

Commonwealth Of Kentucky

Court of Appeals

NO. 2002-CA-001635-MR

WANDA JONES and
RALPH JONES, individually and
Doing business as Homes by Ralph APPELLANTS

v. APPEAL FROM CHRISTIAN CIRCUIT COURT
HONORABLE JOHN L. ATKINS, JUDGE
ACTION NO. 01-CI-01672

CHRISTIAN COUNTY SCHOOL
EMPLOYEES FEDERAL CREDIT UNION,
STATE FARM INSURANCE COMPANIES,
And LANNY MILLER APPELLEES

OPINION
AFFIRMING

** ** * * *

BEFORE: BUCKINGHAM, COMBS, AND TACKETT, JUDGES.

BUCKINGHAM, JUDGE: Ralph and Wanda Jones, individually and doing business as Homes by Ralph, appeal from two separate orders of the Christian Circuit Court granting summary judgment in favor of Christian County School Employees Federal Credit Union, State Farm Insurance Companies, and Lanny Miller. The effect of those summary judgment orders was to dismiss the Joneses' complaint against the appellees. We affirm.

Malcolm Woodard's home was severely damaged by a fire on October 18, 1997. State Farm, Woodard's insurer, investigated the loss and paid Woodard \$40,500, the actual cash value of the residence. State Farm also advised Woodard that \$37,987.16 remained under the policy for replacement cost benefits.

In June 1998, Woodard wrote State Farm Team Manager, Lanny Miller, and enclosed a signed contract between Woodard and Wanda Jones of Homes by Ralph. The contract provided that Woodard would pay Homes by Ralph \$78,765.19 to build a single family dwelling. Miller wrote back to Woodard and advised him that if Homes by Ralph was a licensed contractor and the contract amount was the amount actually incurred in repairing or replacing the dwelling, then State Farm would pay the replacement cost benefits up to the \$37,987.16 remaining for the claim. Miller also stated in the letter that the payment would be made once construction was in the latter stages.

In December 1998, Woodard called State Farm and advised that construction on his house was nearly complete and that he wished to make a claim for replacement cost benefits. State Farm advised Woodard that it would include the contractor's name on the settlement check, and Woodard advised State Farm that Homes by Ralph had performed the work. On behalf of State Farm, Miller wrote Homes by Ralph in late

December 1998 requesting either a federal tax identification number or a social security number for Homes by Ralph so that it could be included on the draft. On December 30, 1998, State Farm received a phone call and was provided Ralph Jones's social security number which was verified by State Farm. A draft was then issued jointly payable to Woodard and Homes by Ralph in the amount of \$35,987.16 for replacement cost benefits. The draft was mailed to Woodard, and he forged Jones's signature and received all the proceeds without Jones's knowledge. The check was honored at the Credit Union.

On January 18, 1999, State Farm received a letter from Jones's attorney referring to Miller's letter of December 23, 1998. Jones's attorney advised Miller that Jones had been hired to rebuild Woodard's home, but that after digging and pouring the footer, Woodard had Jones cease construction. Jones's attorney further advised Miller that Woodard had apparently retained someone else to complete the construction. The letter indicated that Jones had been paid for his work by Woodard. Thus, Jones's attorney advised that there was no need to include Jones's name on a draft sent to Woodard. On January 26, 1999, Jones's attorney sent another letter to Miller. This letter stated that Homes by Ralph had been paid \$1,772.98 from Woodard for digging and pouring the footer.

On November 15, 1999, State Farm received a letter from another attorney on behalf of Jones stating that the attorney understood that a draft had been issued by State Farm to Woodard and Homes by Ralph for \$35,987.16. The attorney stated that Jones had learned that Woodard had forged the draft on behalf of Homes by Ralph and that the attorney had been retained by Jones to collect the entire \$35,987.16 that had been paid to Woodard on the forgery. The letter also noted that Woodard had pled guilty in criminal court to the crime of forgery.

On November 23, 1999, State Farm received another letter from Jones's attorney requesting that State Farm reissue the draft in the full amount in Jones's name only. On February 3, 2000, State Farm received a signed affidavit executed by Jones on November 24, 1999, asserting that the entire proceeds of the draft payable to Woodard and Homes by Ralph were to be paid to Homes by Ralph for work performed in repairing or building Woodard's home. This claim by Homes by Ralph for the entire proceeds of the draft appears to us to be at odds with a prior representation by Jones's first attorney that Jones had only dug and poured the footer and had been paid for that work.

When Woodard received the check from State Farm, he forged Jones's signature on the check and deposited the full amount in his checking account with the Credit Union. He later

withdrew the funds. State Farm had drawn the check on its account with Suntrust Bank of Nashville, Tennessee, and it likewise honored the forged endorsement by initially charging State Farm's account for the amount of the check. After the forged endorsement was discovered, Suntrust Bank reversed the charge against State Farm's account, thereby making State Farm whole. The Credit Union later repaid Suntrust Bank for the full amount of the check. Thus, the entire loss fell upon the Credit Union because it was the first to give value to Woodard for the check.

On November 30, 2001, the Joneses filed a civil complaint in the Christian Circuit Court against Woodard, the Credit Union, State Farm, and Lanny Miller. The demand for damages included a demand for a judgment in the amount of \$35,987.16 and a demand for up to \$100,000 "for the wrongful cashing of the check and his stress, humiliation and anxiety caused by the wrongful and false tax liability incurred by the Defendants actions." The Credit Union, State Farm, and Miller filed motions for summary judgment with the circuit court. The court granted both motions and rendered separate orders of summary judgment. This appeal by the Joneses followed.

Summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, stipulations, and 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 law." CR¹ 56.03. "The record must be viewed in a light most favorable to the party opposing the motion for summary judgment and all doubts are to be resolved in his favor." Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., Ky., 807 S.W.2d 476, 480 (1991). "The standard of review on appeal of a summary judgment is whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law." Scifres v. Kraft, Ky. App., 916 S.W.2d 779, 781 (1996).

State Farm argued to the circuit court that it should be awarded summary judgment because it did not have a duty to include Jones's name on the check and because it did not perpetrate any fraud against the Joneses by reporting false information to the IRS. Although State Farm and Miller argue that the circuit court agreed with these two arguments by entering an order awarding summary judgment, we note that the order and judgment does not give specific reasons in support thereof.

Section I-Conditions, Section 8 of Woodard's policy with State Farm provides in part that "[w]e will adjust all losses with you. We will pay you unless some other person is

¹ Kentucky Rules of Civil Procedure.

named in the policy or is legally entitled to receive payment." Thus, it is clear from the terms of Woodard's policy that State Farm owed no duty to pay the insurance proceeds to anyone but Woodard. See Servicemaster of St. Cloud v. GAB Business Services, Inc., 544 N.W.2d 302, 307 (Minn. 1996).

In the Servicemaster case the insurance company failed to include on the check the name of the contractor who did repair work on a residence owned by an insured and damaged as a result of a fire. The Minnesota Supreme Court held that, while such a duty on the part of the insurance company could have been created by a contractual relationship, a statute, the common law, or the conduct of the parties, no such duty was created in that case. Id. at 307. However, that case is distinguishable from the case *sub judice* in that the insurance company (State Farm) assumed a duty to the contractor (Homes by Ralph) by including its name on the check.

Nevertheless, State Farm's duty was discharged when Woodard forged the draft and cashed the check. Although we have not been cited to any Kentucky authority addressing this issue, it was addressed by a Texas appellate court in Benchmark Bank v. State Farm Lloyds, 893 S.W.2d 649 (Tex. App. 1994). In that case the court held:

Where a party takes a draft in payment for an underlying obligation, the obligation is suspended *pro tanto* until the party presents

the draft for payment. Honor of the draft when presented discharges the obligor on the underlying obligation. Payment to and possession of a draft by one joint payee is constructive possession by the other joint payee. [Citations omitted.]

Id. at 651. We agree with the analysis of the issue in that case. In short, State Farm has no liability to Jones or Homes by Ralph in connection with the check because the check was delivered to and cashed by a co-payee (Woodard).

The second part of Jones's claim against State Farm and Miller concerns his allegation that they perpetrated a fraud against him by filing a Form 1099 with the IRS in 1998 that represented compensation in the amount of \$35,987.16. He states in his brief that he "has suffered harm and damages from these acts by the simple fact that the Internal Revenue Services has sought to establish his tax liability for the said income." Based upon this, he argues that he "has established his claim and cause of action for fraud and/or mistake which is compensable against the Appellees."

The facts indicate otherwise. Although State Farm issued a Form 1099 to Homes by Ralph for \$35,987.16 on December 30, 1998, it was never reported to the IRS. On January 29, 1999, before the deadline required by the IRS, State Farm sent Homes by Ralph a corrected Form 1099 for the year ending 1998 for the amount of \$1,772.99, the original amount paid to Jones

for his initial work to Woodard's house. On the same day State Farm issued a W-9 to the IRS reporting the amount of \$1,772.99 earned by Homes by Ralph in 1998. Further, on January 17, 2001, State Farm sent Homes by Ralph a Form 1099 for the year ending 2000 for the amount of \$7,600, the additional amount paid to him by State Farm pursuant to the order of the Christian Circuit Court. On the same day State Farm issued a W-9 to the IRS reporting that amount. In short, Jones has no valid claim against State Farm in connection with its issuance of the check or in connection with its IRS reporting. Summary judgment in favor of State Farm and Miller was appropriate.

The Credit Union also presented two arguments to the circuit court in support of its motion for summary judgment. First, it argued that Jones's claims against it were barred under KRS² 355.3-420(2). Second, it argued that Jones's complaint was barred by the three-year statute of limitations in KRS 355.3-118(7)(a). We will address each argument separately.

Because the forged instrument was received by delivery to another co-payee (Woodard), Jones had a cause of action for conversion against the Credit Union. See KRS 355.3-420(1)(b). However, the Credit Union argues that the limitation on recovery set forth in KRS 355.3-420(2) prohibits any recovery by Jones against it. That statute states that "[i]n an action under

² Kentucky Revised Statutes.

subsection (1) of this section, the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument." KRS 355.3-420(2). The Credit Union argues that Jones "has no ownership interest in the check because he has not released nor been paid for State Farm's obligation to him on the insured fire loss to his house." We fail to follow this argument because State Farm had no obligation to Jones on the insured fire loss.

The Credit Union also cites the Official Comment to § 3-420 on page 128 of Vol. 2, Uniform Laws Annotated-Uniform Commercial Code, (1991), and Winn v. First Bank of Irvington, Ky. App., 581 S.W.2d 21 (1978), in support of his argument. Because there was a delivery of the check to a co-payee (Woodard), those cited authorities are not applicable to the facts of this case. Thus, we conclude that Jones had a valid cause of action against the Credit Union which was limited to the amount of his interest in the check.

The Credit Union also argues that Jones's action against it is barred by the three-year statute of limitation set forth in KRS 355.3-118(7)(a). On the other hand, Jones argues that the five-year statute of limitation in KRS 413.120(7) is applicable. That statute is applicable to "action[s] upon a bill of exchange, check, draft, or order, or any endorsement

thereof, or upon a promissory note placed upon the footing of a bill of exchange." The three-year statute of limitation in KRS 355.3-118(7)(a) relates to actions regarding claims for conversion of an instrument and is more specific than the statute of limitation set forth in KRS 413.120(7). Therefore, the three-year statute of limitation is applicable. See Boyd v. C & H Transp., Ky. 902 S.W.2d 823, 824 (1995), citing Land v. Newsome, Ky., 614 S.W.2d 948 (1981). See also Haddad's of Illinois, Inc. v. Credit Union 1 Credit Union, 678 N.E.2d 322, 324 (Ill. App. 1997).

The Credit Union argues that Jones did not properly commence the conversion action within the three-year time period. The Credit Union honored Jones's forged endorsement on State Farm's check on December 31, 1998. Suit was filed against the Credit Union on November 30, 2001. This was within the three-year limitation period.

However, the Credit Union argues that Jones's action against it was not properly commenced until May 2002 when it was served with summons. It maintains that summons was not delivered to anyone with authority to serve it upon the Credit Union until the first week of May 2002. The Credit Union argues that "the running of a statute of limitations is not tolled by the mere issuance of service of process within the limitations period. Such issuance of process must then be accompanied by a

good faith effort and a bona fide intent to have the process served." See Louisville & N.R. Co. v. Little, 264 Ky. 579, 95 S.W.2d 253, 255 (1936).

Jones has not disputed the Credit Union's assertion that the action was not commenced until May 2002. However, Jones argues that he did not know of the Woodard forgery until the fall of 1999 and that, pursuant to KRS 413.130, causes of action for fraud or mistake do not accrue until its discovery.

Jones's argument is without merit for two reasons. First, Jones's action against the Credit Union was for negligence or wrongfully honoring Woodard's forged endorsement and was not based on fraud or mistake. Thus, KRS 413.130 is not applicable. Second, we agree with the conclusion in the Haddad's of Illinois case that "the discovery rule does not apply to causes of action for conversion of negotiable instruments" absent fraudulent concealment on the part of the defendant. Id. at 326. Therefore, even though we believe Jones had a valid cause of action against the Credit Union that would be limited to his interest in the check, we conclude that the action against the Credit Union was not properly commenced within the three-year limitation period in KRS 355.3-118(7)(a).

The summary judgments of the Christian Circuit Court in favor of the Credit Union, State Farm, and Miller are affirmed.

ALL CONCUR.

BRIEF FOR APPELLANTS:

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BRIEF FOR APPELLEES:

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