koss hired the executive. Koss put her in a position with such limited oversight that she was able to steal $34 million dollars over a decade without anyone realizing it was gone. The SEC actually sued the company and its CEO because the lack of oversight was so egregious. The Bank dutifully sent monthly statements detailing all Koss account transactions, so the evidence was readily available to Koss if someone had just chosen to look. Koss handed the executive the keys to the corporate vault, and then left her alone to do what she pleased. Now that the theft has come to light, Koss is trying to recoup its losses by re-packaging claims of bank negligence as "bad faith" under UFA. This Court must prevent this from happening.

Todays' corporate depositors are complex, diverse and often very large. The nature of these depositors, coupled with the enormous quantity and speed of banking transactions and the massive rise of the electronic marketplace, make it absolutely untenable for banks to be legally responsible for the actions of their depositor's fiduciaries. This reality is reflected in the UFA, and court interpretations of UFA. Banks cannot be expected to actively police the actions of their depositors' fiduciaries to ferret out fraud. That must be the job of the depositors themselves.

UFA specifically relieved banks of the duty to monitor the propriety of fiduciary transactions. It imposed much higher standards for recovery against a bank in the event of fiduciary theft, such as "actual knowledge" and "bad faith." If the Court adopts the position asserted by Koss, banks would then be in the truly impossible position of trying to figure out how to monitor the millions of transactions that flow through bank deposit accounts in any given year, and how to do it without grinding commerce to a crawl. This directly contradicts the express purpose of UFA.

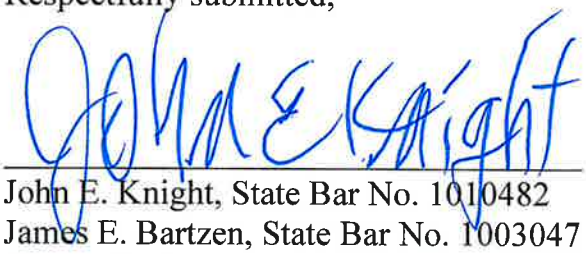
CONCLUSION

The actions of the Bank do not rise to the level of "bad faith" under UFA, and should not provide grounds for Koss to recover under UFA. If

the Court were to find "bad faith" in this case, the decision would be contrary to the clear, established interpretation of UFA under which banks have long been operating. It also would undercut the intent of UFA, which is to require bank customers to monitor how their own fiduciaries are using corporate funds. For the reasons provided herein, WBA and ABA respectfully urge this Court to uphold the decision of the Court of Appeals.

Dated this 27th day of April, 2018.

Respectfully submitted,



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CERTIFICATION

I certify that this brief conforms to the rules contained in §809.19(8)(b) and (c) for a brief produced using the following font: proportional serif font: minimum printing resolution of 200 dots per inch, 13 point body text, 11 point for quote and footnotes, leading of minimum 2 points, maximum of 60 characters per full line of body text. The length of this brief is 2,828 words.

Dated: April 27, 2018.

John E. Knight, State Bar No. 1010482

CERTIFICATE OF COMPLIANCE
WITH WIS. STAT. §809.19(12)

I hereby certify that I have submitted an electronic copy of this brief, excluding the appendix, if any, which complies with the requirements of Wis. Stat. §809.19(12). I further certify that this electronic brief is identical in content and format to the printed form of the brief filed as of this date. A copy of this certificate has been served with the paper copies of this brief filed with the court and served on all opposing parties.

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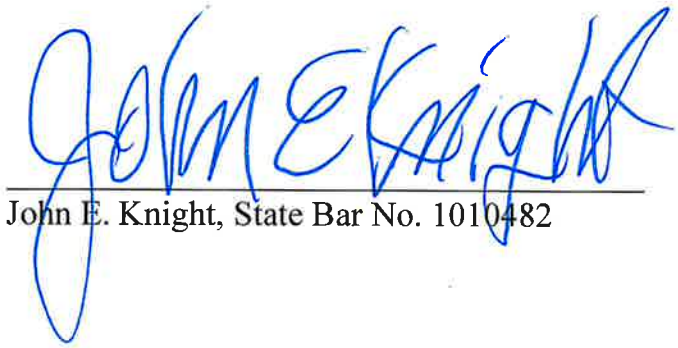

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