

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

EXPERI-METAL INC.,
a Michigan corporation,

Plaintiff,

vs.

Case No. 2:09-cv-14890

Hon. Patrick J. Duggan

COMERICA BANK,

Defendant.

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**PLAINTIFF'S SUPPLEMENTAL BRIEF ON
THE GOOD FAITH STANDARD ARTICULATED
IN ARTICLE 4A OF THE UNIFORM COMMERCIAL CODE**

Experi-Metal Inc. submits this Supplemental Brief to address the cases cited by Comerica Bank in its Amended Proposed Findings of Fact and Conclusions of Law with respect to the “good faith” standard applicable in this case.

In its Opinion and Order Denying Defendant’s Motion for Summary Judgment in this case, the Court noted that one of the areas where the Court found a genuine issue of material fact was with respect to whether Comerica acted in “good faith” when it accepted the wire transfer orders in this case (see Opinion and Order, p. 13).

In its Opinion and Order, this Court noted that Article 4A of the Uniform Commercial Code (“UCC”) defined “good faith” as honesty in fact and the observance of reasonable commercial standards of fair dealing. MCLA 440.4605(1)(f). The Court also noted that the same definition appears in other articles of the UCC.

As noted in this Court’s Opinion and Order, the Third Circuit has noted that “good faith” as defined in the UCC “has both a subjective prong -- honesty in fact -- and an objective prong -- observance of reasonable standards of fair dealing.” *In re Jersey Tractor Trailer Training, Inc.*, 580 F3rd 147, 156 (3rd Cir. 2009). In *Jersey*, the Third Circuit also adopted the following two-part test established by the Maine Supreme Court for evaluating the second component:

“First, whether the conduct...comported with industry or ‘commercial’ standards applicable to the transactions and second, whether those standards were reasonable standards intended to result in fair dealing.”

In re Jersey Tractor Trailer Training, Inc., 580 F3rd at 157 (citing *Maine Family Fed. Credit v. Sun Life Assurance Co. of Canada*, 727 A2d 335, 343 (ME 1999)).

The cases cited by Comerica in its Amended Proposed Findings of Fact and Conclusions of Law are generally based on a single prong definition of “good faith” (honesty in fact) rather than the two prong definition set forth in Article 4A of the UCC or are not UCC cases at all.

In analyzing the cases cited by Comerica, it must be noted that the definition of “good faith” under the Uniform Commercial Code has evolved over time. A description of the history of the “good faith” definition in the Uniform Commercial Code is set forth in Official Comment 20 to Revised Article 1 of the Uniform Commercial Code which provides as follows:

“Good faith.” Former Section 1-201(19) defined “good faith” simply as honesty in fact; the definition contained no element of commercial reasonableness. Initially that definition applied throughout the Code with only one exception. Former Section 2.103(1)(b) provided that “in this Article...good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” This alternative definition was limited in applicability in three ways. First, it applied only to transactions within the scope of Article 2. Second, it applied only to merchants. Third, strictly construed, it applied only to uses of the phrase “good faith” in Article 2; thus, so construed it would not define “good faith” for its most important use, the obligation of good faith imposed by former Section 1-203.

Over time, amendments to the Uniform Commercial Code brought the Article 2 merchant concept of good faith (subjective honesty and objective commercial reasonableness) into other Articles. First, Article 2A explicitly incorporated the Article 2 standard. See Section 2A-103(7). Then, other Articles broadened the applicability of that standard by adopting it for all parties rather than just for merchants. See, e.g., Sections 3-103(a)(4), 4A-105(a)(6), 8-102(a)(10), and 9-102(a)(43). All of these definitions are comprised of two elements – honesty in fact and observance of reasonable commercial standards of fair dealing. Only revised Article 5 defines “good faith” solely in terms of subjective honesty, and only Article 6 and Article 7 are without definitions of good faith....Given these developments, it is appropriate to move the broader definition of “good faith” to Article 1. Of course, this definition is subject to the applicability of the narrow definition in revised Article 5.”

In analyzing the cases cited by Comerica, it is important to take into consideration the historical changes in the definition of “good faith” over time. For example, Comerica has cited *Auto-Owners Insurance Co. v. Bank One*, 852 NE2d 604, 611-612 (Ind. Ct. App. 2006). The quote cited by Comerica appears at page 615 of the case and not at page 611-612 as cited by

Comerica. More importantly, the quotation is actually a quote from an earlier case, *Shearson Lehman Brothers, Inc. v Wasatch Bank*, 788 F Supp 1184, 1194 (D Utah 1992). The definition of “good faith” in Article 1 of the Uniform Commercial Code at the time of the *Shearson Lehman Brothers* Opinion was the former Section 1-201(19), which defined good faith simply as honesty in fact and did not include the objective commercial reasonableness prong from Articles 2, 3, 4, 8 and 9 of the Uniform Commercial Code. Thus, the *Shearson* case quoted by Comerica was decided under the old definition of good faith before it was amended to include the objective prong that is applicable to this case under Article 4A of the Uniform Commercial Code.

Comerica cites [*J*] *Walter Thompson, USA, Inc. v. First Bank Americano*, 518 F3rd 128 (2nd Cir. 2008) for the proposition that good faith is not a negligence standard. The court in *J. Walter Thompson* correctly noted that the Uniform Commercial Code definition of good faith has both subjective and objective components. However, the court did not address the meaning of reasonable commercial standards of fair dealing other than to note another court’s holding that reliance on a positive Pay System precluded a finding of lack of good faith. The Opinion contains no analysis of the objective component of “good faith.”

Comerica also cites *State Bank of the Lakes v. Kansas Banker Surety Co.*, 328 F3rd 906 (7th Cir. 2003). The case involved an action by a bank on a crime bond and concerned the interpretation of the term “good faith” used in the bond itself. This case does not arise under the Uniform Commercial Code at all and is inapplicable to this case. The court, in that case, in construing the meaning of the term “good faith” in the crime bond mentioned in passing the definition of good faith in Article 3 of the Uniform Commercial Code, noting that the definition included both subjective and objective prongs. The language quoted by Comerica in its Proposed Amended Findings of Fact and Conclusions of Law is mere dicta, as the case did not involve the Uniform Commercial Code at all.

Likewise, the next case cited by Comerica, *FDIC v. Raymond*, 117 F3rd 994 (7th Cir. 1997) was not a case involving the Uniform Commercial Code but involved an action by the FDIC on a written guaranty. The guarantor argued that the FDIC violated the covenant of good faith and fair dealing by its actions. The court did not analyze the Uniform Commercial Code definition of good faith and has no application in this case. In addition, the language allegedly quoted in Comerica's Amended Proposed Findings of Fact and Conclusions of Law is actually a paraphrase of the language cited in the Opinion from *Kham & Nate's Shoes # 2, Inc. v. First Bank of Whiting*, 908 F2d 1351, 1357 (7th Cir. 1990). That case was a bankruptcy case concerning inequitable conduct and subordination of a secured creditor's claim. The court was addressing the implied obligation of good faith that exists in every contract. In analyzing the term the court noted the definition of "good faith" as previously defined in UCC Section 1-201(19) which, at that time, included only the subjective prong, honesty in fact. Accordingly, the language cited by Comerica is not relevant to the definition of good faith in Article 4A that includes both the objective and subjective prongs.

The final case cited by Comerica is *Continental Casualty Co. v. Fifth/Third Bank*, 418 F Supp 2d 964 (N.D. Ohio 2006). The *Continental Casualty* case is a UCC case. In analyzing whether the bank exercised good faith in accepting a series of stolen checks for deposit over a period of time, the court did not quote the definition of good faith but rather discussed whether a finding of bad faith was warranted. The Opinion cited to *Pavex, Inc. v. York Federal Savings & Loan Assoc.*, 716 A2d 640 (PA. Super 1998) and quoted from *Pavex* that the mere failure to follow commercially reasonable banking procedures or to comply with its own policies does not *per se* amount to bad faith. The *Pavex* decision, although the Opinion was issued in 1998, examined conduct that occurred in the 1980s and the underlying action was filed in 1989 which preceded the two-pronged definition of "good faith" in Articles 3, 4, 8, and 9 of the Uniform

Commercial Code and is not applicable to this case. In addition, as noted by this Court in its Opinion and Order Denying Defendant's Motion for Summary Judgment, the burden of proof in this case is on Comerica to prove that it accepted the wire transfer orders in good faith as defined in Article 4A of the UCC. The burden in this case was not on the Plaintiff to show bad faith.

CONCLUSION

Cases cited by Comerica generally do not address the correct definition of "good faith" under Article 4A of the Uniform Commercial Code and therefore do not address the analysis of both the subjective and objective prongs of the good faith definition cited by this Court in its Opinion and Order Denying Defendant's Motion for Summary Judgment.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on February 17, 2011, I electronically filed the foregoing papers with the Clerk of the Court using the ECF system, which will send notification of such filing to the following ECF participants: Todd A. Holleman (P57699) and Lara Lenzotti Kapalla (P67667).

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