Nos. 23-1148 & 23-1766

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

STUDCO BUILDING SYSTEMS US, LLC,

Plaintiff-Appellee.

v.

1ST ADVANTAGE FEDERAL CREDIT UNION,

Defendant-Appellant,

On Appeal from the United States District Court
for the Eastern District of Virginia, No. 2:20-cv-00417-RAJ-LRL
Before the Honorable Judge Raymond A. Jackson

BRIEF FOR AMICI CURIAE THE CLEARING HOUSE ASSOCIATION L.L.C. AND NACHA IN SUPPORT OF DEFENDANT-APPELLANT 1ST ADVANTAGE CREDIT UNION SEEKING REVERSAL

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October 17, 2023

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

DISCLOSURE STATEMENT

- In civil, agency, bankruptcy, and mandamus cases, a disclosure statement must be filed by **all** parties, with the following exceptions: (1) the United States is not required to file a disclosure statement; (2) an indigent party is not required to file a disclosure statement; and (3) a state or local government is not required to file a disclosure statement in pro se cases. (All parties to the action in the district court are considered parties to a mandamus case.)
- In criminal and post-conviction cases, a corporate defendant must file a disclosure statement.
- In criminal cases, the United States must file a disclosure statement if there was an organizational victim of the alleged criminal activity. (See question 7.)
- Any corporate amicus curiae must file a disclosure statement.
- Counsel has a continuing duty to update the disclosure statement.

No. 23-1148 Caption: Studco Building Systems US, LLC v. 1st Advantage Federal Credit Union

Pursuant to FRAP 26.1 and Local Rule 26.1,

The Clearing House Association L.L.C.
(name of party/amicus)

who is amicus, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐YES ☑NO

2. Does party/amicus have any parent corporations? ☐YES ☑NO
If yes, identify all parent corporations, including all generations of parent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐YES ☑NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation? ☐YES ☑NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐YES ☐NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐YES ☑NO
If yes, the debtor, the trustee, or the appellant (if neither the debtor nor the trustee is a party) must list (1) the members of any creditors' committee, (2) each debtor (if not in the caption), and (3) if a debtor is a corporation, the parent corporation and any publicly held corporation that owns 10% or more of the stock of the debtor.

7. Is this a criminal case in which there was an organizational victim? ☐YES ☑NO
If yes, the United States, absent good cause shown, must list (1) each organizational victim of the criminal activity and (2) if an organizational victim is a corporation, the parent corporation and any publicly held corporation that owns 10% or more of the stock of victim, to the extent that information can be obtained through due diligence.

Signature: /s/ Noah Levine Date: 10/17/2023

Counsel for: TCH L.L.C.

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UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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No. 23-1148 Caption: Studco Building Systems US, LLC v.1st Advantage Federal Credit Union

Pursuant to FRAP 26.1 and Local Rule 26.1,

Nacha
(name of party/amicus)

who is amicus, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐YES ☑NO

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Signature: /s/ Noah Levine Date: 10/17/2023

Counsel for: Nacha

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INTEREST OF AMICI CURIAE[1]

The Clearing House Association L.L.C. (the "Association"), the oldest banking association in the United States, has worked to improve the reliability and efficiency of the nation's financial system since 1853. Its sister company, The Clearing House Payments Company L.L.C., operates four payment systems that clear and settle more than $2 trillion of payments every business day.

Nacha governs the ACH Network, a payment system with the capacity to reach all United States bank and credit union accounts. In 2022, there were 30 billion ACH Network payments, valued at nearly $77 trillion. Nacha also writes rules defining the roles and responsibilities of ACH Network participants, ensuring that millions of payments occur smoothly and reliably each day.

The Association and Nacha participate as amici curiae in cases that are important to the payments industry. This brief provides perspective on the interplay between Article 4A of the Uniform Commercial Code and banks' other statutory and regulatory duties, showing how the district court's ruling disrupts

[1] Pursuant to Fed. R. App. P. 29(a)(4)(E), amici state that no party's counsel authored this brief in whole or in part, no party or party's counsel contributed funding to the preparation or submission of this brief, and that no person other than amici and their counsel contributed funding to the preparation or submission of this brief. All parties have consented to the filing of this brief.

Article 4A's framework and jeopardizes the day-to-day feasibility of the nation's funds-transfer systems.

INTRODUCTION AND SUMMARY OF ARGUMENT

Article 4A establishes an end-to-end set of rules governing the commercial payment known as a funds transfer.[2] Funds transfers are, as a payment method, unique. "The typical funds transfer involves a large amount of money." U.C.C. Art. 4A Refs. & Annos. prefatory note; *see id.* ("Multimillion dollar transactions are commonplace."). The parties to a funds transfer are usually "sophisticated business or financial organizations," and funds transfers are conducted at rapid speed. *Id.* "Most funds transfers are completed on the same day, even in complex transactions in which there are several intermediary banks in the transmission chain." *Id*. Finally, as compared to other payment mechanisms, funds transfers also offer astounding affordability. "A transfer that involves many millions of dollars can be made for a price of a few dollars." *Id.*

These sui generis features raise special considerations when it comes to allocating risk of loss. For example, "[b]ecause the dollar amounts involved in

[2] The payment at issue in this case was a commercial ACH funds transfer, which falls under Article 4A's purview. *See* U.C.C. Art. 4A Refs. & Annos. prefatory note. Most payments processed via ACH are not covered by Article 4A—they are consumer payments governed by other statutes and not implicated by the legal rules discussed here. *See id.*

funds transfers are so large, the risk of loss if something goes wrong in a transaction may also be very large." U.C.C. Art. 4A Refs. & Annos. prefatory note. And because "[t]he primary purpose of using a [funds transfer] is to enable the beneficiary to get the funds quickly," *Corfan Banco Asuncion Paraguay v. Ocean Bank*, 715 So. 2d 967, 972 (Fla. Dist. Ct. App. 1998) (Nesbitt, J., dissenting), straight-through processing and finality are paramount.

Despite the unique characteristics and high stakes of funds transfers, there was "no comprehensive body of law" defining their attendant "rights and obligations" until Article 4A. U.C.C. Art. 4A Refs. & Annos. prefatory note. Courts were left to apply haphazard, inconsistent, state-by-state liability regimes to fill gaps, producing a "great deal of uncertainty." *Id.* As the drafters said in the 1980s, "Article 4A is intended to provide the comprehensive body of law that we do not have today." *Id.* Article 4A thus provides "a set of model rules governing commercial dealings, with the twin aims of providing efficiency and uniformity." *Goodman v. Commercial Bank & Tr. Co.*, 72 F.4th 122, 125 (6th Cir. 2023); *Patco Constr. Co. v. People's United Bank*, 684 F.3d 197, 207 (1st Cir. 2012) (Article 4A was developed to "deliver clarity" to the law governing "commercial ACH transfers"). This careful framework provides certainty and finality by assigning responsibilities, allocating risks, and defining exposure. Article 4A was rapidly adopted by all 50 States and the District of Columbia.

To advance Article 4A's goals, the statute states explicitly that "resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article." Va. Code §8.4A-102 (official comment) (Virginia's codification of Article 4A). Armed with clear rights, obligations, and liabilities, banks craft procedures to facilitate high-volume, seamless funds transfers on a daily basis—exactly as Article 4A's drafters intended. The district court's order threatens to upend this meticulously constructed framework.

A brief primer on some of Article 4A's key terms sets the stage for a discussion of the district court's errors:

- A "[f]unds transfer" is a series of distinct payment orders, beginning with the originator's payment order to its bank and ending with the beneficiary bank's acceptance of a similar but separate payment order for the benefit of the beneficiary. Va. Code §8.4A-104(a).
- The "[o]riginator" is "the sender of the first payment order in a funds transfer." *Id.* §8.4A-104(c). Here, that was Studco.
- The "[o]riginator's bank" is the "bank to which the payment order of the originator is issued[.]" *Id.* §8.4A-104(d). That was Studco's bank.

- The "[b]eneficiary's bank" is "the bank identified in a payment order in which an account of the beneficiary is to be credited[.]" *Id.* §8.4A-103(a)(3). That was 1st Advantage Federal Credit Union.[3]
- A "[p]ayment order" is "an instruction of a sender to a receiving bank … to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary[.]" *Id.* §8.4A-103(a)(1). There were multiple payment orders in this case, none between Studco and 1st Advantage. First, Studco issued a payment order to its own bank. Then, to carry out Studco's instruction, Studco's bank issued a new payment order to an intermediary bank—not 1st Advantage. That intermediary bank, in turn, sent another payment order to 1st Advantage.[4]
- The "[b]eneficiary" is "the person to be paid by the beneficiary's bank." *Id.* §8.4A-103(a)(2). A "beneficiary," in Article 4A parlance, may not be the person whom the originator *intends* to pay. Rather, as a general rule,

[3] While 1st Advantage is organized as a credit union, it is a "[b]ank" as defined in Article 4A and therefore we refer to it as such throughout the brief. Va. Code §8.4A-105(a)(2).

[4] It is evident there was at least one intermediary bank involved in these funds transfers (namely, a Federal Reserve Bank) because the record reflects 1st Advantage received the ACH transfers in question from the "federal reserve." Dist. Ct. Dkt. 63 at 23; *see* Federal Reserve Bank, Operating Circular No. 4, §3.2 (Sept. 18, 2023) (provision not changed from that in effect in 2018).

> the "beneficiary" is the person whose account is identified as the beneficiary's account in the originator's payment order.[5] Here, the beneficiary was a person whose account appears to have been used by a fraudster.

The district court erroneously held 1st Advantage (the beneficiary's bank) liable for a fraud perpetrated by an outside party on Studco (the originator). That flouts Article 4A's liability regime, under which the duties of a beneficiary's bank run only to those with whom it is in privity through the receipt of a payment order; the beneficiary's bank has no duties to the sender of a prior payment order (as Studco was here). Further, under Article 4A, a beneficiary's bank is potentially liable only when it has actual knowledge that a payment order misdescribes a beneficiary and such liability runs only to the party that sent the payment order to the beneficiary's bank, which generally is not, and in this case was not, the originator.[6] Finally, Article 4A displaces common-law obligations like bailment in favor of a unitary framework whose predictability and prudent allocation of risk facilitates nationwide commerce.

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[5] Exceptions to this rule do not apply in this case.

[6] It is possible for a bank to hold accounts for both the originator and the beneficiary, which might require a different analysis, but that is not the case here.

Funds transfers are high-volume operations that accomplish their critical aims at exceptionally low cost due to clear and carefully defined rules limiting the potential liability of banks that act as delineated by the statute. The district court's opinion muddles these rules, uncaps banks' liability, and threatens the efficiency of all U.S. funds-transfer systems—not just the ACH networks—to the detriment of every economic participant, down to the consumer. The judgment should be reversed.

ARGUMENT

I. THE DISTRICT COURT ERRED IN FINDING FOR STUDCO UNDER 4A-207

A. The District Court Erred By Ignoring Article 4A's Privity Requirement

As described above, Article 4A establishes an end-to-end ruleset for commercial ACH funds transfers pursuant to a privity principle that provides liability only between adjacent parties in the chain of payment orders that make up a funds transfer. *See, e.g.*, *Grain Traders, Inc. v. Citibank, N.A.*, 160 F.3d 97, 102 (2d Cir. 1998) (Article 4A's privity limitation "allows each sender of a payment order to seek refund only from the receiving bank it paid"). The district court ignored this privity requirement—with serious consequence. "To allow a party to, in effect, skip over the bank with which it dealt directly, and go to the next bank in the chain would result in uncertainty as to rights and liabilities, would create a risk

of multiple or inconsistent liabilities." *Id.* In line with the privity principle, Article 4A's provisions relating to misdescribed beneficiaries limit recovery in critical ways. For example, under Section 4A-207, "if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered [by the originator] from *that person* to the extent allowed by the law governing mistake and restitution[.]" Va. Code §8.4A-207(d) (emphasis added). The disappointed originator has recourse under common law against the person paid—but not against the bank that paid that person (i.e., the beneficiary's bank) based upon a payment order the bank received. This carefully constructed allocation of loss reflects both the precision of Article 4A's liability regime and the centrality of privity to that framework.

Studco's Article 4A claim fails as a matter of law because Studco was never in privity with 1st Advantage, via payment order or otherwise. For this reason, Studco may not recover from 1st Advantage under any Article 4A claim. *See* Va. Code §§8.4A-207(b)(2), 8.4A-204(a). Under similar circumstances, courts routinely dismiss misdescribed-beneficiary claims for lack of privity. *See, e.g.*, *Approved Mortg. Corp. v. Truist Bank*, 638 F. Supp. 3d 941, 951 (S.D. Ind. 2022) (Section 4A-207's rule directing "each party in the chain of transactions to recover from only the next party in line" "provides certainty as to each party's rights and

liabilities and prevents multiple and potentially inconsistent liabilities"), *appeal pending*, No. 22-3163 (7th Cir.); *Scura, Wigfield, Heyer, Stevens & Cammarota, LLP v. Citibank, NA*, 2022 WL 16706948, at *6 (D.N.J. Oct. 3, 2022) (dismissing Section 4A-207 claim for lack of privity); *Frankel-Ross v. Congregation OHR Hatalmud*, 2016 WL 4939074, at *3 (S.D.N.Y. Sept. 12, 2016) (same). The district court's opinion disrupts Article 4A's scheme of recovery and the certainty of each party's rights and liabilities for funds transfers.

B. Section 4A-207 Imposes An Actual Knowledge Standard

Section 4A-207 furthers the broader purposes of Article 4A by establishing clear liability rules regarding a misdescription of a beneficiary. *See* Va. Code §8.4A-207 cmt. 2 ("The [pre-4A] case law is unclear on the responsibility of a beneficiary's bank in carrying out a payment order in which the identification of the beneficiary by name and number is conflicting. … Section 4A-207 resolves the issue."). Section 4A-207(b)(1) allows a beneficiary's bank to "rely on the [bank account] number as the proper identification of the beneficiary of the order" if "the beneficiary's bank does not know that the name and number refer to different persons." Critically, "[t]he beneficiary's bank need not determine whether the name and number refer to the same person." *Id*. §8.4A-207(b)(1); *see id.* §8.4A-207 cmt. 2 ("[b]eneficiary's [b]ank has no duty to determine whether there is a

conflict, and it may rely on the number as the proper identification of the beneficiary of the order").

In Section 4A-207, the drafters made a calculated policy choice to facilitate efficient, automatic processing of payment orders rather than requiring fraud or error detection by a beneficiary's bank when it receives a payment order. *See* Va. Code §8.4A-207 cmt. 2 ("[I]f a duty to make that determination is imposed on the beneficiary's bank the benefits of automated payment are lost."). Automated processing is critical to the flow of commerce in the United States. In 2022 alone, there were 4.2 billion business-to-business ACH credit entries. As intended by Article 4A's drafters, it is the normal course for beneficiary banks to rely only on an account number because banks do not typically know offhand about conflicts between the name on an account and the number.

Even if banks tried to match the beneficiary's name on a payment order with the name related to the account number stated in the order, there would frequently be innocuous mismatches. ACH entries only allow 17 characters for a beneficiary's name; thus, many names are truncated or abbreviated in ACH entries. Names may mismatch due to the presence or absence of initials, middle names, or suffixes. Commonly, accounts are owned by more than one person but only one is named in the payment order; similarly, it is unexceptional for a legitimate business to be known by a name that is different from its legal name. Making beneficiary

banks responsible for adjudicating the suspiciousness of a mismatch would massively delay payments. Alternatively, to avoid time-consuming and resource-intensive investigation, beneficiary banks might simply reject many legitimate payment orders because the cost of resolving discrepancies and the potential liability for a misjudgment would be untenable. These practicalities illustrate why Article 4A's choice to allow beneficiary banks to rely on account numbers is crucial to protect.

Only when the beneficiary's bank "*knows* that the name and number identify different persons" is there potential recourse against that bank under Article 4A. Va. Code §8.4A-207(b)(2) (emphasis added). Importantly, the word "knows" means "actual knowledge." *Id.* §8.1A-202(b). The district court's opinion recites the correct definition of "knows," *see* JA572 ¶5 ("'Know' means actual knowledge"), but then misapplies the standard, contrary to its own definition, to be one of constructive knowledge. For that erroneous conclusion, the court relies heavily on a section of the Uniform Commercial Code identifying the *time* from which notice or knowledge is deemed to run. JA572-573 ¶¶5-6. Section 1-202(f) of Article 1 states that "[n]otice, knowledge, or a notice or notification received by an organization is effective for a particular transaction from the time it is brought to the attention of the individual conducting that transaction and, in any event, from the time it would have been brought to the individual's attention if the

organization had exercised due diligence." Va. Code §8.1A-202(f). This provision concerns *when* an organization is put on notice or receives knowledge—not what notice or knowledge requires. *See id*. §8.1A-202 cmt. 3 (subsection (f) "makes clear" that notice or knowledge is effective "only from the time" specified in the subsection).

The words "notice" and "knowledge" are not synonymous under the Virginia Code. *See* Va. Code §8.1A-202(a) ("a person has 'notice' of a fact if the person: (1) has actual knowledge of it; (2) has received a notice or notification of it; or (3) from all the facts and circumstances known to the person at the time in question, has reason to know that it exists"). The portion of this section referring to "the time [the information] would have been brought to the individual's attention if the organization had exercised due diligence" can refer only to "[n]otice"—not "knowledge"—because actual knowledge means that one has "subjectively recognized" the information. *Parrish ex rel. Lee v. Cleveland*, 372 F.3d 294, 303 (4th Cir. 2004). It is not enough that someone "*should have* recognized it; they actually must have perceived [it]." *Id.*; *see also Cook v. Jones*, 606 F. App'x 131, 132 (4th Cir. 2015) (per curiam) ("Constructive notice is insufficient to show actual knowledge"); *cf. J.W. Woolard Mech. & Plumbing, Inc. v. Jones Dev. Corp.*, 367 S.E.2d 501, 504 (Va. 1988) (contrasting "the objective requirement of 'notice'" with "the more subjective requirement of 'actual

knowledge'"). Courts addressing Section 4A-207 have made clear that "[d]ata stored in a computer system does not constitute actual knowledge, even if inspection of the data would have revealed a misdescription." *Langston & Langston, PLLC v. SunTrust Bank*, 480 F. Supp. 3d 737, 744 (S.D. Miss. 2020); *Squeeze Me Once, LLC v. SunTrust Bank*, 630 F. Supp. 3d 763, 774 (M.D. La. 2022) (same); *see also Peter E. Shapiro, P.A. v. Wells Fargo Bank N.A.*, 795 F. App'x 741, 749 (11th Cir. 2019) (per curiam) (no actual knowledge of a potential name mismatch where bank screener "reviewed only the original payment order (and not the information generated by [a separate] audit trail)").

Even if 1st Advantage was required to conduct due diligence at peril of an actual knowledge finding—it was not—there was no finding that 1st Advantage failed to satisfy the due diligence requirements of Article 4A. Va. Code §8.1A-202(f) states:

> An organization exercises due diligence if it maintains reasonable routines for communicating significant information *to the person conducting the transaction* and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

(Emphasis added.) This provision creates a minimum obligation for a company to keep its representatives aware of information material to their commercial

dealings. Critically, an obligation to communicate information does not arise unless and until the knower "has reason to know *of the transaction*" that would be materially affected by the information or such communication is part of the individual's regular duties. *Id.* (emphasis added). This final sentence significantly limits when internal communication would be required.

C. The District Court Erred In Treating A Bank's KYC/BSA/AML Compliance As Relevant To A Private Party's Article 4A Claims

The absence of an Article 4A obligation to check the description of a beneficiary in a payment order does not mean that banks can onboard customers and process funds transfers however they choose, without fear of consequence. Weighty government-facing obligations under the Bank Secrecy Act ("BSA") and other anti-money laundering ("AML") laws, including know-your-customer ("KYC") obligations, ensure that banks undertake due diligence throughout the funds transfer process. As described below, the problem in this case is that the district court imported those BSA/AML obligations into a (nonexistent) constructive knowledge requirement under Article 4A, creating a dangerous precedent.

The district court erred as a matter of law when it read the general requirement under Va. Code §8.1A-202(f) that the representatives of an organization be informed of pertinent, significant information to be an element of

actual knowledge—one that somehow creates an obligation for beneficiary banks to integrate all their various BSA/AML/KYC processes with their funds-transfer processing systems to ensure that the names and account numbers of beneficiaries of funds transfers match.

BSA/AML law makes banks accountable *to the government* for establishing risk-based compliance programs that are designed to prevent misuse of the financial system. A bank's KYC obligations are not a feature of Article 4A; they stem from the BSA and its implementing regulations. *See* 31 C.F.R. part 1020 (detailing requirements for bank customer information programs).

From their inception, KYC obligations have been understood to run from banks to the government—not from banks to customers (or noncustomers, as in this case) to vindicate private liabilities. *See* Lumsden, *The Future Is Mobile: Financial Inclusion and Technological Innovation in the Emerging World*, 23 Stan. J.L. Bus. & Fin. 1, 20 (2018) ("The purpose of KYC is to prevent banks from becoming vehicles for criminal activities."). Indeed, because "a defendant's liability for failure to comply is to the United States government, … courts are unanimous in holding that there is no private right of action under the BSA or Patriot Act." *Venture Gen. Agency, LLC v. Wells Fargo Bank, N.A.*, 2019 WL 3503109, at *7 (N.D. Cal. Aug. 1, 2019); *see also Ray v. First Nat'l Bank of Omaha*, 413 F. App'x 427, 430 (3d Cir. 2011) (per curiam) ("courts that have

considered the question have concluded that the Patriot Act does not provide for a private right of action for its enforcement"); *AmSouth Bank v. Dale*, 386 F.3d 763, 777 (6th Cir. 2004) ("the Bank Secrecy Act does not create a private right of action"). "Further, as there is no private right of action, there can be no duty of care arising out of the BSA's monitoring requirements." *Venture Gen. Agency*, 2019 WL 3503109, at *7; *In re Agape*, 681 F. Supp. 2d 352, 360-361 (E.D.N.Y. 2010) ("because the Bank Secrecy Act does not create a private right of action, the Court can perceive no sound reason to recognize a duty of care that is predicated upon the statute's monitoring requirements"); *Marlin v. Moody Nat'l Bank, N.A.*, 2006 WL 2382325, at *7 (S.D. Tex. Aug. 16, 2006) ("The obligation under [the BSA] is to the government rather than some remote victim. The [bank's] obligation is not to roam through its customers looking for crooks and terrorists. By that act, banks do not become guarantors of the integrity of the deals of their customers. It does not create a private right of action and, therefore, does not establish a standard of care."), *aff'd*, 248 F. App'x 534 (5th Cir. 2007).

1. KYC procedures

As described above, Article 4A establishes obligations and allocates risk among parties to a funds transfer. Nothing in Article 4A makes a bank liable for failures in its KYC and account-opening procedures.[7]

While the district court may have doubted the sufficiency of 1st Advantage's oversight over the beneficiary's account, a bank's KYC compliance is a matter of distinct regulatory guidance and supervisory consequence, not a matter for which 1st Advantage can be made liable to a private party under Article 4A. *See Gaswint v. Primerica Life Ins. Co*., 2023 WL 4560906, at *4 (W.D. Wash. July 17, 2023) ("Since there is no private right of action, there can be no duty of care arising out of the Bank Secrecy Act's 'know your customer' provision."); *see also Public Serv. Co. of Okla. v. A Plus, Inc.*, 2011 WL 3329181, at *8 (W.D. Okla. Aug. 2, 2011) ("Courts have repeatedly rejected negligence claims based on a bank's duty

[7] In any event, as a matter of law, negligence at account opening, including a bank's performance of its KYC obligations, is not expressly addressed in Article 4A and would need to be asserted as a separate, common-law claim. Courts differ on whether these types of claims are displaced by Article 4A's scope. This Court has permitted such common-law claims in *Eisenberg v. Wachovia Bank, N.A.*, holding that Article 4A "has no application to [the bank's] conduct" in "allowing [a fraudster] to open [a suspicious] bank account, failing to discover [his] improper use of the account and failing to train its employees to recognize and prevent fraud." 301 F.3d 220, 224 (4th Cir. 2002); *and Nirav Ingredients, Inc. v. Wells Fargo Bank, N.A.*, 516 F. Supp. 3d 535, 540 (W.D.N.C. 2021) ("claims regarding the opening and management of fake accounts will not be preempted" by Article 4A), *aff'd*, 2022 WL 3334626 (4th Cir. Aug. 12, 2022).

arising under the [Bank Secrecy] Act, concluding a bank's duty created by the Act is owed *only* to the government and not to private parties.").

It was error for the district court to find that discrepancies in information used for KYC at account opening gave 1st Advantage constructive knowledge somehow sufficient to confer Article 4A liability at the much later time, and in the different context, of a subsequent funds transfer.

2. Ongoing failure to detect money laundering risks

The district court also erroneously supported its determination of Article 4A liability with findings about the bank's failure to monitor ongoing BSA/AML alerts.

"FCRM," the district court acknowledged, is "anti-money laundering software" used "[t]o comply with BSA requirements." JA558 ¶33. But, according to the district court, "1st Advantage did not act in a commercially reasonable manner when they failed to take an active role in determining the thresholds for the alerts in the [FCRM] rules"; specifically, "1st Advantage did not change the pre-programmed rules in FCRM." JA580.

Nothing in Article 4A makes a bank liable for undertaking an insufficiently hands-on approach to its BSA/AML compliance software. The district court should not have imported its perception that 1st Advantage's AML program was

weak into its analysis of whether the bank had requisite knowledge of a specific funds transfer's misdescription under Section 4A-207.

Similarly, the district court faulted 1st Advantage under Article 4A for not catching "textbook money laundering practices," specifically the "types of withdrawals [the customer] used" and the "textbook pattern of 'high turnover' and 'pass through' accounts." JA580. And the district court criticized 1st Advantage for failing to monitor "DataSafe reports" or develop a "system … to escalate pertinent alerts[.]" JA578. Again, ongoing detection of suspected money laundering is an AML function—not a criterion that should bear on knowledge under Article 4A. The district court erred as a matter of law when it found the bank's BSA/AML compliance relevant to support a private party's claims under Article 4A.

D. Conflating A Bank's BSA/AML Duties With Article 4A Knowledge Threatens The Efficiency Of The Nation's Funds-Transfer Systems

Holding banks liable under Article 4A based on their failure to integrate BSA/AML infrastructure with the systems they use to process funds transfers is improper as a matter of law and perilous as a matter of public policy, threatening the efficiency and the carefully balanced risk allocation that Article 4A secured.

As discussed above, BSA/AML obligations are distinct in kind from the duties imposed by Article 4A. Conflating BSA/AML duties with Article 4A

knowledge would expand Article 4A liability in a way not contemplated by the framers of the statute, creating exponential, unpredictable exposure by making beneficiary banks accountable for scams against originators that they have no knowledge or control of. As this Court has already recognized, Article 4A does not "make banks insurers for their account holders' Internet security measures and for peoples' mistakes in falling for phishing scams." *Nirav Ingredients, Inc. v. Wells Fargo Bank, N.A.*, 2022 WL 3334626, at *3 (4th Cir. Aug. 12, 2022).

Article 4A, as written, fulfills its drafters' intent to create a legal framework that supports fast, efficient funds-transfer systems in which banks can predict and manage their legal exposure with confidence. If the district court's ruling stands, that certainty will evaporate because the circumstances giving rise to what a bank apparently *should know* about each of the hundreds, if not thousands, of commercial ACH credit entries and other funds transfers it receives each day are boundless and undefined. This uncapped legal liability will unquestionably threaten banks' ability to offer fast and efficient funds transfers—likely harming small, independent banks and credit unions (often serving historically under-resourced populations) most of all. Degradation of the speed and efficiency of the nation's funds-transfer systems would harm the economy as a whole, down to individual bank customers. *See* Federal Reserve Board of Governors, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation* 7 (Jan. 2022)

("[I]nterbank payment services are critical to the functioning and stability of the financial system and the economy more broadly.").

II. THE DISTRICT COURT ERRED IN FINDING FOR STUDCO ON ITS COMMON-LAW BAILMENT CLAIM

A. Funds Transfers Do Not Meet The Common-Law Definition Of Bailment

It is well settled under Virginia law that a "general deposit in a bank is 'not a bailment.'" *Gardner v. Commonwealth*, 546 S.E.2d 686, 687 (Va. 2001). Similarly, a funds transfer cannot be a bailment for at least two important reasons: (1) neither the funds transfers themselves, nor the credits to bank accounts made in connection with those transfers, are goods, and (2) the originator of a funds transfer is not the owner of any property in the transfer and thus lacks standing to assert a claim in bailment.

First, bailment applies to physical goods only, and neither funds transfers nor the credits banks make to accounts in connection with those transfers are physical goods. As the Virginia Supreme Court has recognized, bailment is "the rightful possession of goods by one who is not the owner." *K-B Corp. v. Gallagher*, 237 S.E.2d 183, 185 (Va. 1977); *see id.* ("Ordinarily, for a bailment to arise there must be a delivery of the chattel by the bailor and its acceptance by the bailee.").

Here, there was no delivery of goods or chattels by Studco, which negates the possibility that a relationship of bailment could arise. An ACH entry is an electronic instruction (a payment order) to a bank to debit or credit an account. The Permanent Editorial Board for the Uniform Commercial Code has reiterated this important concept, explaining that accepted and executed payment orders "create contractual obligations that result in a series of credits and debits to bank accounts" and "do not involve a transfer of property of the originator to the beneficiary." PEB Commentary No. 16, at p.2 (July 1, 2009). Further support appears in Article 4A's treatment of creditor process. A creditor of an originator can "levy on the account of the originator in the originator's bank *before* the funds transfer is initiated," but once the transfer has been an initiated, such a creditor "cannot reach any other funds *because no property of the originator is being transferred*." *See* Va. Code §8.4A-502 cmt. 4 (emphasis added).

ACH entries simply result in debits and credits to deposit accounts—in other words, changes to account balances. A bank account balance (often described colloquially as the "funds" in the account) is neither a chattel nor a good. It is well established that a deposit account is nothing more than the obligation of the bank to pay the depositor the amount of the deposit. *See In re Smith*, 382 B.R. 279, 284 (Bankr. D. Md. 2006) ("A deposit account at a financial institution … is not a bailment of cash but rather is a contract under which the bank is obligated to pay to

the account customer the amount commonly referred to as the account balance, upon a legally sufficient demand by the customer."); Laurence, *Out-of-State Garnishments: Work-in-Progress, Offered in Tribute to Dr. Robert A. Leflar*, 50 Ark. L. Rev. 415, 429-430 (1997) ("[T]he account balance is in fact a debt running from the bank to the depositor, intangible and susceptible to distorted definitions of its location."). No aspect of an ACH entry, including the ACH funds transfers at issue in this case, involves physical goods, so bailment does not apply.

Second, a bailment claim by an originator "bailor" regarding a funds transfer to a beneficiary "bailee" fails to meet the common-law requirement that the chattel transferred to the bailee remains the property of the bailor. *See United States v. Newport News Shipbuilding & Dry Dock Co*., 21 F.2d 112, 116 (E.D. Va. 1927) (when property is placed with the bailee, the bailee must redeliver it to the bailor, as the rightful owner of the property, in the condition in which the bailee agreed to do so), *aff'd in part, rev'd in part*, 34 F.2d 100 (4th Cir. 1929); *see also AdvanceMe, Inc. v. Shaker Corp*., 79 Va. Cir. 171, 173 (2009) (bailee is expected to return bailor's property to bailor). Because, under bailment law, the bailor is the rightful owner of the property, the property subject to the bailment is intended to be returned to the bailor at the conclusion of the bailment agreement. *See Automotive Servs. Fin., Inc. v. Affordable Towing, Inc*., 71 Va. Cir. 15 (2006).

Putting aside the fact that the originator in this case lacked *any* agreement with the beneficiary's bank (let alone a bailment agreement), the nature of a funds transfer is such that an originator cannot retain any alleged property right in such transfer. When a beneficiary's bank—here, 1st Advantage—accepts a payment order, it is obligated to pay the amount of the payment order to the beneficiary identified in the payment order (including identification by account number) and the beneficiary has a statutory right to payment of that amount. *See* Va. Code §8.4A-404 (beneficiary's bank obligated to pay). If the Court were to recognize that the originator simultaneously had a property interest in the credit to be made to the beneficiary's account, that would mean the beneficiary's bank would face double liability—the statutory obligation under Article 4A to pay the amount of the payment order to the account holder upon acceptance of that order and the obligation to return the "property" to the bailor/originator.

B. Common-Law Claims Like Bailment Are Displaced By Article 4A

Article 4A was enacted to standardize the rights and obligations of parties to funds transfers by displacing innumerable common-law obligations, like bailment, in favor of a single statutory framework. Although plaintiffs frequently test Article 4A's scope by asserting common-law claims in the funds transfer context, courts routinely reject such claims as displaced. *See, e.g.*, *Donmar Enters., Inc. v. Southern Nat'l Bank of N.C.*, 64 F.3d 944, 949-950 (4th

Cir. 1995) (any negligence duties related to funds transfer events at issue would conflict with and are thus displaced by Article 4A); *Patco Constr. Co. v. People's United Bank*, 684 F.3d 197, 216 (1st Cir. 2012) ("standard for the duty of care as to both sides is set forth in Article 4A and its limitation of liability," thus Article 4A displaces negligence claim related to commercial ACH transfers); *Ma v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 597 F.3d 84, 89-90 (2d Cir. 2010) (Article 4A bars common-law claims arising from allegedly unauthorized funds transfers); *see also Approved Mortg.*, 638 F. Supp. 3d at 953 (negligence claim barred because "acceptance of wire transfers and liability for losses associated with wire transfers is expressly addressed in" Article 4A); *Attisha Enters., Inc. v. Capital One, N.A.*, 505 F. Supp. 3d 1051, 1058-1059 (S.D. Cal. 2020) (Article 4A displaces claims related to "acceptance of [a] wire transfer and release of funds").[8]

This displacement principle is squarely applicable to bailment claims. At core, Studco's claims arise from 1st Advantage's handling of a funds transfer, including its receipt of a payment order and crediting funds to the account

[8] *Eisenberg* is not to the contrary. The Court permitted negligence claims to proceed notwithstanding Article 4A because the wire transfers were "incidental" to the challenged conduct—namely, permitting a client to operate using a fraudulent "dba" name, 301 F.3d at 223-224. Here, Studco's claims go directly and exclusively to the bank's handling of a payment order in which the beneficiary was misdescribed and so are squarely addressed by the black letter of Article 4A.

identified in that payment order. Article 4A expressly governs (1) the obligation of the beneficiary's bank to pay and provide notice of the payment to the beneficiary, *see* Va. Code §8.4A-404; (2) payment by the beneficiary's bank to the beneficiary, *see id* §8.4A-405; and (3) payment by the originator to the beneficiary, *see id.* §8.4A-406. Permitting a facts-and-circumstances bailment claim to displace this clean set of rules would reprise the havoc Article 4A has redressed.

C. Treating Funds Transfers As Bailments Between A Beneficiary's Bank And A Noncustomer Originator Would Vitiate The Public Policy Manifest In Article 4A

In addition to the legal deficiencies of treating funds transfers as bailments, it would be an error of public policy to find that a funds transfer creates a bailment between a beneficiary's bank and a noncustomer originator. Imposition of common-law bailment standards of care for funds transfers involving parties not in privity would produce tremendous uncertainty for banks involved in funds transfers, directly contrary to Article 4A's core purpose. Standards of care differ state by state and for different types of bailments. *See, e.g.*, 19 *Williston on Contracts* §53:5 (4th ed. 2023) ("[I]n some states, degrees of negligence are not recognized as between different types of bailments" but "elsewhere, the classifications of negligence applicable to bailees have been established and are well understood."). "What constitutes ordinary care or diligence varies with the circumstances under which the bailment is made, the nature of the subject matter,

the business in which the bailee is engaged, and the usages of that particular industry, and is necessarily a question for the jury." *Leprino Foods Co. v. Gress Poultry, Inc.*, 379 F. Supp. 2d 659, 670 (M.D. Pa. 2005).

Making funds transfers subject to common-law bailment would thus take a decisive step backwards from Article 4A's innovation, permitting plaintiffs to go on roving searches for fact-dependent standards of care to apply to the handling of funds transfers. It is precisely because of the unique nature of funds transfers and the need for certainty regarding the rights and responsibilities of the parties to funds transfers that the drafters of Article 4A made clear that "resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article." Va. Code §8.4A-102 (official comment). It is, in sum, perplexing that the district court turned to common-law bailment when a statute (Article 4A) is so squarely designed to deal with this particular type of transaction (a funds transfer) and situation (a misdescribed beneficiary).

CONCLUSION

The judgment of the district court should be reversed.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(g)(1), the undersigned hereby certifies that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) and Fed. R. App. P. 29.

1. Exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(f), the brief contains 6,319 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Word for Office 365 in 14-point Times New Roman font. As permitted by Fed. R. App. P. 32(g)(1), the undersigned has relied upon the word count feature of this word processing system in preparing this certificate.

/s/ *Noah A. Levine*
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October 17, 2023

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of October, 2023, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Fourth Circuit using the appellate CM/ECF system. Counsel for all parties to the case are registered CM/ECF users and will be served by the appellate CM/ECF system.

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