IN THE SUPREME COURT OF OHIO

PAUL CHEATHAM IRA,	)	
Plaintiff-Appellee,	)	Case No. 2018-0184
v.	)	On Appeal from the Court of Appeals of Ohio, Sixth Appellate District, Lucas County
THE HUNTINGTON NATIONAL BANK,	)	Case No. L-16-1292
Defendant-Appellant.	)	Court of Common Pleas, Lucas County, Ohio
	)	Case No. CI0201502696

MERITS BRIEF OF AMICUS CURIAE AMERICAN BANKERS ASSOCIATION

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Statement of Interest of Amicus Curiae

The American Bankers Association ("ABA") is the country's largest national banking trade association. It represents banks and holding companies of all sizes in each of the fifty states and the District of Columbia. The ABA also represents savings associations, trust companies, and savings banks. ABA members hold approximately 95% of the United States banking industry's domestic assets, including in Ohio. The ABA frequently appears in litigation, either as a party or amicus curiae, to address the interests of the banking industry and its members. ABA members routinely serve as trustees for trusts, including indenture trusts like the one at issue here.

Here, the ABA is concerned about the effect of the erroneous interpretation of a provision of the Uniform Commercial Code adopted by the Sixth District Court of Appeal on its Ohio members, as well as the potential ripple effect on its members in other states, and submits this Brief so that the Court may consider its views.

Statement of the Case and Facts

The ABA generally adopts the Statement of the Case and Facts presented by Appellant The Huntington National Bank ("Huntington").

Appellant's Proposition of Law

PROPOSITION OF LAW: Absent a valid assignment of claims, the mere sale of a municipal bond does not automatically vest in the buyer, by operation of R.C. 1308.16 (Section 8-302 of the Uniform Commercial Code), all claims and causes of action of the seller relating to the bond that arose before the transaction.

Argument in Support of Appellant's Proposition of Law

Appellee Paul Cheatham IRA ("Cheatham") claimed the right to sue Huntington for breaches of contract that allegedly occurred before Cheatham acquired the bonds upon which he bases these claims. The sole method by which he claims to have acquired the chose in action is

R.C. 1308.16(A). R.C. 1308.16(A) provides in relevant part: "a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer."

At common law, a mere transfer of property did not automatically transfer all choses in action arising from ownership of property prior to transfer. To the contrary, the transfer of a chose in action required a specific, separate assignment. The question presented to the Court is whether by enacting R.C. 1308.16(A), the General Assembly reversed the common law rule.

Courts across the country interpreting the same provision have held that this U.C.C. section does not have that effect. The ABA suggests that the Court should join these other courts in this interpretation. Since it is undisputed that Cheatham purchased only the bonds at issue (at a discounted price) and did not receive a separate assignment of any claim arising from his ownership, the Sixth District erred in holding that he could assert a chose in action which arose prior to his purchase merely by purchasing the bonds. Its decision should be reversed.

A. The rules for statutory interpretation.

This Court's duty in interpreting a statute is to determine and give effect to the language as intended by the General Assembly. *Pelletier v. City of Campbell*, ___ Ohio St.3d ___, 2018-Ohio-2121, ___ N.E.3d ___, ¶ 14. Courts are not to insert language into a statute under the guise of interpreting its provisions. *Doe v. Marlington Local School Dist. Bd. of Edn.*, 122 Ohio St.3d 12, 2009-Ohio-1360, 907 N.E.2d 706, ¶ 29.

The General Assembly legislates against the background of the common law. "[T]he general assembly will not be presumed to have intended to abrogate a settled rule of the common law unless the language used in a statute clearly supports such intention." *Mandelbaum v.*

Mandelbaum, 121 Ohio St.3d 433, 2009-Ohio-1222, 905 N.E.2d 172, ¶ 29, quoting *State ex rel. Hunt v. Fronizer*, 77 Ohio St. 7, 16, 82 N.E. 518, 5 Ohio L. Rep. 452 (1907).

B. Interpreting U.C.C. provisions.

R.C. 1308.16 is a portion of Ohio's enactment of U.C.C. 8-302. The U.C.C. (and Ohio's enactment of it) has three principal purposes:

> (1) To simplify, clarify, and modernize the law governing commercial transactions;
>
> (2) To permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and
>
> (3) To make uniform the law among the various jurisdictions.

R.C. 1301.103(A) (U.C.C. 1-103).

The General Assembly explicitly recognized that the enactment of the U.C.C., like other statutes, was against the backdrop of the common law:

> (B) *Unless displaced by the particular provisions* of Chapters 1301., 1302., 1303., 1304., 1305., 1307., 1308., 1309., and 1310. of the Revised Code, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement their provisions.

R.C. 1301.103(B) (emphasis added). Accordingly, the common law is not supplanted by the U.C.C. unless the "principles of common law and equity [] are inconsistent with either its provisions or its purposes and policies." U.C.C. 1-103, Official Comment 2.

In interpreting U.C.C. provisions, and consistent with the legislative directive of uniformity in R.C. 1301.103(A)(3), this Court has noted that "it is desirable to conform our interpretations of the Uniform Commercial Code to those of our sister states." *Edward A. Kemmler Mem. Found. v. 691/733 E. Dublin-Granville Rd. Co.*, 62 Ohio St.3d 494, 499, 584 N.E.2d 695 (1992).

As an interpretive tool, "[r]elying on the Official Comments to the UCC helps to achieve this uniformity." *Casserlie v. Shell Oil Co.*, 121 Ohio St.3d 55, 2009-Ohio-3, 902 N.E.2d 1, ¶ 18.

C. Ohio's common law regarding assignments of choses in action.

The essential argument put forth by Cheatham and adopted by the Sixth District is that R.C. 1308.16 automatically assigns a "chose in action" relating to ownership of the security when a security is transferred. This Court has defined a chose in action as "[t]he right to bring an action to recover a debt, money, or thing" and encompasses both tort and contractual causes of action. *Pilkington N. Am., Inc. v. Travelers Cas. & Sur. Co.*, 112 Ohio St.3d 482, 2006-Ohio-6551, 861 N.E.2d 121, ¶ 19.

Ohio's common law requires an express assignment of a chose of action: "[a] valid assignment must contain clear evidence of the intent to transfer rights, must describe the subject matter of the assignment, must be clear and unequivocal * * * ." 6 Ohio Jurisprudence 3d, Assignments, Section 26 (2018); citing 6 American Jurisprudence 2d, Assignments, Section 82 (2018); *Morris v. George C. Banning, Inc.*, 77 N.E.2d 372 (Ohio 2d Dist.1947); *Midland Funding LLC v. Farrell*, 1st Dist. Hamilton No. C-120674, 2013-Ohio-5509, ¶ 14, citing *Capital Fin. Credit v. Mays*, 191 Ohio App.3d 56, 2010-Ohio-4423, 944 N.E.2d 1184, ¶ 6 (1st Dist.); *Zwick & Zwick v. Suburban Constr. Co.*, 103 Ohio App. 83, 84, 74 Ohio Law Abs. 183, 134 N.E.2d 733 (8th Dist.1956).

Ohio's common law is consistent with the common law of other states. "[M]any jurisdictions generally do not recognize an assignment of a litigation right or claim when an underlying property is transferred unless the assignor 'manifest[s] an intention to transfer the right.'" *Royal Park Invs. SA/NV v. HSBC Bank USA, N.A.*, S.D.N.Y. Nos. 14 Civ. 8175 (LGS); 14 Civ. 9366 (LGS), 2018 U.S. Dist. LEXIS 17623, at *22-29 (Feb. 1, 2018), citing Restatement

of the Law 2d, Contracts, Section 324 (1981) and *DNAML Pty, Ltd. v. Apple Inc.*, S.D.N.Y. No. 13 Civ. 6516, 2015 WL 9077075, at *4 (Dec. 16, 2015) (surveying history of common law rule; noting that at common law, there was "no presumption of an automatic assignment of the right to bring a claim associated with the property when the property was sold" and that, generally, "the law has required an express assignment of right to bring a cause of action.").

In nearly identical circumstances, Ohio's property law statute was held *not* to convey a cause of action relating to harm to the real property merely by transferring title to the property. *Prince v. Jordan*, 9th Dist. Lorain No. 97CA006906, 1998 Ohio App. LEXIS 4613, at *11 (Sept. 30, 1998). In *Prince*, the Ninth District held that a chose in action for damage to real property did not transfer to the purchaser of the real property merely because the fee interest had been transferred. The plaintiff in that case sought to recover damages for harm to the property prior to the plaintiff's purchase, and pointed to R.C. 5302.04 to argue that the conveyance of the ownership interest automatically included choses of action that arose from the ownership. *Prince*, 1998 Ohio App. LEXIS 4613, at *11. R.C. 5302.04 (similar to R.C. 1308.16) provides: "In a conveyance of real estate or any interest therein, all rights, easements, privileges, and appurtenances belonging to the granted estate shall be included in the conveyance, unless the contrary is stated in the deed, and it is unnecessary to enumerate or mention them either generally or specifically."

Prince reasoned that "[b]ecause a chose in action is considered personal property, and not an interest in real property, such chose in action is separate from the real property although it arose out of damage to the real property." 1998 Ohio App. LEXIS 4613, at *11. Moreover, there was nothing in the legislative history of R.C. 5302.04 which suggested that the General Assembly intended to abrogate the common law rule that a transfer of ownership property did

not automatically transfer choses of action related to that ownership. Accordingly, *Prince* held that transfer of title to the property did *not* automatically transfer a chose of action for damages to the property arising prior to ownership.

D. R.C. 1308.16 governs claims of ownership to a security, not to choses of action arising from ownership of the security.

R.C. 1308.16(A) is based on U.C.C. 8-302 and was enacted in Ohio in 1998. It provides, in pertinent part: "a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer." The U.C.C. defines a "security" as:

> an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:
>
> > (a) Which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;
> >
> > (b) Which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and
> >
> > (c) Which:
> >
> > > (i) Is, or is of a type, dealt in or traded on securities exchanges or securities markets; or
> > >
> > > (ii) Is a medium for investment and by its terms expressly provides that it is a security governed by this chapter.

R.C. 1308.01(15). Nothing in this definition includes a "chose of action."

Not surprisingly, the Prefatory Comment to Article 8 makes clear that U.C.C. 8-302 was to address transfers of the ownership rights *in* the security, and not choses of action which may *relate* to ownership of the security:

> Article 8 deals with the settlement phase of securities transactions. It deals with the mechanisms by which interests in securities are transferred, and the rights and duties of those who are involved in the transfer process. It does not deal with the process of entering into contracts for the transfer of securities or *regulate the rights and duties of those involved in the contracting process.*

Prefatory Note to U.C.C. Article 8 (emphasis added).

Courts have applied U.C.C. 8-302 (and its nearly identical predecessor in previous Section 8-301)[1] to cases involving competing adverse ownership claims *in* the security. A non-exhaustive list is below:

- *Garner v. First Natl. City Bank*, 465 F.Supp. 372, 381 (S.D.N.Y.1979) (holding that a purchaser of a stock with notices of potential claims to ownership of the stock took the stock subject to those claims).
- *Satterfield v. Haymond*, D.Utah No. C-84-0646W, 1985 U.S. Dist. LEXIS 14322, at *18 (Oct. 31, 1985) (holding that a stock purchaser through a clearinghouse qualifies as a bona fide purchaser for value when notices of adverse claims of ownership were not sent to the original owner before the clearinghouse purchase occurred).
- *In re Legel, Braswell Govt. Secs. Corp.*, 648 F.2d 321, 326 (5th Cir.1981) (holding that a transferee for value has superior rights over a party claiming the securities were pledged for a debt).
- *Falcigno v. Falcigno*, Super.Ct. No. NNHCV126033535S, 2014 Conn. Super. LEXIS 302, at *12 (Feb. 6, 2014) (describing U.C.C. 8-302 as the embodiment of the "shelter rule" protecting holders in due course and noting that it has limited applicability in a claim between the buyer and the seller of securities).
- *Mossy Dell, Inc. v. AB&T Natl. Bank (In re Beauchamp)*, 500 B.R. 235, 244 (M.D.Ga.2013) (in a bankruptcy forced stock transfer, abrogating a close

[1] The provisions of what is now U.C.C. 8-302 were previously found in U.C.C. 8-301. Facciolo, *Father Knows Best: Revised Article 8 and the Individual Investor*, 27 Fla.St.U.L.Rev. 615, 621 (2000).

shareholder restriction on transfer but noting that the stock would be taken subject to the claims of third parties as a result of U.C.C. 8-302).

- *F.B.I. Farms, Inc. v. Moore*, 798 N.E.2d 440, 449 (Ind.2003) (noting that a purchaser of restricted transfer stock at a sheriff's sale takes subject to the restrictions even if it makes the shares otherwise unmarketable).
- *Meadow Homes Dev. Corp. v. Bowens*, 211 P.3d 743, 747 (Colo.App.2009) (a bond purchaser for value with notice of a third party's lien cannot claim to be a bona fide purchaser).

Thus, the Prefatory Note to U.C.C. Article 8 and the Comments to Section 8-302 demonstrate the intended purpose of this provision: to govern the rights of enforcement of ownership claims to the security between the buyer, seller, and any third parties. It was not intended to create any new rights or obligations as to claims or interests that arose from ownership of the security. The case law and the commentary correctly reflect that the proper interpretation of Section 8-302 is only to determine who **owns** the security, not what rights may come along with such a transfer.

Here, this Court could answer the question based solely on U.C.C. and routine statutory interpretation principles. R.C. 1308.16 governs only transfers of a "security" itself, and does not embody a specific abrogation or reference that it is altering the Ohio common law rule that a transfer of property does not include prior choses of action arising from ownership of that property. Unless otherwise specifically referenced as abrogated, the common law controls. U.C.C. 1-103, Official Comment 2. The Court need go no further; the Court should reverse the Sixth District and hold that R.C. 1308.16 does not transfer any chose in action relating to ownership of a security in the absence of a specific agreement transferring that chose of action.

E. Other states have also interpreted U.C.C. 8-302 to govern only transfer of ownership of the security, not to govern transfer of choses of action relating to the security.

As noted above, R.C. 1308.16 is part of the U.C.C., and Ohio has explicitly acknowledged the benefits of uniform interpretation of the U.C.C. across state lines. Other states have addressed the question of whether U.C.C. 8-302 changed the common law rule that the transfer of ownership of property does not automatically transfer choses of action related to the property, and have held that it did not. The Decision below directly contradicts the interpretation of U.C.C. 8-302 by other states.

For example, in *Consol. Edison, Inc. v. Northeast Utils.*, 318 F.Supp.2d 181, 188 (S.D.N.Y.2004), the U.S. District Court for the Southern District of New York interpreted New York's identical version of U.C.C. 8-302. The court concluded that nothing in U.C.C. 8-302 was intended to change the common law rule on the transfers of choses of action, and that U.C.C. 8-302 governed only claims to ownership of the security itself:

> The legislative history of the predecessor provision to § 8-302(a) and the structure of U.C.C. Article 8 confirm that § 8-302(a), rather than defining what rights are in the security, involves the mechanism for transferring rights and applies primarily to disputes over the quality of title and the competing ownership rights passed from transferor to transferee.

Id. The *Consol. Edison* holding has regularly been recognized and adopted. *Fraternity Fund Ltd. v. Beacon Hill Asset Mgt., LLC*, 479 F.Supp.2d 349, 373 (S.D.N.Y.2007), fn. 126; *Broadbill Partners L.P. v. Ambac Assur. Corp.*, N.Y. S. Ct. No. 653869/2012, 2014 NY Slip Op 30647(U), ¶ 11 (Mar. 12, 2014).

Reflecting that U.C.C. 8-302 does not provide for the transfer of claims related to ownership of a bond, the New York legislature adopted a statute – apart from the U.C.C. – that does transfer choses in action upon transfer of the bond: N.Y. General Obligations Law Section

13-107(1) (Consol. 2018) ("Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferrer, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond, (b) for damages against the trustee or depositary under any indenture under which such bond was issued or outstanding, and (c) for damages against any guarantor of the obligation of such obligor, trustee or depositary."). Notably, the Ohio General Assembly has not adopted an equivalent statute.

In *In re CFS-Related Secs. Fraud Litigation*, N.D.Okla. No. 99-CV-825-K(J), 2001 U.S. Dist. LEXIS 27387, at *44 (Dec. 21, 2001), the U.S. District Court for the District of Oklahoma was confronted with the same question interpreting Oklahoma's version of the U.C.C. That court concluded that "Section 8-102(a)(15) contains a definition of security which is not broad enough to encompass choses in action related to a security." *Id.* The court added that U.C.C. Article 8 deals only with "adverse claims" as defined in U.C.C. 8-102(a)(1) as "a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset." R.C. 1308.01(A)(1) (U.C.C. 8-102).

Here, this Court has recognized its goal of construing R.C. 1308.16 consistently with its treatment by other state courts. *Edward A. Kemmler Mem. Found.*, 62 Ohio St.3d at 499. Other courts have recognized that U.C.C. 8-302 did not change the common law rule that, absent an express assignment, the transfer of a security does not transfer choses of action related to the security. The Sixth District erred in its application and this Court should restore the appropriate uniformity.

F. Policy reasons support the conclusion that U.C.C. 8-302 does not automatically transfer a chose of action when a security is transferred.

There are policy reasons for the rule that a transfer of ownership of property does not transfer all choses of action arising from ownership of the property. The first is the practical one: if value of an item of property has been damaged, the transfer price reflects its diminished value; providing for a transfer of a chose of action along with the security deprives the former owner of its rights to recover damages and provides the transferee with a windfall.

If the securities' price has already been depressed, "[m]arket forces assured that the price plaintiff paid for certificates which would never be wholly redeemed reflected their diminished value. The injury was sustained by the sellers who parted with these certificates at a reduced price, not by plaintiff who purchased them at their post-[injury] value." *Bluebird Partners, L.P. v. First Fid. Bank*, 896 F.Supp. 152, 157 (S.D.N.Y.1995). In such a circumstance, "any misconduct was already factored into the purchase price. Because any subsequent investors [] purchased the Certificates at a price discounted to reflect any previous [] misconduct, it would be unfair to allow them to assert a claim that any pre-acquisition conduct caused harm." *Blackrock Balanced Capital Portfolio (FI) v. Deutsche Bank Natl. Trust Co.*, S.D.N.Y. No. 14-CV-09367 (JMF)(SN), 2018 U.S. Dist. LEXIS 133942, at *23-24 (Aug. 7, 2018).

It is for this reason that courts require assignment of choses in action to be express. "By ensuring that the parties' expressed intent determines who receives redress for a wrong, the value of the cause of action will be figured into any sale of property, and a purchaser will be less likely to realize a windfall." *DNAML Pty, Ltd. v. Apple Inc.*, S.D.N.Y. No. 13cv6516 (DLC), 2015 U.S. Dist. LEXIS 168245, at *13 (Dec. 16, 2015).

Similarly, in addressing claims for security fraud, federal courts focus on which party suffered an injury from the alleged misconduct. *Arnlund v. Deloitte & Touche LLP*, 199

F.Supp.2d 461, 491 (E.D.Va. 2002). These courts have held that it is generally the person who had ownership of the security at the time of the alleged misconduct who has the claim, and that the transfer of the security does not automatically transfer the choses in action which arise from the ownership of the security. *In re Nucorp Energy Sec. Litigation*, 772 F.2d 1486, 1490 (9th Cir. 1985).

This rule also has the benefit of preventing misbehavior within the entity issuing the security. As the court in *In re Saxon Secs. Litigation*, 644 F.Supp. 465, 474 (S.D.N.Y.1985) reasoned: "If 10b-5 rights were automatically assigned to subsequent holders then by definition a defrauded seller would have transferred his rights by selling in reliance on the fraud. The seller's cause of action would simultaneously accrue and be transferred out of his hands." For example, "an insider who fraudulently depresses the value of his corporation's security through incomplete disclosure, [c]ould purchase the security at the depressed price and then be immune to a 10b-5 action because he would also hold the rights to the recovery." 644 F.Supp. at 474. Automatically transferring a chose in action encourages a misbehaving party to reap the rewards of their misbehavior.

The rule adopted by the Decision puts Ohio in conflict with how other states have interpreted U.C.C. 8-302, contrary to the goal of uniformity in interpretation of the U.C.C. *Edward A. Kemmler Mem. Found.*, 62 Ohio St.3d at 499. If a claim relating to ownership of a security is made against a bank or trustee in other states, the claim may be resolved directly with the person who held the claim at the time of the alleged wrongdoing. But if the Decision remains the law of Ohio, a subsequent purchaser of the security could also bring suit, subjecting issuers and trustees to conflicting claims and potentially multiple liability.

In large bond issuances like this one, there is a fluid, national (or international) secondary market. In such circumstances, secondary sellers may be in multiple states with secondary buyers potentially in multiple states. There is no limit on the number of sales that may occur after a potential breach of contract arises. The elegance of Ohio's common law rule is that the chose in action stays with the owner of the bond at the time of the breach unless there is a clear assignment of rights that would transfer the claim to the bond's purchaser. There is clarity in determining who is the one and only person who owns the chose in action.

If the Decision stands, there is a cloud of uncertainty over ownership of the chose in action, particularly if post-breach sales occur between or among residents of different states who have adopted different interpretations of the U.C.C. provision (or for example, live in New York where the claim may have been assigned by operation of a separate statute).

There is another problem with the Decision: it forces the party holding the security at the time of the alleged misconduct to continue to hold it to maintain a claim. Under the Decision's interpretation of U.C.C. 8-302, a party who was injured by the diminished value allegedly caused by the misconduct could not assign her claim, as it would be deemed to have become part of security. To recover for the loss in value, the injured party would be forced to hold the security until suit was brought.

The Sixth District's Decision poses yet another significant concern. Because the holding subjects banks and other trustees to conflicting and multiple liability, banks (and corporations) will have a disincentive to do business in Ohio. This could discourage lending in Ohio for projects funded by municipal bonds.

The Sixth District's Decision ignores Ohio common law, the Prefatory Statement within U.C.C. Article 8, and expands the scope of R.C. 1308.16 beyond its intended purpose. It should be reversed.

Conclusion

This case involves a straightforward statutory construction analysis. At common law, the transfer of property did not automatically transfer choses of action related to ownership of the property, and nothing in R.C. 1308.16 reflects a legislative intention to abrogate that rule. That is all the more problematic given the problems created by such an automatic transfer.

The Court should hold that a transfer of "all rights in the security" refers to ownership of the security itself, not choses in action arising from a pre-sale breach of contract unless expressly included in an assignment agreement. The Court would be harmonizing the law of sister states with the same provisions, and avoiding the problems of inconsistency in parallel or analogous circumstances. The Decision should be reversed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on August 24, 2018, I electronically filed the foregoing Merits Brief of Amicus Curiae American Bankers Association and served a copy by regular U.S. mail, with a courtesy copy by electronic mail, on the following:

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