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Meaning Of "Engaged In Business Of Banking" Under Article 4A, U.C.C.; In Case Of First Impression In Illinois Futures Commission Merchant Deemed A "Bank" Under Article 4A. *Whitaker v. Wedbush Secs, Inc.*, 2020 IL 124792 (2020) (Kilbride, J.).

Brief Summary: *Whitaker* arose from fraudulent wire transfer requests "sent by a third-party who had hacked [plaintiff Dr. Whitaker's[2]] email account" to defendant commodities futures merchant, Wedbush Securities. *Whitaker*, 2020 IL 124792 at ¶5. "Defendant held plaintiffs' funds in customer segregated accounts at BMO Harris Bank … [and] … BMO Harris provided an online portal for defendant to process wire transfers for its customers." *Id* at ¶4. "Defendant used the online portal to transmit each of the four [fraudulent] wire transfer requests [totaling $374,960] to BMO Harris for execution." *Id* at ¶6[3]. "After defendant refused plaintiffs' demand for return of the transferred funds, plaintiffs filed suit, asserting claims of fraudulent concealment and seeking a refund of the transferred funds under article 4A of the UCC (810 ILCS 5/4A-101 et seq…" *Id* at ¶ 8.[4] "The claims based on article 4A proceeded to a bench trial …. [and] …. the circuit court entered judgment for defendant … stating [that] the evidence did not establish that defendant operated as a 'bank' under the definition of that term in article 4A (810 ILCS 5/4A – 105(a)(2) …)." *Id* at ¶9. The Appellate Court affirmed, holding that "plaintiffs failed to prove … that defendant was a bank, as required to establish their claim under … [,] article 4A." *Id* at ¶11. "[P]rior to this case, no Illinois court ha[d] addressed what it means to be 'engaged in the business of banking' under article 4A, and … [no] … Illinois decision [had] constru[ed] the definition of the term 'bank' in section 4A-105(a)(2)." *Id* at ¶ 19. The Illinois Supreme Court reversed, holding that defendant fell within "the definition of a bank in article 4A," *Id* at ¶¶ 35,

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[2] There were two plaintiffs in *Whitaker*: Dr. James Q. Whitaker, who was replaced by the executor of his estate after he died during the litigation, and Pathology Institute of Middle Georgia, P.C., which was "owned and controlled" by Dr. Whitaker. *Id* at ¶3 and n.1.

[3] The fraudulent requests directed the "wire transfer of funds to an account purportedly held by plaintiff the Pathology Institute of Middle Georgia at a bank in Poland." *Id* at ¶6.

[4] The first "a" in "article 4A" is typically lower case in the Court's opinion and therefore that is the convention used here unless grammar rules or the text of a different authority, such as the Comments to the Illinois U.C.C., provide otherwise.

36, and remanded the case to the trial court to determine whether plaintiff could prove other elements necessary for recovery under article 4A. *Id* at ¶40.

Why *Whitaker* Matters: It is important for any financial institution that offers wire transfer services, whether or not it also offers checking services or other traditional banking services or otherwise is traditionally considered a "bank," to understand *Whitaker*. *Whitaker* sets forth the analysis for determining whether such an entity is a "bank" within the meaning of article 4A, which in turn may dictate such entity's rights in the event of a dispute regarding funds transfers.[5]

Key Points:

1. "The drafters of [article 4A] sought to create a legal framework to balance the rights and obligations between a bank and its institutional customers when completing funds transfers." *Id* at ¶18.

2. Relevant [here] … article 4A balances the risk involved if a third party steals a customer's identity and issues a fraudulent payment order to a bank.… A bank is generally required to refund amounts lost through unauthorized payment orders. See 810 ILCS 5/4A – 204(a) (West 2014) …. [But] [w]hile the bank generally bears the risk in this situation, article 4A provides a means for the bank to protect itself from liability and shift the risk of loss to the customer…" if certain requirements are satisfied. *Id* at ¶18 (citations omitted except to sections of 810 ILCS 5/4A).

3. 810 ILCS § 5/4A-105(a)(2) provides that for purposes of article 4A "bank" means "a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this Article.'" 810 ILCS 5/4A-105(a)(2). Comment 1 states in relevant part: "The definition of 'bank' in subsection (a)(2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers." 810 ILCS 5/4A-105, Comment 1; *see also*, *Whitaker*, 2020 IL 124792 at ¶¶ 19, 32.

4. "[A]rticle 4A does not apply to every party making a funds transfer"; it is "confined to *financial institutions* that meet the definition of a bank in section 4A-105." *Id* at ¶ 32 (emphasis in original)

5. Whether or not a "financial institution" offers checking services is not dispositive of whether that institution is a "bank" under article 4A; the court rejected defendant's argument that it could not be considered a bank because it did not offer checking services. *Id* at ¶¶ 25-30.

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[5] The funds transfers that fall within the scope of article 4A are enumerated in 810 ILCS §§ 5/4A-102, 4A-104, 4A-108. The discussion in this *Update* is concerned with *Whitaker's* holding regarding the definition of "bank" under article 4A and not with other aspects of article 4A.

6. Further, "the definition of a bank in article 4A is certainly not precise and it must be applied based on the specific facts of a given case.":

a. "article 4A does *not* apply to every person or entity that processes a funds transfer"

b. "the definition ordinarily would not include law firms, title companies, or similar entities unless the organization may fairly be considered a financial institution providing wholesale wire transfers."

c. But "courts have consistently held mutual fund companies, brokerage firms, and insurance companies may fall within the definition of a bank under articles 3, 4, and 4A."

Id at ¶ 34, 35 (emphasis in original).

7. Another boundary of article 4A is that it is "limit[ed] … to payment made through the banking system," which in turn "typically involve[s] very large amounts of money," while "[a] transfer of funds made by an entity outside the banking system is excluded." 810 ILCS 5/4A-104, UCC Comment 2; *see also*, *Whitaker*, 2020 IL 124792 at ¶ 33 ("Article 4A was intended to govern '[w]holesale wire transfers' typically involving 'very large amounts of money,' not ['… transfer[s] of funds through an entity other than a bank that are usually …'] consumer-based transactions involving 'relatively small amounts of money and a single contract.' 810 ILCS 5/4A-104, UCC Comment 2, at 537 (Smith-Hurd 2014).").

8. Here, "the undisputed evidence shows defendant meets the definition of a bank in article 4A":

a. "defendant is a financial institution": "defendant … is a registered futures commission merchant," is also a "registered as a broker-dealer" and the predecessor entity that held plaintiffs' accounts "sent a letter … stating defendant was a 'leading financial services company' that offered a variety of services, including brokerage and trading services";

b. "defendant processed four unauthorized wire transfers out of plaintiffs' trading accounts over the course of less than two weeks totaling $374,960 …."

c. "defendant [also] regularly assisted its customers in processing funds transfers… [a] current and a former employee both testified they processed 15 to 20 wire transfer requests per day on average… [and] [a]nother former employee was asked if she recalled working on any wire transfer requests to Poland … and … replied that … '[b]ecause of volume, I don't remember locations.'"

Id at ¶¶ 35, 36; *see generally*, ¶¶ 19-37.

Review In Depth:

1. "Article 4A of the UCC was drafted in 1989 to address a dramatic increase in wholesale wire transfers between financial institutions and other commercial entities…. The drafters sought to

create a legal framework to balance the rights and obligations between a bank and its institutional customers when completing funds transfers." *Id* at ¶17(citations omitted).

2. Among other things, "article 4A balances the risk involved if a third party steals a customer's identity and issues a fraudulent payment order to a bank.… A bank is generally required to refund amounts lost through unauthorized payment orders. See 810 ILCS 5/4A – 204(a) (West 2014) (requiring bank to refund payment plus interest when it accepts an unauthorized payment order). While the bank generally bears the risk in this situation, article 4A provides a means for the bank to protect itself from liability and shift the risk of loss to the customer. Specifically, under section 4A-202, the customer bears the risk of loss from an unauthorized payment order if (1) the bank and its customer have agreed to implement a commercially reasonable security procedure to protect against unauthorized payment orders and (2) the bank accepts the payment order in good faith and in compliance with the parties' security procedure and any written instructions from the customer restricting acceptance of payment orders. 810 ILCS 5/4A – 202(b)…." *Id* at ¶18 (citations omitted except to sections of 810 ILCS 5/4A).

3. § 5/4A-105(a)(2) provides that for purposes of article 4A "'bank" means "a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this Article.'" 810 ILCS 5/4A-105(a)(2). Comment 1 states in relevant part: "The definition of 'bank' in subsection (a)(2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers." 810 ILCS 5/4A – 105, Comment 1; *see also Whitaker*, 2020 IL 124792 at ¶¶19, 32.

4. Article 4A is "limit[ed] … to payment made through the banking system," which in turn "typically involve[s] very large amounts of money," while "[a] transfer of funds made by an entity outside the banking system is excluded." 810 ILCS 5/4A-104, UCC Comment 2; *see also*, *Whitaker*, 2020 IL 124792 at ¶ 33. ("Article 4A was intended to govern '[w]holesale wire transfers' typically involving 'very large amounts of money,' not ['… transfer[s] of funds through an entity other than a bank that are usually …'] consumer-based transactions involving 'relatively small amounts of money and a single contract.' 810 ILCS 5/4A-104, UCC Comment 2, at 537 (Smith-Hurd 2014).").

5. Relying upon *Gold v. Merrill Lynch & Co.*, 2009 U.S. Dist. LEXIS 61719 (D. Ariz. July 14, 2009) and *Covina 2000 Ventures Corp. v. Merrill Lynch*, 2008 U.S. Dist. LEXIS 32799 (S.D.N.Y. Apr. 21, 2008), *affirmed*, *Ma v. Merrill, Lynch,* 597 F.3d 84 (2nd Cir. 2010) – in both of which Merrill, Lynch was held to be a bank within the meaning of article 4A – and the text of article 4A and the commentary thereto, the Court held that "[b]ased on the evidence … defendant is a financial institution acting on behalf of its customers in funds transfers … [and] … [g]iven the specific circumstances of this case, defendant meets the definition of a bank under article 4A," *id* at ¶¶ 35, 37 and generally ¶¶ 19-37:

a. "…courts have construed the term 'bank' in article 4A liberally to promote the purposes and policies of the UCC," *id* at ¶37 (citations omitted)

b. "…the analysis in *Gold, Covina*, and *Ma* [, *supra*,] is persuasive when considering whether defendant is a bank within the meaning of article 4A. As in *Gold*, plaintiffs here rely on the official comment to section 4A-105 … [which] … states, in pertinent part, that the term 'bank' 'includes some institutions that are not commercial banks' and that '[t]he definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers.' 810 ILCS Ann. 5/4A-105, UCC Comment 1, at 541 (Smith-Hurd 2014)." *Id* at ¶33.

c. Courts have consistently held mutual fund companies, brokerage firms, and insurance companies may fall within the definition of a bank under the UCC, *Id* at ¶32;

d. "Defendant state[d] [that] it is a registered futures commission merchant. Prior to trial, defendant's attorney stipulated that defendant is also registered as a broker-dealer," *Id* at ¶35;

e. "When KCG Futures sold plaintiffs' accounts to defendant, KCG Futures sent a letter to plaintiff account holder stating defendant was a 'leading financial services company' that offered a variety of services, including brokerage and trading services. It is clear that defendant is a financial institution." *Id*.

f. "Additionally, the undisputed evidence shows defendant processed four unauthorized wire transfers out of plaintiffs' trading accounts over the course of less than two weeks totaling $374,960" and that "defendant regularly assisted its customers in processing funds transfers …. [a] current and a former employee both testified they processed 15 to 20 wire transfer requests per day on average … [and] …. [a]nother former employee … [could not recall if she] work[ed] on any wire transfer requests to Poland[,] [stating that] … '[b]ecause of volume, I don't remember locations'." *Id* at ¶ 36.

Id at ¶¶ 19-37.

6. The court rejected defendant's argument that "it cannot be a bank within the meaning of article 4A because there was no admissible evidence before the trial court showing it provided its customers with checking services,":

a. The Court distinguished decisions under articles 3 and 4 of the UCC that held various entities to be banks because they provided checking services. Such cases, the Court stated, "generally address[ed] disputes involving checking services" and it therefore was "not surprising that they focused on that activity in determining whether a defendant was a bank within the context of articles 3 and 4…." The court did "not believe those cases intended to limit the definition of a bank under the UCC strictly to institutions offering checking services." Id at ¶¶ 25-29.

b. "More importantly, the language of article 4A does not support an interpretation that offering checking services is necessary to meet the definition of a bank. If the legislature had intended to limit the definition of a bank to financial institutions providing checking

> services, it could have easily done so. The legislature did not enact the statute with a provision requiring checking services to meet the definition of a bank, however, and we cannot add provisions or limitations not expressed by the legislature." *Id* at ¶ 30

7. The court also rejected defendant's argument "that plaintiffs seek to rewrite the definition of a bank to apply to anyone who processes a funds transfer": "We find the official comments to section 4A-105 clarify that the definition of a bank operates to narrow the application of article 4A to financial institutions. See 810 ILCS Ann. 5/4A-105, UCC Comment 1, at 541 (Smith-Hurd 2014) (stating '[t]he definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks'). Thus, article 4A does not apply to every party making a funds transfer. Rather, it is confined to *financial institutions* that meet the definition of a bank in section 4A-105. The definition of a bank is not superfluous under a construction of the statute including financial institutions within its scope…. Significantly, in the cases cited by defendants and the appellate court, different types of financial institutions, including mutual fund companies, brokerage firms, and insurance companies, were considered banks within the meaning of the UCC." *Id* at ¶¶ 31, 32 (citations omitted except to 810 ILCS Ann. 5/4A – 105).

8. The court "recognize[d] that the definition of a bank in article 4A is certainly not precise and it must be applied based on the specific facts of a given case" and "emphasize[d] … that article 4A does *not* apply to every person or entity that processes a funds transfer…. the definition ordinarily would not include law firms, title companies, or similar entities unless the organization may fairly be considered a financial institution providing wholesale wire transfers." *Id* at ¶ 34 (emphasis in original).