THE CHECK BOOK

A GUIDE FOR CHECK DISPUTES

MAY 2012

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Note to Readers

Not Legal Advice. This Guide is not intended to express any legal opinions or to provide legal advice. You should consult an attorney for legal advice.

Code Interpretations. You should refer to the actual code provisions that are cited in the text, as I have employed a degree of poetic license in summarizing and describing the law. Since the actual wording may be slightly different, we have added a UCC Index at the end to help you find your way.

California's UCC. This Guide is based primarily on California's version of the Uniform Commercial Code. California's UCC varies in a few respects from the "Official Text" of the uniform law employed by other states. For example, the words "substantially contributes" are changed to "contributes" in California's version of Section 3406 ("Failure to Exercise Ordinary Care"). Note also: New York has not adopted the 1990 version of the UCC.

Case Code Citations. Readers should bear in mind that pre-1991 cases often refer to sections of the UCC that were relocated with the revised code in the 1990s (e.g., the warranty sections). Unless you keep this in mind, reading older cases can be a confusing experience. Note also that some states use a different UCC numbering system (e.g., in Virginia § 4208 warranties are found at § 4207).

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Views. This Guide does not express the views or positions taken by Wells Fargo Bank, N.A., or any client of the authors.

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1. FORGED MAKER CHECKS

A. General Rule

- **A customer is not liable for a check drawn on his account if he didn't sign the check or benefit from its proceeds.**[1]

- **As between the maker's bank and the depositary bank (or any collecting bank), the maker's bank is usually liable for a forged maker signature.**[2]

  – Not properly payable. Without the customer's signature, the check is not considered to be "properly payable."[3]

  – Impact on other checks. If the payment of a forged check causes other legitimate checks to be returned, the customer's bank may be liable for damages proximately caused by such "wrongful dishonor."[4] In light of this, consideration should be given to closing an account with forged maker checks, not only to prevent the processing of other forged checks, but to prevent the future dishonor of other legitimate checks pending the bank's review and possible reimbursement of the account. The customer should be notified of the closure and advised to stop issuing checks against the account. Note: Advance notice may be appropriate if the customer is receiving electronic deposits of social security or if the customer participates in cash management services (e.g., contract collection or lockbox) where immediate termination might harm the customer.

  – Missing signature. If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is deemed to be "unauthorized" if one of the required signatures is missing.[5]

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[1] This rule dates back to the English case of *Price v. Neal*, 97 Eng. Rep. 871 (K.B. 1762). A bank's initial liability for paying a forged check applies without regard to whether it exercised due care or was negligent. *Roy Supply, Inc. v. Wells Fargo Bank*, 39 Cal. App. 4th 1051, 46 Cal. Rptr. 2d 309 (1995). An item is not properly payable if it is not authorized by the customer and in accordance with any agreement between the bank and the customer. UCC § 4401. Unless the account agreement provides otherwise, a customer is not liable for an overdraft by another accountholder if he neither signed the item nor benefited from its proceeds. UCC § 4401(b). **(Note: All code (§) cites are to the California Uniform Commercial Code unless otherwise indicated)**.

[2] A forgery is an unauthorized signature. UCC § 1201(41). A counterfeit check is a forged check. For a discussion of counterfeit checks, see Henry J. Bailey and Richard B. Hagedorn, *Brady on Bank Checks: The Law of Bank Checks*, Revised Edition, ¶ 28.03 (hereinafter "*Brady on Bank Checks*, Revised Edition").

[3] UCC §§ 3401(a) and 4401(a).

[4] A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. UCC § 4402.

[5] UCC § 3403(b).

– Counterfeit check. A counterfeit check is generally treated as a forged maker[6] check.[7]

Exceptions: A customer is liable for a forgery if the customer "ratifies" the transaction or is otherwise "precluded" from denying it.[8]

– Ratification. "Ratification" is a retroactive adoption of the unauthorized signature by the person whose name is forged and may be found from conduct (e.g., a decision not to report the forgery or to retain the benefits of the transaction) as well as from express statements (e.g., "I don't intend to make a claim. The forger is my son."). See Sections 1.B (2) and 2.B (8).

– Preclusion. A customer may be "*precluded*" (i.e., prevented) from asserting the forgery if (a) the customer's negligence contributed to the forgery[9] (See Section 1.B (7)), or (b) the customer fails to review statements and returned checks with reasonable promptness and report the forgery in a timely fashion (e.g., see Section 1.B (4)).[10]

B. Payor Bank Defenses

(1) Payment was by agreement. The payor bank may be able to shift the loss associated with unauthorized signatures by agreement with its customer in certain

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6 While the term "maker" and "drawer" are commonly used interchangeably, under the UCC the term "maker" means a person who signs or is identified in a note as a person undertaking to pay (UCC § 3103(a)(5)) and the term "drawer" means a person who signs or is identified in a draft as a person ordering payment (UCC § 3103(a)(3). In short, a maker makes a note and a drawer draws a draft or check.

7 *MTBA Employee Credit Union v. Employees Mut. Liab. Ins. Co.*, 374 F. Supp. 1299 (D. Mass. 1974); *Triffin v. Pomerantz Staffing Servs., Inc*., 370 N.J. Super. 301, 851 A.2d 100 (2004). Under common law, the words "forged" and "counterfeit" are virtually synonymous, at least with respect to documents other than currency. The general rule may not apply in the case of checks that are chemically erased, except for the maker's signature. *See*: *Bank of America v. Amarillo Nat'l Bank*, 2004 WL 294086 (Tex. App. 2004); *Firstar Bank, N.A. v. Wells Fargo Bank, N.A.*, 2004 WL 1323942 (N.D. Ill. 2004). A bank is liable on a counterfeit cashier's check if it does not return it within the midnight deadline. *Northern Trust Co. v. Chase Manhattan Bank*, 582 F. Supp. 1380, *aff'd per curiam*, 748 F.2d 803 (2d Cir. 1984).

8 UCC § 3403(a).

9 A customer whose failure to exercise ordinary care contributes to the making of a forged signature on a check is precluded from asserting the forgery against the bank if the bank pays the check in good faith. If the bank fails to exercise ordinary care in paying the check, the loss is allocated between the customer and the bank. The burden of proving the customer's failure to exercise ordinary care is on the bank, and the burden of proving the bank's failure to exercise ordinary care is on the customer. UCC § 3406.

10 UCC § 4406(d) and (f).

limited circumstances (e.g., by means of a facsimile signature[11] or cash management agreement).[12]

Lines of Inquiry:

- ☐ Has the customer entered into a facsimile signature agreement with the bank? If the forgery involved the use of a facsimile signature, check the customer's deposit and cash management agreements for an authorization to honor transactions purporting to bear the facsimile signature of the customer.

- ☐ Did the person signing the checks have apparent signing authority? Check resolutions and authorizations on file. Check for powers of attorney.

- ☐ Did the customer authorize the bank to honor the check, notwithstanding the signature, as part of a cash management service (e.g., Positive Pay)?

(2) **Customer ratified the transaction**. A bank is not liable for paying a forged check if its customer approves the transaction, ratifies the forgery, or is otherwise precluded from making a claim (e.g., where the customer intentionally fails to report the forgery, requests the bank not to prosecute, or enters into a direct settlement with the forger).[13]

Lines of Inquiry:

- ☐ Did the customer accept the benefits of the transaction in whole or in part?

- ☐ Did the customer enter into a settlement agreement with the forger?

- ☐ Did the customer previously allow the forger (who was not an authorized signer) to complete incomplete checks or write checks on occasion?

- ☐ Did the customer intentionally fail to report the forgery to the bank for any period of time?

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[11] *See Jefferson Parish Sch. Bd. v. First Commerce Corp.*, 669 So. 2d 1298 (La. Ct. App. 1996); *Spears Ins. Co. v. Bank of America*, 2000 WL 139370, 40 UCC Rep. Serv. 2d 807 (N.D. Ill. 2000); *Perini Corp. v. First Nat'l Bank*, 553 F.2d 398 (5th Cir. 1977). *But see Cumis Ins. Soc'y, Inc. v. Girard Bank*, 522 F. Supp. 414 (E.D. Pa. 1981) (facsimile resolution insufficient to relieve bank from liability); *Lormar/Toto, Inc. v. 1st Constitution Bank*, 2005 WL 873324 (N.J. Super. Ct. App. Div. 2005) (corporate resolution didn't clearly and unequivocally shift risk of loss for forged facsimile signatures on checks to customer); *Triffin v. Pomerantz Staffing Services, LLC*, 370 N.J. Super. 301, 851 A.2d 100 (App. Div. 2004) (checks appeared to be counterfeit at time presented to bank).

[12] UCC §§ 1302 and 4103(a). Losses cannot always be shifted by agreement. Institutions may not disclaim responsibility for their own lack of good faith or their failure to exercise ordinary care. Agreements can set the standards by which such responsibility is to be measured, however.

[13] A depositor who accepts the benefits of a contract with the payee of an unsigned check may be deemed to have ratified the transaction. *Spec-Cast, Inc. v. First Nat'l Bank & Trust Co. of Rockford*, 128 Ill. 2d 167, 538 N.E.2d 543 (Ill. 1989). See the other ratification cases cited in the discussion of forged payee checks (*see* Section 2.B (8)).

- ☐ Did the customer ask the bank not to file a report with the police or attempt to seek restitution from the forger?

- ☐ Did the customer authorize the check (e.g., is it an approved remotely created check or demand draft)?[14] Was it authorized through a Positive Pay or other account reconcilement service?

(3) **Customer failed to examine statements and report the forgery (the "Repeat Wrongdoer Rule").** A customer has a duty to promptly examine account statements and returned checks, and to notify the bank of any unauthorized signatures.[15] A customer is liable for unauthorized signatures (or alterations) by the same wrongdoer if the customer fails to discover or report the problem to the bank within a reasonable time (not exceeding 30 days or any shorter period set forth in the customer's deposit agreement) following the mailing of the first statement or check reflecting the forgery (or alteration).[16]

– Bank's failure to exercise ordinary care. If the customer proves that his bank failed to exercise ordinary care[17] in paying the item and that the failure contributed to the loss, the loss is allocated between the customer and the bank according to the extent to which each contributed to the loss.[18]

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[14] See Section 1.B(11), below, regarding demand drafts. The depositary bank is deemed to warrant that the accountholder (the person on whose account the check is drawn) authorized the issuance of the check in the amount and to the payee shown on the item. The Electronic Check Clearing House Organization ("ECCHO") is the national clearing house for electronic check image exchange, and the ECCHO Operating Rules, with the most recent version dated March 2012, are used by over 3, 000 member financial institutions to provide rules coverage for their check image exchange and return transactions. Under ECCHO Operating Rules § XIX(N), generally referred to as Rule 8, the payor bank's customer has 60 days after the account statement that first reflects the check to deliver a claim affidavit to the payor bank. The payor bank must then submit a warranty claim within 15 days to the clearing house or depositary bank. Further, The Clearing House ("TCH") operates the SVPCO Image Payments Network. TCH's Clearing House Electronic Check Clearing System ("CHECCS") Operating Rules, as amended through October 7, 2009, adopt the ECCHO Operating Rules, with certain additions and modifications, and govern electronic image exchange through the SVPCO network. Under the CHECCS Operating Rules, ECCHO Operating Rules § XIX(N) has been adopted without change thereunder.

[15] UCC § 4406(c). This applies even if the customer is incapacitated. *Peters v. Riggs National Bank, N.A.*, 942 A.2d 1163, 65 U.C.C. Rep. Serv. 2d 340 (D.C. 2008). A California court has found, however, that it does not apply after the customer's death. *Mac v. Bank of America*, 76 Cal. App. 4th 562, 90 Cal. Rptr. 2d 476 (1999).

[16] UCC §§ 4406(d) (2) and 4103(a). *Espresso Roma Corp. v. Bank of* America (2002) 100 Cal.App.4th 525. The period begins on the date the bank sends or makes its statement available, not on the date the statement is received by the customer. The bank may shorten the 30-day period by agreement. *Union Planters Bank Nat. Ass'n. v. Rogers*, 2005 WL 976996 (Supreme Court of Mississippi, 2005). A statement held by the bank at its customer's request is deemed available on the first day it is held. *Tatis v. U.S. Bancorp*, 473 F.3d 672 (6th Cir. 2007). A customer that fails to notify its bank about forged checks on one account is subject to preclusion under UCC § 4406 with respect to other accounts at the same bank. *L&B Real Estate v. Wells Fargo Bank, N.A.*, 66 U.C.C. Rep. Serv. 2d 24, 2008 WL 2486815.

[17] Defined at UCC § 1201(b)(20) as the observance of reasonable commercial standards prevailing in the area. In the case of a bank that takes a check for processing, for collection or payment by automated means, this does not require the bank to examine the check if the failure to do so does not violate the bank's standards and the bank's procedures do not vary unreasonably from general banking usage. *Story Road Flea Market, Inc. v. Wells Fargo Bank, N.A.*, 42 Cal. App. 4th (1996) (Bank used a $50,000 bulk file threshold).

[18] UCC § 4406(e). Note: A bank does not owe a fiduciary duty to its customer. *Copesky v. Superior Court (San Diego Nat'l Bank)*, 229 Cal. App. 3d 678 (1991). It has no duty to monitor a trust account. *LaVista Cemetery Assn. v. American Sav. & Loan Assn.*, 12 Cal. App. 3d 365 (1970); *Chazen v. Centennial Bank*, 61 Cal. App. 4th 532 (1998). A bank has no duty to supervise account activity. *Software Design & Applications, Ltd. v. Hoefer & Arnett, Inc.*, 49 Cal. App. 4th 472 (1996).

– Bank's lack of good faith. If the customer proves that his bank did not pay the item in good faith, the customer is not precluded from asserting the forgeries by his failure to act in a timely manner.[19]

– Receipt of statements. A customer is deemed to receive statements even if they are intercepted by a dishonest employee. The employer, though not imputed with the knowledge of the wrongdoing, is (as principal) deemed to know the information contained in the statement and on the checks.[20]

– Warranty claims. If the customer is precluded by this rule from recovering against the bank, the payor bank may not recover from a depositary or collecting bank for breach of warranty with respect to an unauthorized signature or alteration.[21]

Lines of Inquiry:

☐ When did the first forgery occur and when was the first statement sent that included a forged item?

☐ Were there forgeries on any other accounts that preceded the forgery claimed by the customer?[22] Note: Do not assume that the customer has notified the bank of the earliest forgery (which could hamper the customer's claim on later checks).

☐ Were there other unauthorized transactions (e.g., involving credit cards, lines of credit, or wire transfers) that should have put the customer on notice?

☐ Did the customer also have electronic access to the information reflecting the fraud (e.g., through online systems, telephone banking, or otherwise)? Did the customer check the account balance at an ATM, and should that have put the customer on notice of the problem?

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19 UCC § 4406(e).

20 If the depositor entrusts statements with a dishonest agent, the depositor, though not imputed with knowledge of the fraud of his faithless agent, is, as principal, chargeable with such information as an honest employer, unaware of the wrongdoing, would have acquired from the examination of the canceled checks and bank statements. *Basch v. Bank of America*, 22 Cal. 2d 316, 327, 139 P.2d 1 (1943); *Kiernan v. Union Bank*, 55 Cal. App. 3d 111, 127 Cal. Rptr. 441 (1976); *Dean v. Centerre Bank of North Kansas City*, 684 S.W.2d 373 (Mo. 1984) (rule applies even when a trust is involved); *Read v. South Carolina Nat'l Bank*, 335 S.E.2d 359 (S.C. 1985). Claimants are deemed to have knowledge of claims even if they are mentally incapable of discovering the unlawful conduct. *Hollywood v. First Nat'l Bank of Palmerton*, 859 A.2d 472, 2004 WL 185 (Pa. Super. Ct. 2004). Statements are "made available" even if they are held by the bank at its customer's request. *Tatis v. U.S. Bancorp*, 473 F.3d 672 (2007).

21 UCC §§ 3417(c) and 4208(c), referencing, among other sections, UCC § 4406.

22 The Repeat Wrongdoer Rule, e.g., may be invoked by a bank with regard to suspected wrongdoing against related accounts owned by the same apparent victim. See *Coleman v. Brotherhood Bank*, 3 Kan.App.2d 162 (1981).

- ☐ Was the customer on notice of the problem because of his receipt of statements from other institutions that reflected similar forgeries or alterations?

- ☐ Were the checks reported out-of-sequence on the account statement? (Note: This should have highlighted the problem.)

- ☐ Did the customer maintain a check register? Ask to see the register.

- ☐ When should the customer have noticed the forgery? Note that the rule allows up to 30 days. It may be shorter depending on the circumstances.

(4) **Customer failed to report forgery in a timely manner**.[23] Without regard to care or lack of care by the customer or the bank,[24] a customer who does not discover and report forgeries or alterations within one-year (or any shorter period provided in the customer's account agreement) after the statement or items were made available to him, is precluded from asserting the unauthorized signatures and alterations.[25]

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[23] Note: This UCC § 4406 defense is not a statute of limitation, but a statute of repose. As such, equitable tolling does not apply. Unless the bank pleads it as a separate defense from a statute of limitation, it may be barred from raising it in a motion for summary judgment. *Pinigis v. Regions Bank*, 977 So. 2d 466, 63 U.C.C. Rep. Serv. 2d 338 (Ala. 2007).

[24] *Falk v. Northern Trust Co.*, 763 N.E.2d 380 (I..Ct.App. 2001) (exception for bank's bad faith), *but see Halifax v. First Union Nat'l. Bank*, 546 S.E.2d 696 (Va. 2001) and *Pinigis v. Regions Bank*, 977 So.2d 446 (Ala. 2007).

[25] UCC § 4406(f). This subdivision (f) is not a statute of limitations; it is an issue-preclusion statute. The period is measured from each check, regardless of the number of checks that are part of the series of forgeries. *Roy Supply, Inc. v. Wells Fargo Bank, N.A.*, 39 Cal. App. 4th 1051, 46 Cal. Rptr. 2d 309 (1995); *Espresso Roma Corp. v. Bank of America*, 200 Cal. App. 4th 525 (2002); *Chatsky and Associates v. Superior Court*, 117 Cal. App. 4th 873, 12 Cal. Rptr. 3d 154 (2004). It is irrelevant that the customer was incompetent during the time in question or that bank employees attended the customer's competency hearing, where evidence of forgery had been presented. UCC § 4406(f) is not a statute of limitation subject to "tolling" or other equitable exceptions. *Union v. Branch Banking & Trust Co*., 59 UCC Rep. 2d 37, 2006 WL 69465 (N.C. Ct. App.); *Indiana Nat'l Corp. v. Faco, Inc.*, 400 N.E.2d 202 (Ind. Ct. App. 1980); *Siecinksi v. First State Bank of East Detroit*, 531 N.W.2d 768 (Mich. Ct. App. 1995); *Brown v. Cash Management Trust of America*, 963 F. Supp. 504 (D. Md. 1997); *American Federation of Teachers, AFL-CIO v. Bullock*, 605 F. Supp. 2d 251 (D.D.C. 2009). The one-year period does not begin for an account where the accountholder has died (since the statements were not "available" to the customer) until a statement becomes available to a successor accountholder. *Mac v. Bank of America*, 76 Cal. App. 4th 562, 90 Cal. Rptr. 2d 476 (Ct. App. 1999). "Bad faith" on the part of the bank does not extend the deadline. *Halifax Corp. v. First Union Nat'l Bank*, 546 S.E.2d 696, 44 UCC Rep. 2d 661 (Va. 2001). UCC § 4406(f) does not contain a "good faith" requirement, and the "good faith" provision of UCC § 1201 does not apply. *Chester Township Board of Trustees v. Bank One, N.A.*, 2007 WL 1881311 (Ohio 2007); *Pinigis v. Regions Bank*, 2007 WL 1953895 (Ala. 2007). UCC § 4406(f) bars all claims of conversion, breach of fiduciary duty, and aiding and abetting. *The American Federation of Teachers, AFL-CIO v. Bullock*, 605 F.Supp.2d 251 (D.D.C. 2009).

Note: The bank may shorten this one-year period by agreement with its customer. Check the account agreement.[26]

(5) **Customer didn't file action against bank in a timely manner**. An action to enforce an obligation, duty, or right arising under the code with respect to checks must be commenced within three years after the cause of action accrues.[27]

Note: A bank may shorten this period by agreement with its customer. Check the account agreement.

(6) **Customer experienced no loss.** The bank is not liable if there is no loss (e.g., the customer receives the check proceeds or the benefit of the transaction).[28]

Lines of Inquiry:

- ☐ What happened to the proceeds of the check? Did the depositor recover any of the proceeds?
- ☐ Did the forger use any of the funds to pay debts owed by the forger to the customer (or owed by the customer to third parties)?
- ☐ Does the bank know where the proceeds are located? (Note: If the funds are held on deposit elsewhere by the wrongdoer, the bank may be able to

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[26] A reduction in the preclusion time limit is a variation of § 4406(f), which is permitted by UCC § 4103(a) (and has been upheld by a number of courts throughout the United States; *see American Airlines Employees Fed. Credit Union v. Martin*, 29 S.W.3d 86 (Tex. 2000); *Canfield v. Bank One, Texas, N.A.*, 51 S.W.3d 828 (Tex. App. Ct. 2001); *W.J. Miranda Const. Corp. v. First Union Nat'l Bank*, 40 UCC Rep. Serv. 2d 8 (Fla. Cir. Ct. 1999) (allowing 60 days); *Douglas Companies v. Commercial National Bank of Texarkana*, 2005 WL 1993971 (8th Cir. (Ark.) 2005); *Peters v. Riggs Nat'l. Bank, N.A.*, 942 A.2d 1163 (6 months); *Napleton v. Great Lakes Bank, N.A., 945 N.E.2d 111 (Ill Ct., App. 2011) (30 days).* Courts have upheld agreements imposing limits as short as 30 and 14 days. Barkley Clark & Barbara Clark, *The Law of Bank Deposits, Collection and Credit Cards*, 3d Edition, ¶10.05[1][c][i]). *National Title Ins. Corp. Agency v. First Union Nat'l Bank*, 559 S.E.2d 668 (Va. 2002) (60 days); *Napleton v. Great Lakes Bank, N.A.*, 945 N.E.2d 111 (Ill. Ct.App. 2011) (30 days). *Stowell v. Cloquet Co-op Credit Union*, 557 N.W.2d 567 (Minn. 1997) (20 days of mailing statement); *Borowski v. Firstar Bank Milwaukee, N.A.*, 579 N.W.2d 247 (Wis. 1998) (14 days not manifestly unreasonable); *American Airlines Federal Credit Union v. Martin*, 29 SW3d 86 (Tex. 2000) (60 days). *Freese v. Regions Bank, N.A.*, 2007 WL 959719 (Ga. App. 2007) (30 days). *See also Cooper v. Union Bank* (1973) 9 Cal. 3d 371 (employer's failure to discover defalcation within six months was responsible for loss).

[27] UCC §§ 3118(g) and 4111. Cal. Code of Civ. Proc. § 340 provides that an action by a customer against a bank for the payment of a forged or raised check, or for a check that bears a forged or unauthorized Indorsement, is subject to a one-year statute of limitation. *See Edward Fineman Company v. The Superior Court*, 66 Cal. App. 4th 1110, 78 Cal. Rptr. 2d 478 (1998); *In re McMullen Oil Co.*, 36 Bankr. Ct. Dec. 109, 251 B.R. (2000); *Mills v. First Union Nat'l Bank of Md.*, 2004 WL 1630501 (Cal. Ct. App. 2004) (not officially published); *Chatsky & Associates v. Superior Court*, 117 Cal.App.4th 873, 12 Cal.Rptr.3d 154 (2004). Action accrues when injury occurs, not upon discovery. *Stefano v. First Union Nat'l Bank*, 981 F. Supp. 417 (E.D. Va. 1997); *Leichliter v. National City Bank of Columbus*, 134 Ohio App. 3d 26, 729 N.E.2d 1285 (1999); *Gerber v. Manufacturers Hanover Trust Co.*, 64 Misc. 2d 687, 315 N.Y.S.2d 601 (N.Y. Civ. Ct. 1970). If there is a series of forgeries, most courts treat each forgery as a separate incident, rather than as one continuing violation. Since each forgery is considered a separate act, the statute of limitation applies separately to each check. *Rodriguez v. Olin Employees Credit Union*, 406 F.3d 434 (7th Cir. 2005). Some states follow a discovery rule. *See YF Trust v. JP Morgan Chase Bank*, 66 UCC Rep. Serv. 2d 493, 2008 WL 821856 (Arizona, 2008) (Arizona applies the "discovery rule").

[28] Under UCC § 4103(e), the measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. *La Monte v. Sanwa Bank*, 45 Cal. App. 4th 509, 52 Cal. Rptr. 2d 861, 29 UCC Rep.Serv. 2d 1263 (Cal. App. 2 Dist. 1996) (Husband forged wife's signature, deposited funds to their joint account, and removed the funds. Bank held not liable to wife). *Meyers v. Bank of America*, 11 Cal. 2d 92, 77 P. 1084 (1938) (compensated surety defense – not followed by most states).

freeze the funds by serving an adverse claim form on the branch that holds the funds; see Section 4.G.)[29]

(7) **<u>Customer was negligent</u>.** If the customer's failure to exercise ordinary care contributes[30] to the making of the forged signature,[31] the customer is precluded from asserting the forgery against the bank (except to the extent that the bank's failure to exercise ordinary care contributed to the loss). When both the customer and the bank fail to exercise ordinary care, the loss is allocated between them according to the extent to which the failure of each to exercise ordinary care contributed to the loss.[32]

<u>Lines of Inquiry</u>:

- ☐ How did the forger obtain the checks in question?[33]
- ☐ What security procedures did the customer follow in storing the checks? If the customer has written procedures, were they followed?
- ☐ Did the customer discover or report the loss of any checks?
- ☐ Did the customer submit a declaration of loss?
- ☐ Has the customer previously experienced unauthorized transactions regarding its accounts (in which case the customer should have exercised greater care)?[34]
- ☐ Did the customer report the loss in a timely fashion?

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[29] See Cal. Fin. Code §§ 1451 and 1620 for property held at banks, and Cal. Fin. Code § 6661 for property held at a savings and loan.

[30] California does not use the "substantially contributes" wording found in other state codes. See UCC Official Comment No. 2 for an explanation of what is meant by "substantially contributes."

[31] Note the use of "forged signature," rather than "unauthorized signature" in UCC § 3406. The latter is a broader concept that includes not only forgeries but also the signature of an agent that does not bind the principal under the law of agency. UCC Official Comment No. 2 to § 3406.

[32] UCC § 3406. The UCC displaces common law actions for negligence based on forged signatures. *Roy Supply, Inc. v. Wells Fargo Bank*, 39 Cal. App. 4th 1051, 1066, 46 Cal. Rptr. 2d 309 (1995); *Newman v. Wells Fargo Bank*, 87 Cal. App. 4th 73, 85, 104 Cal. Rptr. 2d 310 (2001); *Johnson Dev. Co. v. First Nat'l Bank of St. Louis*, 999 S.W.2d 314, 318 (Mo. Ct. App. 1999); *Berthot v. Security Pacific Bank of Arizona*, 170 Ariz. 318, 823 P.2d 1326 (1991). Section 3406 requires the bank to act "in good faith" before it can assert its customer's negligence. Good faith does not mean the absence of negligence, even though UCC § 1201(b)(20) (formerly § 3103) defines "good faith" to mean "honesty in fact and the observance of reasonable commercial standards of fair dealing." *Any Kind of Checks Cashed, Inc. v. Talcott*, 830 So. 2d 160, 2002 WL 31255509 (Fla. Dist. Ct. App. 2002); *Gerber & Gerber, P.C. v. Regions Bank*, 266 Ga. App. 8, 596 S.E.2d 174 (Ga. Ct. App. 2004); *San Tan Irrigation District v. Wells Fargo Bank*, 3 P.3d 113 (Ariz. Ct. App. 2000). *See also* UCC comments to §§ 1201(b)(20) and 3406. UCC Bulletin, July 2005, "The Good Faith Standard For Holder in Due Course Status Under UCC Revised Article 3: The Wheels Keep Turning -- So Far."

[33] *Jurcisin v. Fifth Third Bank*, 2006 WL 2918569 (Ohio 2006) (Plaintiff negligently allowed new roommate to have access to checks).

[34] Husband not liable for checks forged by wife living with him, even though he was aware of her prior financial misdeeds, since he made reasonable attempts to prevent her from gaining access to checks. *Nesper v. Bank of America*, 2004 WL 628783 (Ohio Ct. App. 2004).

- ☐ How long did the forgeries go on?
- ☐ Should the forgeries have been noticed due to the amounts in question?
- ☐ Do the forged signatures resemble the customer's signature?
- ☐ Did the customer actually review statements and canceled checks?
- ☐ Did the customer maintain a check register? Ask to see it.
- ☐ Should the customer have noticed the forgeries based on the names of the payees? Were vendors complaining about past due debts?
- ☐ Did the customer ignore reports that reflected unauthorized activity (e.g., Positive Pay reports or ATM balance inquiries)?

In the case of dishonest bookkeepers:

- ☐ Did the customer follow careless office procedures?
- ☐ Did the customer fail to separate the checkwriting and statement review functions?[35]
- ☐ Did the customer adopt and follow audit procedures?
- ☐ Was the customer careless in handling facsimile signature stamps or devices?[36]
- ☐ Did the customer fail to do a background check of the employee (e.g., check references) or knowingly hire an untrustworthy employee (e.g., someone with a criminal record)?[37]
- ☐ Has the customer filed a police report?

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[35] *G.D.F. Enterprises, Inc. v. Nye*, 37 Ohio St.3rd 205, 525 N.E.2d 10 (1988) (negligent hiring and training; unsupervised employee); *Elliott Black v. Whitney National Bank*, 618 So. 2d 509 (1993) (lack of supervision); *Mid-America Clean Water Systems, Inc.*, 159 B.R. 941 (Bankr. Kan. 1993) (lack of supervision).

[36] Use of a fraudulently made facsimile signature stamp is a forgery. *MBTA Employee Credit Union v. Employers Mut. Liab. Ins. Co.*, 374 F. Supp. 1299 (D. Mass. 1974). *See also Cumis Ins. Soc'y Inc. v. Girard Bank*, 522 F. Supp. 414 (D. Pa. 1981) (facsimile check agreement; bank cannot disclaim responsibility); *Citizens Fid. Bank & Trust Co. v. Southwest Bank & Trust Co*., 238 Neb. 677, 472 N.W.2d 198 (1991) ("notice" vs. "knowledge"; counterfeit check is an "item" containing a "forgery"; depositary bank may be a "holder"; maker's bank still subject to midnight deadline rule); and *Zambia Nat'l Commercial Bank, Ltd. v. Fid. Int'l Bank*, 855 F. Supp. 1377 (D.N.Y. 1994) (negligence contributing to counterfeit check loss).

[37] *Stenseth v. Wells Fargo Bank*, 41 Cal. App. 4th 457, 48 Cal. Rptr. 2d 192 (1995) (plaintiff exercised due care); *Firemans Fund Ins. Co. v. Bank of New York*, 146 A.D.2d 95, 539 N.Y.S.2d (1989) (failure to investigate); *Commercial Credit Equipment Corp. v. First Alabama Bank of Montgomery*, 636 F.2d 1051 (1981) (failure to do background check and safeguard checks).

- ☐ Did the customer fail to take preventative action after learning of a forgery or alteration (e.g., conducting an investigation and suspending the employee in question)?

- ☐ Did the customer follow any fraud prevention recommendations made by the bank (e.g., in the account agreement)?

(8) **The signature was made by the customer's agent**. The signature may be valid if it was made by someone with authority (e.g., under a power of attorney or agency agreement).[38]

Lines of Inquiry:

- ☐ Although the representative may not be a designated signer on the account signature card, was (s)he authorized to act on behalf of the customer by contract, power of attorney, or as shown by a course of conduct (e.g., where the customer may have permitted the representative to sign checks previously)? Check the account history for other checks written by the representative (perhaps, with the knowledge of the customer or to pay the customer's bills).

- ☐ Did the customer allow others to sign his name when he was out-of-town? (This sometimes happens on business accounts where there are only one or two authorized signers.)

- ☐ Did the customer allow the representative to enter into other agreements generally on its behalf (without the benefit of any authorization on file)?

- ☐ Check the customer's deposit and cash management resolutions, authorizations, powers of attorney, and agreements for evidence of the representative's authority to act.

(9) **Lack of ordinary care by depositary or collecting banks.** As a general rule, payor banks will have difficulty shifting forged maker losses to depositary and collecting banks, even if they have dealt directly with the forger, if they are "holders in due course" or have in good faith changed their position in reliance on

[38] If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. UCC § 3402. *Dement v. Red River Valley Bank*, 506 So. 2d 1329 (La. App. 2 Cir. 1987) (No forgery occurred when authorized signer used fictitious name on checks; citing UCC § 3401); *Rohrbacher v. BancOhio Nat'l Bank,* 567 N.Y.S.2d 431 (N.Y. App. Div. 1991) (attorney-client agreement contained authorization); *Triffin v. Ameripay, LLC*, 2004 WL 1066244 (N.J. Super. Ct. App. Div. 2004) (employer named in upper left-hand side of payroll check issued by payroll company, rather than payroll company, was liable for check even though payroll company's agency status not reflected on check). An Indorsement of an instrument by one of the partners of a partnership may be deemed effective as against the partnership, for example. Cal. Fin. Code § 1451 provides that, when the depositor has authorized any person to sign on an account, in the absence of written notice otherwise, the bank may assume that the check was authorized.

the payor bank's payment of the check. Collecting banks are required only to exercise ordinary care.[39]

– Exception: Where there is a breach of presentment warranty.[40] Note, however, that depositary and collecting banks give only a limited warranty: that the warrantor has no knowledge that the signature of the drawer is unauthorized. Negligence is usually not a factor in determining the liability of a depositary or collecting bank on forged maker checks. The test is sometimes referred to as that of a "pure heart and empty head." The code requires that the collecting bank take the item in "good faith."

– When a Federal Reserve Bank prepares and presents on behalf of a sender a photocopy of an item reported lost or destroyed, the sender guarantees all prior and any missing indorsements. Upon payment of the photocopy, the sender agrees to hold each collecting bank and the paying bank harmless from any loss suffered, if payment is stopped on the original check and the original check (as well as any electronic or paper derivative from the original check) remains unpaid.[41]

Lines of Inquiry:

☐ Were the circumstances of the depositary bank's acceptance such that it was put on notice of a problem involving the check?[42]

☐ Was the forgery obvious (e.g., white-out and ink of a different color)?

☐ Did the depositary bank open the account negligently (e.g., failing to obtain identifying information)? Did it follow its own written procedure?

☐ Did the depositary bank misapply the check proceeds?[43]

(10) **The signature was authorized**. Do not assume that the signature is not that of the customer merely because the customer makes that claim.[44]

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39 UCC §§ 3103(a) (7) and 4202.

40 UCC §§ 3417 and 4208.

41 Federal Reserve Bank Operating Circular No. 3, ¶ 22.4(b). Similar arrangements may be available under certain clearing house rules.

42 *Waukon Auto Supply v. Farmers & Merch. Sav. Bank*, 440 N.W.2d 844 (Iowa 1989) (collecting bank had notice of potential fraud by bookkeeper).

43 Lockbox bank which credited the wrong account was liable to the drawer of the check. The drawee bank did not violate the "properly payable" rule. *Cellco P'ship v. Federal-Mogul Global, Inc.*, 31 B.R. 363 (Bankr. D. Del. 2005).

44 "Unauthorized" signature is defined at UCC § 1201(41).

Lines of Inquiry:

- ☐ Does the signature appear to be that of the customer?
- ☐ Has the customer been experiencing financial difficulty?
- ☐ Does the customer know how the forgery was made or who received the benefit of the funds?
- ☐ Is the customer reluctant to file a police report or provide information about the loss?
- ☐ Was the customer's use of the account abnormal during the period in question (suggesting, perhaps, that the customer knew about the forgery or had access to the funds)?
- ☐ Did the customer or any member of the customer's family benefit from the proceeds?

(11) **The check is a demand draft**. The depositary bank, rather than the payor bank, is responsible for unauthorized maker signatures for demand drafts. [Note: This applies to California and at least 18[45] other states whose Commercial Codes address the issue of demand drafts.]

– Definition. A "demand draft" is an instrument not signed by a customer that is created by a third person, purportedly with the authority of the customer.[46] It normally contains the statement "No signature required, "Signature on file" or words to that effect in the space generally reserved for the maker's signature.

– Warranty. If a check is a demand draft, the person who transfers it for consideration warrants that creation of the instrument according to the terms on its face was authorized by the person identified as the drawer. The depositary bank, which is charged with knowing its customer, assumes the risk of an unauthorized transaction.[47]

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[45] At least 18 other states have adopted similar legislation, following California's form or the form advanced by the Uniform Law Commission ("ULC," formerly the National Conference of Commissioners on Uniform State Laws): Colorado; Hawaii; Idaho; Iowa; Maine; Minnesota; Missouri; Nebraska; Nevada; New Hampshire; North Dakota; Oregon; Tennessee; Texas; Utah; Vermont; West Virginia; and Wisconsin

[46] UCC § 3104(k). Demand drafts do not include instruments that bear the forged or unauthorized signatures of customers. Demand drafts do not include instruments drawn or purportedly drawn and signed by a fiduciary. Instruments bearing forged or unauthorized signatures should be handled under the forgery and unauthorized signature provisions of UCC Articles 3 and 4. *See* Legislative intent to California UCC § 3104(k).

[47] UCC §§ 3417(a) (4) and 4208(a) (4). In those states following California or ULC, the depositary bank may, in turn, turn to its customer to cover its liability as warrantor under UCC §§ 3416(a)(6) and 4207(a)(6). Alternatively, the depositary bank may turn to its customer under the terms, if any, of an account agreement.

– Other states. The warranty of the depositary bank is not given if it is not returned. For example, banks in other states which have not adopted a provision similar to that of California do not receive the benefit of the warranty if they are not required to provide the warranty under their local law.[48]

(12) **Claimant is not bank's customer**. The person bringing the claim is not the bank's customer.[49] For example, the president of a corporation has no standing to sue the bank for its payment of a forged check drawn on the corporation's account.[50]

(13) **The paying and depositary banks both have not opted out of ECCHO Operating Rules § XIX(O) (Rule 9)**. If the paying bank and the depositary bank have both not opted out to be bound by Rule 9,[51] the bank of first deposit (rather than the paying bank) warrants that: (a) all signatures on the item are authentic and authorized, and the item is not a maker forgery, and (b) the related physical item is not counterfeit. As such, the bank of first deposit agrees to assume responsibility for forged maker and counterfeit checks, provided:

– The customer of the paying bank has notified the paying bank of the forgery/counterfeit item within 60 days of the statement date;

– The paying bank presents an adjustment to the depositary bank within 15 days of a claim;

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48 UCC §§ 3417(h) and 4207(f).

49 "Customer" is defined at UCC § 4104(a)(5) as "[a] person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank." A bank owes no duty to a noncustomer. *Eisenberg v. Wachovia Bank, N.A.*, 301 F.3d 220 (4th Cir. 2002).

50 *Roy Supply v. Wells Fargo Bank, N.A.*, 39 Cal. App. 4th 1051, 46 Cal. Rptr. 2d 309 (1995); *Loucks v. Albuquerque Nat'l Bank*, 418 P.2d 191 (N.M. 1966) (partner may not sue personally for wrongful dishonor of partnership checks); *Farmers Bank v. Sinwellan Corp.*, 367 A.2d 80 (Del. 1976) (president may not sue); *Singleton v. American Security Bank of Ville Platte, Inc.*, 849 So. 2d 72 (La. Ct. App. 2003) (primary shareholder has no standing for wrongful dishonor); *Rodriguez v. Bank of the West*, 162 Cal. App. 4th 454, 75 Cal. Rptr. 3d 543 (No duty to lawyer whose office manager committed identity theft and opened account in lawyer's name; no liability for failing to follow procedure in opening account; no liability to him as a "putative customer" or involuntary customer; name on signature card did not make him a customer under UCC § 4104(a)(5)); *Dodd v. Citizen's Bank of Costa Mesa*, 222 Cal. App. 3d 1624 (1990); *Thrash v. Georgia State Bank of Rome*, 375 S.E.2d 112 (Ga. App. 1988) (minority shareholder is not a customer); *Plummer v. Prairie State Bank*, 951 F.2d 1260 (10th Cir. 1991) (husband and wife used corporate existence to argue that their personal debts could not be charged to corporation). A bank owes no duty to non-customers to investigate or disclose suspicious activities on the part of an account holder. *Casey v. United States Bank Nat. Assn.*, 127 Cal. App. 4th 1138 (2005); *Gil v. Bank of America*, 138 Cal. App. 4th 1371 (2006); *Software Design & Application, Ltd. v. Hoefer & Arnett, Inc.*, 49 Cal. App. 4th 472, 479 (1996). But *see Jana v. Wachovia, N.A.*, 2006 WL 3731190 (Pa.Com.Pl.), 61 UCC Rep.Serv.2d 583 (Not reported in A.2d) (owner of subchapter S corporation allowed to bring suit for wrongful dishonor under UCC § 4402); *Karsh v. American City Bank*, 169 Cal. Rptr. 851 (Cal.App. 1980) (president and sole owner of corporation that hadn't issued stock and was transparent shell can sue for wrongful dishonor); *Kendall Yacht v. United California Bank*, 123 Cal.Rptr. 848 (Cal. App. 1975) (owner of corporation that hadn't issued stock and was a transparent shell can sue for wrongful dishonor); *Parrett v. Platte Valley State Bank*, 459 N.W.2d 371 (Neb. 1990) (president, guarantor and principal shareholder of small company may sue for wrongful dishonor); *Murdaugh Volkswagen, Inc. v. First National Bank*, 801 F.2d 719 (4th Cir. 1986) (bank's acceptance of personal guarantee from president for corporation's liability justified a finding that he was a customer); and *Koger v. East First National Bank*, 443 So. 2d 141 (Fla. App. 1983) (corporation as an undercapitalized shell); and *Kesner v. Liberty Bank & Trust Co*., 390 N.E.2d 259 (Mass. App. 1979) (importance of capitalization in determining customer status).

51 Banks may opt out of Rule 9 by notifying ECCHO. The CHECCS Operating Rules have adopted ECCHO Operating Rules § XIX(O) except that § XIX(O)(12) has been superseded by CHECCS Operating Rules version thereof .

– There are sufficient funds in the customer's account at the depositary bank to cover the full amount of the check; and

– The depositary bank is unable to establish that the signature is effective or that the drawer is precluded from asserting that the drawer's signature is unauthorized.

– The depositary bank may seek to reduce its liability under a breach of warranty on the basis that the paying bank did not exercise ordinary care or act in good faith.[52]

(14) **Check was converted to an ACH debit.** If so, the allocation of loss would be resolved under the NACHA rules and Regulation E.

(15) **Signature was by a "responsible employee."** *See* Section 2.B.(13).

C. Depositary Bank Defenses

(1) **The depositary bank, generally, is not liable for forged maker checks if it acts with ordinary care**.[53]

(2) **Midnight deadline**. If the depositary bank acts with ordinary care, the payor bank is liable for the check if it fails to return it within its midnight deadline (See Section 5.A.).[54]

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[52] ECCHO Operating Rules § XIX(O)(11).

[53] *Kane v. Bank of America*, 67 Cal. App. 4th 1192, 79 Cal. Rptr. 2d 712 (1998). As between the maker's bank and the depositary bank, the maker's bank is liable for a counterfeit check where the drawer was fictitious. In such a case, the depositary bank becomes the "holder" of the check. Since the entire check was counterfeit, there was no "alteration" and the depositary bank did not breach any § 4205(a) (1) or (2) warranties. *Firstar Bank, N.A. v. Wells Fargo Bank, N.A.*, 2004 WL 1323942 (N.D. Ill. 2004). *See* Section 3.D.(10) regarding counterfeit checks. Even if the depositary bank does not operate with ordinary care in opening an account, it may not be liable if its negligence is not the cause of the loss (i.e., the negligence does not involve "paying or taking the instrument"). *Auto-Owners Ins. Co. v. Bank One*, 852 N.E.2d 604 (Ind. Ct. App. 2006).

[54] A bank that finally pays a counterfeit cashier's check or official check ostensibly issued by it becomes responsible for the item under the midnight deadline rule, even if its payment of the check is by mistake. UCC §§ 3418 and 4302. The bank cannot prevail on a breach of warranty theory against the payee under UCC §§ 3417 and 4208 because the warranty is limited to forged endorsement claims. There is no warranty with respect to counterfeit checks. *Northern Trust Co. v. Chase Manhattan Bank*, 582 F. Supp. 1380, *aff'd per curiam*, 748 F.2d 803 (2nd Cir. 1984) (bank liable for paying its own stolen official check).

2. FORGED PAYEE CHECKS

A. General Rule

- **Depositary and collecting banks warrant good title and that no endorsement necessary to title has been forged.**[55]

- **A payor bank is liable to its customer for forged payee checks.**[56]

- **As between the depositary bank and the payor bank, the depositary bank is usually liable for forged payee checks.**[57]

- **As between the depositary bank and its customer, the customer is liable for forged payee checks.**[58]

- **Liability is limited to the loss suffered by the breach, but not more than the amount of the check plus expenses and loss of interest incurred as a result of the breach.**[59]

  – Breach of warranty. Since forged payee indorsements are ineffective,[60] depositary and collecting banks are liable to subsequent transferees (e.g., the payor bank)[61] and may recover from previous transferors for breach of warranty based on forged indorsements.

  – Claims and defenses. Persons taking checks with forged or missing indorsements are not "holders" and cannot be holders in due course, even

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55 UCC §§ 3416, 3417, 4207 and 4208. Liability for breach of presentment warranty cannot be disclaimed (UCC § 4208(e)). Although UCC § 4103(a) gives banks the right to modify the rules of the UCC by agreement, that does not apply to presentment warranties. *Bank One Dearborn, N.A. v. Wachovia Bank*, 2005 WL 67073 (E.D. Pa. 2005) (reference to Uniform Rules for Collection 552 for international collection cannot defeat warranty claim).

56 Forged payee checks are not properly payable. See California Code Comment to 1992 Amendment for UCC § 4401(a). The rule does not apply to checks that are paid to "cash" or that are endorsed in blank with the payee's actual Indorsement, followed by the forged Indorsement of another person. UCC § 3205(b). If the payor bank is sued for conversion, it should give notice of the suit to the depository bank and request the depository bank to defend it against the claim. UCC § 3119.

57 The payor bank does not have a duty to check payee Indorsements. *Guardian Life Ins. Co. of America v. Weisman*, 223 F.3d 229 (3d Cir. 2000). Liability of a bank is governed by the law of the place where the branch is located. UCC § 4102(b).

58 UCC §§ 3416(a)(1) and 4207(a)(1).

59 UCC §§ 3416(b), 4207(c). The measure of liability against the payor bank for conversion is presumed to be the amount payable on the check, but recovery may not exceed the amount of the plaintiff's interest in the check. UCC § 3420(b). A collecting bank which takes forged payee checks in good faith and in accordance with reasonable commercial standards is not liable in conversion to the true owner beyond the amount of any proceeds remaining in its hands. UCC § 3420(c). A depositary bank is not liable for § 3420 conversion to the beneficial owner/assignee of funds who is not the payee of stolen checks. *American Nat'l Ins. Co. v. Citibank, N.A.*, 2008 WL 4172668 (7th Cir. 2008).

60 UCC §§ 3401 and 3403.

61 *Mills v. U.S. Bank*, 166 Cal. App. 4th 871, 83 Cal. Rptr. 3d 146 (drawer is not a "transferee").

if they act in good faith and take the checks for value and without notice of a defense or claim.[62]

– Conversion. A check is converted when it is paid on a forged endorsement.[63] If a check is received by the payee,[64] stolen by someone, and then cashed on a forged endorsement, the payor bank is liable to the payee for the amount of the check. Note: An action for conversion may not be brought by the issuer[65] or acceptor of the check or by a payee or endorsee who did not receive delivery of the check either directly or through delivery to an agent or a co-payee.[66] Drawers normally bring suit against the payor bank under § 4401, rather than for conversion or breach of warranty.[67] Payees that receive delivery of checks may sue the collecting bank for conversion.[68]

– Fiduciaries. When a check is payable to a represented person (i.e., principal, beneficiary, or company) or the fiduciary, as such, the bank is put on notice of a potential breach of fiduciary duty if the check is used to

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[62] A depositary bank may become a holder under UCC § 4205 if it receives the item from a customer who was a holder of the item at the time of delivery. Under UCC § 4205, the depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account. *See* UCC § 1201(b)(21) for the definition of "holder." When a check is payable to A and B, but is indorsed only by A, A is not a "person entitled to enforce" the instrument (UCC § 3301) and is not a "holder" (UCC § 3110(d) and comment to UCC § 3420). Note that the UCC supersedes a payee's common law cause of action for negligence when the collecting bank accepts a check with a missing indorsement. Missing indorsements on an organization's checks are unauthorized indorsements within the meaning of the UCC (§ 3403(b)), and a negligence action is "displaced" and subsumed by a conversion action. *Gil v. Bank of America National Association*, 138 Cal. App. 4th 1371, 42 Cal. Rptr. 3d 310; *Roy Supply, Inc. v. Wells Fargo Bank* (1995) 39 Cal. App. 4th 1051, 1066; *Cal. Mill Supply Corp. v. Bank of America* (1950) 36 Cal. 2d 334, 339; *Feldman Constr. Co. v. Union Bank* (1972) 28 Cal. App. 3d 731, 736. *See Mills v. U.S. Bank*, 166 Cal. App. 4th 871, 83 Cal. Rptr. 3d 146, for a discussion of the difference between statutory and common law claims of negligence. Depositary bank has no statutory duty of care to drawer for taking checks with missing indorsement. No cause of action under UCC §§ 4103, 3409, 3405, 3406 or 4202.

[63] UCC § 3420. In an action for conversion, the measure of damages is presumed to be the amount payable on the check, but recovery may not exceed the amount of the plaintiff's interest in the item. Under UCC § 3420(c), the liability of the depositary bank for conversion to the owner of the check is not limited to the amount of the proceeds not paid out. UCC § 3420 displaces common law theory of conversion. *Empire State Capital Corp. v. Citibank, N.A.*, 2011 WL 4484453 (S.D.N.Y. 2011).

[64] A check is received when it is put in the payee's mailbox or delivered to its agent or co-payee. Comment to UCC § 3420.

[65] The rationale for precluding a drawer from suing on a conversion action is that the check represents an obligation of the drawer rather than the property of the drawer. *Mid-Continent Specialists, Inc. v. Capital Homes, L.C.*, 2005 WL 387252.

[66] *Jenkins v. Wachovia Bank, N.A.*, 309 Ga. App. 562, 711 S.E.3d 80 (2011). Plaintiff which did not receive check cannot recover under a common law theory of conversion or common law negligence, as common law is displaced by the UCC. *Olympic Title Co. v. Fifth Third Bank*, 2004 WL 2009285 (Ohio Ct. App. 2004; not officially published). *See also* § 1103. Allowing a payee to sue for negligence would be an "end run" around the statutory requirements. *Halifax Corp. v. Wachovia Bank*, 604 S.E.2d 403 (Va. 2004) (UCC § 3406 can't be used as a "sword," but only as a "shield"). *See also Lee Newman, M.D. Inc. v. Wells Fargo Bank*, 87 Cal. App. 4th 73 (2001) (can't use UCC § 3405 to do an end run around UCC § 3420). *See also ALG, Inc. v. Estate of Eldred*, 29 Kan. App. 2d 1011 (2001). *See* Official Comment 1 to UCC § 3420.

[67] The remedy of the payor bank is against the depositary bank for breach of warranty under UCC §§ 3417(a) (1) or 4208(a) (1). *See* Official Comment 1 to UCC § 3420.

[68] Defenses to conversion: UCC § 3118(g) (3 year statute of limitation); UCC § 3404 (imposter or fictitious payee); UCC § 3405 (responsible employee); UCC § 3420(a) (check not received by payee plaintiff); UCC § 3420(a) (plaintiff is drawer); UCC § 3406 (negligence facilitated the fraud); UCC § 3110(d) (manner of payment; check payable in alternative); endorsement not unauthorized; common law defenses under UCC § 1103 (*e.g.*, laches).

pay the personal debt of the fiduciary or deposited to his account.[69] Unless the bank is aware of a breach of fiduciary duty, it is not deemed to know that a check issued by the represented person or the fiduciary, as such, and made payable to the fiduciary personally is a breach of fiduciary duty.[70] If a check is issued by the represented person or the fiduciary, as such, to the bank as payee, the bank has notice of a breach of fiduciary duty if the check is: (a) taken in payment of or as security for a debt known by the bank to be the personal debt of the fiduciary, (b) taken in a transaction known by the bank to be for the personal benefit of the fiduciary, or (c) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.[71]

– Payee must have loss. The payee may proceed against the payor bank only if the underlying debt for which the check was given has been extinguished. Otherwise, there would be no loss.[72]

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69 UCC § 3307. Note that § 3307 does not contain a comparative fault provision like that of UCC § 3405(b) for checks made payable to a corporation which are deposited by a dishonest employee into his personal account.

70 *Casey v. U.S. Bank National Association*, 127 Cal. App. 4th 1138, 26 Cal. Rptr. 3d 401 (2005) (Bank not liable for aiding and abetting a depositor's breach of fiduciary duty absent actual knowledge of the underlying wrong the depositor is perpetrating). *Collins v. First Union National Bank*, 272 Va. 744, 636 S.E.2d 442, 61 UCC Rep. Serv. 2d 257 (Virginia 2006) (Beneficiaries of a "For Benefit of" account are not customers of the bank). *Jelmoli Holding, Inc. v. Raymond James Financial Services, Inc.*, 470 F.3d 14 (1st Cir. 2006) (plaintiff must show knowledge by the taker, and not just warning clues, that the person tendering the check is a fiduciary). A bank has no duty to monitor trust accounts for breaches of fiduciary duty. California Financial Code §§ 1450 and 1451. *United States v. First Nat. Bk.*, 18 Cal.App. 437 (1912) (guardian of a minor dissipated trust funds); *La Vista Cemetery Assn. v. American Sav. & Loan Assn.*, 12 Cal.App.3d 365 (1970); *Blackmon v. Hale* (1970) 1 Cal.3d 548, 83 Cal.Rptr. 194, 463 P.2d 418. The relationship between a bank and a depositor is not a trust. *Price v. Wells Fargo Bank* (1989) 213 Cal.App.3d 465, 476 (banks "are not fiduciaries for their depositors"). *Copesky v. Superior Court* (1991) 229 Cal.App.3d 678. The bank contract does not involve any implied duty "to supervise account activity." *Software Design & Application, Ltd. v. Hoefer & Arnett, Inc.* (1996) 49 Cal.App.4th 472 (Although the bank did not follow its procedures and allowed tortfeasor to open an account for an non-existent partnership, its procedures were for its protection of the bank, not that of third parties). *Keeney v. Bank of Italy* (1917) 33 Cal.App. 515. The bank's contract entails no contractual obligation to persons other than the account holder. *Dodd v. Citizens Bank of Costa Mesa* (1990) 222 Cal.App.3d 1624. Commercial banks have no duty to police their fiduciary accounts. Considerations of confidentiality also militate against imposing on banks a duty to monitor accounts for wrongdoing. *Chicago Title Ins. Co. v. Superior Court* (1985) 174 Cal.App.3d 1142 (escrow company suffered losses in an alleged check kiting scheme. Bank had no duty to disclose suspicions). *Sun 'n Sand, Inc. v. United California Bank* (1978) 21 Cal.3d 671, 148 Cal. Rptr. 329 (bank allowed employee to deposit employer's checks payable to the bank to her account. The circumstances were "sufficiently suspicious" to give rise to a "reasonably foreseeable" risk of loss to the plaintiff. By crediting the account without making reasonable inquiries to verify the employee's authority to make the deposits, the bank "affirmatively engaged in risk-creating conduct" resulting in liability for negligence).

71 UCC § 3307(b). When a check is payable in the name of a bank or brokerage and deposited into an account of someone who does not owe it money, the bank/brokerage may owe a common law duty to the drawer to exercise due care to make sure the drawer intended the depositary to receive its money (*Travelers Casualty and Surety Co. of America v. Wells Fargo Bank, N.A.*, 374 F.3d 521 (7th Cir. 2004)). Although bank did not follow its own procedures in opening the account, the account was labeled as an "escrow" account in the title, bringing it within the "account of the fiduciary as such" exception. Plaintiff's common law claim that the bank could be liable without actual knowledge of its customer's breach of fiduciary duty is displaced by UCC § 1103. Bank had reason to believe checks payable to it were intended for the escrow account. *Quilling v. Compass Bank*, 54 UCC Rep. Serv. 2d 975, 2004 WL 2093117 (N.D. Tex. 2004; not reported in F. Supp. 2d). When there are several payees on a stolen check, any may sue for conversion for the entire amount, but will ultimately be limited to damages for their actual loss. *Saxon Mortg. Services, Inc. v. Harrison*, 186 Md. App. 228, 973 A.2d 841 (2009).

72 *See* UCC Comment 1 to § 3420. Since the payee's right to enforce the underlying obligation is unaffected by the interception of a check by a thief, there is no reason to give any additional remedy to the payee. The maker of the check has no conversion remedy, but the maker's bank is not entitled to charge the maker's account when it wrongfully honored the check. The remedy of the maker's bank is against the depositary bank for breach of warranty under UCC §§ 3417(a) (1) or 4208(a) (1). Ultimately, the loss will fall upon the person who gave value to the thief for the check. For its part, a collecting bank can avoid strict liability for breach of presentment warranty by showing that the intended payee received the proceeds of the check. *Comerica Bank v. Mich. Nat'l Bank*, 27 UCC Rep. Serv. 2d 547 (1995).

– Warranty to payor bank. The payor bank, in turn, has a right to recover its loss from the collecting bank for breach of the presentment warranties.[73]

B. Depositary Bank Defenses.

(1) No forgery.[74] Affidavits of forgery may not always be truthful[75] and/or may be subject to various defenses. As such, the circumstances involving a claim of forgery should be evaluated, if only to confirm that a forgery has taken place. Likewise, any settlement of a claim should include representations regarding the facts, to ensure that a defense (e.g., the "imposter rule" defense, described at Section 2.B.(12)) is not available, that the depositor has not already been compensated for the loss (e.g., by the forger's or maker's bank), that the loss (once discovered) was reported in a timely fashion, that the person is not aware of claims on any other items, and that the settlement will not be deemed an admission of liability by the bank (e.g., with respect to other forged checks yet to be discovered and/or reported).

Lines of Inquiry:

- ☐ Did the forgery involve a facsimile signature of the payee?
- ☐ Was the payee's name actually forged, or was the check deposited without a signature or with a different name in the space for the payee's endorsement?[76]
- ☐ Did the payee report the forgery to the police?
- ☐ Did the payee receive the check?[77] If not, the payee may not have any loss and may not be in a position to make a claim for conversion.[78]

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[73] UCC §§ 3417 or 4208. A person asserting rights under the warranty may recover an amount equal to the amount paid, plus expenses and loss of interest. The right to recover attorneys' fees as "expenses" varies from state to state. *Grasso v. Crow*, 57 Cal. App. 4th 847, 67 Cal. Rptr. 2d 367, (1997) (attorneys fees not recoverable in California). Attorneys' fees may be permitted by some states. *See*: the UCC comments to §§ 3417 and 3418; *TD Banknorth, N.A. v. Key Bank, N.A.*, 463 F.Supp.2d 87; and *Federal Insurance Company v. Pueblo International Insurance*, 5 F.3d 428 (1993) (tort also involved.) Note: The drawer does not have a right to sue the depository bank under UCC §§ 3147 or 4208 (the warranty is given to the drawee/payor bank, not to the drawer). If the payor bank is sued for conversion, it should promptly notify the collecting bank to indemnify it. UCC § 3119.

[74] Checks "endorsed in blank" by firm's clients were not forged. As such, when the bad bookkeeper deposited them to her account, the depositary bank legitimately accepted them for deposit. *Gerber & Gerber, P.C. v. Regions Bank*, 596 S.E.2d 174 (Ga. Ct. App. 2004).

[75] *Chiofalo v. Ridgewood Sav. Bank*, 816 N.Y.S.2d 324 (2006) (bank liable for chargeback of check based on false affidavit of forgery). After final settlement, a voluntary refund by the collecting bank is at its own peril. *622 West 113th Street Corp. v. Chemical Bank N.Y. Trust Co.*, 276 N.Y.S.2d 85 (1966).

[76] If another person's name was inserted, it may not be a "forgery" for certain purposes, e.g., the comparative fault defense of § 3406. *See John Hancock Fin. Serv., Inc. v. Old Kent Bank*, 346 F.3d 727 (6th Cir. 2003) (Depository bank could not assert contributory negligence of payee under § 3406 when its name was not "forged"). If the intended recipient of checks involved in a Ponzi scheme improperly endorsed checks whose deposit he controlled, the improper Indorsement may be irrelevant to the loss. *See Condor v. Union Planters Bank, N.A.*, 384 F.3d 397 (7th Cir. 2004).

- ☐ Has the payee allowed others in the past to endorse its checks? Is the suspected forger known to the payee?
- ☐ Is the payee experiencing financial distress?
- ☐ Does the forged signature resemble the party's actual signature?
- ☐ Did the customer issue a receipt for the check (as evidence of payment)?
- ☐ Was the check stolen from the payee before or after it had endorsed the item?

(2) **Payor bank not liable**. Depositary and collecting banks may not be liable for forged payee checks (e.g., for breach of warranty based on an unauthorized endorsement or alteration) if the payor bank is not liable to its customer (e.g., because the customer is precluded from asserting a claim by its failure to exercise ordinary care or to review statements and report the forgeries in a timely manner).[79] If the payor bank asserts a claim for breach of warranty based on an unauthorized signature or alteration, the depositary bank may defend by proving that: (a) the endorsement is effective under the imposter rule, the fictitious payee rule, or the responsible employee rule, described in (12) and (13) below;[80] or (b) the payor's customer is precluded from asserting the unauthorized endorsement or alteration against the payor due to the customer's lack of ordinary care or its failure to report the problem (e.g., an alteration) in a timely manner.[81]

Lines of Inquiry:

- ☐ Obtain a copy of the other bank's deposit agreement to determine whether its terms preclude the claimant from asserting the claim.
- ☐ Does the payor bank have an agreement with its customer that shortens the time period under the code for reporting unauthorized signatures and alterations?

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[77] The identity of the payee is not determined by the name written on the check, but by the intent of the person who signs the check. If a signee intends a check to be payable to John Smith, but misidentifies him as John Jones on the check, the payee is nevertheless John Smith. The intent of the signer controls even if the check is forged. *Unlimited Adjusting Group, Inc. v. Wells Fargo Bank, N.A.*, 2009 DJDAR 8086 (6/5/09).

[78] UCC § 3420.

[79] If there is a preclusion under UCC § 4406 (e.g., due to the customer's failure to report forgeries within the time limits set by the code or account agreement), the payor bank may not recover for breach of warranty under UCC § 4208 with respect to the unauthorized signature or alteration to which the preclusion applies. UCC § 4406(f). *Manufacturers & Traders Trust Co. v. North Fork Bank*, 791 N.Y.S. 2d 599, 2005 WL 602500. Common law claims are displaced by the UCC. *Willier, Inc. v. Hurt*, 2007 WL 4613033 (S.D. W. Va.).

[80] UCC §§ 3417(c) and 4208(c).

[81] UCC §§ 3406, 3417(c), 4208 and 4406.

- ☐ Does the payor bank have any other agreement with its customer that would prevent the customer from recovering from the payor bank (e.g., a Positive Pay or facsimile signature agreement)?

- ☐ Did the payor bank's customer exercise ordinary care in managing checks, reviewing statements, and reporting unauthorized transactions?

- ☐ Contact the claimant directly to determine whether there are facts (not set forth in the affidavit of forgery) that suggest a defense.

(3) **Maker or intended payee was negligent**. If the maker or intended payee is negligent, and the bank acts in good faith and in accordance with reasonable commercial standards, the maker or intended payee may be precluded from asserting the unauthorized signature.[82] If the bank contributes to the loss by its failure to exercise ordinary care, the loss is allocated between the parties to the extent each contributes to the loss.[83]

Lines of Inquiry:

- ☐ Was the maker or intended payee negligent in the making or handling of the check? Did the maker use a pencil or an erasable ink pen?

- ☐ Did the maker send the check to a person with the same name as the payee?

- ☐ Did the loss occur because the claimant failed to follow reasonable audit procedures?

- ☐ Did the claimant knowingly hire an untrustworthy bookkeeper? Did it employ negligent hiring practices?

- ☐ Did the payee fail to secure its check or facsimile stamp?[84]

- ☐ Has the payee made similar claims in the past?

- ☐ Did the bank act in good faith and in accordance with reasonable commercial standards (e.g., by following its bulk filing procedure)?

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[82] UCC § 3406.

[83] The burden of proving the customer's failure to exercise ordinary care is on the bank, and the burden of proving the bank's failure to exercise ordinary care is on the customer. UCC § 3406. The comparative negligence rule of UCC § 3404(d) does not apply if the intended payee receives the check. *Unlimited Adjusting Group, Inc. v. Wells Fargo Bank, N.A.*, 174 Cal. App. 4th 883, 94 Cal. Rptr. 3d 672 (Bank allowed check to be deposited to an account in a different name than that of the payee; plaintiff not prejudiced).

[84] Payee failed to exercise ordinary care in endorsing and maintaining checks. Payee is liable only if depositary bank acts in good faith ("honesty in fact" and observance of reasonably commercial standards of fair dealing). *Gerber & Gerber, P.C. v. Regions Bank*, 596 S.E.2d 174 (Ga. Ct. App. 2004).

(4) **Unreasonable delay in making claim**. Depositary and collecting banks are discharged to the extent of any loss caused by a party's unreasonable delay (after learning of the forgery) in asserting a warranty claim. A claim against the depositary or collecting bank for breach of warranty must be given within 30 days after the claimant has reason to know of the breach and the identity of the warrantor.[85]

Lines of Inquiry:

- ☐ When did the claimant first discover the forgery? Note that this may be earlier than the date the claimant signed the affidavit of forgery – which may be important in connection with the 30-day rule.[86]
- ☐ When did the claimant first have "reason to know" of the claim?
- ☐ If the claimant had acted more promptly in reporting the claim, could the bank have reduced the amount of the loss?
- ☐ Did the customer submit a declaration of loss, a police report, or an insurance claim?

(5) **Double forgery**. A check bearing the forgery of both the maker's and payee's signatures, generally, is handled as a forged maker check (which shifts the loss to the maker's bank, unless it has a defense).[87]

– Washed checks. A chemically "washed" check may constitute a double forgery if both the maker and payee signatures are removed.[88]

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[85] UCC §§ 3416, 3417, 4207 and 4208. If the maker's bank delays notifying the collecting bank, enabling the forger to withdraw the check proceeds in the interim, the maker's bank can only recover the amount (if any) left in the hands of the collecting bank. If the collecting bank suffers a loss in an action by the true owners, it may seek to recover that loss from the maker's bank. *Cooper v. Union Bank*, 9 Cal. 3d 371, 507 P.2d 609 (1973). Liability is discharged only to the extent the loss was caused by the delay. *Home Indemnity Co. v. First Nat'l Bank of Waukegah*, 659 F.2d 796 (7th Cir. 1981); *First Nat'l Bank of St. Paul v. Trust Co. of Cobb County,* 510 F. Supp. 651 (N.D. Ga. 1981). The collecting bank is responsible for proving the delay caused the loss. *Mich. Nat'l Bank v. American Nat'l Bank & Trust Co.*, 34 Ill. App. 3d 30, 339 N.E.2d 375 (1975).

[86] UCC §§ 3417(e) and 4208(e).

[87] *Perini Corp. v. First Nat'l Bank of Habersham County*, 553 F.2d 398 (5th Cir. 1977); *Winkie, Inc. v. Heritage Bank of Whitefish Bay*, 92 Wis.2d 784, 285 N.W.2d 899 (1979), *aff'd*, 99 Wis. 2d 616, 299 N.W.2d 829 (1981); *Cumis Ins. Soc'y, Inc. v. Girard Bank*, 522 F. Supp. 414 (E.D. Pa. 1981); *Payroll Check Cashing v. New Palestine Bank*, 401 N.E.2d 752 (Ind.App. 1980); *Brighton, Inc. v. Colonial First Nat'l Bank*, 176 N.J.Super. 101, 422 A.2d 433 (1980), *aff'd*, 86 N.J. 259, 430 A.2d 902 (1981); *Nat'l Credit Union Admin. v. Mich. Nat'l Bank of Detroit*, 771 F.2d 154 (6th Cir. 1985). *See Chin & Assoc., Inc. v. First Union Bank*, 256 Va. 59, 500 S.E.2d 516 (1998), regarding the right of the drawer to assert the negligence of the bank of first deposit under UCC §§ 4404 or 4405 for accepting a check with a double forgery. The *Chin* case has not been followed in other jurisdictions. *See*, for example, *San Tan Irrigation Dist. v. Wells Fargo Bank*, 197 Ariz. 193, 195, 3 P.3d 1113,1115 (2000). For a discussion of double forgeries, *see* Brady on Bank Checks, Revised Edition, ¶ 28.11[8]. In a double forgery case involving forged maker and payee signatures by a "responsible employee," the employer may sue the depositary bank for its negligence under UCC § 3405. *Victory Clothing Co., Inc. v. Wachovia Bank, N.A.*, 59 UCC Rep. Serv. 2d 376 (Pa. 2006) (not reported in A.2d).

[88] Counterfeit checks are treated generally as forged maker checks. *See* 3.D (10). When it is unclear whether a check has been changed by an alteration of the original check or by its duplication (i.e., a counterfeit check -- making it a "forged check"), the court may treat it as an altered check, even though the drawee bank has destroyed the original check. *Wachovia Bank, N.A. v. Foster Bancshares*, 457 F.3d 619 (7th Cir. 2006). The opposite result was reached in an unpublished opinion of the Fourth Circuit. *Chevy Chase Bank, FSB v. Wachovia*

– Comparative negligence. Loss may be allocated between the payor bank and the depositary bank based on the extent that each is negligent and contributed to the loss.[89]

(6) **No loss to maker**.[90] A maker who suffers no loss (e.g., because the proceeds reached the intended payee[91] or the check was used to pay the maker's debt) cannot recover from the maker's bank or another party.[92]

(7) **No loss to payee**. A payee who does not receive the forged check cannot claim a loss since the underlying debt by the maker has not been paid.[93]

– Payee's holder status. Until delivery, a payee has no interest in the check and doesn't become a "holder." As such, the payee cannot enforce the check.

– Co-Payees. If a co-payee forges the signature of the other payee, the defrauded payee is entitled only to what would have been his or her share of the check proceeds.[94]

Bank, N.A., 61 UCC Rep. 2d 458, 2006 WL 3522503 (2006). Note: Bank operations attorneys are split on whether a check that has been signed by an authorized person and then chemically wiped clean and resigned by a forger should be treated as a forged maker check. There are good arguments for each position.

89 UCC §§ 3404(d) and 3405(b). No common law negligence claim against bank. *Newman v. Wells Fargo Bank*, 87 Cal. App. 4th 73, 104 Cal. Rptr. 2d 310 (2001); *Willier, Inc. v. Hurt*, 64 UCC Rep. 2d 759, 2007 WL 4613033 (S.D. W. Va) (depository bank also owes no duty of care to non-customers).

90 *Thigpen v. Allstate Indem. Co.*, 757 F. Supp. 757 (1991). UCC § 4207 and § 4208 presentment and transfer warranties do not inure to the benefit of the drawer. *Mills v. U.S. Bank*, 166 Cal. App. 4th 871, 882-883. UCC § 4207 warranties do not apply to payees. *Gil v. Bank of America, N.A.*, 138 Cal. App. 4th 1371. Note that the revised 1992 version of the UCC repudiates the ruling of *Sun N' Sand, Inc. v. United California Bank* with respect to the warranties.

91 *Ohio Bell Tel. Co. v. BancOhio Nat'l Bank*, 27 Ohio App. 3d 8, 499 N.E.2d 327 (1985). *Bank of Miami Beach v. Newman*, 163 So. 2d 333 (1964). *Balsbaugh v. Fidelity Brokerage Services, LLC*, 866 N.E.2d 1002 (Mass. Ct. App. 2007).

92 *Comerica Bank v. Mich. Nat'l Bank*, 211 Mich. App. 534, 536 N.W.2d 298 (1995). No loss when intended payee received funds. *Ohio Bell Tele. Co. v. BankOhio Nat'l Bank*, 27 Ohio App. 3d 8, 499 N.E.2d 327 (1985); *Stella v. Dean Witter Reynolds*, 241 N.J. Super. 55, 574 A.2d 468 (1990). Maker received consideration when check was endorsed by an unauthorized person acting for the corporation. *McCook v. First State Bank of Abilene*, 367 S.W.2d 66 (Tex. Civ. App. 1963). The maker of the check with a forged payee Indorsement may not sue the depositary bank for conversion. The maker's remedy is against the payor bank for recredit to the maker's account for unauthorized payment of the check. *See* UCC Comment to § 3420. The remedy of the payor bank is against the depositary bank for breach of warranty under UCC §§ 3417(a) (1) or 4208(a) (1). The loss will fall on the person who gave value to the thief for the check.

93 *Justus Co. v. Gary Wheaton Bank*, 509 F. Supp. 103 (N.D. Ill. 1981); *Mazon Associates, Inc. v. Comerica*, 195 S.W.3d 800 (Tex. Civ. App. 2006). Actual or constructive delivery is essential for a conversion action by the payee. *Hartsock v. Rich's Employees Credit Union*, 279 Ga. App. 724, 632 S.E.2d 476 (2006) (unless payee receives the check, it cannot sue for conversion). Until delivery, the payee has no interest in the check and is not a "person entitled to enforce" the check. UCC § 3301. See UCC § 3420 Official Comment No. 1.

94 Comment to UCC § 3420. *Southern Cal. Permanente Med. Group v. Bozinovski*, 148 Cal. App. 3d 503, 196 Cal. Rptr. 150 (1983). UCC § 3420(b). *American State Bank v. Union Planters Bank, N.A.*, 332 F.3d 533 (8th Cir. 2003) (Bank's obligation for damages reduced by loan payments to plaintiff by co-payee that deposited the check). *Mueller v. Fidelity-Baltimore Nat'l Bank*, 226 Md. 629, 174 A.2d 789 (1961) (co-payee could not establish her entitlement to any of the check proceeds). *Bloomquist v. Zion's First Nat'l Bank*, 18 Utah 2d 65, 415 P.2d 213 (1966) (check payable to car dealer and borrowers. No damages despite borrower's signature forgery as funds were meant for dealer).

– Delivery. Delivery to one of two or more co-payees is deemed to be delivery to all of the payees.[95]

– Deposit to Joint Account. Deposit of the check (without the payee's endorsement) to a joint account of the payee and another person may be acceptable.[96]

A bank is not liable to a payee who suffers no loss.[97]

Lines of Inquiry:

☐ Was the check payable to the co-payees in the alternative or in an ambiguous manner? If so, the check may have been properly paid to any of the co-payees.[98]

☐ Did the payee actually receive the check (directly, through a co-payee or an agent)?[99]

☐ Did the payee receive a replacement check from the maker?

☐ Did the payee benefit in any manner from the check or its proceeds?[100]

(8) **Ratification**. As with forged maker checks, a person's actions with respect to the transaction may preclude him from asserting the forgery.[101]

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95 See UCC Comment to § 3420.

96 *Marshall v. First Bank & Trust*, 848 So. 2d 660 (La Ct. App. 4 Cir. 2003). *LaMonte v. Sanwa Bank Cal.*, 45 Cal. App. 4th 509, 52 Cal. Rptr. 2d 861 (1996) (Bank issues check to wife; husband intercepts check and deposits it (with only his Indorsement) to the joint account of husband and wife; without the knowledge of the wife, husband removes funds to pay gambling debts – bank has no duty to review Indorsement on back of items and is not liable to wife).

97 *Kaskel v. Northern Trust Co.*, 328 F.3d 358 (7th Cir. 2003) (Payee delivered check to third party without payee's Indorsement; no loss due to lack of Indorsement); *Richards v. Seattle Metro. Credit Union*, 117 Wash. App. 30, 68 P.3d 1109 (2003) (Funds deposited into UTMA rather than trust account. UTMA was the functional equivalent of trust account). *Starkey Constr. Co. v. Elcon, Inc*., 248 Ark. 258, 457 S.W.2d 509 (1970); *Trans-American Steel Corp. v. Federal Ins. Co.*, 535 F.2d 1185 (D. Ga. 1982) (payee settled claim with forger).

98 UCC § 3110(d).

99 Bank not liable when check payable to wife was deposited by husband to account of husband and wife. *LaMonte v. Sanwa Bank California*, 45 Cal. App. 4th 509 (1996).

100 No liability if no loss occurred. *Comerica Bank v. Mich. Nat'l Bank*, 27 UCC Rep. Serv. 2d 547 (1995); *Ambassador Fin. Serv. v. Ind. Nat'l Bank*, 605 N.E.2d 746 (Ind. 1992); *Bankers Trust of S.C. v. S.C. Nat'l Bank of Charleston*, 284 S.C. 238, 325 S.E.2d 81 (1985); *Segel v. First State Bank of Miami*, 432 So. 2d 1378 (Fla. Dist. Ct. App. 1983); *Northeast Bank of Clearwater v. Bentley*, 413 So. 2d 480 (Fla. Dist. Ct. App. 1982); *Blackmon v. Hale*, 1 Cal. 3d 548, 83 Cal. Rptr. 194 (1970). *See also Atlantic Bank of New York v. Israel Discount Bank Ltd.*, 108 Misc. 2d 342, 441 N.Y.S.2d 315 (1981); *Commercial Credit Corp v. Empire Trust Co.*, 260 F.2d 132 (8th Cir. 1958).

101 The principles of law and equity, including estoppel, supplement the UCC unless displaced by its particular provisions. UCC § 1103. A bank may justify payment on principles of estoppel, or on the basis of misleading conduct which directly or proximately causes it to pay the item. *Atlas Vegetable Exch., Inc. v. Bank of America*, 10 Cal. App. 3d 868, 89 Cal. Rptr. 274 (1970). A payee may be estopped from denying authority due to its negligence in allowing another to clothe himself with apparent authority to endorse the check. *Walsh v. American Trust Co.*, 7 Cal. App. 2d 654, 47 P.2d 323 (1935). A bank was justified in relying on a spurious resolution which was properly

– The principles of law and equity, including estoppel, supplement the UCC.[102]

Lines of Inquiry:

☐ Did the claimant enter into a settlement with the wrongdoer?

☐ Did the customer intentionally fail to report the forgery or ask the bank not to take action against the forger?

☐ Did the claimant benefit from the check or its proceeds?

☐ Did the wrongdoer appear to have authority for its actions due to the action or inaction of the claimant?

(9) **Payment was by agreement**. The payee's direction to honor items presented in a certain fashion (e.g., under a cash management arrangement) or bearing its apparent authorization (e.g., facsimile signature)[103] may preclude an action against the depositary bank.[104]

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certified by the wrongdoer/secretary. *Condor Corp. v. Cunningham,* 71 Cal. App. 2d 25, 162 P.2d 21 (1945); *see also* Cal. Corp. Code § 314. Failure to report forged checks after the customer learns of them constitutes ratification. *Kores Carbon Paper & Ribbons Mfg. Co. v. Western Office Supply Co.*, 349 Ill. App. 208, 110 N.E.2d 461 (1953), *Common Wealth Ins. Sys., Inc. v. Kersten*, 40 Cal. App. 3d 1014, 115 Cal. Rptr. 653 (1974); *Fulka v. Fla. Commercial Banks, Inc*., 371 So. 2d 521 (Fla. Dist. Ct. App. 1979). Suit against collecting bank may ratify the collection of funds by the collecting bank from the maker's bank, relieving it from liability. *Cooper v. Union Bank*, 9 Cal.3d 371, 507 P.2d 609 (1973). Suit by employer against forger employee did not preclude employer from later suing the bank for any deficiency; doctrine of election of remedies does not apply. *Hennesy Equipment Sales Co. v. Valley National Bank*, 25 Ariz. App. 285, 543 P.2d 123 (1976). Forgery ratified where contractor continued to do business with subcontractor who forged contractor's Indorsement. *Thermo Contracting Corp. v. Bank of N.J.*, 69 N.J. 352, 354 A.2d 291 (1976). Victim ratified forgery by asking bank not to prosecute forger (his brother) and had an agreement with the forger to pay back the money. *Eustler v. First Nat'l. Bank, Pawhuska,* 639 P.2d 1245 (1982). No liability to bank for accepting husband's check when wife routinely deposited his endorsed paychecks and had apparent authority; evidence that husband benefited from proceeds. *First Nat'l. Bank in Miles City v. Nunn,* 192 Mont. 487, 628 P.2d 1110 (1981). Ratification by accepting benefits from forged item. *Rakestraw v. Rodriguez*, 8 Cal.3d 67, 500 P.2d 1401 (1972); *Spec-Cast, Inc. v. First Nat'l Bank & Trust Co.*, 128 Ill. 2d 167, 538 N.E.2d 543 (1989). Generally, the appropriate test of estoppel is that (1) the party to be estopped must know the facts, (2) he must intend that his conduct shall be acted on or must act so that the party asserting the estoppel has a right to believe it is so intended, (3) the latter must be ignorant of the true facts, and (4) he must rely on the former's conduct to his injury. Ratification may be express or implied. *Cook v. Great Western Bank & Trust*, 141 Ariz. 80, 685 P.2d 145 (1984) (substantial delay in reporting loss may or may not be ratification). Payor bank's settlement with customer did not constitute waiver by the bank of the right to sue the collecting banks for breach of warranty. *Garnac Grain Co. Inc. v. Boatmen's Bank & Trust Co. of Kan. City*, 694 F. Supp. 1389 (W.D. Mo. 1988). Ratification where payee intended to entrust the funds to the wrongdoer and was aware that checks had been drawn against his investment account to effect the transfer. *Stella v. Dean Witter Reynolds Inc.*, 241 N.J. Super. 55, 574 A.2d 468 (1990).

[102] § 1103.

[103] *Spears Ins. Co., Ltd. v. Bank of America*, N.A., 2000 WL 139370, 40 UCC Rep. Serv. 2d 807 (N.D. Ill. 2000); *Perini Corp. v. First Nat'l Bank of Habersham County, Georgia*, 553 F.2d 398 (5th Cir. 1977). *But see Cumis Ins. Soc'y, Inc. v. Girard Bank*, 522 F. Supp. 414 (E.D. Pa. 1981).

[104] Payee authorized wrongdoer to deposit funds to her account. Although she promised to pay him the amount, she stole the funds instead. Endorsement over to wrongdoer freed the depository bank from liability. *Neal v. Port of Seattle Federal Credit Union*, 2007 WL 1733208 (Wash. Ct. App. 2007). Son could deposit check payable to his father into a joint account with the father after the father's death since the father had endorsed the check "for deposit only" to that account prior to his death. *Estate of Ostlund v. Ostlund*, 2007 WL 858819 (2007).

(10) **Statute of limitation**. A claim is barred if it is not filed within three years after the cause of action accrues.[105]

– In California, a one-year statute of limitation applies to claims by depositors against a payor bank for the payment of forged or raised checks, or checks that bear a forged or unauthorized endorsement.[106]

(11) **Signature by authorized person**. A signature may be made by an agent or other representative, and his authority may be established as in other cases of representation. No particular form of appointment is necessary to establish such authority.[107]

☐ Was the check payable to multiple payees? In the alternative? Ambiguous?[108]

(12) **Imposter or fictitious payee**. When a check is payable to an imposter or fictitious payee:[109]

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[105] UCC § 4111. A cause of action "accrues" for each check individually at the time the check is collected. *Copier Word Processing Supply, Inc. v. WesBanco Bank, Inc.*, 540 S.E.2d 102 (W.Va. 2006).; *Willier, Inc. v. Hurt*, 2007 WL 4613033 (S.D. W. Va); *Menichini v. Grant*, 995 F.2d 1224 (3rd Cir. (Pa) 1993). Most courts reject the "discovery rule" (where cause of action accrues when the plaintiff actually discovers or should have discovered the conversion with the exercise of reasonable diligence), as there is strong public policy favoring finality on a conversion claim. *John Hancock Fin. Serv., Inc. v. Old Kent Bank*, 346 F.3d 727 (6th Cir. 2003); *Auto-Owners Ins. Co. v. Bank One*, 852 N.E.2d 604 (Ind. App. 2006). See UCC § 3118(g).

[106] *Kiernan v. Union Bank*, 55 Cal. App. 3d 111 (1976); *Chatsky & Associates v. Superior Court*, 117 Cal. App. 4th 873 (2004); *Roy Supply, Inc. v. Wells Fargo Bank*, 39 Cal. App. 4th 1051 (1995). The one-year limitations period of California Code of Civil Procedure § 340(c), rather than the three-year limitations period of California UCC § 4111, applies to a claim by a depositor against his bank for the payment of forged checks written on the depositor's account. The period applies independently with respect to each forged check. *See Hughes Electric Corp. v. Citibank*, 120 Cal. App. 4th 251, 15 Cal. Rptr. 3d 244 (Cal. App. 2 Dist. 2004), where Citibank's account agreement provision applying New York law allowed Citibank to assert California's statute of limitation under New York's "borrowing statute." See also *Mills v. First Union Nat'l Bank of Md.*, 2004 WL 1630501 (Cal. Ct. App. 2004) (California's one-year rule applies to banks located in other states for actions brought in California since it is a statute of limitation, rather than a choice of law. The forum state is entitled to control the remedies available in its courts. Nor could plaintiffs assert negligence under UCC § 3118(g) (three-year statute of limitation) based on a payor bank's failure to act in accordance with ordinary commercial banking care, as that section doesn't apply to a cause of action for negligence. Finally, plaintiff cannot try to get around CCP § 340's one-year period by bringing a conversion cause of action under § 3420). Note: The *Mills* decision was not officially published. As such, it may not be cited.

[107] A person is not liable on an item unless (1) the person signed the item, or (2) the person's agent or representative signed the item. UCC § 3401. For the rule on signatures by a representative, *see* UCC § 3402. Depositary bank may be liable for deposits by embezzling employee if the bank has notice of breach of fiduciary duty by the person who deposits the checks. UCC §§ 3401(a), 3402, and 3404(a). See also Cal. Corp. Code §§ 313 and 314 (apparent authority), UCC § 3307 (fiduciary), and UCC § 3110 (determination of payee). *Grosberg v. Mich. Nat'l Bank-Oakland*, 420 Mich. 707, 362 N.W.2d 715(1984) (Partner opened account by forging partner's name on signature card and checks; implied authority of partner). *Dement v. Red River Valley Bank*, 506 So. 2d 1329, 1331 (La.Ct. App. 2 Cir. 1987) (Partnership liable for checks signed by partner even though partner signed fictitious name on signature card and checks).

[108] If a check is payable to two or more persons alternatively, it is payable to any of them and may be negotiated by any or all of them. *Danco, Inc. v. Commerce Bank/Shore, NA*, 290 N.J. Super. 211, 675 A.2d 663 (1996) (bank not liable when co-payee of ambiguous check forged other payee's name). A check drawn ambiguously to more than one payee is deemed to be payable in the alternative (e.g., payees whose names are stacked on top of each other, not separated by any punctuation or symbols. *Pelican Nat'l Bank v. Provident Bank*, 849 A.2d 475 (Md. 2004); *Meng v. Maywood Proviso State Bank*, 702 N.E.2d 258 (Ill. App. Ct. 1998); *Allied Capital Partners, L.P. v. Bank One*, 68 S.W.3d 51 (Tex. Ct. App. 2001); *J.R. Simplot, Inc. v. Knight*, 988 P.2d 955 (Wash. Ct. App. 1999)); *In re Ames Dept. Stores, Inc.*, 2005 WL 433642. UCC § 3110(d). Stacked payee names on checks were not ambiguous under the circumstances. *Bank of America v. Allstate Insurance Co.*, 29 F. Supp. 2d 1129 (1998).

[109] UCC § 3404.

– An endorsement by <u>any</u> person in the name of the payee (or in a name substantially similar to the payee) is effective.[110]

– The instrument's deposit (with or without endorsement) to an account in the name of the payee (or in a name substantially similar to the payee) is effective.[111]

No bank is liable if:

– An imposter, by use of the mails or otherwise, induces the maker to issue a check to him or his confederate, by impersonating the payee of the item or a person authorized to act for the payee (e.g., Joe Crook represents that he is Joe Payee and gets the maker to issue a check to him as "Joe Payee". An endorsement or deposit in the name of Joe Payee is legally effective as the endorsement of the payee if the bank acts in good faith and pays the instrument or takes it for value or for collection). This is known as the "*imposter rule*."[112]

– A person signing as or on behalf of the maker intends the payee[113] to have no interest in the instrument, whether or not the payee is real or fictitious (e.g., an embezzling treasurer who is authorized to issue checks makes them payable to "Mary Payee," not intending her to have any interest in them. An endorsement or deposit in Mary's name by anyone is legally effective as the endorsement of the payee in favor of a person who, in good faith pays the check or takes it for value or for collection). This is known as the "*fictitious payee rule*."

Since the endorsement is effective in these situations, the loss generally falls on the negligent/duped bank customer, rather than on any bank which cashes, collects or pays the check. The maker's bank may pay the item and the collecting bank has no liability for breach of warranty (absent knowledge of wrongdoing).

If a bank fails to exercise ordinary care in paying or taking the check and that failure contributes[114] to a loss resulting from payment of the instrument, the

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110 UCC § 3404. The party taking the check must act "in good faith" (i.e., honesty in fact and the observance of reasonable commercial standards of fair dealing). Check casher couldn't assert fictitious payee rule since it failed to follow its own internal procedures when cashing a check payable to a corporation for an individual. *Valley National Bank v. P.A.Y. Check Cashing*, 2004 WL 3390073 (N.J. Super. 2004).

111 UCC § 3404. If the check is paid by the drawee bank, there is no breach of warranty under UCC §§ 3417(a) (23) or 4208(a) (3) since the depositary bank is a person entitled to enforce the check. The drawee may have a claim against the collecting bank if it was negligent in opening an account in the name of a fictitious person. UCC § 3404(d).

112 *But see Advocate Health and Hosp. Corp. v. Bank One, N.A.*, 2004 WL 834727 (Ill. App. Ct. 2004) (Dishonest attorney who orally misrepresented his authority to settle a claim and forged his client's signature is not an "imposter").

113 UCC § 3404's reference to "person identified as payee" refers to the named payee, not the intended payee. *Unlimited Adjusting Group, Inc. v. Wells Fargo Bank, N.A.*, 174 Cal.App.4th 883, 94 Cal.Rptr.3d 672.

114 Note that California's version of UCC §§ 3405(b) and 3406(b) uses "contributes" rather than "substantially contributes."

person bearing the loss may recover from the bank to the extent its failure contributed to the loss.[115]

(13) **Endorsement by "responsible" employee**. If a check is payable to an employer, a forged endorsement purporting to be that of the employer, signed by an employee with "responsibility" for checks, is effective as the endorsement of the employer if the bank acts in good faith in paying the check or taking it for value or for collection.[116] The same rule applies to checks issued by an employer if a "responsible" employee forges the endorsement of the person identified as the payee (Note: the forged name must be substantially similar to the name of that person).[117]

- Employee. The term "*employee*" includes an independent contractor and the employee of an independent contractor retained by the employer.

- Responsibility. An employee has "*responsibility*" if (s)he is authorized to: (a) sign or endorse items on behalf of the employer, (b) process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (c) prepare or process items for issue in the name of the employer, (d) supply information determining the names and addresses of payees of items to be issued in the name of the employer, (e) control the disposition of items to be issued in the name of the employer, or (f) act otherwise with respect to the items in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to items or to blank or incomplete checks that are stored or transported or are part of incoming or outgoing mail, or similar access.[118]

- Contributory negligence by bank. If the bank's failure to exercise ordinary care contributes to the loss resulting from the fraud, the bank assumes responsibility to the extent its failure contributed to the loss.[119]

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115 UCC § 3404(a) and (d). UCC Comment 4 suggests that, under some circumstances, a depositary bank that opens an account negligently (e.g., by failing to obtain adequate documentation) may be liable for failing to exercise ordinary care, contributing to the loss suffered by the employer. The trier of fact could allow recovery by the employer from the depositary bank for all or part of the loss. *But see Auto-Owners Ins. Co. v. Bank One*, 879 N.E.2d 1086 (Supreme Court Indiana 2008) (UCC § 3405(b) applies to negligent "paying" or "taking" of check, not to failing to follow procedures when opening account).

116 *CBSK Financial Group, Inc. v. Bank of America*, 60 UCC Rep. 2d 177 (Cal. Ct. App. 2006) 2006 WL 1530260. UCC § 3405(b). Tennessee interprets "good faith" differently than most states and applies a more liberal reckless disregard standard. *Contour Industries, Inc. v. U.S. Bank, N.A.*, 75 UCC Rep. 2d 491 (6th Cir. 2011).

117 UCC § 3405(c). *Environmental Equipment & Service Co. v. Wachovia*, 72 UCC Rep.2d 949 (ED Pa. 2010)(Bookkeeper altered/forged checks drawn on and payable to employer; common law claims are displaced).

118 *But see Schrier Brothers v. Golub*, 2005 WL 280733 (employee received checks and employer exercised little control over this practice).

119 UCC § 3405(b). The bank's negligence must be pled with specificity. *CBSK Financial Group, Inc. v. Bank of America*, 60 UCC Rep. 2d 177 (Cal. Ct. App. 2006) 2006 WL 1530260 (not reported in Cal. Rptr. 3d). The contributory negligence rule of UCC § 3405(b) represents an exception to the general rule that a bank owes no duty of care to a non-customer.

Lines of Inquiry:

- ☐ What were the responsibilities of the employee?
- ☐ What titles did the employee have?
- ☐ What does the bank's account agreement provide about separating the check writing and account reconcilement functions, maintaining checks in a secure manner, reviewing statements and notices, reporting discrepancies, monitoring employee activities, and pursuing insurance coverage?[120]
- ☐ What was the employee's job description?
- ☐ Did the employee's responsibilities increase on occasion (e.g., when the employer was away on business or on vacation)?
- ☐ Who supervised the employee?
- ☐ What employer policies and procedures are in place to prevent this type of loss? Were they followed?
- ☐ Did the employer maintain a check register? Ask to see it.
- ☐ Was the payee's endorsement forged? Was the forged name substantially similar to the name of the payee?[121]
- ☐ Did the depositary bank have knowledge of a breach of fiduciary duty by the depositor?[122]

(14) **Payment was to a permitted co-payee**. If a check payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, it is payable to them alternatively.[123]

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120 *Meyers v. Bank of America Nat'l Trust & Sav. Ass'n*, 11 Cal.2d 92, 77 P.2d 1084 (1938) (Bank not liable to insurance company (a compensated surety) for bank's passive negligence. *Fireman's Fund Ins. Co. v. Morse Signal Devices*, 151 Cal. App. 3d 681, 198 Cal. Rptr. 756, (1984). Note: The compensated surety defense is not available in most states (*See*: *The Banking Law Journal*, Nov/Dec 2002). Consult the bank's agreement for any terms related to insurance and check losses.

121 If the employee deposits his employer's check into his personal account without an indorsement, the transaction is potentially covered by UCC § 3307, rather than § 3405. Note that § 3307 does not contain a comparative fault provision like § 3405. Absent knowledge of wrongdoing, a payee may not be liable for taking checks payable to it as payment by dishonest bookkeeper. *Travelers Casualty and Surety Co. v. Citibank (South Dakota)*, 2007 WL 2875460, 64 UCC Rep. Serv. 2d 99 (M.D. Fla. 2007); *Burns v. The Neiman Marcus Group, Inc.*, 173 Cal. App. 4th 479, 93 Cal. Rptr. 3d 130.

122 Depositary bank may be liable for deposits by embezzling employee if the bank has notice of breach of fiduciary duty by the person who deposits the checks. UCC § 3307. For a discussion of "knowledge" versus "reason to know," *see Jelmoli Holding, Inc. v. Raymond James Financial Services*, 470 F.3d 14 (1st Cir. 2006) (actual knowledge required; bank believed depositor was the owner of the drawer company and "could use the checks as he pleased").

(15) **<u>Check was a "bearer instrument"</u>**. If a check is payable to "bearer" or was endorsed in blank by the payee before it was lost or stolen, it is a bearer instrument and can be presented by anyone.[124]

(16) **<u>No provable fraud</u>.** It is extremely difficult to state a cause of action for fraud. The elements of fraud are a misrepresentation, knowledge of its falsity, intent to defraud, justifiable reliance and resulting damage.[125]

(17) **<u>Bank's negligence not the cause of the loss</u>.** If wrongdoer had the power to deal with the checks/funds and caused the loss, the bank's negligence may have been irrelevant.[126]

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[123] UCC § 3110(d). Even if it is jointly payable, § 3420(b) limits the bank's liability to the amount of the plaintiff's interest in the check. Check payable to "stacked" payees without reference of "or" or "and" was ambiguous and payable to any one of the payees. Court refused to use extrinsic evidence of custom or practice in the banking industry to determine whether check was payable to multiple payees. *Pelican Nat'l Bank v. Provident Bank of Md.*, 381 Md. 327, 849 A.2d 475 (2004). However, notwithstanding UCC § 3110(d) at least one federal court has concluded that a check payable to "stacked" payees without reference of "or" or "and" requires the endorsement of all payees, reflecting common banking custom or practice. *Bank of America Nat'l Trust and Sav. Ass'n v. Allstate Ins. Co.*, 29 F. Supp. 2d 1129, 1138 (C.D. Cal. 1998). Checks payable to two parties whose names are separated by a virgule ("/") are payable to them alternatively. *New Wave Technologies, Inc. v. Legacy Bank of Texas*, 66 U.C.C. Rep. Serv. 2d 113, 2008 WL 2553519.

[124] A check made payable to a bank may not be bearer paper. As such, banks may have a duty to inquire regarding the authority of the presenting party. *Richards v. Seattle Metropolitan Credit Union*, 117 Wash. App. 30, 68 P.3d 1109 (Wash. Ct. App. 2003) (Credit union had inquiry notice of a breach of fiduciary duty; application of UCC § 3307). *Travelers Casualty and Surety Co. v. Wells Fargo Bank, N.A.*, 374 F.3d 521 (7th Cir. 2004) (check payable to securities broker; depositary institution presented with check made out to it by drawer that owes it no money, for deposit into the presenter's account, does not take check in due course, and is not a "holder in due course" of the check).

[125] *Universal By-Products, Inc. v. City of Modesto* (1974) 43 Cal. App. 3d 145, 151. Fraud causes of action must be pled with specificity. A general pleading of the legal conclusion of fraud is insufficient. *Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal. 3d 197, 216.

[126] *Mills v. U.S. Bank*, 166 Cal. App. 4th 871 83 Cal. Rptr. 3d 146 (Any negligence in accepting check without proper endorsement was irrelevant as loss would have occurred in any event). *In re McMullen Oil Co.* ((Bankr. C.D. Cal. 2000) 251 B.R. 558) (person depositing check to wrong account had the power to endorse the check and deposit it).

3. ALTERATIONS

A. General Rule

- **Although the maker's bank is liable to its customer for paying an altered item, the depositary bank (or the depositor, if he is still around) usually ends up responsible for the loss.**[127]

- **Unless the maker is negligent, ratifies the transaction, or is precluded from asserting a claim, it is not liable for an unauthorized "material alteration" of its check,**[128] **and the payor bank may charge its account for the check only as it was originally drawn (assuming the bank acts in good faith).**[129]

- **The depositary and collecting banks, in turn, warrant to the payor bank that the item has not been altered. They are liable to the payor bank for damages for breach of warranty equal to the amount paid by the payor bank, less the amount the payor bank is entitled to receive from the drawer because of the payment, plus compensation for expenses and loss of interest resulting from the breach.**[130] **The right of the payor bank to recover damages is not affected by any failure on its part to exercise ordinary care in making payment.**[131]

- **A depositor that deposits an altered item is liable to the depositary bank for damages arising from the alteration.**[132]

B. Material v. Immaterial Alterations. An alteration is (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.[133]

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127 The maker's bank is not required to credit its customer's account for an altered check prior to bringing an action for breach of presentment warranty against the presenting bank. *J. Walter Thompson, U.S.A. v. First Bancomericano*, 518 F.3d 128 (2008).

128 UCC § 3407(b).

129 UCC § 4401(d) (1). The drawer/maker would not sue the depository bank directly for its loss. Warranties against alteration run to the payor bank only (UCC §§ 3417(a) and 4208(a) (2)) (See UCC Comment 2 to § 3417). Note: a drawer might obtain standing by taking a formal assignment of the payor bank's upstream warranty rights, however, rather than demand a recredit to its account.

No presentment warranty against alteration is given for cashier's checks, as they are not "unaccepted drafts" for purposes of § 4208. Note that the warranty of UCC § 4207 does not apply to the drawee bank since it is not a "collecting bank" by definition.

130 UCC § 4208. Some states (not including California) may allow for an award of attorneys' fees. See UCC Comment 6 to § 3416 and Comments to § 3417.

131 UCC § 4208(b). Likewise, the payor bank has no burden of proving negligence on the part of the bank of first deposit. The loss is imposed on the depositary bank based on the premise that it is in the best position to stop the check from entering the collection stream.

132 UCC § 4207(a) (3).

133 UCC § 3407(a). A totally fictitious check is not "altered" (*Firstar Bank, N.A. v. Wells Fargo Bank, N.A.*, 2004 WL 1323942 (N.D. Ill. 2004).

A "*material alteration*" is one which modifies in any respect the obligations of a party. For example:

- Changing the number or relations of the parties;[134]
- Changing the payee name;[135]
- Backdating the date of a postdated check;
- Deleting restrictive "only for deposit" indorsements;[136]
- Completing an incomplete check other than as authorized;
- Any increase or reduction in the amount;[137] and
- Any other unauthorized addition or deletion which would change the contract of the parties.[138]

An "*immaterial alteration"* does not change the obligations of the parties. For example:

- Conforming the check figures to the written amount;[139]
- Changing an impossible date (e.g., November 31) to the next possible date;[140]
- Inserting, deleting or changing any memorandum on a check that is not part of the "contract" (e.g., the "For _____" memo section found at the bottom, left side of most checks);[141]

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134 *Charleston Paint Co. v. Exch. Banking and Trust Co.*, 129 S.C. 290, 123 S.E. 830 (1924) (adding an additional payee). *Union Tool Co. v. Farmers and Merch. Nat'l Bank of L.A.,* 192 Cal. 40, 218 P. 424 (1923) (deleting the words showing fiduciary relationship).

135 *Sundial Construction Co. v. Liberty Bank of Buffalo,* 277 N.Y. 137, 13 N.E.2d 745 (1938) (changing "C.D. Blair" to "C.D. Blair & Co., Inc."). *Gutfreund v. East River Nat'l Bank,* 251 N.Y. 58, 167 N.E. 171 (1929) (inserting initials before payee's name). *Garnac Grain Co. Inc. v. Boatman's Bank & Trust Company of Kan. City*, 694 F. Supp. 1389 (W.D. Mo. 1988) (addition of "or" and an additional payee).

136 *Menthor, S.A. v. Swiss Bank Corp.*, 549 F. Supp. 1125 (D.N.Y. 1982). Cases go both ways on the deletion of "in full payment." *See* Brady on Bank Checks, Revised Edition, § 27.02.

137 *Keller v. State Bank of Rock Island*, 292 Ill. 553, 127 N.E. 94 (1920) (reducing the amount of a dishonored check so that it equaled what was in the account).

138 *Trustees of German Evangelical Etc. Congregation v. Merch. Nat'l Bank,* 139 Minn. 80, 165 N.W. 491 (1917) (changing "and" to "or" on a two-payee check). *Union Tool Co. v. Farmers & Merchants Nat'l Bank*, 192 Cal. 40, 218 P. 424 (1923) (deletion of words showing fiduciary relationship of the payee).

139 *St. Paul Fire and Marine Ins. Co. v. State Bank of Salem*, 412 N.E.2d 103 (Ind. Ct. App. 1980); *Pitts v. First State Bank*, 390 P.2d 867 (1963). If a check contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers. UCC § 3114. Bank not liable for paying $100,478.23 when figure amount was $478.23, but written amount was imprinted for $100,478.23 in error. *St. Paul Fire & Marine Ins. Co. v. State Bank of Salem*, 412 N.E.2d 103 (Ind. Ct. App. 1980).

140 *Holliday v. Anderson*, 428 S.W.2d 479 (Tex. Civ. App. 1968) (adding "on demand" when maturity is left blank). *Whittier v. First State Bank*, 73 Colo. 153, 214 P. 536 (1923) ("February 29" changed to "March 1").

141 *In re Estate of Chiodo*, 123 Mich. App. 254, 333 N.W.2d 241 (1983).

– Non-fraudulent reduction of amount to reflect a part payment;[142]

– Addition of a date to a check[143]; and

– Addition of words on the payee line that do not change the payee.[144]

C. Right to Enforce Altered Check. A payor bank that pays a fraudulently altered check or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the check: (i) according to its original (unaltered) terms, or (ii) in the case of an incomplete check altered by unauthorized completion, according to its terms as completed.[145] A depositary bank may be liable for the check if the alteration is apparent or the check is otherwise so irregular as to call into question its authenticity.[146]

– HDC status: Persons who take checks showing visible evidence of alteration may take with notice of a claim or defense, preventing them from becoming holders in due course.[147]

D. Payor Bank Defenses

(1) Maker negligence. The payor bank is not liable if the maker's negligence contributed to the alteration and the bank acted in good faith and in a commercially reasonable manner in making payment. The payor bank bears the burden of proving that the customer failed to exercise ordinary care.[148]

– Contributory negligence by bank. If the bank also failed to exercise ordinary care in paying the check, and that failure contributed to the loss,

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142 *Bank of N.M. v. Rice*, 78 N.M. 170, 429 P.2d 368 (1967).

143 *K-Ross Bldg. Supply Center, Inc. v. Winnipesaukee Chalets, Inc.*, 121 N.H. 575, 432 A.2d 8 (1981).

144 *Birmingham Trust and Savs. Co. v. Whitney*, 95 A.D. 280, 88 N.Y.S. 578 (1904), *aff'd Birmingham Trust and Savs. Co. v. Whitney,* 183 N.Y. 522, 76 N.E. 1089 (1905).

145 UCC §§ 3302 and 3407. If the alteration consists of an unauthorized completion of a check originally signed in incomplete form, a holder in due course may enforce the check as completed, even if the completion is unauthorized (e.g., signed blank checks, where the amount is filled in by the crook). This result is intended even though the check is stolen from the issuer and completed after the theft. UCC Comment 2 to § 3407.

146 UCC § 3302(a) (1). In such a case, the party acquires the check subject to potential claims and defenses (i.e., it is not a holder in due course).

147 UCC § 3302(a) (1).

148 UCC § 3406(a) and (c). *HSBC Bank USA v. F&M Bank N.V.*, 246 F.3d 335 (4th Cir. 2001) (leaving one-half inch of open space in numerical portion and one inch of space in written portion is not negligence by maker). *Williams v. Montana National Bank of Bozeman*, 167 Mont. 24, 534 P.2d 1247 (1975); *Owensboro National Bank v. Crisp*, 608 S.W.2d 51 (Ky. 1980) (negligence of customer overcome by negligence of the bank).

the loss is allocated between the bank and the customer to the extent that each contributed to the loss.[149]

Lines of Inquiry:

- ☐ Did the customer leave any portion of the check incomplete?
- ☐ Did the customer leave large spaces before or after the amount or the payee's name?[150]
- ☐ Did the customer allow others (e.g., a bookkeeper) to insert information on checks?
- ☐ Did the maker use a pencil or an erasable ink pen to write the check?
- ☐ Does the customer use checks with fraud-prevention features (e.g., watermarks, copy void pantograph, chemical voids, high-resolution microprinting, or security inks)?
- ☐ Does the customer receive an account reconcilement service?
- ☐ Was the alteration noticeable? Should the payor bank (or the depositary or collecting bank) have noticed the alteration?

(2) **Ratification/Estoppel.** A payor bank is not liable for an alteration if the maker ratifies the transaction or is otherwise estopped from raising a claim.[151]

Lines of Inquiry:

- ☐ Did the claimant enter into a settlement agreement with the wrongdoer?
- ☐ Was the bank's position harmed by the claimant's failure to give timely notice of a claim?
- ☐ Did the claimant lull the bank into thinking it would not make a claim?
- ☐ Did claimant ask the bank not to pursue the wrongdoer (e.g., a relative of the claimant)?

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149 UCC § 3406.

150 *J. Gordon Neely Enters., Inc. v. American Nat'l Bank*, 402 So. 2d 887 (Ala. 1981) (large gaps left in checks). *HSBC Bank USA v. F&M Bank No. Va.*, 246 F.3d 335 (2001) (spaces were not so large as to be negligent).

151 *Rakestraw v. Rodriguez*, 8 Cal. 3d 67, 500 P.2d 1401 (1972). Wife had ratified the transaction since she did not rescind the transaction or benefited from the transaction. A similar result was found in *Common Wealth Ins. Sys., Inc. v. Kersten*, 40 Cal. App. 3d 1014, 115 Cal. Rptr. 653 (1974). *See Midtown Copying and Duplicating Serv., Inc. v. Bank of N.Y.*, 701 N.Y.S.2d 364 (App. Div. 2000).

(3) **Repeat wrongdoer rule.** A customer is liable for alterations by the same wrongdoer if the customer fails to discover or report the problem to the bank within a reasonable time (not exceeding 30 days or any shorter time provided in the customer's account agreement) following the customer's receipt of the first statement or check reflecting the alteration (or any forgery).[152]

– Duty to examine statements. A customer has a duty to promptly examine account statements and returned checks, and to notify the payor bank of any alterations.[153]

– Failure to exercise ordinary care. If the customer proves that the payor bank failed to exercise ordinary care in paying the item and that the failure contributed to the loss, the loss is allocated between the customer and the bank according to the extent to which each contributed to the loss.[154]

Lines of Inquiry:

☐ When did the first alteration or forgery occur, and when was the first statement sent that included a forged or altered item?

☐ Were there alterations or forgeries on any other accounts that preceded the alteration claimed by the customer? Note: Do not assume that the customer has notified the bank of the earliest alteration or forgery (which could hamper the customer's claim on later checks).

☐ Were there other unauthorized transactions (e.g., involving credit cards, lines of credit, or wire transfers) that should have put the customer on notice?

☐ Did the customer also have electronic access to the information reflecting the fraud (e.g., through online systems, telephone banking, or otherwise)?

☐ Did the customer check the account balance at an ATM, and should that have put the customer on notice of the problem?

☐ Did the customer maintain a check register? Ask to see the register.

☐ When should the customer have noticed the alteration? Note that the rule allows up to 30 days. The period may be shorter under the circumstances or under the terms of the customer's deposit agreement.

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152 UCC § 4406(c) (2).

153 UCC § 4406(c).

154 UCC § 4406(e). See *Roy Supply, Inc. v. Wells Fargo Bank*, 39 Cal. App. 4th 1051, 46 Cal. Rptr. 2d 309 (1995). The court held that UCC § 4406 precludes an independent action for negligence based on the forgery itself. The one-year claim period should apply.

(4) **Incomplete check.** The payor bank is not liable if the alteration involves an unauthorized completion of an incomplete check (e.g., filling in a blank left for the amount) and the payor bank pays it without notice of the unauthorized completion. The payor bank may enforce the check in such circumstances according to its terms as completed.[155]

Note: This rule applies even if the instrument is stolen from the issuer and completed after the theft.[156]

Lines of Inquiry:

- ☐ Did the customer pre-sign checks (e.g., payroll checks in advance of a business trip or vacation)?
- ☐ Did the customer allow its bookkeeper to fill-in the names of payees?
- ☐ Did the customer keep signed checks in unsafe places?

(5) **Authorized completion.** If the completion is authorized and if it can be proven, it is not deemed an alteration.[157]

Lines of Inquiry:

- ☐ Was the check a demand draft (i.e., a pre-authorized check not signed by the customer)? As between the bank and its customer, the customer may be responsible for a merchant's unauthorized completion (i.e., inserting a higher dollar amount) of a draft authorized by the customer. Check the deposit agreement for terms associated with demand drafts.
- ☐ Was the person who made the alteration authorized to write checks or perform transactions for the customer?

(6) **Failure to report in timely manner.** A customer is precluded from bringing a claim involving an alteration if he fails to find[158] and report the alteration within one-year (or any other time provided by agreement) of his receipt of a statement or the check reflecting the alteration.[159]

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155 UCC § 3407(c) (2).

156 *See* UCC Comment 2 to § 3407.

157 "Alteration" is defined as an "unauthorized change in an instrument." UCC § 3407(a).

158 UCC § 4406(c) has a "reasonably have discovered" requirement. It may be impossible for a customer to discover a forged payee name if the bank does not return checks to the maker.

159 UCC § 4406(f). This applies without regard to the care or lack of care of the bank. Georgia, Oregon and Washington have shorter reporting periods.

Note: The bank's agreement may preclude the customer from asserting an alteration, without regard to the lack of care of the customer or the bank, less than one-year after the statement or check is made available to the customer. Check the bank's account agreement.

(7) **Statute of limitation.** A customer may not bring an action against the bank for an alteration more than three years from the date the cause of action accrues.[160]

Note: The bank's deposit agreement may require that the action be brought in less than three years. Check the bank's agreement.

(8) **Original terms.** If the bank acts in good faith and without notice of the alteration, it may still enforce the check according to its original terms.[161]

Example: If a $100 check is altered to read $1,000, the payor bank may charge the account $100 (the original amount).

(9) **Breach of presentment warranty.** If none of the above defenses exist, the payor bank can make a claim for breach of presentment warranty to the presenting bank.[162] A presenting bank which receives payment on an altered check warrants that it has not been altered.[163] The presenting bank, in turn, can defend that the issuer was negligent and is precluded from asserting the alteration due to the issuer's failure to review and report the alteration in a timely manner.[164] If the payor bank unreasonably delays notice to the collecting or depositary bank, their liability may be discharged to the extent of any loss caused by the delay (just as with forged checks). The right of the drawer to recover for breach of warranty is not affected by the failure of the drawee to exercise ordinary care in paying the altered check.[165]

Note: Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.[166]

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160 UCC § 4111.

161 UCC § 3407(c) (1).

162 The customer could not make this claim against the collecting bank directly. The warranty is to the payor bank. UCC §§ 3417(a) and 4208(a).

163 UCC § 4207(a) (3).

164 UCC § 4208(a) (2) and(c).

165 UCC § 4208(b).

166 UCC § 4207(d).

Lines of Inquiry:

- ☐ Check the issuer's deposit agreement for provisions governing the reporting of alterations.
- ☐ When did the first alteration occur?
- ☐ When did the customer receive the statement/check reflecting the alteration?
- ☐ When was the alteration first reported?

(10) **Counterfeit check.** If the maker's signature is deemed forged (e.g., if the check is a scanned or chemically washed check), the counterfeit check may be treated not as an alteration, but as a forged maker check. In such a case, there would be no breach of the presentment warranty.[167]

(11) **Immaterial alteration.** The payor bank may pay a check whose alteration is not material. The fact that many changes are made to an instrument does not mean that the alterations are "material," per se. If the alterations do not change the obligation of any party, they are not "material" (e.g., if an instrument that contains contradictory terms is changed so that the numbers agree with the words, there is no "material alteration" because the obligation of the parties is not changed).[168]

E. **Depositary and Collecting Bank Liability.** The payee, depositary bank and collecting bank are deemed to warrant that there are no material alterations. If the payor bank unreasonably delays notice of breach, the liability of depositary and collecting banks is discharged to the extent of any loss caused by the delay.[169] If a drawee asserts a claim for breach of warranty based on an alteration, a warranting bank also may defend by proving that the endorsement is effective under UCC § 3404 (the imposter/fictitious payee rule) or UCC § 3405 (the responsible employee/bad bookkeeper rule), or the drawer is precluded under UCC §§ 3406 (failure to exercise ordinary care) or 4406 (failure to

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[167] Cases dealing with counterfeit checks: *MBTA Employee Credit Union v. Employers Mut. Liab. Ins. Co. of Wis.*, 374 F. Supp. 1299 (D. Mass. 1974); *Citizens Fid. Bank & Trust Co. v. Southwest Bank & Trust Co.*, 238 Neb. 677, 472 N.W.2d 198 (1991); *Lor-Mar/Toto, Inc. v. 1st Constitution Bank*, 871 A.2d 110 (N.J. 2005) (facsimile signature agreement was not broad enough to cover counterfeit checks); *Triffin v. Pomerantz Staffing Services, LLC*, 851 A.2d 110 (N.J. App. Div. 2004) (check-cashing company liable on counterfeit checks since it failed to make use of heat sensitive ink test described on checks). Counterfeit checks are not properly payable (UCC § 4401) since they are not signed or authorized (UCC § 3401). If a check is counterfeit and the depositary bank takes it for deposit to the payee's account, the check is not deemed "altered," the bank is deemed a "holder" under UCC § 1201(b)(21), and the depositary bank is not deemed to have breached the presentment warranties of § 4205(a)(1) or (2). *Firstar Bank, N.A. v. Wells Fargo Bank, N.A.*, 2004 U.S. Dist. LEXIS 10767 (N.D. Ill. June 14, 2004). If it is unclear whether a check with an altered payee signature is a counterfeit check or an altered item, the court may treat it as an altered item, shifting responsibility to the bank of first deposit for breach of its presentment warranty. *Wachovia Bank v. Foster Bancshares*, 457 F.3d 619 (7th Cir. 2006). Note: This presumption of alteration was rejected in an unpublished decision by the Fourth Circuit. *Chevy Chase Bank, FSB v. Wachovia Bank, N.A.*, 2006 WL 3522503 (4th Cir. 2006). *Bank of America v. Mazon State Bank*, 2007 WL 2714117 (2007) (alteration, not forgery assumed).

[168] *See* UCC § 3114. If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers.

[169] UCC §§ 4207(d) and 4208(e).

report in a timely manner) from asserting the alteration. UCC § 4208(c). Depositary and collecting banks may recover from any prior transferor who receives consideration for the item.[170]

– The warranties are given irrespective of the presence or absence of an endorsement on the check. The transferor warrants that it is, or was at the time of transfer,[171] a person entitled to enforce the check or was authorized to obtain payment on behalf of the person entitled to enforce the check, and that the check has not been altered.[172]

– A depositary bank can assert ratification, unjust enrichment (to the extent of any benefit received from the checks), and contributory negligence as defenses against a conversion claim.[173]

– A depositary bank that presents a counterfeit check to the drawee bank does not provide a warranty against alteration.[174]

– Did the drawer approve the check under the terms of its Positive Pay agreement with its bank?[175]

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170 UCC §§ 3417 and 4207.

171 What occurs after the time of presentment is not relevant. *Wachovia Bank, N.A. v. Federal Reserve Bank of Richmond*, 338 F.3d 318 (4th Cir. 2003) (Presentment warranty is made as of the time of presentment).

172 UCC §§ 3417 and 4208 set forth the various "presentment" warranties, which are given by upstream transferors to the payor bank. *See, First Nat'l Bank of Ariz. v. Plymouth-Home Nat'l Bank*, 553 F. Supp. 448 (D. Nev. 1982) *aff'd*, 705 F.2d 439 (1983) (If the check contains a forged Indorsement, the depositary bank as the party taking the check from the forger is in the best position to detect the forgery and should bear the loss). *See also Longview Bank & Trust Co. v. First Nat'l Bank of Azle,* 750 S.W.2d 297 (Tex. Ct. App. 1988). Paying a check with a missing indorsement is the same as paying a check with a forged indorsement. UCC §§ 3416 and 4207 contain warranties given to "transferees" other than the payor bank. *See* UCC § 3301 for the definition of "person entitled to enforce." *Mills v. U.S. Bank*, 166 Cal. App. 4th 871, 83 Cal. Rptr. 3d 146 (drawer is not a "transferee").

173 UCC § 3406. *Nat'l Accident Ins. Underwriters, Inc. v. Citibank*, FSB, 333 F. Supp. 2d 720 (N.D. Ill. 2004) (Plaintiff's employee altered checks and deposited them to his account). Although the bank could not assert common law defenses of *in pari delicto* ("in equal fault"), unclean hands, respondent superior, failure to mitigate damages, or negligent hiring/supervision, the code allows it to assert contributory negligence as an affirmative defense. The fact that the depositary bank may have been negligent does not preclude it from asserting the maker's negligence. *Gerber & Gerber, P.C. v. Regions Bank*, 226 Ga. App. 8, 596 S.E.2d 174 (2004).

174 *Bank of America v. Amarillo Nat'l Bank*, 2004 WL 2940806 (Tex. Ct. App. 2004). UCC § 3407(a) defines an alteration as "an unauthorized change in an instrument" or an "unauthorized addition of words or numbers to an incomplete instrument." The code presupposes the existence of an instrument. The warranty of UCC § 4208(a)(2) applies only to alterations made on the body of an original, and otherwise valid, instrument. In *Firstar Bank, N.A. v. Wells Fargo Bank, N.A.*, 2004 WL 1323942 (N.D. Ill. 2004), the depositary bank received a bogus check drawn on a nonexistent account at Firstar Bank. Although the drawer was fictitious, the depositary bank was deemed a "holder" of an instrument when it accepted it for deposit to an account of the named payee. Since the entire check was counterfeit, the court concluded there was no "alteration." Since the depositary bank was without knowledge that the maker's signature was false, it did not breach the presentment warranties of UCC § 4205 or § 4208. The cases conflict when it comes to determining who has the burden of determining whether a check is counterfeit or altered. *Wachovia Bank v. Foster Bancshares*, 457 F.3d 619 (7th Cir. 2006) (burden is on the bank of first deposit to show it is not an alteration). *Chevy Chase Bank, FSB v. Wachovia Bank, N.A.*, 2006 WL 3522503 (unpublished decision, 4th Cir. 2006) (burden is on payor bank to prove the item was not a counterfeit). *Bank of America, N.A. v. Mazon State Bank*, 2007 WL 2714117 (N.D. Ill. 2007) (alteration should be assumed in cases of doubt as to whether a check has been forged or altered).

175 If so, it may be an authorized check. UCC § 4401.

4. FORGED/ALTERED CHECK CLAIM PROCEDURE

Once a claim is asserted:

A. **Obtain an Affidavit of Forgery/Alteration.** Obtain an affidavit or declaration of the forgery or alteration from the claimant. Do not acknowledge any wrongdoing by the bank, especially since there may be circumstances unknown to it that would limit or eliminate its liability.

- ☐ Ensure that the form is completed in detail. Attach additional pages, if necessary. If several checks are involved, obtain a written statement from the customer and make a reference to it in the form(s) (e.g., "See __/__/__ Statement of _____").
- ☐ If the customer completes the affidavit at the bank, attach copies (front and back) of the forged checks to the customer's affidavit(s).
- ☐ If the claim is made on behalf of an organization, make sure that the person signing the claim is an authorized signer on the account or is otherwise authorized to act on its behalf.
- ☐ If the claimant uses a form other than the bank's form, ensure that it provides the information the bank will need to make a decision (e.g., when the fraud began and was discovered, whether the claimant derived any benefit from the check, and the identity of any suspect).

See the following pages for three sample forms.

FORGED OR ALTERED CHECK

(*Complete a separate form for <u>each</u> check*)

Description of Check – Attach a copy of the check (front and back) **<u>or</u>** describe it below:

- Check Number: _____ Amount: $_____ Dated: _____
- Name of Maker: _____ Acct. No._____
- Name of Payee: _____
- Drawn on (bank): _____ Police report made?
- Deposited at (bank): _____ ( ) Yes ( ) No
- Type: ( ) Check ( ) Cashier's Check ( ) Other: _____

Claimant(s): _____ Phone: _____

Address: _____

DECLARATION

Each of us declares under penalty of perjury under the laws of the State of _____ that the information set forth in this form is true and correct with respect to the check described above:

1. **<u>Unauthorized Action</u>:**

   [ ] Forged Signature: The signature of _____ is a forgery.

   [ ] Alteration: The following alterations were made to the check: _____

   _____

   [ ] Other: _____

2. **<u>Representations</u>.** Except as set forth in Section 4, I represent that the claimant(s) have <u>not</u>:
   - participated in, authorized, approved or ratified the action described in Section 1;
   - received proceeds or any direct or indirect benefit from the check;
   - been reimbursed or promised reimbursement (e.g., by the wrongdoer or an insurance company) for any loss suffered as a result of the unauthorized action described in Section 1;
   - made a claim for reimbursement or assigned or granted any right in the check (or any claim I may have related to the check) to others; or
   - discovered other unauthorized transactions involving my accounts with you or with any other institution during the past 12 months.
3. **<u>Discovery</u>.** The unauthorized transaction was first discovered on ____/____/____
4. **<u>Other information</u>** involving my claim (e.g., person suspected of wrongdoing):

   _____

   _____

   _____ (continue on back)
5. **<u>Loss</u>.** Claimant(s) have incurred a loss of $ _____ as a result of the unauthorized action described in Section 1.

By: _____ ___/___/___

Signature(s) of Claimant(s) Date

FORGED OR ALTERED CHECK

Instruction: Complete a separate form for each check

Check (Describe the check below or attach a copy, front and back)

- Number: _____ Amount: $_____ Dated: _____
- Maker: _____
- Payee: _____
- Drawn on (Name of bank): _____ Acct. No. _____
- Type of item: ( ) Check ( ) Cashier's Check ( ) Money Order
  ( ) Draft ( ) Other:

Claimant(s)

- Name(s): _____
- Address: _____
- Home Phone: _____ Work Phone: _____

TO: *(Insert Name of Institution)*

DECLARATION

Each of us declares under penalty of perjury under the laws of the State of California that the following is true and correct (Check boxes which apply) :

☐ **Forged Signature.** The signature of _____ is a forgery. I did not sign, authorize or approve the signature at any time.

☐ **Check Amount Altered.** The amount of the check was changed from the original amount of $_____ to $_____. I did not change the amount or authorize or approve its alteration at any time.

☐ **Payee Name Altered.** The payee's name was changed from _____ to _____. I did not make, authorize or approve the change at any time.

☐ **Other Alteration.** The following alterations were made by others without my authorization or approval:

_____
_____

☐ **Other:**

_____
_____

(Continued On Reverse)

- I did not receive any proceeds or any direct or indirect benefit from the check, except: _____
- I have not been reimbursed for any loss I suffered except (describe): _____
- I first discovered the above-mentioned alteration or forgery on (date): _____
- I have not made a claim for reimbursement or assigned or granted any right in the check (or any claim I have related to the check) to others except (describe): _____
- I suspect that _____, whose address is _____, may have been involved in the above-described forgery or alteration because: _____
- I ( ) **have** ( ) **have not** reviewed my statements, records and returned checks for other forged or altered items.
- I ( ) **am** ( ) **am not** aware of other unauthorized transactions involving my accounts with you or with any other institution.
- Other information involving my claim: _____
- I ( ) **have** ( ) **have not** reported this to the police.

By:_____ Date: _____
Signature of Claimant

By:_____ Date: _____
Signature of Claimant

DECLARATION REGARDING SEVERAL FORGED AND/OR ALTERED CHECKS

This form may be used to report forged, counterfeit, and/or altered checks drawn against your account with [*Insert name of Bank*].

Claimant Name(s):

_____

Phone: _____

Account Number: _____

Have you reported the loss to the police? [ ] yes [ ] no

DECLARATION

Each of us declares under penalty of perjury under the laws of the State of California that the following is true and correct:

1. **Description of Checks:** I/We have attached: (a) each of the checks, (b) a copy of each check (front and back), or (c) a listing of each of the checks that is counterfeit or contains forgeries and/or alterations.

2. **Unauthorized Action:** The checks contain the forged signature(s) and/or alterations described:

   [ ] On the attached page(s)

   [ ] As follows: _____

   _____

   _____

   _____

   _____ _____ (continue on a separate page).

3. **Representations.** Claimant(s) have not:

   - authorized, approved or ratified the unauthorized actions described above;
   - received proceeds or any direct or indirect benefit from the checks;
   - been reimbursed for any loss suffered as a result of the unauthorized action(s) described above;
   - made a claim for reimbursement or assigned or granted any right in the checks (or any claim related to the checks) to others; or
   - discovered other unauthorized transactions involving the Claimant(s)' accounts with the Bank or with any other institution within the last six months,

   except as follows: _____

   _____

   _____

   _____

   _____ (use additional page, if necessary).

4. **Discovery of Claim.** I/We first became aware of the unauthorized activity on ___/___/___ when:

   _____

   _____.

5. **Other Information.** (Describe how the loss occurred and the person(s) you suspect may have committed the unauthorized transactions):

   _____

   _____

   _____

   _____

   _____

   _____

   _____ (Continue on separate page).

6. **Loss.** Claimant(s) have incurred a loss (net of any recoveries) of $_____ as a result of the unauthorized activity described above.

Date: _____

By: _____
Signature (and title, if applicable)

By: _____
Signature (and title, if applicable)

Check No.	**Description of Unauthorized Action**
_____	_____
	_____
_____	_____
	_____
_____	_____
	_____

B. Obtain Copies of the Forged/Altered Checks.

Obtain the original checks, if available, or copies (front and back).

- ☐ Have the customer review all statements and all checks drawn on the account for the period beginning at least two or three months before the first reported forgery through the present time to determine whether there are other unauthorized transactions. [Note: It is important to ask the claimant when the first unauthorized transaction took place, as the claimant's failure to notice and report the earliest transaction may reduce the bank's liability.]

- ☐ If applicable, note in the file whether the customer has performed a review of other checks/transactions and the period reviewed.

- ☐ Compare the signature on the forged item with the signature on the account signature card and on authorized items issued during the period in question. If appropriate, compare the signature with other signatures on file (e.g., deposits slips, certifications, correspondence, the declaration, etc.). In appropriate circumstances, the bank may consider obtaining the assistance of a handwriting expert to compare signatures.

- ☐ If appropriate, ask to see the claimant's check register, audit procedures and internal control procedures.

- ☐ If the bank does not return checks to its customer, preserve all original checks and other records otherwise scheduled for destruction, as possible evidence in the event of litigation.

C. Determine the Circumstances of the Loss.

- ☐ When did the first forgery/alteration take place? When did the customer discover it? How was it discovered? Should it have been discovered earlier?

- ☐ Has this happened before? Were any of the customer's other accounts at this or any other institution involved? Has the customer made other claims in the past ten years?

- ☐ Has the customer looked at its other checks/transactions to confirm they were authorized? How far back has the customer looked?

- ☐ Is the customer experiencing financial difficulty? Is there evidence that the customer may have participated in the transaction? Does the customer know the suspected forger? The payee? Will the customer make a police report of the loss? Is the loss covered by insurance?

- ☐ Consider the "Lines of Inquiry" set forth above regarding the various defenses potentially available to the bank (e.g., ratification, late claim, customer negligence, no loss, etc.).

- ☐ Contact legal counsel if the amount or circumstances (e.g., potential wrongful dishonor claims) warrant. Counsel may choose to obtain statements from employees familiar with the facts under an attorney-client privilege.

D. File a Suspicious Activity Report and Report Suspected Elder Financial Abuse.

Determine whether the bank needs to file a Suspicious Activity Report (e.g., where the amount is over $5,000 and a suspect can be identified). Some states, such as California, may require the filing of a Report of Suspected Dependent Adult/Elder Financial Abuse, as well.[176]

E. Provisional Crediting, Suspension and/or Closure; Tolling Agreements.

Determine whether the customer's account(s) should be provisionally credited, suspended, or closed while the bank investigates the claim.

- ☐ If the bank concludes that the customer's account has been or may be the subject of fraudulent activity, the bank may elect (with notice to its customer) to close or suspend the account to prevent further loss to the bank or the customer. Closing or suspending the account can help to reduce the potential for wrongful dishonor claims by the customer with respect to authorized checks. Checks that are returned should contain a "Refer to Maker" reason for return.

- ☐ If an account is not closed or suspended, it may be necessary to place the account on "referral" and obtain a listing of all outstanding, authorized checks from the customer.

- ☐ If a hold or extended hold will be placed on deposits, send an appropriate hold notice to the Bank's customer.[177]

If the bank or its customer (or another institution that handled the check) needs additional time to investigate a claim or resolve a dispute, but is running up against a statute of limitation, consider entering into a tolling agreement which suspends the running of the statutory period. For example:

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[176] *See* California Welfare and Institutions Code § 15630.1, which requires employees of financial institutions to report known or suspected instances of financial abuse of persons 65 years of age or older and dependent adults. A report must be made by telephone "immediately, or as soon as practicably possible," followed by a written report (use Form SOC342) within two working days to the local Adult Protective Services agency or law enforcement. W & I Code § 115630.1(d)(1). As of March 2007, thirteen other states had reporting requirements (Delaware, Indiana, Kentucky, New Mexico, North Carolina, New Hampshire, Missouri, Oklahoma, Rhode Island, Tennessee, Texas, Utah and Wyoming), and twenty-six states had laws that provided for voluntary reporting.

[177] Reg. CC § 229.16(c) (2). The bank may have reasonable cause to doubt collectibility (Reg. CC § 229.13(e)). *See* Reg. CC § 229.13(g) for the requirements related to exception holds.

TOLLING AGREEMENT

This Agreement is entered into between _____ ("*ABC*") on behalf of itself and its affiliates, agents, directors, employees, representatives, assigns, partners and attorneys, and _____ acting on behalf of itself and its affiliates, agents, directors, employees, representatives, assigns, partners and attorneys ("*XYZ*") (collectively, the "*Parties*") and shall be effective as of _____, 201__.

RECITALS

A. ABC believes that it may have certain claims against XYZ arising out of or related to:

_____
_____
_____
_____
_____

(the "*Matter*");

B. XYZ believes that it may have certain claims against ABC arising out of or related to the Matter. Hereafter, each Party's respective claims are collectively referred to as the "*Claims*."

C. Both ABC and XYZ wish to avoid the expense of litigating with respect to their Claims while they continue to investigate and discuss the Matter with each other during the term of this Tolling Agreement.

ABC and XYZ agree as follows:

1. Effect of Agreement. In consideration of each Party's forbearance in commencing a lawsuit or any other proceeding regarding the Claims while this Tolling Agreement remains in effect, both ABC and XYZ agree to a tolling of any and all statutes of limitation, contractual time limitations, and any other time-related bars, including (without limitation) any and all statutory, regulatory or administrative time limitations or the equitable defense of laches, (collectively the "*Time Defenses*") with respect to the Claims, or any portion thereof, until the expiration or termination of this Tolling Agreement as described in Paragraph 6 below.

2. No Creation of Defense(s) or Bar(s). Nothing in this Tolling Agreement shall be construed to provide a defense or bar to any action or claim of either ABC or XYZ, nor shall this Tolling Agreement be construed to shorten any applicable statute of limitations.

3. No Admission(s). The Parties recognize and understand that the execution of this Tolling Agreement is not and shall not be deemed to constitute evidence of, or admission of liability for, any claim, cause of action or defense.

4. No Construction Against Drafting Party or Parties. The Parties agree that the rule of construction which potentially allows any ambiguities in a contract to be construed against the drafting party, shall not be employed in the interpretation of this Tolling Agreement, and that the Tolling Agreement shall be given its fair meaning.

5. Written Agreement; No Oral Modification. This Tolling Agreement may be modified only by written agreement of both Parties, signed by all Parties hereto.

6. Expiration. This Tolling Agreement shall expire upon at least _____ (__) days' prior written notice (the "*Notice of Termination*") by either Party by means as specified in Paragraph 15, below.

7. Governing Law. This Tolling Agreement shall be governed by and under the laws of the State of _____, without regard to conflict of laws principles.

8. Severability. If any provision of this Tolling Agreement is determined to be unenforceable for any reason, it shall be adjusted rather than voided, if possible, in order to achieve the intent of the Parties to the extent possible. In any event, the remaining provisions shall be deemed valid and enforceable to the maximum extent possible. The headings in this Tolling Agreement are for reference only, and shall not affect the meaning or interpretation of this Tolling Agreement.

9. Waiver. Any waiver with respect to the provisions of this Tolling Agreement shall not be effective unless in writing and signed by the party against whom it is asserted. The waiver of any provision of this Tolling Agreement by any party shall not be construed as a waiver of a subsequent breach or failure of the same provision or a waiver of any other provision of this Tolling Agreement.

10. Entire Agreement. This Tolling Agreement contains the sole and entire agreement between the Parties pertaining to the subject matter contained in it, specifically, the tolling of limitations periods, and supersedes any and all prior and/or contemporaneous oral or written negotiations, agreements, representations, and understandings with respect to such subject matter. The Parties, and each of them, understand that this Tolling Agreement is made without reliance upon any inducement, statement, promise, or representation other than those contained within this Tolling Agreement.

11. Voluntary Agreement. This Tolling Agreement is executed voluntarily and without any duress or undue influence on the part or behalf of the parties hereto. The Parties acknowledge that:

    (a) They have read this Tolling Agreement;

    (b) They have been represented (or had ample opportunity to be represented) in the preparation, negotiation, and execution of this Tolling Agreement by legal counsel of their own choice; and

    (c) They are fully aware of the legal and binding effect of this Tolling Agreement.

12. Binding on Successors and Assigns. This Tolling Agreement shall be binding upon and inure to the benefit of the Parties, and their respective officers, employees, agents, heirs, administrators, executors, successors and assigns. Each party hereto shall give the other party prompt notice of any transfer or assignment of rights under this Tolling Agreement; provided, however, that a failure to promptly provide such notice shall not constitute a material breach of this Tolling Agreement.

13. Counterparts. This Tolling Agreement may be executed in one or more counterparts, which taken together shall constitute but one agreement.

14. Notices. All notices and demands ("*Notice*") shall be given in writing by personal delivery, express courier service or certified mail, return receipt requested, to the address specified below for the respective Party, provided that if either Party gives Notice of a change of name or address in accordance with the provisions hereof, Notice to that Party shall thereafter be addressed to the attention of, and to the address stated in, that Notice. All Notices given by personal delivery or by express courier service shall be effective upon delivery to the Party, at the address specified herein for notice. All Notices given by certified mail shall be effective upon the third business day after mailing.

The addresses, telephone and facsimile numbers of the Parties are:

ABC: _____
_____
_____
Fax: _____

XYZ: _____
_____
_____
Fax: _____

ABC Date: _____

By: _____

Title: _____

XYZ Date: _____

By: _____

Title: _____

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F. Taking Action.

(1) <u>Denying the Claim</u>. If the bank denies all or part of a claim, send a notice of denial to the customer. The following pages contain a sample form with examples of reasons for denial. The reasons should be tailored for the particular circumstances involved.

[*Date*]
[*Name*]
[*Address*]

Re: Your Claim Regarding Check Nos. _____

Dear _____:

This letter is in response to your claim regarding the above-described checks. We have carefully reviewed your claim and have decided to decline it for the following reason[s]:

[*Insert reasons*]

If you have any additional information which you believe may have a bearing on your claim, please provide it to us in writing with any supporting documentation within the next 30 days. Otherwise, we will consider this matter closed.

Sincerely,

[*Bank Employee Name*]
[*Title*]

<u>Reasons for Decline</u>:

- **Customer ratified the transaction:**
  You approved or "ratified" the transaction when you [accepted the benefits of the transaction][entered into a settlement agreement with the forger][allowed the forger to complete your incomplete checks][allowed the forger, who was not an authorized signer on the account, to write the checks][chose not to report the forger][asked us not to file a report with the police or attempt to seek restitution from the forger][initially approved the transaction]. Under Section 3403 of the Uniform Commercial Code, we are not liable for unauthorized checks which are ratified by an accountholder.

- **Customer failed to examine statements and report problems:**
  We sent you a statement on [*date*] which reflects the first of the transactions you allege were unauthorized. You had a duty to promptly examine your account statements [and returned checks] and report all unauthorized transactions to us in a timely manner. Under Section 4406 of the Uniform Commercial Code [as varied by our agreement], you are precluded now from asserting the unauthorized signatures/alterations against us since [we suffered a loss as a result of your delay][the

unauthorized signatures/alterations were by the same wrongdoer(s) and occurred more than [30 days][*insert any shorter period provided by the account agreement*][178] from the date we sent you the first statement reflecting an unauthorized transaction]. [Since you failed to discover and report the unauthorized signature/alteration(s) within [one-year][*insert any shorter period provided by the account agreement*], you are also precluded from asserting any lack of care on our part by [the terms of your account agreement][Section 4406.][179]

To be used in a letter to a payor bank which makes a claim for breach of warranty:

Since your customer did not report the unauthorized transactions in a timely manner and is precluded from bringing a claim against your institution by UCC § 4406, your institution may not recover for any breach of warranty under Section 4208 with respect to those items. Please see UCC § 4406(f).

- **Statute of limitations:**
  Under [the terms of your deposit agreement][Section 4111 of the Uniform Commercial Code], an action or proceeding by you to enforce any obligation, duty, or right arising under the agreement or by law with respect to your account must be commenced within [three years][*insert any shorter period provided by the account agreement*] after the cause of action accrues. More than [three years][*insert any shorter period provided by the account agreement*] has passed since that date.[180] [*Note: one-year statute of limitations in California under CCP § 340 may apply*.]

- **No loss:**
  You incurred no loss since you received the proceeds or the benefits of the checks.

- **Customer negligence:**
  You failed to exercise ordinary care in connection with the checks in question by [*insert description*]. This failure contributed to the forgery/alteration. As such, you are precluded by Section 3406 of the Uniform Commercial Code from asserting the forgery/alteration against the bank, which [paid the checks][took the checks for value or for collection] in good faith.

- **Signature by agent or representative:**

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178 UCC § 4103 allows the time periods provided by UCC § 4406 to be varied by agreement.

179 Note: This applies only to checks processed more than one-year before the customer reports the unauthorized transactions.

180 *Chatsky & Assoc. v. Superior Court*, 117 Cal. App. 4th 873, 12 Cal. Rptr. 3d 154 (2004). The one-year limitations period of California Code of Civil Procedure § 340(c), rather than the three-year limitations period of California UCC § 4111, applies to claims by depositors against their bank for payment of forged checks written on their account.

Under Uniform Commercial Code Section 3402, you are bound by [the signature of your representative][a signature made on your behalf by your representative] since (s)he was acting, or purporting to act, on your behalf and had apparent authority to do so. We note that *[describe actions which the customer took which led the bank to believe the signer was authorized, e.g., "you allowed your representative to endorse other checks on your behalf in the past."*].

- **Endorsement by "responsible" employee:**
  We note that [*insert name of employee*] had the authority to [sign or endorse items on your behalf][process checks received by you for bookkeeping purposes, for deposit to an account or for other disposition][prepare or process checks for issue in your name][supply information determining the names and addresses of payees on checks issued in your name][control the disposition of checks to be issued in your name] and otherwise act in a responsible capacity with respect to [*employer's name*] checks. [*List other factors showing that the employee was "responsible" for handling checks, such as the employee's title, job description, and responsibilities*]. Under Section 3405 of the Uniform Commercial Code, you are responsible for the actions of your [employee] [independent contractor], and your [employee's][independent contractor's] endorsement is deemed effective as long as it is made in a name (or deposited to an account) which is substantially similar to the name of the payee.

- **No forgery or alteration:**
  We have compared the checks in question with other checks previously issued by you and have concluded that they do not appear to be [unauthorized][forged][altered]. We note that [*insert other facts indicating that the transaction was authorized, e.g., delays in reporting, previous incidents where the forger was allowed to complete checks, similarity of "forged" signature with other signatures on file, etc.*].

- **Wrong party to assert a conversion action:**
  Section 3420 of the Uniform Commercial Code does not allow [the issuer of a check][a payee or endorsee who does not receive delivery of a check either directly or through delivery to an agent or a co-payee] to assert an action for conversion.

- **Imposter defense:**
  We understand that you were induced to issue the check to someone who impersonated [the payee][a person authorized to act on behalf of the payee] of the check. Under Section 3404 of the Uniform Commercial Code, the check's endorsement by an imposter [or any other person] is deemed effective as long as [the endorsement is made in a name][the check is deposited to an account in a name] which is substantially similar to the name of the payee. The check in question was made payable to [*insert name*] and was [endorsed in that name][deposited to an account in

that name]. As such, the check was properly chargeable against your account.

- **Fictitious payee defense:**
  We understand that [*insert name of the person who made out the check*], who determined to whom the check was to be payable, did not intend the person identified as the payee to have any interest in the check. Under Section 3404 of the Uniform Commercial Code, an endorsement by anyone in the name of the payee is deemed to be effective if it is substantially similar to the name of the payee or if the check is deposited to an account in a name substantially similar to that of the payee. In this case, [*insert facts*]. As such, the check was properly chargeable to your account.

  or

  We understand that the person named as the payee on the check is a fictitious person. Under Section 3404 of the Uniform Commercial Code, a check may be charged to an account under these circumstances if [it is endorsed by anyone in a name substantially similar to the name of the payee][it is deposited, with or without endorsement, to an account in a name substantially similar to that of the named payee]. In this case, [*insert facts*]. As such, the check was properly chargeable to your account.

- **Alteration – immaterial (UCC § 3407):**
  The alteration to the check was immaterial since it did not change the obligations of any party to the check. As such, there is no loss for which we have any liability.

- **Alteration – charge according to its original terms:**
  Our liability for the alleged alteration is limited by Uniform Commercial Code § 3407. We are allowed to enforce the check according to its original terms since we took it for value, in good faith, and without notice of the alteration. In this case, the check was originally written for [*insert amount*], and that amount is properly chargeable against your account.

- **Alteration – inserting terms on an incomplete instrument:**
  We understand that the alteration allegedly occurred when [*insert name*] completed the check by inserting [*describe what was inserted*]. Under Section 3407 of the Uniform Commercial Code, we are not responsible for paying the item as altered under such circumstances since we took it for value, in good faith, and without notice of the alteration. [As indicated in the Uniform Commercial Code Comment, this rule applies even though the check was stolen from you and completed after the theft.]

- **Alteration – consent to:**

Under Uniform Commercial Code § 3407, a bank is not liable for any alteration which is authorized or consented to by the drawer. By [*describe action*], you are deemed to have consented to the alteration.

(2) **Approving the Claim.** If the bank intends to reimburse the claimant for the loss:

Confirm first that the claimant is not aware of any other unauthorized transactions.

- ☐ Determine whether, given the circumstances of the loss and the likelihood of future losses, the bank wishes to close the account. If the bank chooses to close the account, it should send a notice to the customer of the bank's decision. Unless there is a threat of ongoing losses (e.g., from the same wrongdoer), provide the customer with reasonable advance notice of the closure, so that the customer can open another account or move its account relationship to another institution.

- ☐ Determine whether the customer received any benefit from the transaction (potentially reducing its actual loss) or any recovery from the wrongdoer or a third party (e.g., another party to the transaction or an insurance company).

- ☐ Confirm that there are no other potential claimants related to the loss (e.g., another institution involved in the transaction that may assert a breach of warranty claim against the bank) and/or that they have waived any claim.

- ☐ Consult with Legal Counsel before agreeing to honor the claim, especially if the loss exceeds [$ _____] or there is a possibility of future claims for other checks.

- ☐ Do not admit that the bank acted negligently, incorrectly, or in violation of its internal policies. There may be unknown facts (e.g., other unauthorized activity) that could substantially increase or eliminate the bank's obligations.

- ☐ If the claimant is willing to execute a settlement and release, obtain an appropriate form from Legal Counsel prior to reimbursing the claimant.

(3) **Settling a Disputed Claim.** There may be situations where the bank elects to settle a claim by paying some or all of the claimant's alleged loss. This can occur due to the cost of investigation/litigation, uncertainty over the facts, comparative negligence on the bank's part, the bank's desire to retain a good customer, or a decision to avoid adverse publicity. In such instances:

- ☐ See (2) above.

- ☐ Determine the amount of the claimant's actual loss and the extent to which the customer or a third party may have contributed to the loss by their actions.

- ☐ Determine whether there are other parties or institutions that should share in the loss/settlement (see (4) below).
- ☐ Reject any "payment in full" checks from the customer (e.g., in connection with any overdraft) unless the bank intends to accept the check as full settlement for the amount that may be due the bank.[181]
- ☐ Obtain a Release form from Legal Counsel and have the claimant execute the release before making any reimbursement. See the following sample Release form.
- ☐ Be careful to maintain the attorney-client privilege with any communications to/from the bank's attorney. Mark such correspondence with a legend (e.g., "Confidential—Attorney-Client Privilege").

RELEASE

In consideration for $ _____, which will be [*paid to you*][182] [*deposited to your account*] upon the execution and return of this Release to [*Insert Bank's name*]("Bank"), [*List all owners of the account*](collectively, "you") jointly and severally release Bank, its past or present officers, directors, attorneys, agents, representatives and employees (hereinafter, "Bank") from all claims, damages, demands, costs, expenses, actions and causes of action of every kind and nature, known and unknown, which you can or shall have arising, directly or indirectly, from [the actions and/or omissions of Bank with respect to][all past actions and/or omissions of the Bank, including without limitation]:[183]

- [*Describe all unauthorized checks/transactions and the accounts involved*]
- [*Identify the accounts and the fact (if applicable) that this is to be a general release of all claims, known and unknown, that the signers may have with respect to those accounts*]
- [*The unauthorized transactions described in the attached Declaration of Forged or Altered Checks, dated* _____][184]
- _____
  _____

(the "Subject of this Release").

Without limiting the generality of the foregoing, this Release shall apply to the Bank's failure or refusal to permit authorized payments, transfers, or withdrawals from your account as a direct or indirect consequence of the Bank's processing of the above-described transactions.[185]

You acknowledge, agree, and represent to the Bank that:

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[181] Crossing out the "payment in full" provision will not prevent an "accord and satisfaction." UCC § 3311. *Wallace v. Wallace*, 2005 WL 563990.

[182] If there are several parties to the Release, consider adding a clause regarding who should receive the settlement check and how the check should be made out.

[183] Sometimes, when a bank is paying a large sum to settle a dubious claim, it will want a general release for all prior actions and omissions beyond the cause of the immediate dispute, especially if the bank believes the claimant may be holding back information.

[184] It may be easier to attach a copy of the Declaration than to list numerous transactions.

[185] This could be important since the Bank may be liable for consequential damages proximately caused by a wrongful dishonor – in an amount greater than the amount stolen.

(1) This Release is part of a settlement and compromise of a disputed claim, and that this Release and the consideration described above shall not be deemed or construed as an admission of liability by you or the Bank.[186] This Release may not be used as evidence in any action or proceeding against the Bank.

(2) No promise or agreement (not expressed herein) has been made to you and that this Release contains the entire agreement between you and the Bank with respect to its subject matter.

(3) You understand that factual matters now unknown to you may have given or may hereafter give rise to causes of action, claims, demands, debts, controversies, damages, costs, losses and expenses which are presently unknown, unanticipated and unsuspected. This release has been negotiated and agreed upon in light of that realization. You waive your rights under § 1542 of the Civil Code of California, which states:[187] "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."

(4) No claim, cause of action, or right with respect to any matters which are the Subject of this Release has been or will be assigned, transferred or subrogated by you to any person or entity. You assign and subrogate to the Bank any claim that you may have against others (e.g., the wrongdoer) in connection with the Subject of this Release, up to the amount of the consideration that has been[188] and/or will be paid to you by the Bank in connection with the Subject of this Release.

(5) [*Insert other information relevant to the claim. For example: "You did not authorize the transactions described above and have never given [Name of perpetrator] authority to sign your name on any checks or to perform transactions on your behalf."*][189]

Optional clauses, as appropriate:

( ) You agree not to disclose the terms of this Release to others without the Bank's prior written consent, which may be withheld with or without cause, unless the disclosure is required by law and you have notified the Bank in advance regarding the proposed disclosure. This confidentiality provision is a material provision of this Release, and is not a mere recital.[190]

( ) You warrant that the information set forth in the attached [insert] is complete, correct and accurate.

( ) You have not been reimbursed or promised reimbursement by third parties for any loss suffered as a result of the transactions described above.

( ) You have not entered into any settlement agreement with, or waived any claims against, [name of

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[186] This could be important if the claimant (or other similarly situated customers) assert other, similar claims against the bank.

[187] This provision applies to California. Other states may have a similar or slightly different provision.

[188] Certain claims (e.g., involving substitute checks) may require a bank to provisionally credit the account for some or all of the disputed amount, pending the outcome of the bank's investigation. A bank also may elect to provisionally pay checks drawn against its customer's account to avoid a wrongful dishonor claim.

[189] This may not be needed if the representation is already covered in the Declaration of Forgery or Alteration.

[190] This provision can be deleted or expanded, depending on the sensitivity of the settlement.

perpetrator] with respect to the Subject of this Release.

( ) You reviewed your Bank account records for the past [*year*][_____] and have fully and accurately reported all unauthorized account activity to the Bank.[191]

( ) This Release shall be governed, interpreted and enforced in accordance with the laws of the State of _____.

( ) You have received adequate consideration for this Release.

( ) The Bank may pay the amount described above by mailing or delivering a check, payable to the order of [insert name], to [insert name] at [insert address].

( ) There are no liens or claims in law, equity or otherwise against the claims or rights you are releasing with this Release. Each of you jointly and severally agrees to indemnify, defend and hold the Bank, its officers, directors, employees and agents harmless from any liability, lien, claim, demand, damage, cost, expense and attorney's fee incurred, directly or indirectly, as a result of any person or entity asserting any such lien or claim.

( ) A waiver or modification of this Release by the Bank will not be effective unless it is in a writing signed by the Bank. A waiver of any provision of this Release shall not constitute a waiver of any other provision or of the same provision at another time.

( ) You will cooperate reasonably with the Bank and law enforcement in their attempts to identify the wrongdoer and recover funds improperly taken from your account(s).

( ) Each individual signing this Release on behalf of another person or entity represents that (s)he is authorized to do so on that party's behalf.

( ) You agree to file a dismissal with prejudice of the complaint in the case of [insert], Case No. _____, filed in the [insert] Court.

( ) You agree to close your accounts with the Bank, and that you will not open any accounts with the Bank in the future.

( ) You agree that the Bank will not be responsible for any expense, including taxes, legal fees or costs, which you have incurred or may incur in connection with the Subject of this Release, or with the preparation and execution of this form.

If any action is commenced to enforce or interpret this Release, the prevailing party shall be entitled to recover its reasonable costs and attorney's fees, in addition to any other relief to which it may be entitled.

BY SIGNING BELOW, YOU ARE CONFIRMING THAT YOU HAVE READ, UNDERSTAND, AND AGREE TO THE TERMS OF THIS RELEASE. YOU ALSO CONFIRM THAT YOU HAVE BEEN AFFORDED AN OPPORTUNITY TO CONSULT WITH LEGAL COUNSEL OF YOUR OWN CHOICE BEFORE SIGNING THIS FORM.

Date: _____, 201__

By: _____
Signature and Title (if applicable)[192]

By: _____
Signature and Title (if applicable)

[191] This could be important, as customers lose certain rights (and the Bank gains new defenses) if customers fail to review statements and report previous unauthorized activity.

[192] Make sure that the signers indicate if they are signing in the capacity of an officer, representative, or trustee.

(4) **<u>Recourse Against Third Parties</u>.** There may be situations where the bank can reduce its obligation for a loss by seeking recourse against a third party.

(a) <u>Breach of Warranty</u>. If the bank was the payor bank and acted in good faith, it received the following warranties from the person obtaining payment (at the time of presentment) and from any previous transferor or collecting bank of the item (at the time of transfer):[193]

– The warrantor is, or was, at the time the warrantor transferred the check, a person entitled to enforce[194] the check or authorized to obtain payment or acceptance of the check on behalf of a person entitled to enforce the check;

– The check has not been altered;

– The warrantor has no knowledge that the signature of the purported drawer of the check is unauthorized; and

– If the check is a demand draft,[195] creation of the demand draft according to the terms on its face was authorized by the person identified as the drawer.

A payor bank may recover from a warrantor damages for breach of warranty equal to the amount paid by the payor bank, less the amount the bank received or is entitled to receive from the drawer because of the payment.[196] It is important that the bank promptly notify transferors of any breach, as its failure to do so within 30 days may reduce their liability to the extent the loss might otherwise have been prevented by the notice.[197]

<u>Note</u>: If the bank is the subject of a breach of warranty claim (see above), it may defend against the claim by proving that: (1) the endorsement is effective under the imposter or fictitious payee rule [see 2.B (12)] or because it is an endorsement by a "responsible" employee [see 2.B (13)]; or (2) the drawer is precluded from asserting the unauthorized endorsement or alteration against the payor bank as a result of the drawer's negligence [see 2.B (3), 3.D (1) and 3.D (3)] or failure to report the claim in a timely manner [see 2.B (2) and 3.D (3) and (6)]. Unless

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193 UCC § 4208. *See also* UCC § 4207 for the warranties a customer or collecting bank gives when it transfers an item. The warranties are given to the transferee and to any subsequent collecting bank (other than the payor bank).

194 The phrase, "person entitled to enforce," is defined at UCC § 3301.

195 *See* UCC §§ 3104, 3417(a) (4) and (h), 4207(a) (6) and (f), and 4208(a) (4) and (g).

196 The payor bank is also entitled to compensation for expenses and loss of interest resulting from the breach. The payor bank's rights are not affected by any failure of the payor bank to exercise ordinary care in making payment. UCC § 4208(b).

197 UCC § 4208(e).

notice of a claim for breach of warranty is given to the bank within 30 days after the claimant had reason to know of the breach and the identity of the warrantor, the bank is discharged to the extent of any loss caused by the delay in receiving notice of the claim.

(b) Encoding Errors. Any person that incorrectly encodes information on or with respect to an item (including collecting banks and customers) warrants to any subsequent collecting bank and the payor bank or other payor that the information is correctly encoded. Any bank receiving the warranty that takes the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.[198]

(c) Notice of Right to Defense. If the bank is sued for a forgery or alteration due to a breach of warranty by a prior collecting bank or other third party, it may give written notice of the litigation and issue its demand for the third party to defend the bank (or otherwise be bound by any determination in the action). If properly notified, the third party will be bound by the determination unless it acts seasonably to come in and defend the action.[199]

Note: If the bank receives a notice to defend an action brought against another bank by a third party, contact Legal Counsel. It may be in the bank's best interest to accept responsibility for the defense, especially if it appears that the bank will ultimately be responsible for the loss and is in the best position to assert factual issues that may provide a defense.

(d) Intermediary Bank. If the bank is an intermediary collecting bank (i.e., not the depositary or payor bank) and acts in good faith and with ordinary care,[200] it may be obligated for a breach of warranty,[201] but will normally be able to push any loss back "up the line" to previous collecting banks or the depositary bank.[202] If the bank fails to exercise ordinary care, its liability is limited to the amount of the item reduced by an amount that could not have been realized by the use of ordinary care.[203]

(5) Closing the Account.

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198 UCC § 4209.

199 *See* UCC § 3119 for the required wording of the notice.

200 *See* UCC § 4202 for a definition of "ordinary care" vis-à-vis collecting banks. *Wauko Auto Supply v. Farmers & Merch. Sav. Bank*, 440 N.W.2d 844 (Iowa 1989) (Collecting bank was on inquiry notice due to ambiguous Indorsements).

201 UCC §§ 3417 and 4208.

202 *See* Regulation J with respect to the rules applicable to Federal Reserve Banks.

203 UCC § 4103(e).

In many cases, a bank will want to close the account that is the target of unauthorized check activity.[204] There are two reasons for this. First, it prevents additional unauthorized transactions from taking place. Second, assuming the bank has not yet decided to credit its customer's account for the amount of the alleged unauthorized transaction, closure of the account prevents additional customer checks from being "wrongfully dishonored" by the bank.[205]

A customer may occasionally ask its bank not to close an account due to the disruption it will cause the customer. While the customer may offer to hold the bank harmless from any liability for future forgeries, alterations and other unauthorized activity, it is questionable whether the bank can legally rely on such an agreement, especially given the bank's knowledge of the unauthorized activity that has occurred.[206] Banks faced with this dilemma for a "good customer" and that want to accommodate the customer should consider requiring the customer to obtain cash management services that are designed to detect or prevent fraud (e.g., checks with fraud prevention features, Positive Pay, and online account reporting). Banks also may want to vary the standard of care and responsibility by which they and their customers will be measured. Consider the following letter agreement. Note that it reduces the time periods for reporting problems set forth at UCC § 4406.

[Company Name and Address]

Re: Continued Maintenance of Account No. _____

Dear _____:

As you know, we recently [proposed to close][closed] the account described above (the "*Account*") due to the discovery of one or more [forged][altered][counterfeit] checks presented against the Account. When unauthorized activity of this nature is discovered, it is generally in the best interests of both the Bank and its customer to close the account and open a new account for the transaction of ongoing business. We normally require this, but understand that [insert name of company] ("*Company*") is requesting the Bank to allow the Account to remain open.

The Bank is willing to accommodate the request of Company, provided that it agrees to:

(1) immediately review all Account statements, notices and checks it receives (or

[204] A bank should be sensitive to the impact a closure may have on cash management services (e.g., automatic deposits, preauthorized loan payments, investment sweep arrangements, and third party collateral obligations) and should discuss with its customer what alternate arrangements should be made.

[205] A bank wrongfully dishonors an item if it dishonors an item that is properly payable. It is liable to its customer for all damages proximately caused by the wrongful dishonor. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or "other consequential damages." UCC § 4402.

[206] Although the UCC allows a bank to vary the effect of the code by agreement, a bank cannot disclaim responsibility for "its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or the failure." The bank and its customer may determine by agreement the standards by which the bank's responsibility is to be measured, however, if those standards are not manifestly unreasonable. UCC § 4103.

which are made available to it electronically) on an ongoing basis to verify that all transactions are authorized and that the checks are valid (Note: Company waives any right it may have under the law or its deposit agreement to review such documentation over a longer period of time);

(2) immediately notify the Bank regarding any forgery, alteration or irregularity with respect to any check or other transaction presented against the Account; and

(3) indemnify, defend and hold the Bank and its employees, officers and agents harmless in connection with any loss, claim, damage, action or cost associated with (a) counterfeit, altered or forged checks presented against the Account over the next _____ months and/or (b) Company's failure to comply with (1) or (2), above, to the fullest extent permitted by law.

In addition, Company must agree that:

(4) The Bank will not be held to a higher standard of care with respect to the Account as a result of its knowledge of the recent unauthorized transactions.

(5) Company will be subject to a higher standard of care and will closely monitor the use of its checks and account as a result of such transactions.

(6) Although the Bank may terminate or suspend the Account without prior notice if it later has reason to believe unauthorized transactions may be taking place, the existence of that right shall not obligate the Bank to adopt special procedures for the Account or to take additional steps to monitor Account activity.

(7) If Company fails to discover and report unauthorized check signatures or alterations within three days after its receipt of the items (or a statement or notice identifying the transactions), Company will be precluded from asserting unauthorized signatures or alternations on checks by the same wrongdoer that are processed by the Bank after the third day and before the Bank receives notice from Company of the problem.

(8) Without regard to care or lack of care of either Company or the Bank, if Company does not discover and report unauthorized check signatures or alterations within 20 days after its receipt of the items (or a statement or notice identifying the transactions), Company will be precluded from asserting the unauthorized signatures or alterations against the Bank.

[Company acknowledges that it has been offered an opportunity to subscribe to the Bank's Positive Pay service in order to prevent the payment of unauthorized or altered checks.]

[Bank has offered to provide Company with Positive Pay services that are designed to prevent check and (if applicable) automated clearing house fraud. Company acknowledges that these services are a reasonable means for preventing losses associated with unauthorized transactions. Company agrees that, if it chooses not to implement Positive Pay, it will be precluded from asserting any claims against Bank for paying unauthorized, altered, counterfeit or other fraudulent items and transactions that otherwise could have been detected or deterred with the service, and that Bank will not be required to re-credit Company's account or otherwise have any

liability for paying such transactions. Company agrees to indemnify and hold Bank harmless for any loss that could reasonably have been prevented with Company's use of Positive Pay.]

[This agreement shall apply to all of Company's accounts with the Bank.]

The Bank processes certain of its checks mechanically each day based only on the information encoded on the items (what is sometimes referred to as "bulk filing"). As such, checks under a certain dollar amount may not be reviewed visually to determine that they are genuine, properly completed and endorsed by authorized person. If the Account is to remain open, it must be with the understanding that the Bank may not be visually reviewing these checks. Counterfeit, altered and forged checks are difficult to detect, and Company should not assume that the Bank will notice the use of different paper stock, check design or duplicate check numbers (or forged signatures) by wrongdoers.

If Company is willing to agree to the provisions set forth above, the Bank will allow the Account to remain open, but reserves the right at any time to close the Account in accordance with its account agreement. Please sign and return the enclosed copy of this letter to me at your earliest convenience.

Sincerely,

AGREEMENT. Company agrees to the terms set forth above.

By: _____ Date: _____

Title: _____

Note: This letter may or may not pass muster under the Code. As such, banks should exercise discretion, based on the circumstances, in allowing accounts to remain open without additional oversight by the bank.

There may be times when a bank wishes to close an account due to unusual activity, rather than as a result of a loss or breach of contract. The following letters may be useful for those occasions.

The bank should be flexible on the termination date in the letters shown below as customers may need to make new arrangements for recurring federal benefit and ACH payments.[207] Branches also need to be sensitive to the impact an account closure may

[207] 31 CFR § 210.4(c)(3) provides "With respect to a recipient of benefit payments, if an RDFI closes an account to which benefit payments currently are being sent, it shall provide 30 calendar days written notice to the recipient prior to closing the account, except in cases of fraud."

have on compensating balance arrangements for a loan or its impact on an interest rate reduction that depends on automatic payments from the customer's account -- both of which should probably continue, even though the account is closed.

Dear _____:

As a bank, we are required by federal law to exercise due diligence in monitoring and understanding the financial transactions of our customers. When we are unable to do that or cannot satisfy ourselves that we have met the standards imposed by law, we must take appropriate action to reduce the risk of loss to the Bank.

During a recent review of your account, we noted a number of transactions that were unusual for your type of account or business, did not appear to have a regular business purpose, or were not the sort of transactions in which you would normally be expected to engage. As a result, we do not feel that we can meet the standard that is expected of us under the law and our own policies.

While we strive to serve the banking needs of our customers, sometimes we find it necessary to sever a banking relationship. This letter will serve as notice of our intent to terminate your account with us in ___ days. We believe this will provide you with sufficient time to make other arrangements to meet your financial needs. If not, please let us know if you will need additional time. No further deposits to your account will be accepted after [*usually two weeks before the account is to be closed to allow for returned items*], and any checks presented after [*date the account is to be closed*] may be returned unpaid.

We regret having to take this action and apologize for any inconvenience that it may cause. I hasten to add that this is not a reflection on you, your business or the manner in which you have maintained your account. It is simply a business decision reached after a consideration of the requirements imposed on us and the potential risks involved.

Sincerely,

Customer Name
Customer Address
City, State, Zip Code

Re: Account No(s). _____

Dear _____:

As a bank, we are required by federal law to exercise due diligence in identifying each of our customers and understanding their financial activity. When we are unable to do that or cannot satisfy ourselves that we have met the standards imposed by law, we must

take appropriate action to reduce the Bank's risk of loss and regulatory criticism.

While we strive to serve the banking needs of our customers, sometimes we find it necessary to sever a banking relationship. Due to [your failure to provide us with (*list information*)][inconsistencies that we noted in the information you provided to us][our inability to confirm your (*identify information*)][the unusual nature of the transactions involving your account], we regret to inform you that _____ Bank has elected to terminate your account, in accordance with the terms of your account agreement.

This letter will serve as notice of our intent to close your account(s) on [*insert date*]. At that time, we will mail a cashier's check to you for the collected available balance in your account(s). We believe this will provide you with sufficient time to make other arrangements to meet your financial needs. If you prefer, you are welcome to visit a _____ Bank branch and close your account(s) in person. [If your account is a Certificate of Deposit, the account will be closed without the imposition of penalties.] No further deposits to an account will be accepted after [*date*]. [If applicable, your ATM card and online banking have already been cancelled.][If you have a safe deposit box, you will need to visit your branch and close the box on or before _____, as well.]

We regret having to take this action and apologize for any inconvenience that it may cause you. I hasten to add that this is not a reflection on you, your business or the manner in which you have maintained your account. It is simply a business decision reached after a consideration of the requirements imposed on us and the potential risks involved.

If you have any questions regarding the closure of your account, please call our Customer Service Department at (___) ___-____ or your branch of account.

Sincerely,

G. Adverse Claims and Disputes. Some states, such as California, allow a bank or savings and loan to freeze an account temporarily if an adverse claim form is presented to the

institution by a third party.[208] Other states prohibit an institution from acting on an adverse claim in the absence of a court order or a bond indemnifying the bank.[209]

(1) **California's Adverse Claim Procedure.**[210] California permits a bank or savings association[211] to freeze an account or safe deposit box for three court days (including the day of delivery) following the institution's receipt of a written adverse claim form.[212] The adverse claim must: (a) be in the form of an affidavit or a declaration under penalty of perjury; (b) be served at the office of the institution where the account or safe deposit box is held;[213] (c) state, based on the claimant's own knowledge, that the person to whose credit the account/box stands (or for whom it is held) is a fiduciary for the adverse claimant;[214] (d) state that the claimant believes the fiduciary is about to misappropriate the deposit or property;

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[208] A bank normally owes no duty to a non-customer. *Terry v. Bank of America*, 350 F. Supp. 2d 727 (W.D. Virginia 2004). The adverse claim procedure is a legislative exception to the rule. The adverse claim procedure applies to accounts. It does not apply to checks. See UCC § 3602 regarding third party claims to checks. *Landrum v. Security Nat'l Bank of Roswell*, 104 N.M. 55, 716 P.2d 246 (1986) (delivery of forgery affidavit did not comply with adverse claim procedure; forged Indorsement claim is not an adverse claim). Adverse claims do not include general claims against the accountholder. An adverse claimant is one who claims that a deposit belongs to him instead of the one to whose credit it stands on the books of the bank. *Id.* at 252; *First National Bank of Arizona v. Butler*, 82 Ariz. 361, 313 P.2d 421 (1957) (bankruptcy trustee not adverse claimant to bank account in the name of the bankrupt); *Perdue v. State Nat. Bank*, 254 Ala. 80, 47 So. 2d 261 (1980) (guardian of husband, as joint tenant on account with wife, was not an adverse claimant); *Fortune v. City National Bank & Trust Co.*, 671 P.2d 69, 1983 Ok CIV App. 30 (1983) (joint tenants can't be adverse claimants); *Aarts Productions, Inc. v. Crocker National Bank*, 179 Cal. App. 3d 1061 (1986) (account signatory cannot be an adverse claimant). The adverse claim procedure was designed to protect banks, not depositors or third parties. *Arizona Bank v. Wells Fargo Bank*, 148 Ariz. 136, 713 P.2d 337; *Landrum v. Security Nat'l Bank of Roswell, supra* at 251; *Goldstein v. Riggs National Bank*, 459 F.2d 1161, 148 U.S. App. D.C. 137 (1972).

[209] State laws sometimes permit a temporary freeze based on a bond or the assertion of a fiduciary obligation by the accountholder. Thirty-six states and the District of Columbia have some form of adverse claim procedure: Ala. Code § 5-5A-42; Alaska Stat. § 06.05.145; Ariz. Rev. Stat. Ann. § 6-233; Ark. Code Ann. §§ 23-32-1006; Cal. Fin. Code § 1450; Colo. Rev. Stat. § 11-6-107; 1992 Conn. Acts 92-12 § 3 (Reg. Sess.); D.C. Code Ann. § 26-203; Fla. Stat. Ann. § 658.61; Ga. Code Ann. § 7-1-353; Idaho Code § 26-717; Ind. Code Ann. §§ 28-9-3-3 and 28-9-4-2; Iowa Code § 524.808; Kan. Stat. Ann. § 9-1207; Ky. Rev. Stat. Ann. § 286.3-800; La. Rev. Stat. Ann. § 6:315; Me. Rev. Stat. Ann. tit. 9-b § 427; Md. Code Ann., Fin. Inst. § 5-306; Mass. Ann. Laws ch. 167D § 31; Mich. Comp. Laws § 487.691; Miss. Code Ann. §§ 81-5-67, 81-12-127; Mo. Rev. Stat. § 362.375; NJ Rev. Stat. § 17:9A-223; NM Stat. Ann. § 58-1-7; NY Banking Law § 134; Ohio Rev. Code Ann. 1161.25; Okla. Stat. tit VI, § 905; Or. Rev. Stat. § 708.525; 7 Pa. Cons. Stat. § 606; SC Code Ann. §§ 34-11-110, 34-28-650; SD Codified Laws Ann. § 51A-1-3; Tenn. Code Ann. § 45-2-706; Tex. Rev. Civ. Stat. Ann. art. 342-705; Utah Code Ann. § 7-1-601; Wash. Rev. Code §§ 30.20.090, 30.22.220, 32.12.120; W. Va. Code § 31A-4-32; Wis. Stat. § 710.05. For foreign country adverse claims, see the Mutual Legal Assistance in Criminal Matters Treaty (May 6, 1991, U.S.-Uru., ch. 1, art. 1, 5 Treaty Doc. No. 102-19); *In re Commissioner's Subpoena*, 325 F.3d 1287 (11th Cir. 2003). The U.S. has bilateral MLATs with 45 countries.

[210] Financial Code § 1450 (previously located at § 952) does not apply to disputes arising between joint accountholders. *Aarts Productions, Inc. v. Crocker National Bank*, 255 Cal. Rptr. 203 (Cal. App. 6 Dist. 1986).

[211] In some states, the adverse claim provision may not apply specifically to savings and loan associations, credit unions or similar institutions. Such institutions may be allowed to freeze funds for a brief, reasonable period of time under common law to permit the filing of an interpleader action or other appropriate litigation.

[212] For banks: Financial Code §§ 1450 (accounts) and 1620 (safe deposit boxes). For savings associations: Financial Code § 6661. The adverse claim procedure applies to accounts. It does not apply to checks. See UCC §§ 3602 regarding third party claims to checks. *Landrum v. Security National Bank of Roswell,* 104 N.M. 55, 716 P.2d 246 (1986) (delivery of forgery affidavit did not comply with adverse claims procedure; forged Indorsement claim is not an adverse claim). Adverse claims do not include general claims against the account holder (e.g., on a note). For adverse claims involving investment securities, see UCC §§ 8102(a), 8105, 8502, and 8510.

[213] Faxed notice of an adverse claim did not satisfy Indiana's adverse claim requirement that it be served on the bank. *Hendricks County Bank v. Guthrie Building Material, Inc.*, 663 N.E.2d 1180 (Ind. App. 1996).

[214] The account title does not have to reflect its fiduciary nature. *Goldstein v. Riggs National Bank*, 459 F.2d 1161, 148 U.S. App. D.C. 137 (1972).

and (e) state the facts upon which the claim of fiduciary relationship and the belief are founded.[215] For example:

[215] Strict compliance with code requirements is essential. *Hendricks Country Bank & Trust v. Guthrie Building Materials, Inc.*, 663 N. E. 2d 1180 (1996) (Even though bank was aware of the faxed adverse claim form, state law required that it be "served" in person.

To: _____ ("Institution")

_____

(*Address of office where Property is carried, held or controlled*)*

_____, California.
(City)

Declaration of Adverse Claim
(Financial Code §§ 1450, 1620 and 6661)

I declare under penalty of perjury under the laws of the State of California that the following is true, correct and based on my own personal knowledge:

1. The following property (*Describe property by account or box number, if known*):

_____

_____

_____

_____

and the proceeds and interest, if any, of such property (collectively "Property") is being held by, in the name of, for the credit of and/or for (*State name of customer*):

_____

also known as _____

and/or _____

("Customer"), either alone or with others.

2. Customer is a fiduciary of the undersigned, based on the following facts (State facts showing how trust, constructive trust, or other fiduciary relationship arose):

_____

_____

_____

_____

3. I have reason to believe Customer is about to misappropriate the Property. My belief is founded on the following facts:

_____

_____

_____

4. Pursuant to Financial Code §§ 1450 and 1620 (for banks) or 6661 (for S & Ls), **you are directed to refuse payment and delivery of the Property for a period of three court days (including the day this Declaration is received)**.

5. If this declaration is being given to you on behalf of a company or other entity, I am authorized to make and deliver this declaration on its behalf.

Date: _____

By: _____

Title: _____

Address: _____

_____

_____

Telephone: _____

Fax: _____

* Note: The Declaration must be delivered to this office.

A notice of an adverse claim must be disregarded[216] until the bank or association receives a claim form that complies with these requirements.[217] Once a qualifying adverse claim form is received by the correct branch, the institution must freeze the account/box for three court days (including the day of delivery). This allows the claimant time to go into court and obtain a restraining order, injunction, or other appropriate order against the bank and/or the fiduciary. If it fails to do so, the bank may release its hold on the funds.[218]

When a financial institution is defrauded by its customers or others, it may be able to use the adverse claim procedure to freeze stolen funds or property traced to another institution. It would be alleging that the thief holds its funds in constructive trust.[219] Once the bank's adverse claim is served on the other institution, the claiming bank should act quickly to obtain an appropriate court order. Alternatively, the other institution may be willing to transfer the funds or property to the claiming bank under a hold harmless agreement.

The bank's customer should be notified promptly of the adverse claim.[220]

(2) **Disputes Between Accountholders.** When disputes arise between joint accountholders, signers on an account, or persons purporting to own or control a business, financial institutions are often asked by one or more of the factions to

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216 A noncomplying form may still impact the bank. For example, a bank may not exercise its right of setoff once it has knowledge of an adverse claim. *Iola State Bank v. Bolan*, 679 P.2d 720 (Kan. 1984); *Four Circle Co-op v. Kansas State Bank & Trust*, 771 F. Supp. 1144 (D.Kan 1991); *Central Bank v. Butler*, 517 So.2d 507 (Miss. 1987); *In re Brittenum & Assoc., Inc.*, 868 F.2d 272 (8th Cir. 1989); *Liberty Sav. Ass'n v. Sun Bank*, 572 F.2d 591 (7th Cir. 1978).

217 See also Financial Code § 1451. A bank that believes it may be in jeopardy if it releases the funds (e.g., because it fears the funds may be derived from a forged Indorsement) may choose, instead, to file an interpleader action. *Arizona Bank v. Wells Fargo Bank*, 148 Ariz. 136, 713 P.2d 337 (1985).

218 *United States v. Boylan*, 392 F.3d 1002 (2004).

219 *Desert Bermuda Properties v. Union Bank*, 265 Cal. App. 2d 146, 71 Cal. Rptr. 93 (1968) (may apply funds against debt owed to bank).

220 *Jaselli v. Riggs Nat'l Bank*, 36 App. D.C. 159, 31 LRA (NS) 763 (1910).

take sides. If the institution chooses the "wrong side," it may find itself liable for its actions, including potential wrongful dishonor claims. Institutions generally deal with these disputes in three ways:

(a) *Stopping Payment* -- Sometimes, the institution will suggest that one of the parties (who is shown as a signer on the bank's books) provide it with instructions to stop payment on all checks, withdrawals and transfers from the account, in essence "freezing" the account.[221]

(b) *Requiring Additional Signatures* -- The law may permit one of the accountholders to require more signatures for the withdrawal of funds. In California, for example, unless the notice is withdrawn, any party to an account (other than a checking account, share draft account, or other similar third party payment instrument) may notify the institution not to permit withdrawals, except with the signatures of more than one of the parties. After that, the institution may only pay the sums on deposit in accordance with the written instructions, pending determination of the rights of the parties or their successors.[222] Many institutions insert a clause in their account agreement authorizing the bank, in its discretion, to (i) require all authorized signers to act together, and/or (ii) require proof, satisfactory to the institution, of each signer's continuing authority to act.

(c) *Freezing the Account by Agreement* – Many institutions insert a protective clause in their account agreement that gives the institution the right to freeze an account whenever the institution is uncertain as to anyone's ownership interest in, or right to control, the account.[223] Here is a typical provision:

> **Conflicting Demands/Disputes**. If there is any uncertainty or conflicting demands regarding the ownership of an account or its funds, we are unable to determine any person's authority to give us instructions, we are requested by [Adult Protective Services][any state or local agency] to freeze the account or reject a transaction due to the suspected financial abuse of an elder or dependent adult, or we believe a transaction may be fraudulent or may violate any law, we may, at our sole discretion: (1) freeze the account and refuse transactions until we receive written proof (in form and substance satisfactory to us) of each person's right and authority over the account and its funds; (2) refuse transactions and return checks, marked "Refer to Maker" (or similar language); (3) require the signatures of all authorized signers for the withdrawal of funds, the closing of an account, or any change in the account regardless of the number of

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221 Any person authorized to draw on an account may place a stop payment order. UCC § 4403(a).

222 Probate Code § 5405(c).

223 A bank may provide for this as between joint accountholders. *Aarts Productions, Inc. v. Crocker National Bank*, 225 Cal. Rptr. 263 (Cal. App. 6 Dist. 1986).

authorized signers on the account; (4) request instructions from a court of competent jurisdiction at your expense regarding the account or transaction; and/or (5) continue to honor checks and other instructions given to us by persons who appear as authorized signers according to our records. The existence of the rights set forth above shall not impose an obligation on us to assert such rights or to deny a transaction.

Depending on the wording in the account agreement, the institution can then send a letter to each disputing party along the following lines. Note: The letter should be sent to both disputing parties and to the customer(s) named in the title of the account at the address of record.

[Name and address for person No. 1]

[Name and address for person No. 2]

[Name and address of the accountholder as shown in the Bank's records]

Gentlemen:

During the last few days we have received a number of conflicting demands and contradictory information regarding the ownership and control of the following accounts:

Account Name	Account No.	Balance
_____	_____	$_____
_____	_____	$_____
_____	_____	$_____

Under the terms of the your deposit agreement, the Bank may:

- refuse to honor any request or order if there is a dispute over the ownership of an account or any person's authority to make a request or order;
- require the signatures of all account holders and/or authorized signers for the withdrawal of funds and
- require evidence, satisfactory to it, of each person's continuing authority to give instructions regarding an account.

The agreement also provides that:

- In no event shall we be liable for any delay or refusal to follow instructions which occurs as a result of any dispute over the authority of anyone to act on behalf of the account holder. We may return checks and other items, marked "Refer to Maker" (or

similar language), in the event there is a dispute over the ownership or control of an account.

- We may refuse to accept a deposit or an addition to an account, limit its size, or return all or part of it to you.

Due to the complexity of the issues being raised by both sides of the dispute, we cannot determine which person(s) are authorized to handle the accounts and funds in question. We also do not believe it is appropriate for us to reach any legal conclusions based on the documentation which is being presented by each side. As such, please be advised that we are taking the following actions:

[ ] Effective immediately, the funds in the above-described accounts will be [frozen][placed in (a blocked savings account) (an interest-bearing, automatically renewing __-day time deposit)]. [No withdrawals or transfers will be permitted from the account without your joint instruction.][Checks drawn on such accounts will be returned and marked "Refer to Maker" (or with similar language).]

[ ] No further deposits or transfers will be permitted into the above-described accounts.

We hesitate to take legal action in connection with the account(s), since the cost of litigation can become significant. If you are unable to come to an arrangement regarding the funds, however, we may interplead the funds with the court, either upon your request or at our own initiative. We are postponing the filing an action at this time in the hopes that you will be able to come to an agreement regarding the funds.

We would encourage both sides of the dispute to meet and resolve their claims to account funds as soon as possible. Until a resolution is reached, we suggest consideration be given to:

1. entering into an agreement (signed by both parties) for the payment of obligations (e.g., taxes or loans) which both parties agree should be paid;

2. obtaining a court order as to the disposition of the accounts; and/or

3. submitting the matter to arbitration or agreeing on a neutral third party who can disburse funds for the day-to-day operation of the business in question.

As you can understand, the Bank does not wish to become embroiled in a costly battle over the funds in question. To the extent we can facilitate a resolution of the dispute, however, we encourage you to keep us

informed on your progress and any arrangements you reach involvingthe accounts.

We will send information regarding the account [and its renewals] to the address of *[name of company*] set forth in our records. Information regarding the status of the account will also be available at the branch. [Unless otherwise directed by a court order, we intend to make such information available to both parties, pending a resolution of this matter.]

[Please direct all further communications regarding this matter to: (insert name and address).]

Sincerely,
[*Name of Bank*]

5. TIMING ISSUES

Payor banks have three duties when returning forged, altered or otherwise unauthorized checks: (1) return the check by the midnight deadline in accordance with the UCC; (2) expeditious return of the item in accordance with Regulation CC, and (3) send notice of nonpayment for checks of $2,500 or more in accordance with Regulation CC.[224]

A collecting bank must exercise ordinary care in: (1) presenting an item for collection; (2) sending notice of dishonor or nonpayment or returning an item; (3) settling for an item when the bank receives final settlement; and (4) notifying its transferor of any loss or delay. "Ordinary care" means taking proper action before its midnight deadline (or within a reasonably longer time) following receipt of an item, notice, or settlement.[225]

If a depositary bank provisionally credits its customer's account for a deposited item which is dishonored for any reason, it may revoke the settlement given by it, charge back the amount of any credit given to its customer for the item, or obtain a refund from its customer if, "by its midnight deadline or within a longer period after it learns the facts," it returns the item or sends[226] notification of the facts to the depositor. If the return or notice is delayed beyond the depositary bank's midnight deadline, it may still revoke the settlement, charge back the credit, or obtain a refund from its customer, but is liable for any loss resulting from the delay. These rights to revoke, charge back, and obtain a refund terminate if and when settlement for the item received by the bank is or becomes final.[227]

A. Midnight Deadline

(1) Payor Bank Deadline. If a payor bank settles[228] for an item (other than a documentary draft)[229] that is presented[230] other than for immediate payment over

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224 An institution must comply with the return requirements of both the UCC and Regulation CC, although Reg. CC (under some circumstances) may extend the UCC's midnight deadline by one day. See *Valley Nat'l Bank v. Hudson United Bank*, 49 UCC Rep. 2d 576 (N.J. Super. Ct., 2002). Reg. CC § 229.30 sets forth the payor bank's responsibility for returning checks. Reg. CC § 229.33 sets forth the notice requirements for checks of $2500 or more that the payor bank decides to return. Reg. CC § 229.34 describes the warranties related to returned checks. Clearing house rules or other agreements may vary the terms of the UCC under UCC § 4103 and subpart C to Reg. CC under § 229.37.

225 UCC § 4202(a) and (b). Reg. CC § 229.31 sets for the returning bank's responsibility for returning checks.

226 "Send" is defined at UCC § 1201(b)(36). An item or notice is sent when it is deposited in the mail or delivered for transmission by any other usual means of communication.

227 UCC § 4214(a). A collecting bank returns an item when it is sent or delivered to the bank's customers. UCC § 4214(b) (preempted in part by Reg. CC § 229.31). A depositary bank that is also the payor bank may charge back the item to its customer's account or obtain a refund in accordance with UCC § 4301. UCC § 4214(b). The right of chargeback is not affected by (1) previous use of a credit given for the item, or (2) failure by any bank to exercise ordinary care with respect to the item (although a bank so failing remains liable). UCC § 4214(d). Reg. CC § 229.32 sets forth the depositary bank's responsibility for returned checks (i.e., acceptance, payment, misrouted returned checks).

228 Settlement is important under the literal wording of the code. UCC §§ 4301(a) and 4302(a) (2). If the bank does not actually settle for an item, it must return the item on the same business day that it is received. The bank does not have a right to wait until the end of the next business day to return the item. *Hanna v. First Nat'l Bank of Rochester*, 87 N.Y.2d 107, 661 N.E.2d 683 (1995). Reg. CC § 229.36(f) provides that, if a check is presented by 8:00 a.m., the payor bank must pay for the check by the close of Fedwire. Otherwise, it becomes accountable for the check.

the counter before midnight of the "*banking day"* of receipt,[231] it may revoke the settlement and recover the settlement if, before it has made "*final payment*"[232] and before its "*midnight deadline*," it either: (i) returns the check[233] or (ii) sends written notice of dishonor or nonpayment if the item is unavailable for return.[234]

– Midnight Deadline. A payor bank's "*midnight deadline*" is midnight of the banking day following the banking day that it is presented with a check for payment.[235]

Example: If the bank receives a check for payment on Monday morning (the first "banking day"), it has until midnight on Tuesday (the next "banking day") to return the check.[236]

– Banking Day. The term "*banking day*" is defined as "the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions."[237] In the absence of a contrary statute, clearing house

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229 "Documentary draft" means a draft to be presented for acceptance or payment if specified documents, certificated securities, statements or the like are to be received by the drawee or other payor before acceptance or payment of the draft. UCC § 4104(a) (6). A bank does not have to act within the midnight deadline for documentary drafts, but must dishonor or pay the draft within the time allowed for acceptance or payment. UCC § 4302(b). *Shannon v. Sunwest Nat'l Bank of Albuquerque N.A.*, 118 N.M. 749, 887 P.2d 285, 25 (1994). Payment or acceptance may be delayed without dishonor until no later than the third business day after receipt, i.e., after "sight." UCC § 3502(c).

230 UCC § 3501(a).

231 The UCC does not define receipt. Reg. CC provides that a check is considered received by the paying bank when it is received (1) at a location to which delivery is requested by the paying bank when it is received: (1) at a location to which delivery is requested by the paying bank; (2) at any address of the bank associated with the routing number; (3) at any branch or head office if the bank is identified on the check by name but without an address; or (4) at a branch, head office, or other location consistent with the name and address identified on the check if the bank is identified on the check by name and address. Reg. CC § 229.36(b). FRB Operating Circular No. 3 provides that checks delivered by the Federal Reserve are deemed received when made available for pick-up as arranged, whether or not the paying bank picks them up as arranged. The Operating Circular is binding on participating banks. UCC § 4103(b). Cases dealing with FRB delivery: *Heartland State Bank v. American Bank & Trust*, 2010 WL 4249786 (S.D. 2010) (checks mailed by FRB); *Los Angeles Nat'l Bank v. Bank of Canton*, 31 Cal.App.4th 726 (Cal.Ct.App. 1995) (items available for pickup at the FRB).

232 A bank's preliminary stamping of a check as "paid," by itself, does not mean it has finally been paid. Often, this is simply evidence of internal processing which the bank may cancel before its midnight deadline. *Trump Taj Mahal Associates, LLC v. The Bank of New York*, 61 UCC Rep. Serv. 2d 77, 2006 WL 295633 (New Jersey 2006).

233 Check the local check clearing house rules or Regulation J and Federal Reserve Bank Operating Circular No. 3 for the manner and timing of returns via the clearing house or the Fed.

234 UCC § 4301(a). Under UCC § 4302, a payor bank is accountable for the amount of a demand item other than a documentary draft if it misses this deadline. Under UCC §§ 3418(a) and 4215(a), late return constitutes payment and would be final in favor of a holder in due course or a person who has in good faith changed his position in reliance of the payment. *Southern Bank of Commerce v. Union Planters National Bank*, 67 U.C.C. Rep. Serv. 2d 410, 2008 WL 5101014 (Supreme Court of Arkansas, 12/4/08) (Bank was a holder in due course at the time it took cashier's check for deposit. Notice of defect received afterwards does not affect status).

235 UCC § 4104(a) (10). For example, a check received on Thursday, August 30, must be dispatched on or before midnight on Friday, August 31. Availability of checks to bank's processing agent commences the start of the midnight deadline rule. *Los Angeles National Bank v. Bank of Canton*, 31 Cal. App. 4th 726, 37 Cal. Rptr.2d 389 (1995). When a bank reserves the right to revoke settlement by its deposit ticket or account agreement, an on-us check deposited over-the-counter by the payee is subject to the midnight deadline rule. UCC §§ 4214(c) and 4301.

236 "Midnight Deadline" is defined as "midnight on [the bank's] next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later." UCC § 4104(a) (10). A payor bank that fails to comply with the midnight deadline rule is liable for a check even if it is drawn on insufficient funds.

237 UCC § 4104(a) (3). Under this definition, Saturday would not be deemed a banking day if the bank is open for only limited functions, e.g., to receive deposits and cash checks, but with loan, bookkeeping and other departments closed. "Banking Day" is determined by the

rule or agreement, the bank must either return the check or give notice of dishonor to the presenting bank by the "next banking day" following the "banking day" that it received the item for payment. If it fails to do that, it assumes responsibility for the check, whether or not (a) there are sufficient funds in the drawer's account to cover the check, (b) the bank is negligent, or (c) the bank's behavior causes any loss to the holder or depositary bank.[238] If it acts to return the item within the midnight deadline, it reverses the provisional settlement given to the presenting bank and is not responsible for the check.[239]

– Cutoff hour. A bank may fix a cutoff hour of 2 p.m. or later for the handling of items and the making of entries on its books.[240] If it receives an item after that point in time, the item will be deemed received as of the next banking day for purposes of the midnight deadline.[241] For example, if a bank sets 2 p.m. as its cutoff hour for presentment, a check that is presented for payment at 3 p.m. on Monday will not be deemed received until the next banking day (Tuesday). The bank will then have until midnight of the next banking day (Wednesday – the banking day following the banking day of receipt) before it becomes accountable for the item (assuming the check is not "finally paid" in the interim). This essentially gives the bank an additional day to determine whether it wishes to be accountable for the item.[242]

– Final Payment. A bank may not return a check after it has been "finally paid." Final payment occurs when the bank does any of the following:

(1) pays the item in cash (e.g., at a teller window);

(2) settles for the item without having a right to revoke the settlement under statute, clearing house rule, or agreement;[243] or

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banking functions offered on a day. *United Bank of Crete-Steger v. Gainer Bank, N.A.*, 874 F.2d 475 (7th Cir. 1989). Reg. CC § 229.30(c) (2) contains an exception to the midnight deadline for banks that are open for substantially all business on Saturday, so that they are not required to return checks by midnight on Saturday (given that few, if any, banks process checks on Saturday evening).

238 A bank becomes liable for the item even though its delay causes no damage. See *Citizens Fid. Bank & Trust Co. v. Southwest Bank & Trust Co.*, 238 Neb. 677, 472 N.W.2d 198 (1991), involving the deposit of a counterfeit check.

239 Although Reg. CC § 229.36(d) rejects the concept of provisional settlement, an official comment to the regulation explains that it is not intended to change the liability scheme under the UCC.

240 UCC § 4108.

241 A bank "receives" a check from a Federal Reserve Bank when it is available for pickup, whether or not it picks up the item. *L.A. Nat'l Bank v. Bank of Canton*, 31 Cal. App. 4th 726, 37 Cal. Rptr. 2d 389 (1995).

242 Clearing house rules and Regulation CC also may determine when an item is deemed received by a bank.

243 UCC § 4213 contains the timing rules with respect to settlement. It is unusual for a drawee bank to settle for an item without reserving a right to revoke the settlement. Typically, settlement through a clearing house is provisional, and the payor bank has until its midnight deadline to revoke the settlement.

(3) makes a provisional settlement for the item and fails to revoke the settlement in the time and manner permitted by statute, clearing house rule, or agreement.[244]

When an item is "finally paid," the bank becomes accountable to the presenter[245] for the amount of the item unless it has a valid defense. If the bank settles for a check (presented other than for immediate payment over the counter), it may revoke the settlement before final payment occurs and recover the amount if it returns the check or sends written notice of dishonor or nonpayment if the item is unavailable for return. The return must be made prior to final payment and before the bank's midnight deadline.[246]

– Return. A payor bank must "return" a check within its midnight deadline.[247] The bank "returns" a check for purposes of the midnight deadline rule when the check physically leaves the bank's premises to be delivered to the collecting or depositary bank.[248] Sending a check from a branch to the bank's processing center is not sufficient.[249] Sending a

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244 If provisional settlement for an item does not become final, the item is not deemed finally paid. UCC § 4215(b).

245 An assignee who purchases a check with notice of the dishonor lacks standing to bring an action against a bank to enforce UCC § 4302. The payee has standing to bring an action, as well as anyone who takes an assignment prior to the check's presentment for payment. *Triffin v. Bridge View Bank*, 750 A.2d 136 (N.J. Ct. App. 2000). Title company could not assert a right to sue under principles of equitable subrogation. *American Title Ins. Co. v. Burke & Hebert Bank & Trust Co.*, 813 F. Supp. 423 (E.D. Va. 1993), *aff'd* 25 F.3d 1038 (4th Cir. 1994); *Lawyers Title Ins. Corp. v. United American Bank of Memphis*, 21 F. Supp. 2d 785 (W.D. Tenn. 1998).

246 A bank's misencoding of the check it returned prior to the deadline did not make it liable under the midnight deadline rule. *NBT Bank v. First Nat. Community Bank*, 393 F.3d 404 (3rd Cir. 2004).

247 UCC §§ 4301 and 4302. The UCC does not define the term "return," except to the limited extent described in UCC § 4301(d). An item is returned when it is "delivered" to the presenting or last collecting bank or the clearinghouse or is "sent" or delivered in accordance with clearinghouse rules. In all other cases, it is delivered when sent or delivered to the bank's customer or transferor. "Delivery" means voluntary transfer of possession (UCC § 1201(b)(15)). "Send" means deposit in the mail or deliver for transmission by any other usual means for transmission (UCC § 1201(b)(36)). Regulation CC uses the term in connection with the process of transmitting the check so that it is received ultimately by the depositary bank (Reg. CC § 229.30). *NAT Bank, N.A. v. First Nat'l Cmty. Bank*, 393 F.3d 404 (3rd Cir. 2004) – NSF check in a check-kiting scheme which was improperly encoded with routing number for bank other than depositary bank, but was physically dispatched by payor bank to Federal Reserve Bank by midnight deadline, was "delivered." Misencoding did not constitute violation of midnight deadline rule. Returning a check after the midnight deadline may violate Regulation CC § 229.34 warranties and result in damages under §§ 229.34(e) and 229.38.

248 Reg. CC § 229.30 requires a payor bank to return a check in an "expeditious manner" in one of two ways. First, it can return the check in a manner such that it would normally be received by the depositary bank not later than 4:00 p.m. (local time) on: (a) the second business day following the banking day on which the check was presented to the payor bank if the payor bank and the depositary bank are located in the same check processing region; or (b) the fourth business day if they are not located in the same region. (Inasmuch as only one check processing region remains located at the head office of the Federal Reserve Bank of Cleveland, effective February 27, 2010, there is only one check processing region for purposes of Reg. CC.) Second, it can return the check in a manner that a similarly situated bank would send a similar check for forward collection. The deadline for return or notice of nonpayment is extended if the payor bank uses a means of delivery that would ordinarily result in its receipt by the bank to which it is sent on or before the receiving bank's next banking day following the otherwise applicable deadline (Reg. CC § 229.30(c)). Note: The expeditious return requirement applies to a payable-through and payable-at bank, and begins when either receives the check for forward collection, not when the payor bank returns a check to them. For purposes of the UCC midnight deadline, however, a check sent through either is not considered to be drawn on either (Commentary to Reg. CC § 229.30). The expeditious return (§ 229.30(a) and 229.31(a)), notice-of-nonpayment (§ 229.33) and same-day settlement requirements of Reg. CC do not apply to a check drawn on the U.S. Treasury, U.S. Postal Service money orders, or to a check drawn on a state or local government unit that is not payable through or at a bank (Reg. CC § 229.42).

249 *Chicago Title Ins. Co. v. California Canadian Bank*, 1 Cal. App. 4th 798, 2 Cal. Rptr. 2d 422 (1991), *reh'g denied* (1992) (sending checks to in-house data center is not a "return" under the applicable clearing house rules).

notice of nonpayment also is not sufficient unless the item is unavailable for return.[250]

(2) **Extending the Midnight Deadline**. A bank may return a check after its midnight deadline if it acts to return the item to the depositary bank (or to a returning bank)[251] in a highly expeditious manner (e.g., by courier) so that it is received by the close of that bank's banking day[252] following the expiration of the midnight deadline.[253] For example, if a bank receives a check for payment before its cutoff on Monday, it may return the check by courier to the depositary bank by the close of the banking day on Wednesday, even though the normal midnight deadline would have passed at midnight on Tuesday.[254]

(3) **Notice of Nonpayment**. Regulation CC requires that banks provide notice of nonpayment if they are returning a check of $2,500 or more.[255] This rule is separate from the midnight deadline rule, and compliance with the return notice requirement does not suffice for compliance with the rule.[256]

Note: Clearing house rules may provide a different threshold amount for notices.

Notice must be received by the depositary bank by 4:00 p.m. (local time) on the second banking day following the banking day on which the check was presented to the paying bank (or by the next banking day if it is not a banking day for the depositary bank).[257] For example, notice must be received by 4:00 p.m. on Wednesday for a check presented on Monday.

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250 UCC § 4301(a) (2). See UCC § 4202 for collecting banks, which calls for sending notice of dishonor or returning the item.

251 There is some debate as to whether Regulation CC allows an extension of the deadline when checks are returned to an intervening collecting bank, such as the Federal Reserve Bank. *Oak Brook Bank v. N. Trust Co*., 2000 WL 294081 (N.D. Ill. 2000) (delivery to Federal Reserve Bank is sufficient).

252 "Banking day" is defined as that part of a business day (Monday through Friday, other than standard Federal holidays) when a bank is open to the public for carrying on substantially all of its banking business. Reg. CC § 229.2(f) and (g).

253 Reg. CC § 229.30(c). The deadline for return or notice of nonpayment under the U.C.C. or Reg. CC § 229.36(f) (2) is extended if a paying bank, in an effort to expedite delivery of a returned check to a bank, uses a means of delivery that would ordinarily result in the returned check being received by the bank to which it is sent on or before the receiving bank's next business day following the otherwise applicable deadline. This deadline is extended further if a paying bank uses a highly expeditious means of transportation (e.g., by air courier between the west and east coasts), even if this means of transportation would ordinarily result in delivery after the receiving bank's next banking day. *U.S. Bank Nat'l Ass'n v. HMA, L.C.*, 2007 WL 1452649 (Utah 2007).

254 *First Nat. Bank of Chicago v. Standard Bank & Trust*, 172 F.3d 472 (7th Cir. 1999) (bank executives drove checks to receiving bank's processing center).

255 Reg. CC § 229.33(a).

256 Payable-through banks are treated as the drawee bank with respect to Reg. CC's requirements to return the check within Reg. CC's time frame and to give timely notice of dishonor to the bank of first deposit (Reg. CC § 229.36(a)). Payable-through banks are not considered a "payor bank" with respect to the UCC midnight deadline rule, however. There is no "payor bank" in the case of a payable-through draft. *Farm Credit Serv. of America v. American State Bank*, 339 F.3d 764 (8th Cir. 2003). *See* UCC §§ 4302, 4105(3) and 4106.

257 Reg. CC § 229.33(a).

Notice may be provided by any reasonable means, including the returned check, a writing (including a copy of the check), telephone, Fedwire, telex, or other form of telegraph.[258]

(4) **Defenses**. A payor bank is accountable for checks that are retained beyond its midnight deadline.[259] There are a few exceptions and defenses to liability for missing the midnight deadline, however:[260]

(a) Breach of presentment warranty. The check bears a forged payee endorsement or has been altered.[261]

(b) Fraud. The person asserting the midnight deadline presented or transferred the check for the purpose of defrauding the payor bank.[262]

(c) Emergency conditions. The delay was caused by an interruption of communications or computer facilities, emergency conditions, failure of

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258 *See* Reg. CC § 229.33(b) for the required contents of the notice. Depositary banks, in turn, must send notice to their customers of the facts by midnight of the banking day following the banking day on which they received the returned check or notice, or within a longer reasonable time. Reg. CC § 229.33(d). *See* UCC § 4214(a) in connection with the right of chargeback and refund.

259 *Chi. Title Ins. Co. v. Cal. Canadian Bank*, 1 Cal. App. 4th 798, 2 Cal. Rptr. 2d 422 (1991), *reh'g denied* (1992) (liability is independent of negligence, contributory negligence, and without regard to actual damage suffered). See UCC § 4109(a) (waiver or extension of time by collecting bank to secure payment for up to two additional banking days). *Citizens Fid. Bank & Trust Co. v. Southwest Bank & Trust Co.*, 238 Neb. 677, 472 N.W.2d 198 (Neb. 1991) (payor bank liable to depositary bank on a counterfeit check held beyond the payor bank's midnight deadline). A bank is responsible for retaining a check beyond its midnight deadline, whether or not the account against which the check is drawn has sufficient funds to cover the check. A payor bank is strictly liable to the depositary bank for the amount of the check. UCC § 4302(a) (1). Standing to sue for a UCC § 4302 violation is limited to entities who suffer or might have suffered a loss (i.e., the payee, others who have received the check before dishonor, and collecting banks. An assignee who purchases a check with notice of dishonor lacks standing to bring an action. *Triffen v. Bridge View Bank*, 750 A.2d 136 (N.J. Ct. App. 2000). Title insurer had no standing to sue under a subrogation theory. *American Title Ins. Co. v. Burke & Herbert Bank & Trust Co.*, 813 F. Supp. 423 (E.D. Va. 1993), *Lawyers Title Ins. Corp. v. United American Bank of Memphis*, 21 F. Supp. 2d 785 (W.D. Tenn. 1998).

260 *See* Barkley Clark & Barbara Clark, *The Law of Bank Deposits, Collection and Credit Cards*, (Revised Edition) ¶ 6.02(2), involving defenses arising from the manner of presentment, interbank agreements, the application of clearing house rules, emergencies, breach of warranty, etc.

261 UCC § 4302(b). Depositary banks warrant to the payor bank that they have good title to the item. UCC § 4208. Note: Payor banks are not subject to a late return (midnight deadline) claim if the check is subject to defenses based on breach of warranty (UCC § 4208) or if the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank.. UCC § 4302(b). *First National Bank & Trust Co. of the Treasure Coast v. Belmont National Bank*, 43 UCC Rep. Serv. 2d 666 (OH 2001). A payor bank has three years to assert a breach of warranty claim against the depositary bank after the payor bank has reason to know of the breach. UCC § 4208(f). Of course, the depositary bank may be able to assert defenses to a breach of warranty claim, such as the drawer's failure to exercise ordinary care in preparing the check (leading to its alteration).

Even though the code excuses a late return in this circumstance, the Federal Reserve's Circular No. 3, *Check Collection and Return*, instructs payor banks not to return items through normal return channels after the midnight deadline, unless permitted by Reg. CC § 229.30(c) (extension of deadline through highly expeditious means of return) or UCC § 4109 (delays). Late-return checks should be returned (e.g., in connection with warranty claims) "without entry" through adjustment channels. The Federal Reserve does not settle claims between banks involving disputed late returns. Under Reg. CC, a payor bank is not responsible for its failure to make an expeditious return to a party that has breached a presentment warranty under UCC § 4208 (Commentary to Reg. CC § 229.30).

262 UCC § 4302(b). *Bank Leumi Trust Co. of N.Y. v. Bally's Park Place, Inc.,* 528 F. Supp. 349 (S.D.N.Y. 1981) (depositor knew that maker of check had died and that his estate was insolvent); *Bank of America NT & SA v. Hubert*, 101 P.3d 409 (Wash. 2004) (check kite by customer's employee imputed to customer; payor bank's accountability is subject to statutory and common law defenses); *American National Bank of Powell v. Foodbasket*, 497 P.2d 546 (employee deposited his bad checks through employer's account; agent's knowledge imputed to the principal).

equipment, or other circumstances beyond the control of the bank, and the bank has exercised such diligence as the circumstances require.[263]

(d) Consent to hold beyond deadline. An advice accompanying the checks allows the bank to hold the check beyond its midnight deadline (e.g., until sufficient funds are available to cover the item).[264]

(e) Failure to meet burden of proof. The payor bank has the benefit of a presumption in favor of timely return. [Note: It is sometimes difficult to tell whether an item has been returned beyond the midnight deadline.][265]

(f) The bank met an extended midnight deadline. The check was received after the bank's cutoff hour,[266] a later clearinghouse deadline,[267] and/or the bank returned the item within the extended deadline of Reg. CC by directly delivering the check in an expedited manner to the depositary or returning bank (e.g., by courier).[268]

(g) Mistake. The check was paid by mistake (Note: This will be narrowly construed and probably depends on unusual circumstances, such as where the drawer has no account with the bank).[269]

(h) No damages. The claimant was not damaged.[270]

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263 UCC § 4109(b). *Port City State Bank v. American Nat'l Bank, Okla.*, 486 F.2d 196 (10th Cir. 1973) (computer malfunction); *Sun River Cattle Co., Inc. v. Miners Bank of Mont., N.A.*, 164 Mont. 237, 521 P.2d 679 (Mont. 1974) (bank liable since it failed to exercise due diligence). *See* Reg. CC § 229.38(e) (delay due to interruption of communication or computer facilities, suspension of payments by a bank, war, emergency conditions, failure of equipment, or other circumstances beyond the bank's control).

264 *Wolverton Farmers Elevator v. First American Bank of Rugby*, 851 F.2d 223 (8th Cir. 1988) (item sent for collection); *SCADIF, S.A. v. First Union Nat'l Bank*, 344 F.3d 1123, (11th Cir. 2003) (check sent for collection to drawee). *See* UCC § 4109. *David Graubart, Inc. v. Bank Leumi Trust Co.*, 399 N.E.2d 930 (N.Y. 1979) (agreement between banks).

265 *Conn v. Bank of Clarendon Hills*, 53 Ill. 2d 33, 289 N.E.2d 425 (1972); *Van Senus Auto Parts, Inc. v. Mich. Nat'l Bank-Wyo.*, 116 Mich. App. 342, 323 N.W.2d 391 (1982).

266 UCC § 4108 allows a bank to establish a cutoff hour of 2:00 p.m. or later for the handling of items and the making of entries on its books. If a check received at 4:00 p.m. comes after the bank's cutoff hour (e.g., 2:00 p.m.), it is not deemed received for the purpose of the midnight deadline until the opening of the next banking day. This cutoff provision does not apply to notices, however. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Devon Bank*, 702 F. Supp. 652 (N.D. Ill. 1988). Some states treat each branch as a separate bank for purposes of computing the time within which and determining the place at or to which action may be taken. UCC § 4107. This could affect, for example, the manner in which interbranch check transactions are processed for midnight deadline purposes.

267 Clearinghouse rules may extend the deadline. UCC § 4103. *West Side Bank v. Marine National Exchange Bank*, 155 N.W. 2d 587 (Wis. 1968). According to Barkley Clark, *The Law of Bank Deposits* (Revised Edition), courts should use a strong presumption that clearinghouse rules are not intended to expand the midnight deadline. He notes that Reg. CC and Reg. J do not appear to permit it.

268 Reg. CC § 229.30(c). The deadline for return and notice of return is extended to the time of dispatch of such return or notice when a paying bank uses a means of delivery that would ordinarily result in the check's receipt by the bank to which it is sent on or before the receiving bank's next banking day following the otherwise applicable deadline. This deadline is extended further if a paying bank uses a highly expeditious means of transportation, even if this means of transportation would ordinarily result in delivery after the receiving bank's next cutoff hour or banking day. An example would be a courier that leaves after midnight to deliver checks. Reg. CC also allows a returning bank other than the drawee bank a one-day extension of the midnight deadline if it converts a "raw" return into a "qualified" return by MICR-encoding the return information. Reg. CC § 229.31(a)(2).

269 UCC § 3418(b). The bank is a collecting bank. *Nat'l Sav. and Trust Co. v. Park Corp*, 722 F.2d 1303 (6th Cir. 1983) (payment made in error); *First Nat'l Bank in Harvey v. Colonial Bank*, 898 F. Supp 1220 (N.D. Ill. 1995) (not a mistake, but a bad business decision).

(i) No standing. The claimant is not a collecting bank or other party involved in the collection and payment of the item that the midnight deadline is designed to protect.[271]

(j) Delay caused by marking on check. A bank may limit its liability for delays caused by markings on a check by agreement with its customer.[272]

(k) Comparative Negligence. If a person or bank fails to exercise ordinary care or act in good faith in endorsing a check, accepting a returned check or notice of nonpayment, or otherwise, the damages incurred are diminished in proportion to the amount of negligence or bad faith attributable to that person.[273]

(l) Statute of limitation. Action brought under the UCC after more than 3 years (1 year for Reg. CC).[274]

(m) Check sent for collection. The midnight deadline rule does not apply when a check is sent for collection (when funds "become available") rather than payment.[275]

(n) Waiver. The payee waived notice of dishonor and consented to a late return.[276]

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[270] Cases go both ways on this defense. *Channel Equipment, Co., Inc. v. Cmty. State Bank*, 996 S.W.2d 374 (Tex. Ct. App. 1999) (plaintiff denied recovery since it received funds by asserting rights under mechanics lien); *Union Bank of Benton v. First Nat'l Bank in Mt. Pleasant Tex.*, 621 F.2d 790, 796 (5th Cir. 1980) (use of collateral security to reduce losses); *State & Savings Bank of Monticello v. Meeker*, 469 N.E.2d 55 (Ind. Ct. App. 1984) (liability reduced through mitigation by plaintiff); *First State Bank of Sherwood v. Twin City Bank of North Little Rock*, 290 Ark. 399, 720 S.W.2d 295 (1986) (plaintiff not allowed double recovery); *First Nat'l Bank in Harvey v. Colonial Bank*, 831 F. Supp 637 (N.D. Ill. 1993) (partial recovery already obtained from check kiter). This defense does not appear to impose any obligation on customers to take action to mitigate their losses however. *See* "Accountability As Strict Liability For the Face Amount of the Check – Or is It?" by Robert Mulford, *The Banking Law Journal*, April 2002.

[271] *American Title Ins. Co. v. Burke & Herbert Bank & Trust*, 813 F. Supp. 423 (E.D. Va. 1993) (assignee of checks does not have standing under equitable subordination or § 4302); *Triffin v. Bridge View Bank*, 750 A.2d 136 (N.J. Super. Ct. App. Div. 2000) (assignee lacked standing to sue the payor bank for violation of the midnight deadline); *Triffin v. TD Banknorth*, 190 N.J. 326 62 UCC Rep. Serv. 2d 653, (Supreme Court of New Jersey 2007) (assignee who purchased checks with notice of dishonor lacks standing to bring action against payor bank); *Triffin v. Third Federal Savings Bank* (unpublished opinion, 2008 WL 5233796 (N.J. Super. A.D.)) (midnight deadline is not assignable as a claim); *Triffin v. Wachovia Bank, N.A.*, 406 N.J. Super. 427, 968 A.2d 177 (assignee has no vested interest in the timely payment of returned items and cannot assert midnight deadline claim); *Triffin v. TD Bank-North, NA*, 190 N.J. 326, 920 A2.d 649 (2007) (no assignment of midnight deadline obligation).

[272] Commentary to Reg. CC § 229.37.

[273] Reg. CC § 229.38(c).

[274] UCC § 4111; Reg. CC § 229.38(g).

[275] *Scadif, S.A. v. First Union Nat'l*, 344 F.3d 1123 (11th Cir. 2003). *Idaho First Industries, Inc. v. Minden Exchange Bank & Trust Co.*, 326 N.W.2d 176 (Neb. 1982). *Iverson v. First Bank of Billings*, 712 P.2d 1285 (Mont. 1985).

[276] UCC § 3504. A second presentment of a check that was returned late the first time does not constitute a waiver of the payee's cause of action for missing the midnight deadline. *Continental National Bank v. Sanders*, 581 S.W.2d 293, 27 UCC Rep. Serv. 766 (1979). If a customer deposits an item a third time after it has been returned in a timely manner twice before, timely notice of return may be excused since the customer couldn't really place reliance on the check being paid. *Leaderbrand v. Central State Bank*, 450 P.2d 1 (Kan. 1969) (Note: This case has come under criticism).

(o) Not the Drawee Bank. The bank acted as a collecting bank or the item is not payable upon presentation or demand. [277]

Lines of Inquiry: If the bank is seeking to return a check after its midnight deadline, consider the following:

- ☐ Does a clearing house rule define "banking day" differently than the UCC?[278]
- ☐ Has the bank established a cutoff hour for the presentment and payment of checks of 2:00 p.m. or later?
- ☐ When did the bank receive the item for payment?[279] Was presentment made electronically (before submission of the actual check) under an agreement? Was presentment made to a processor or Federal Reserve Bank designated by the payor bank?
- ☐ If the item was lost, was notice of dishonor sent in lieu of return by the midnight deadline?
- ☐ Was the return delayed due to circumstances beyond the bank's control despite its exercise of due diligence?
- ☐ Is there still time for the payor bank to return the item beyond the midnight deadline, as permitted by Reg. CC? Can a courier take the check to a local branch of the depositary bank before it closes? To a branch of the Federal Reserve Bank by the close of its banking day?[280]

B. Stop Payment Orders, Knowledge, Setoff and Legal Process

Any knowledge, notice, or stop payment order received by, legal process served upon, or setoff exercised by a payor bank comes too late to terminate, suspend, or modify the bank's right or duty to pay a check or to charge its customer's account for the check if the knowledge, notice, stop payment order, or legal process is received or served and a

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277 See Barkley Clark, *The Law of Bank Deposits (Revised Edition)* at ¶ 6.02(2)(k). UCC § 4109 provides some flexibility. In this case, the presenting/collecting bank's duties are found in UCC § 4202. A negligence standard, rather than strict liability, applies. The payee must prove its damages. UCC § 4103(e). Note that the Reg. CC return and notification rules apply to payable through drafts just like regular checks and treat a payable through bank like a drawee bank, even if that is not true under the UCC.

278 *City Check Cashing, Inc. v. Mfrs. Hanover Trust Co.*, 166 N.J. 49, 764 A.2d 411 (2001) (midnight deadline extended by clearing house rule, as allowed by UCC § 4103).

279 Regulation CC defines when (and where) a check is received. *See* Reg. CC § 229.36. If a bank designates another bank or processing agent to receive its checks for processing purposes, the receipt of checks by that entity begins the midnight deadline process. If a bank agrees to electronic presentment, the process may begin when the presentment notice is received, rather than by delivery of the item itself. UCC § 4110. See the electronic presentment agreement for the applicable terms. If an item is received by a Federal Reserve Bank at the request of the bank, the paying bank is considered to have received the cash item when it is delivered as requested, or when it is made available for pickup as arranged, whether or not the paying bank actually picks up the check at that time. *Los Angeles Nat. Bank v. Bank of Canton*, 31 Cal. App. 4th 726, 37 Cal. Rptr. 2d 389 (1995) (failure to meet the midnight deadline results in strict liability).

280 *Oak Brook Bank v. Northern Trust Company*, 256 F.3d 638 (7th Cir. 2001) (Federal Reserve Bank of Chicago deemed to be open 24 hours).

reasonable time for the bank to act thereon expires or the setoff is exercised after the earliest of the following:

– Final payment of the item (e.g., acceptance or certification of the check; payment in cash over-the-counter; or settling for the check without a right to revoke the settlement under statute, clearing house rule, or agreement);

– The midnight deadline; or

– The cutoff hour established by the bank (usually in its deposit agreement) for this purpose on the next banking day following its receipt of the check.[281]

Note: This may mean that a bank has to "unpost" the previous night's processing for items that are affected by a stop payment order or levy, provided the stop payment order or levy is received prior to the time described above (which may be on the next banking day).

> *Example*: A check is presented for payment on Monday. The bank processes the item Monday evening. On Tuesday, the bank receives a levy at 5:00 p.m., just before its closing time. There are not enough funds in the account to satisfy the levy. If the bank has not established an earlier cutoff hour than 5:00 p.m. under § 4303 (and hasn't certified the check, paid it in cash, or settled for it without having a right to revoke the settlement), it must "unprocess the item" and use the funds to honor the levy.

C. Chargeback

If a collecting bank makes provisional settlement with its customer for a check and fails for any reason to receive settlement (e.g., by reason of dishonor), it may revoke its settlement and charge back the amount to its customer if by its midnight deadline (or within a longer reasonable time after it learns of the facts) it returns the item or sends notification of the facts. If the return or notice is delayed beyond that point in time, the bank may be liable for any loss resulting from the delay.[282]

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281 The cutoff hour can be no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the check and not later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check. UCC § 4303. Most institutions take advantage of the Code by establishing an early cutoff hour by agreement with their depositor. Institutions have several cutoff hours (e.g., for UCC § 4108, Reg. CC, and wire transfer purposes). As such, you must be careful not to confuse them with the UCC § 4303 cutoff hour. You also need to be careful not to advance the hour for the bank's right of setoff (which should be set for the end of the day).

282 UCC § 4214(d)(2). See also UCC § 4103(e). *Liberty Bank and Trust Co. of Oklahoma City v. Bachrach*, 916 P.2d 1377 (1996). The bank of first deposit has a duty to exercise ordinary care in promptly notifying the depositor if there is a dishonor. UCC § 4202. Damages for violating this duty are normally capped at the amount of the check. Consequential damages are available, however, if the bank is guilty of bad faith. UCC § 4103(e). *Gossels v. Fleet Nat'l Bank*, 876 N.E.2d 872 (Mass. Ct. App. 2007). If both the payor bank and the depositary bank violate their respective midnight deadlines (§ 4302(a), § 4214), liability passes upstream to the payor bank. *Hanna v. First National Bank of Rochester*, 87 N.Y.2d 107, 661 N.E.2d 683 (1995). A late chargeback may not cause any damage for which a bank may be liable. *Wells Fargo Bank, N.A. v. FSI, Financial Solutions, Inc.*, 74 UCC Rep.2d 916, 2011 DJDAR 9811 (7/1/11).

– The right of chargeback is not affected by the customer's use of any credit given for the item or the failure of the bank to exercise ordinary care with respect to the item.[283]

– Depositary banks that accept a late return from the payor bank (i.e., the payor bank misses its midnight deadline) may not charge back the check to the depositor's account.[284]

– Arguably, the chargeback may be permitted if the account agreement allows that action by the bank (e.g., in cases where the bank reasonably believes that the customer has breached a warranty based on alteration or forged endorsement).[285]

D. Federal Reserve Challenge Procedure

When a drawee bank returns a check through the Federal Reserve, the Fed credits the drawee bank's account with the Fed and debits the depository bank's Fed account. If the return occurs after the drawee bank's midnight deadline, the depository bank can challenge the late return in accordance with the FRB's Operating Circular No. 3.[286] It does that by returning the item to the Federal Reserve Bank with a statement that the drawee bank missed its midnight deadline. The Federal Reserve will then revoke its previous entries. When the drawee bank is notified about the revocation, it can submit a statement to the Fed verifying that the drawee bank did, in fact,

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283 UCC § 4214(d)(1) and (2). The right of a depositary bank to charge back and revoke a provisional credit granted on a deposited item is not affected by its negligence in handling the item for collection. *Symonds v. Mercury Savings and Loan Association*, 225 Cal.App.3d 1458 (1990). Although retaining its right to charge back, a bank may nonetheless be held liable for harm from its own negligence in handling the item. UCC § 4214(d)(2). Bank owed no duty to its customer, who was bilked in a Nigerian (counterfeit) official check scam, to examine the checks before taking them for deposit. Whether bank exercised ordinary care in the check settlement process was irrelevant to its chargeback rights under UCC § 4214(d). The bank could be liable for negligent misrepresentation under common law theories, however, depending on how it described or discussed the check with its depositor. *Valley Bank of Ronan v. Hughes*, 147 P.3d 185 (Mont. 2006) (counterfeit official checks described as "good" and "the same as cash"). *See also Call v. Ellenville Nat'l Bank*, 774 NYS 2d 76 (Sup. Ct. App. Div. 2004). *Drew v. Commerce Bank, N.A.*, 2007 WL 1468683 (2007) (bank's statement that funds were "available" did not misrepresent that counterfeit check had "cleared"). *First Georgia Bank v. Webster*, 168 Ga. App. 307 (1983) (check incorrectly described by bank as "good"); *First National Bank of Denver v. Ulibarri*, 38 Colo. App. 428 (1976) (bank assured customer that check had "finally settled"). *Holcomb v. Wells Fargo Bank*, 155 Cal. App. 4th 490 (2007) (branch manager allegedly told customer check had cleared; negligent misrepresentation). *Chase v. Morgan Guaranty Trust Co.*, 590 F.Supp. 1139 (SDNY 1984)(bank assurance did not cause the loss). *National Bank of Georgia v. Weiner*, 348 SE2d 492 (Ga. Ct. App. 1986)(bank could exercise chargeback against attorney escrow account even though original overdraft involved the funds of a different party). Cases dealing with claims that the drawee bank made negligent representations about whether it would pay checks: *Sabin Meyer Regional Sales Corp. v. Citizens Bank*, 502 F. Supp. 577 (N.D. Ga. 1980) (bank allegedly said the account contained, and would contain, sufficient funds to cover checks given to payee); *WB Farms v. Freemont National Bank & Trust*, 756 F.2d 663 (8th Cir. 1985) (bank agreed to pay check "whenever funds come into the account"); *Mitchell Buick & Oldsmobile Sales, Inc. v. McHenry Savings Bank*, 601 N.E.2d 1360 (Ill. App. Ct. 1992) (bank agreed to pay check if its customer deposited $10,000 or more).

284 UCC § 4215(d). *Lema v. Bank of America*, 826 A.2d 504 (Md. 2003). The right to revoke, charge back and obtain a refund terminates when settlement for the item becomes final. UCC § 4214(a). Banks often change this result by contract with their customers (see 12(n)). This may not prove effective with respect to the rights of third parties to the funds. *United States v. Payment Processing Center, LLC*, 461 F. Supp. 2d 319 (E.D. Pa. 2006) (government can levy on the funds even though bank reserves the right to chargeback after passage of the midnight deadline).

285 This is subject to some debate. Under the code, if a collecting bank receives a settlement for an item which becomes final, the bank is accountable to its customer for the amount of the item, and any provisional credit given for the item in an account with its customer becomes final. *See Bank of America NT & SA v. Hubert*, 115 Wash. App. 368, 62 P.3d 904 (2003). Some courts have allowed recovery of punitive damages for exercise of charge-back following acceptance of a late-return item. *Gordon v. Planters & Merch. Bancshares, Inc*., 326 Ark. 1046, 935 S.W.2d 544 (1996); *Sun Bank, NA v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 637 So. 2d 279 (Fla. Ct. App. 1994).

286 The challenge procedure is optional and does not affect the rights of the parties under the UCC. *Continental Nat'l Bank & Trust Co. v. Sterling Nat'l Bank & Trust Co.*, 565 F. Supp. 101 (S.D.N.Y. 1983).

meet its UCC and Reg. CC deadlines. This will cause the Fed to reverse the entries a final time, potentially causing the depository bank to incur a loss[287] All this is done automatically by the Fed; it does not take any side in the disputed return. [288]

A drawee bank that lies about having met the midnight deadline may be found to have acted in bad faith (and, arguably, of having submitted a false statement, violating state and federal criminal statutes).[289]

[287] At this point, the depository bank can either sue the drawee bank or attempt to charge back the amount to its depositor's account (assuming its account agreement allows a chargeback for items that are returned late).

[288] Some drawee banks return forged and altered checks through the Fed after their midnight deadline in order to assert a breach of warranty claim against the depository bank. The Operating Circular does not permit this. Drawee banks warrant under Reg. CC that such checks are returned within the midnight deadline. Breach of this warranty may lead to consequential damages and entitle the depository bank to attorney fees.

[289] Reg. CC §§ 229.34(d) and 229.38(a); UCC §§4103(e) and 4208(b). Checks returned due to breach of warranty (e.g., due to a forgery or alteration) should be returned on a "without entry" basis.

6. CHECK KITES[290]

A. **Definition.** Check kiting is a form of bank fraud in which the bank's customer deposits checks drawn against uncollected funds to cover other checks written against uncollected funds, with no real expectation of being able to cover the checks with good funds.[291] The customer essentially "plays the float" and obtains an interest-free loan. Ultimately, when the bank discovers and interrupts the kite (e.g., by placing a hold on deposits and returning checks), the customer is unable to cover the resulting overdraft.

B. **Elements.** There are three elements to the typical check kite:

(1) The wrongdoer opens two accounts at different banks (or different branches of the same bank).

(2) The wrongdoer covers checks drawn on one account with deposits of checks from the other account (which does not have finally collected, good funds).

(3) By carefully timing deposits of these worthless checks, the kiter is able to create the impression of having a real, or collected, balance in each bank by taking advantage of the float. The kiter relies on the time lag inherent in the check collection process, and on bank personnel who are not alert to the risks involved (or who have been "conditioned" to accept the kiter's transactions at face value).

> *Example*: Kiter opens accounts at Bank A and Bank B with $100 cash deposits. The Kiter then pays for goods or services by writing a $500 check drawn on Bank A. Before this $500 check clears and overdraws the account, the kiter covers the first check by depositing a $525 check drawn on Bank B. Before the $525 check drawn on Bank B clears and overdraws the account, the wrongdoer covers it with a check drawn on Bank A. This scheme is repeated numerous times until one of the banks discovers the fraud.

C. **General Rule.** The first bank to discover the check kite and cover itself by placing a hold on deposits or requiring good funds often avoids taking a loss. A bank has no duty to notify other banks that they may be involved in a check kite.[292]

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290 This term originated during the late 1700's and was originally referred to as "draft kiting" and "free riding."

291 *Fid. & Cas. Co. of N.Y. v. Bank of Altenburg,* 216 F.2d 294 (8th Cir. 1954).

292 Although banks have a duty to act in "good faith" (§§ 1201(b)(20) and 3103(a) (4)), there is no duty of inquiry or of affirmative notification. *Citizens Nat'l Bank v. First Nat'l Bank*, 347 So. 2d 964 (Miss. 1977) (correspondent relationship does not give rise to duty to disclose kite); *Mid-Cal Nat'l Bank v. Fed. Reserve Bank of S.F.*, 590 F.2d 761 (9th Cir. 1979) (no special relationship; no duty to notify even when bank knows of kiting activity); *Ennis State Bank v. Heritage Bank*, 2004 WL 1109833 (Tex. Ct. App. 2004) (UCC § 1-203 does not support an independent cause of action for failure to perform or enforce in "good faith"). *See also Frost Nat'l Bank v. Midwest Autohaus, Inc.*, 241 F.3d 862 (7th Cir. 2001) (no duty to give notice unless there is a fiduciary or confidential relationship, a contractual relationship, a duty created by law, or fraud by the bank). However, *see Farmers & Merchants State Bank v. Western Bank*, 841 F.2d 1433 (9th Cir. 1988) (bank could stop payment on its cashier's check given to another bank since the other bank had knowledge of defense to payment). A correspondent (controlled disbursement) banking relationship, by itself, does not give rise to a fiduciary relationship. *Wells Fargo Bank v. Citizens Bank of Texas*, 181 S.W.3d 790 (2005).

D. Discovering the Kite. Banks often discover check kites through the use of "kiting," "large transaction," "float," "balance fluctuation," and "overdraft" reports. The following circumstances may be indicative of a kite:

- Accounts appearing on the kiting report for the first time
- Large dollar variances between ending balance and deposit totals (abnormal balance and deposit activity)
- Unusual late deposit and NSF activity (especially for new accounts)
- Number of times on kiting report
- Unusual daily deposit activity (most kites will show daily activity)
- Paid check activity equal to or close to deposit total
- Gradual increase in deposit and check values
- Deposited items drawn on like-name or allied accounts at other banks
- Frequent withdrawals or transfers payable to the same person or business (or an affiliated company)
- Frequent depositor requests for balance information
- Large transactions with low daily balances
- Eccentric deposit activity
- Excessive number of deposited items returned unpaid
- The constant exchange of items with distant banks (which increases the float)
- Banking away from the logical area
- Deposits and checks posting for even dollar amounts
- Increased chargeback activity on merchant credit card accounts
- Overdraft activity following a denied request for credit
- Payee and maker are the same
- Low beginning and ending book balances

E. Interrupting the Kite. A single uncollected funds hold can stop a kite and prevent a loss. Whenever the bank has reason to believe that a check kite is in process, it may use the "reasonable cause to doubt collectibility" exception of Regulation CC to place a

hold.[293] By placing a hold on funds (or requiring the deposit of finally collected funds, e.g., by wire or cashier's checks), the bank breaks the chain of the kite.[294]

The bank must act quickly when it discovers that a check kite may be in progress. If the bank returns items, the return must be within the midnight deadline (see Section 5.A). If a check is returned after the deadline, the bank will be accountable for the face amount of the item.[295] Note: Checks returned after the midnight deadline may still be returnable under Reg. CC § 229.30(c), which extends the deadline by one extra day in certain situations.[296]

F. The Aftermath of a Kite. The first bank to discover a kite can often avoid loss by being the first bank to place a hold on deposited funds and return items drawn against such funds within its midnight deadline. By the time the second bank receives notice of the return, there are little or no finally collected funds in its customer's account to cover overdrafts, and the time for returning checks before the midnight deadline has passed.

If a bank is second in line to discover a kite, it may still be able to argue that payment on its cashier's checks (received by the other institution – the first to discover the kite) may be stopped based on the other institution's knowledge of the kite.[297] This argument may not succeed unless the other institution can be shown to have intentionally aided and abetted in the kite (i.e., acted in bad faith).[298] Banks generally have no duty to discover or report suspected check kiting to other institutions.[299] The defense of mistake also is not available in most circumstances, unless the bank can show that it did not intend to make the payment.[300]

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293 Reg. CC § 229.13(e). The bank may indicate as the reason for invoking the exception that the bank has confidential information which indicates the check may not be paid.

294 Legitimate customers that depend too heavily on float would do well to consider a formal line of credit.

295 UCC § 4302(a) (1).

296 *First Nat. Bank of Chicago v. Standard Bank & Trust*, 172 F.3d 472 (7th Cir. 1999). *See* Clark & Clark, *The Law of Bank Deposits, Collections and Credit Cards*, 6.02[2].

297 UCC § 4302(b).

298 *Merrill Lynch Pierce Fenner & Smith v. First National Bank*, 774 F.2d 909 (8th Cir. 1985) (bank delayed returning checks contrary to its policy in order to gather additional deposits); Barnett Bank of West Florida v. Hooper, 498 So.2d 923 (Fla. 1986).

299 *Citizens Nat'l Bank v. First Nat'l Bank*, 347 So. 2d 964 (Miss. 1977) (relationship between banks did not create duty to disclose); *Mid-Cal Nat'l Bank v. Fed. Reserve Bank of S.F.*, 590 F.2d 761 (9th Cir. 1979) (no duty to discover kite or disclose; no special relationship); *Alta Vista State Bank v. Kobliska*, 897 F.2d 930 (8th Cir. 1990); *Community Bank v. United States Nat'l Bank of Orange*, 555 P.2d 435 (Or. 1976). *Smith v. American National Bank*, 982 F.2d 936 (6th Cir. 1992) (no duty to warn investor who covered checks with a note about the kite); *Frost National Bank v. Midwest Autohaus*, 241 F.3d 862 (7th Cir. 2001) (first bank to discover kite could freeze account and continue to accept deposits); *Wells Fargo Bank v. Citizens Bank of Texas*, 181 S.W.3d 790 (Tex. App. 2005) (no duty to disclose kite); *Bohac v. Walsh*, 233 S.W.3d 858 (Mo. App. 2007) (no duty to disclose that husband was kiting checks to wife). The institution at loss would be arguing, essentially, that the other institution does not qualify as a "holder in due course." See § 4302(b). *Norwest Bank Black Hills, N.A. v. Rapid City Teachers Fed. Credit Union*, 433 N.W.2d 560 (S.D. 1988). *South Central Bank of Davies County v. Lynnville Nat'l Bank*; 901 N.E.2d 576 (Ind. App. 2009) (no duty to place a hold on funds). *Southern Bank of Commerce v. Union Planters National Bank*, 375 Ark. 151, 2008 WL 5101014 (notice of fraud to holder is ineffective if received after check is taken for value).

300 UCC § 3418(b). *Nat'l Savings and Trust Co. v. Park Corp.*, 722 F.2d 1303 (6th Cir. 1983) (payment made in error); *First Nat'l Bank in Harvey v. Colonial Bank*, 898 F. Supp. 1220 (N.D. Ill. 1995) (not a mistake, but a bad business decision). The remedy of restitution is not

If the bank is caught in a kite, it should carefully review the timing of returns to confirm that all items were processed within the midnight deadline and that large dollar return notices were provided as required by Regulation CC and any applicable clearing house rule.[301] If the bank has outstanding cashier's checks, it may be able to argue that the presenter is not a holder in due course (in which case, the bank should probably write "void" or "cancelled" on the check's face) and is subject to the bank's claims and defenses.[302]

Once a check kite is discovered, the bank should review all other arrangements it has with the kiter (e.g., ACH payment arrangements, merchant credit card agreements, and cash management arrangements) to see if it is subject to other potential losses or has the ability to foreclose on collateral. It should also file a Suspicious Activity Report.

Note: Not all suspected check kites are illegal. Care should be taken when freezing accounts and rejecting transactions since that might cause the bank to be accused of breach of contract, wrongful dishonor and lender liability. A bank should provide in its deposit contract with customers that it may freeze accounts and reject transactions under certain circumstances (see Part 12 for an example).

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available against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment of acceptance. UCC § 3418(c).

301 Note: The midnight deadline may be extended under certain circumstances. *See* UCC § 4103 regarding extensions permitted by clearing house rules and Reg. CC § 229.30(c).

302 The cases are mixed on this issue. *See*: *Sainz Gonzalez v. Banco de Santander-Puerto Rico*, 932 F.2d 999 (1st Cir. 1991); *Turbine Fed. Credit Union v. Amsterdam Fed. Sav. & Loan Ass'n*, 224 A.D.2d 753, 637 N.Y.S.2d 492 (1996*); Godat v. Mercantile Bank of Northwest County*, 884 S.W.2d 1 (Mo. Ct. App. 1994); *Di Roma v. Merch. Bank of N.Y.*, 92 A.D.2d 42, 459 N.Y.S.2d 592 (1983); *First R.R. Cmty. Fed. Credit Union v. Columbia Country Bank*, 849 F. Supp. 780 (M.D. Fla. 1994); *Univ. State Bank v. Allied Conroe Bank*, 712 S.W.2d 193 (Tex. Ct. App. 1986). A bank with actual knowledge of the check kite (as opposed merely to a suspicion) may not be acting in good faith and may not be a holder in due course. *See* UCC § 1202 for the definitions of "notice" and "knowledge." *Farmers & Merch. Bank v. W. Bank*, 841 F.2d 1433 (9th Cir. 1987) (issue of subjective good faith). *Lawyers Title Ins. Corp. v. United American Bank of Memphis,* 21 F. Supp. 2d 785 (W.D. Tenn. 1998) (No basis for equitable subrogation because the party would have had to pay its insured even if the bank had returned the checks prior to the midnight deadline).

7. STOP PAYMENT ORDERS

A. General Rule. A customer[303] may stop payment on an item drawn on the customer's account by describing the item with "reasonable certainty"[304] and in a time[305] and manner that affords the bank a reasonable opportunity to act on it.[306] The order is effective for six months, but lapses after 14 days if the original order was oral and not confirmed in writing within that period.[307]

B. Proof of Damage. The customer has the burden of establishing the fact and amount of damages if the check is paid despite a timely stop payment order.[308] The amount of loss may include damages for the wrongful dishonor of subsequent checks.[309]

C. Subrogation. If the bank pays over a timely and proper stop payment order, it is subrogated to the rights of (a) any holder in due course of the item against the drawer or maker, (b) the payee or holder of the item against the drawer or maker either on the item

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303 Any one person authorized to sign on the account (even for a 2-signature-required account) may place a stop payment order (except in Florida). UCC § 4403. This includes a person claiming an interest in the customer's account following the customer's death (UCC § 4405). A payee has no right to place a stop payment order on the item, however. A payee may try to argue that (s)he has a right where a check in the payee's possession has been lost or stolen. There is no such right. *Unaka Nat'l Bank v. Butler*, 113 Tenn. 574, 83 S.W. 655 (1904). A drawer has no obligation to place a stop payment order on a check in order to satisfy a writ of garnishment. *Frickleton v. Fulton*, 626 S.W.2d 402 (Mo. Ct. App. 1981). A non-customer payee cannot bring an action against a payor bank for wrongfully honoring a stop payment order. *H. Kay Interiors, Inc. v. Peninsula United Methodist Homes, Inc.*, 61 UCC Rep. Serv. 2d 60, 2006 WL 2788186 (Delaware 2006) (not reported in A.2d).

304 Most cases hold that a bank should honor an order even though there is a minor inconsistency (e.g., the amount is off by a few cents). *See First State Bank v. Dixon*, 21 Ark. App. 17, 728 S.W.2d 192 (1987) (bank liable even though its computer system needed the exact amount). The comment to UCC 4403 states, however, that, in the absence of an agreement to the contrary, the customer must meet the standard of what information "allows the bank under the technology then existing to identify the item with reasonable certainty." Bank deposit agreements should describe the need for accuracy, based on system requirements (e.g., "Tell us the EXACT amount of the check (dollars and cents)").

305 A stop payment order comes too late if the payor bank has accepted or certified it, paid it in cash, settled for it without having a right to revoke the settlement, or has become accountable for it under the midnight deadline rule. UCC § 4303(a). The bank must have a reasonable time to act on the order and notify appropriate personnel. What is "reasonable" will depend on the circumstances. *See* Brady on Bank Checks, Revised Edition, ¶ 26.04 for a listing of cases. *See* UCC § 4303 regarding the establishment of a cutoff hour for stop payment orders and the processing of checks. The right to stop payment (e.g., of a check mistakenly issued for the wrong amount) exists against the bank and the payee. *Cody Chevrolet v. Royer*, 123 Vt. 389, 189 A.2d 554 (1963). The enforceability of the underlying debt is not affected by the order, however. *Whitmore v. Woodbury*, 154 Ga. App. 161, 267 S.E.2d 783. The revocation of a signer's authority to sign checks for a corporation is not a stop payment order. *First Piedmont Bank & Trust Co. v. Doyle*, 97 Idaho 700, 551 P.2d 1336 (1976). Nor is a subsequent assignment of an account as to a check previously issued. *Willow City Farmers Elevator v. Vogel*, 268 N.W.2d 762 (N.D. 1978).

306 UCC § 4403(a). A check presented a second time after it was returned late the first time (making it a "finally paid" item) is still subject to a stop payment order placed by the customer. *Trust Co. of Ga. v. Student Air Travel Agency, Inc.*, 142 Ga. App. 248, 235 S.E.2d 670 (1977). Once a bank agreed to stop the payment of a check (in this case drawn on another of its customer's accounts), it no longer possessed the authority to change its mind and pay the item (based on the original order coming too late). *Bank of America v. Hubler*, 211 S.W.3d 859.

307 UCC § 4403(b). Florida and Texas recognize only written stop payment orders. Payment after six months (i.e., payment of a stale check) may raise an issue as to whether the bank is acting in good faith. *Liebling v. Glendale National Bank of New Jersey*, 710 A.2d 1067 (N.J. Super 1998).

308 UCC § 4403(c). *Southeast First Nat'l Bank v. Atl. Telec, Inc.*, 389 So. 2d 1032, 1033 (Fla. Dist. Ct. App. 1980). Illinois requires a customer to notify the bank within one-year of any statement that shows the bank paid over a stop payment order. Illinois UCC § 4-403(d). Customer who enters into settlement agreement with the payee has no damages. *Southtrust Bank v. Partsbase.com, Inc.*, 875 So. 2d 17 (Fla. App. 2004).

309 UCC § 4403(c).

or the underlying transaction, and (c) the drawer or maker against the payee or any other holder with respect to the transaction out of which the item arose.[310]

D. Holder in Due Course. A holder in due course who takes the check may be able to enforce the check against the drawer, notwithstanding the stop payment order.

A party will be deemed a "holder in due course" if:

(a) the check does not bear any evidence of forgery or alteration;

(b) the check is not otherwise so irregular or incomplete as to call into question its authenticity; and

(c) the holder takes the check for value, in good faith, and without notice that:[311]

(i) it is overdue (e.g., more than 90 days after its issue date),[312]

(ii) it has been dishonored, or

(iii) there is an uncured default with respect to payment of another instrument issued as part of the same series,

(iv) the instrument contains an unauthorized signature or has been altered,

(v) there is a claim to the instrument described in UCC § 3306 (i.e., a claim of property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and recover the instrument or its proceeds), or

(vi) any party has a defense or claim in recoupment described in UCC § 3305 (e.g., infancy, duress, lack of legal capacity, fraud that induced the obligor to sign the instrument, or discharge of the obligor in insolvency proceedings).[313]

A holder in due course "takes free of any claim to the instrument" and various UCC defenses (UCC §§ 3305(b) and 3306), but not free of a defense based on infancy,[314] duress, lack of legal

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310 UCC § 4407. One of the code's objects is to prevent unjust enrichment. A drawee also may recover for its mistake under § 3418(a). For cases describing how subrogation works, *see* Brady on Bank Checks, Revised Edition, ¶ 26.20(1). *Siegel v. Merrill Lynch*, 745 A.2d 301 (D.C. App. 2000).

311 A holder in due course may transfer his rights to someone who is aware of a defense. UCC § 3203(b). This is known as the "Shelter Rule." The Rule enables an HDC to transfer its rights to someone who does not qualify as an HDC.

312 UCC § 3304.

313 UCC § 3302. Note that a bank cannot qualify as an HDC under UCC § 3307 if it allows a fiduciary of the named payee to deposit a check payable to her company into her personal account. *C-Wood Lumber Co., Inc. v. Wayne County Bank*, 2007 WL 187892 (Tenn. Ct. App. 2007).

314 The policy is one of protection of the infant even at the expense of an innocent HDC.

capacity,[315] or illegality of the transaction which nullifies the obligation of the obligor, fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms,[316] or discharge of the obligor in insolvency proceedings.[317]

An HDC can enforce the check against the drawer.[318] If the drawer has placed a stop payment order on the check, however, the drawee bank should refuse to honor the check when it is presented for payment.

Example: Bill Washington writes a check to Fred Hamilton, who endorses the back of the check. The check is later stolen by Raymond Burr and given to Leif Jefferson, who meets the definition of an HDC, as defined above. Jefferson took the check in good faith, for value, without any knowledge that it had been stolen. If Washington places a stop payment order on the check before Jefferson presents it for payment, Washington's bank should refuse payment. This doesn't stop Jefferson from suing Washington and collecting the amount of the check, however.

In the above example, Jefferson takes free of any claim to the check by Hamilton or any defense to payment by Washington.

Check cashers often assert HDC rights. They may receive stolen checks that have been endorsed by the payee or were payable to "cash," checks that were lost (and replaced with other checks), checks issued by persons who did not receive goods or services as promised, checks subject to a dispute between the drawer and payee, and checks issued by mistake. Drawers can assert limited defenses against check cashers in such situations. For example:

- The check has been outstanding for more than 90 days (i.e., an overdue item)
- The payee's signature is forged or the check has been altered
- The check stated on its face that it was "Void if not cashed within [X] days," and that period has passed
- The check casher did not take the check "in good faith" (i.e., honesty in fact and the observance of reasonable commercial standards of fair dealing)[319]

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315 This could include, for example, mental incompetence, ultra vires acts or lack of corporate capacity to do business.

316 An example would be someone who is tricked into signing a check, thinking it is merely a receipt or some other document. See the UCC comment to § 3305.

317 UCC § 3305(b).

318 Note that a depository bank may need to assert its rights as an HDC against the drawer in cases where the depository bank allows its customer to draw against a check before it can collect good funds.

319 Much has been written about the meaning of "good faith" and the observance of "reasonable commercial standards of fair dealing" under both the 1962 and 1990 versions of the Code. See, for example, Bailey and Hagedorn, Brady on Bank Checks (Revised Edition), A.S. Pratt & Sons, ¶ 1.26, and Clark, The Law of Bank Deposits, Collections and Credit Cards (Revised Edition), A.S. Pratt & Sons, ¶ 2.06(c). The Commentary to the 1990 definition (§3103(a)(4), moved to §1201(b)(20) in California) provides that, "[a]lthough fair dealing is a

- The check was so irregular as to call into question its authenticity (e.g., an incomplete check)
- The drawer's signature is forged
- The transferor or predecessor in interest was not a holder in due course, and the check was acquired by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding
- The transferor or predecessor in interest was not a holder in due course, and the check was acquired by the check casher by purchase as part of a bulk transaction not in the ordinary course of business of the transferor
- The check was not properly endorsed (i.e., the check casher is not a "holder")

A transferee of an HDC is an HDC even if it has notice of a stop payment order, since the transfer of an instrument vests in the transferee any rights of a holder in due course (unless the transferee engaged in fraud or illegality affecting the instrument).[320]

A bank generally may not stop payment on its own check as against a holder in due course.[321] If the presenter defrauded the bank or is otherwise not a holder in due course, its presentment would be subject to whatever claims and defenses to payment the bank may choose to raise.[322]

Lines of Inquiry:

- ☐ Did the customer actually suffer a loss?[323]

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broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept that failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3-103(a)(7), are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct." Commenters on the section note a tug-of-war of cases applying either an objective or a subjective standard. Some of the more recent cases, addressing a party's degree of knowledge and sophistication, suggest that courts may be leaning toward a more "objectivize" standard. "Under this higher standard, the party must not only be subjectively honest, but must act in a more or less reasonably acceptable manner" (i.e., a pure heart, but not a totally empty head). *The Uniform Commercial Code Law Letter*, Vol. 38, Number 3, May 2004. See *Gerber & Gerber, P.C. v. Regions Bank*, 266 Ga. App. 8, 596 S.E.2d 174 (2004); *Any Kind Checks Cashed, Inc. v. Talcott*, 830 So.2d 160 (Fla. Dist. Ct. App. 2002)(check cashier cashed a $10,000 check for $500 from a broker who could have cashed it elsewhere for less); and *Buckeye Check Cashing, Inc. v. Camp*, 825 NE2d 644 (Ohio Ct. App. 2005)(check casher did not act in "good faith" when it accepted a postdated check). Note: not all states follow the "uniform" definition of "good faith."

320 UCC § 3203(b); *Triffen v. Quality Urban Housing Partners*, 800 A.2d 905 (N.J. Super. Ct. 2002). A check cashing company may not be an HDC if it doesn't act in good faith ("honesty in fact and the observance of reasonable commercial standards of fair dealing"). *Buckeye Check Cashing, Inc., v. Camp*, 159 Ohio App. 3d 784, 825 N.E.2d 644; *Any Kind Checks Cashed, Inc. v. Talcott*, 830 So. 2d 160 (Fla. App. 2002). UCC § 3103(a) (4).

321 UCC § 3411.

322 Otherwise, it is generally not a good idea for a bank to refuse to pay its own check, given the potential for consequential damages under UCC § 3411.

323 If the customer enters into a release agreement with the payee in connection with the check, the bank may be able to use the release as a defense. A bank's subrogation rights are fixed at the time the check is wrongly honored. The later acts of the drawer and the payee, where the bank is not a party, cannot strip the bank of its subrogation rights (*SouthTrust Bank v. PartsBase.com, Inc.*, 875 So. 2d 17 (Fla. Dist. Ct. App. 2004)).

- ☐ Was the customer's stop payment order reasonably certain in its detail so that the Bank could stop payment? What information does the Bank's account agreement require for stop payment orders?

- ☐ Can the Bank exercise its right of subrogation against the holder, maker or payee?

- ☐ Does the presenter qualify as a holder in due course?[324]

[324] *State Security Check Cashing, Inc. v. American General Financial Services (DE)*, 972 A.2d 882 (Md.Ct.App. 2009) (check casher acted in good faith in taking check from imposter).

8. MISENCODED CHECKS

A. General Rule. The party that encodes a check after it is issued warrants to subsequent collecting banks and the payor bank (or other payor) that the information is correctly encoded.[325]

B. Damages. A bank that misencodes a check is liable for actual damages, expenses and loss of interest.[326]

C. Defenses.

(1) **Untimely reporting**.

(2) **Failure of the bank receiving warranty to mitigate its damages**. Banks must exercise ordinary care once misencoding is discovered.[327]

(3) **Statute of limitation** (3 years).[328]

(4) **Collecting banks** that exercise ordinary care are usually not liable for the mistake or misconduct of the depositary bank.[329]

(5) **Mistake**. Banks may be able to recover excess payments made to customers by mistake under state laws dealing with restitution and mistake.[330]

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[325] UCC § 4209(a). See also UCC § 4202 regarding the duty of ordinary care. If the customer of a depositary bank encodes, that bank also makes the warranty. Commentary 1 makes it clear that subsequent banks handling the item make no encoding warranty. A misencoding of the amount of a check is not an alteration under UCC § 3407(a), because it does not change the contract of the parties.

[326] If a drawer writes a check for $2,500 and the bank of first deposit misencodes it for $25,000, the drawer can recover the amount of the overage from the payor bank since the check was not properly payable under UCC § 4401. The payor bank can then look to the bank of first deposit for the overage without pursuing the payee. Intervening banks would not be liable to the payor bank for the misencoding by the bank of first deposit. If the original check was for $25,000, but is misencoded by the depository bank for $2,500, the payor bank is liable to the payee for the full amount of the check. *See* UCC § 4302 Comment 2. The payor bank's rights against the depository bank depend on whether the payor bank has suffered a loss (e.g., because it cannot change the drawer's account for the full amount. There is no requirement that the payor bank pursue collection action against the drawer beyond the amount in the drawer's account as a condition to the payor's action against the depository bank for breach of warranty. See Comment 2 to UCC § 4302. *Georgia Railroad Bank & Trust Co. v. First Nat'l Bank & Trust*, 229 S.E.2d 482 (1976), aff'd 235 S.E.2d 1; *First Nat'l Bank of Boston v. Fidelity Bank, N.A.*, 724 F. Supp. 1168 (1989), *aff'd* 908 F.2d 962 (3d Cir. 1990). *See* UCC § 4209(c) for amount that may be recovered. Arguably, this could include losses that a payor bank incurs if it rejects checks due to an overencoding, causing it to be liable for wrongful dishonors under UCC § 4402. *NBT Bank, N.A. v. First Nat'l Cmty. Bank*, 393 F.3d 404 (2004). No damages since returning bank had notified the paying bank by phone and FedLine that it was returning the NSF item (which was misdirected due to the misencoding). Under Regulation CC, the measure of damages for failure to exercise ordinary care is the amount of loss incurred, up to the amount of the check, reduced by the amount of the loss that the plaintiff would have incurred even if the encoder had exercised ordinary care. Reg. CC § 229.38(a). As such, a party responsible for a misdirected/misencoded check would not be subject to strict liability under the UCC for the entire amount of the check.

[327] *Douglas Companies v. Commercial National Bank of Texarkana*, 419 F.3d 812 (8th Cir. Ark.) (2005) (Misencoding trumps failure of payor bank to meet its midnight deadline. Encoding bank was in best position to prevent loss. Bank did not expand scope of UCC § 4406 notice to cover encoding errors).

[328] UCC § 4111. If a check with an over-encoding error is processed by the Federal Reserve Bank, the drawee bank has six months from the date the check was presented to submit a Check Adjustment Form and receive an entry (credit) to its FRB account for the difference.

[329] UCC § 4202(c). See also Regulation CC § 229.31. Banks that receive misrouted checks due to misencoding must act promptly (within the midnight deadline), but they are not required to meet the expeditious requirements (Reg. CC § 229.32(c)). Misrouted checks may be sent back to the bank from which they are received or to the correct depositary bank, if known.

9. DEATH/INCOMPETENCE OF CUSTOMER

A. Death. A bank may pay or certify checks drawn by its deceased customer for 10 days after the date of death[331] unless it receives a stop payment order from a person claiming an interest in the account.[332]

– Unlike incompetent customers, a deceased customer is not subject to the statement review and timing requirements of UCC § 4406.[333]

B. Incompetence. A payor or collecting bank may accept, pay, or collect an item even though the maker was incompetent at the time of its issuance or collection if the bank does not know of an adjudication of incompetence.[334]

– An incompetent customer is subject to the statement review and timing requirements of UCC § 4406.[335]

C. Knowledge of Death/Incompetence. Neither death nor incompetence revokes the authority to accept, pay or collect until the bank "knows" of the fact of death or of an adjudication of incompetence[336] and has a reasonable opportunity to act on it.[337]

D. Bankruptcy. A payor bank is not liable for paying a check after its customer files for bankruptcy if it pays the check without actual knowledge of the bankruptcy.[338] If a check written prior to bankruptcy is not cashed until after the filing, the funds represented by

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330 See a discussion by Bailey and Hagedorn, Brady on Bank Checks (Revised Edition) at ¶ 21.03.

331 UCC § 4405(b). The bank may do this even if it knows about the death. The rule applies even if the bank is the check payee. *In re Schenck's Estate*, 313 N.Y.S.2d 277 (1970); *Cirar v. Bank of Hartshorne*, 567 P.2d 96 (Okla. 1977). The rule does not give a bank the right to set off against the decedent's account after it learns of his death. *Joseph v. United of America Bank*, 266 N.E.2d 438 (Ill. Ct. App. 1970). After the 10-day period, the check is no longer effective.

332 UCC § 4405(b). See Comment 3 to UCC § 4405, indicating that a surviving relative, creditor or other person who claims an interest in the account may be entitled to direct the bank not to pay checks, or not to pay a particular check. The bank has no duty to determine the validity of the claim or even whether it is "colorable." The bank must act in good faith, however. *Russello v. Highland National Bank of Newburgh*, 392 N.Y.S.2d 439 (App. Div. 1977). Some states may also require accounts to be frozen for state inheritance tax purposes.

333 The one-year period of § 4406 would come into play as soon as there is a successor accountholder. *Mac v. Bank of America*, 76 Cal. App. 4th 562, 90 Cal. Rptr. 2d 476 (Ct. App. 1999).

334 The 10-day period described above for deceased customers does not apply with respect to an adjudication of incompetence. Once the bank learns of the adjudication, its authority to pay a check is revoked. See Section 1B (4) regarding the obligation of customers to review statements and report forgeries, regardless of the customer's lack of competence.

335 It is irrelevant that the customer was incompetent during the time in question or that bank employees attended the customer's competency hearing, where evidence of forgery had been presented. UCC § 4406(f) is not a statute of limitation subject to "tolling" or other equitable exceptions. *Union v. Branch Banking & Trust Co*., 59 UCC Rep. 2d 37, 2006 WL 69465 (N.C. Ct. App.); *Indiana Nat'l Corp. v. Faco, Inc*., 400 N.E.2d 202 (Ind. Ct. App. 1980*); Siecinksi v. First State Bank of East Detroit*, 531 N.W.2d 768 (Mich. Ct. App. 1995); *Brown v. Cash Management Trust of America*, 963 F. Supp. 504 (D. Md. 1997).

336 There must be an adjudication of incompetence. *Beaucar v. Bristol Fed. Sav. & Loan Ass'n*, 268 A.2d 679 (Conn. Cir. 1969).

337 UCC § 4405(a). See UCC § 1202 regarding "knowledge." An employee's knowledge may be imputed to the bank if the information is obtained as part of the employee's regular duties (e.g., to review obituaries for the bank). Bank owed no duty to determine if 76-year-old woman was competent. *Republic National Bank of Miami v. Johnson*, 622 So. 2d 1015 (Fla. Dist. Ct. App. 1993).

338 *Bank of Marin v. England*, 385 U.S. 99 (1966); Bankruptcy Code § 542(c).

the check are an asset of the bankruptcy estate.[339] For purposes of the 90-day preference period of the Bankruptcy Code, a transfer does not take place until the check has been honored by the drawee bank.[340]

[339] *In re Danowski*, 320 B.R. 886 (Bankr. N.D. Ohio 2005). The funds are property of the estate under § 541 of the Bankruptcy Code. *In re MJK Clearing, Inc.*, 286 B.R. 109, 49 UCC Rep.2d 11 (Bankr. D. Minn. 2002) (under UCC § 3408, check does not operate as an assignment of the funds; drawee is not liable on check until he pays or certifies it). *Outdoor Technologies, Inc. v. Allfirst Financial, Inc.*, 2001 WL 541972 (check not an assignment; payee can't sue drawee bank for wrongful dishonor as there is no privity of contract) [Note: Not cited in A.2d]. *In re Sawyer*, 57 UCC Rep. Serv. 2d 560, 2005 WL 114770 (U.S. Bankruptcy Court, D. Arizona, 3/30/05) (checks did not clear accounts until post-petition; collecting bank could do no more than provide provisional credit until payor bank made final settlement).

[340] *Barnhill v. Johnson*, 503 U.S. 393 (1992) (check delivered 92 days before bankruptcy, but not paid until 89 days before bankruptcy; transfer doesn't occur until bank finally pays the check). Note: This would not be the case for a cashier's check or certified check. Transfer takes place upon their delivery. UCC § 3310. The bankruptcy preference rule can be found at 11 U.S.C. § 547. For a case involving the contemporaneous exchange exception, see *Velde v. Kirsch*, 2008 WL 4330264 (8th Cir. 2008). Banks receiving checks at the tail end of a kite can claim a security interest in the check for which a provisional credit was granted by the bank. UCC §§ 4210 and 9203(c). *In re Cannon*, 237 F.3d 716 (6th Cir. 2001) (security interest in future checks); *Pereira v. Summit Bank*, 44 UCC Rep.2d 193 (S.D.N.Y. 2001); *In re Frigitemp Corp*., 34 B.R. 1000 (Bankr. S.D.N.Y. 1983), aff'd 753 F.2d 203 (2d Cir. 1985); *In re Matter of Summit Financial Services*, 240 B.R. 105 (Bankr. N.D. Ga. 1999). But see *In re Sophisticated Communications, Inc*., 369 B.R. 689 (Bankr. S.D. Fla. 2007) (bank allowed kiter to draw against overdraft for cashier's checks).

10. SUBSTITUTE CHECKS[341]

A. General Rule

- **The first reconverting bank (i.e., the bank converting an electronic check to paper form or creating a substitute check from the original check) will generally be held responsible if the original check or another copy of the substitute check is presented for payment (i.e., a double payment).**

- **The first reconverting bank will generally be responsible for a loss caused by its failure to produce the original check or a sufficient copy.**

- **The first reconverting bank may be able to transfer some or all of this liability back to the party that truncates the original check and transmits it electronically.**

B. Bank Warranties. A bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) warrants to the party to which it transfers, presents, or returns the substitute check,[342] and to any subsequent recipient, that:

(1) The substitute check meets Reg. CC's requirements for "legal equivalence"; and

(2) No depositary bank, drawee, drawer, or indorser will receive presentment or return of, or otherwise be charged for, the substitute check, the original check, or a paper or electronic representation of the substitute check or original check such that the person will be asked to make a payment based on a check that it already has paid (i.e., a double payment).[343]

The first warranty (1) represents a risk to the extent that the bank or its customer may fail to "accurately represent [on the substitute check] all of the information on the front and back of the original check as of the time it was truncated." While technology has advanced to a point where imaging is very good, problems can still arise in the imaging process (e.g., because of the condition of a check, the color of the ink, or background details). Substitute checks also would not contain security features that might otherwise help to detect forged, altered or counterfeit checks.

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341 A substitute check is the legal equivalent of an original check for all persons and all purposes if it (a) accurately represents all of the information on the front and back of the original check as of the time the original check was truncated, and (b) bears the legend, "This is a legal copy of your check. You can use it the same way you would use the original check." Reg. CC § 229.51(a).

342 The warranties flow with the substitute check. They do not flow to a person who receives the original check or a representation of an original check that was not derived from a substitute check.

343 Reg. CC § 229.52(a). These warranties are made automatically, and all UCC and Reg. CC warranties that apply to the original check also apply to the substitute check (Commentary 3 to Reg. CC § 229.52(a)). Note that these warranties are not given by a bank that truncates the original check and transfers it electronically to the reconverting bank. The parties may allocate liability back to the truncating bank by agreement, however.

The second warranty (2) applies regardless of whether the ultimate payment is based on the original check, the substitute check, or some other electronic or paper representation of either, and regardless of the order in which the duplicative payment results from a fraudulent substitute check about which the warranting bank had no knowledge.

Although all banks that transfer, present, or return a substitute check provide the above warranties, warranty losses generally will be taken by the first reconverting bank, unless it is able to lay the liability off on someone else (e.g., its customer or a truncating bank)[344] by agreement.

C. Bank Indemnity. A bank that transfers, presents, or returns a substitute check or a paper or electronic representation of a substitute check for which it receives consideration must indemnify the recipient and any subsequent recipient for any loss incurred due to the receipt of a substitute check instead of the original check.[345]

The amount of the indemnity is the amount of any loss (including interest, costs, reasonable attorneys' fees, and other expenses of representation) proximately caused by a breach of the warranty described in the preceding section (10.B). If the loss did not result from a warranty breach, the amount of the indemnity will be the amount of the loss (up to the amount of the substitute check), interest, costs, reasonable attorneys' fees, and other expenses of representation. If a loss results in whole or in part from the indemnified person's negligence or failure to act in good faith, the indemnity amount is reduced in proportion to the amount of negligence or bad faith attributable to the indemnified person.[346]

If the indemnifying bank produces the original check or a sufficient copy, it will only be liable for losses that are incurred up to the time that it provides the original check or sufficient copy to the indemnified person. The indemnifying bank is subrogated to the rights of the person that it indemnifies to the extent of the indemnity and may attempt to recover from another person based on a warranty or other claim. Indemnified persons have a duty to comply with all reasonable requests for assistance from an indemnifying bank in connection with any claim the indemnifying bank brings against a warrantor or other person related to the check.[347]

D. Consumer Rights. A consumer may make a claim for recredit if:

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344 A bank that truncates an original check from the forward collection or return process and sends to a recipient in lieu of such original check, a substitute check or, by agreement, information relating to the original check, whether with or without the subsequent delivery of the original check is a "truncating bank." Reg. CC § 229.2(eee).

345 Reg. CC § 229.53(a). This indemnification flows to a collecting or returning bank, the depositary bank, the drawer, the drawee, the depositor, and any Indorser. It covers a loss caused by receipt of the substitute check as well as the loss that a bank incurs because it pays an indemnity claim to another person. For example, a bank may be liable because the original check, which contained security features, would have shown an alteration and alerted the indemnified bank. On the other hand, if the bank would have ignored the security features (based on its bulk filing procedures), the indemnity would not apply. The indemnity of § 229.53 does not protect a person who handles only the original check or a paper or electronic version of the original check that is not derived from a substitute check.

346 Reg. CC § 229.53(b) (2).

347 Reg. CC § 229.53(c).

(1) The bank holding the consumer's account charged the account for a substitute check;

(2) the substitute check was not properly payable or the consumer has a warranty claim with respect to the check;

(3) the consumer suffered a loss; and

(4) production of the original check is necessary to determine whether the substitute check was improperly charged or whether the consumer's warranty claim is valid.[348]

The consumer must submit the claim so that the bank receives it by the end of the 40th calendar day after the later of the day the bank mailed or delivered the check or the statement reflecting the transaction. The time period is extended if there are extenuating circumstances.[349]

The consumer's oral or written claim must include: a description of the claim (i.e., the improper charging or warranty breach); an estimate of the loss; the reason why production of the original check or a sufficient copy is necessary to determine the validity of the claim; and sufficient information for the bank to identify the substitute check and investigate the claim.[350]

The bank's responsibility for a consumer claim:

(1) *Valid Claims*. The bank must recredit the account if the claim is determined to be valid for the amount of the loss, up to the amount of the substitute check, plus interest if the account is interest-bearing, no later than the end of the business day after the banking day on which the bank makes its determination. The bank must send a notice to the consumer, as required by Reg. CC.

(2) *Invalid Claims*. The bank must send a notice to the consumer, as provided by Reg. CC.

(3) *Recredit Pending Investigation*. While the bank is investigating, it must provisionally recredit the consumer's account by the end of the 10th business day after the banking day that it received the claim in an amount of $2,500 or the amount of the claimed loss, whichever is less, plus interest if the account is interest-bearing. It also must send a notice to the consumer, as required by Reg. CC. The bank must recredit the account the remaining amount (plus interest, if the account is interest-bearing) no later than the end of the 45th calendar day after the banking day on which it received the claim, and send a notice to the consumer, as required by Reg. CC, unless it determines the claim is invalid (in

[348] Reg. CC § 229.54(a).

[349] Reg. CC § 229.54(b).

[350] Reg. CC § 229.54(b).

which case, it may reverse any prior recredit). Reg. CC allows for delayed availability of recredits for new accounts, accounts with recent overdraft activity, and if the bank has reasonable cause to believe the claim is fraudulent.[351]

Banks with indemnity claims against a bank may make an expedited-recredit claim against an indemnifying bank if: the claimant bank or a bank it has indemnified has received a claim for expedited recredit from a consumer; it is obligated to provide an expedited recredit or otherwise has suffered a loss; and the production of the original check or a sufficient copy is necessary to determine the validity of the charge to the consumer's account or the validity of any warranty claim connected to the substitute check. The claimant bank must submit its claim within 120 calendar days after the date of the transaction that gave rise to the claim. The indemnifying bank has 10 business days to (1) recredit the claimant bank for the amount of the claim, up to the amount of the substitute check, plus interest if applicable; (2) provide the claimant bank with the original check or a sufficient copy; or (3) explain why it is not obligated to do (1) or (2).[352]

[351] Reg. CC § 229.54(c).

[352] Reg. CC § 229.55.

11. "FULL PAYMENT" CHECKS

A. General Rule. A claim is discharged by a check if (i) the drawer adds language to the check or an accompanying communication[353] that it is tendered in full satisfaction of the claim,[354] (ii) the payer acts in good faith,[355] (iii) the amount of the claim is unliquidated or subject to a bona fide dispute,[356] and (iv) the claimant obtained payment of the instrument.[357]

B. Exceptions. There are two exceptions to the rule:

(1) Organizations. If the claimant is an organization, the claim is not discharged if it can prove that (a) within a reasonable time before the tender[358], the claimant sent a conspicuous[359] statement to the payer that communications concerning disputed debts (including "paid in full" checks) must be sent to a designated person, office or place, and (b) the check or accompanying communication was not received by that person, office or place.

(2) Rejection of Payment. Whether or not the claimant is an organization, the claim is not discharged if the payee: (a) does not send a notice described in (1), above, and (b) returns the amount within 90 days to the claimant.[360]

Neither of the above exceptions applies if the payor is able to prove that the payee (or an agent having direct responsibility with respect to the disputed obligation) knew that the check was offered in full satisfaction of the claim.[361]

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353 The code requires that this be done conspicuously. UCC § 3311(b). "Conspicuous" is defined at UCC § 1201(b)(10) and described in the comments to UCC § 3311. *Brucato v. Ezenia! Inc.*, 351 F. Supp. 2d 464 (E.D. Va. 2004).

354 The payer must clearly state that the check is being tendered as a settlement of the dispute. *Western Builders & Developers, Inc. v. McBerry*, 891 A.2d 430, 59 UCC Rep. 2d 205 (Md. Ct. Spec. App. 2006), *cert. denied*, 898 A.2d 1005 (Md. 2006). The words "full payment" do not have to be used. Printing "FAIR AND REASONABLE PAYMENT" and "REASONABLE & CUSTOMARY ADJ" on insurance checks is not sufficient to manifest an intent of full satisfaction. *Auto Glass Express, Inc. v. Hanover Insurance Co.*, 912 A.2d 513 (2006). Courts will look to the overall intent shown. *Harvard v. Kemper Nat'l Ins. Cos.*, 945 F. Supp. 953 (5th Cir. 1995); *Tegrant Alloyd Brands, Inc. v. The Merchant of Tennis, Inc.*, 73 U.C.C. Rep. Serv. 2d 486 (N.D. Ill. 2011). The claim must relate to the same dispute. *Milton M. Cooke Co. v. First Bank and Trust*, 290 S.W.3d 297 (Tex.Ct.App. 2009).

355 An offer that is ridiculously low may not be in good faith. *Caddell v. CitiMortgage, Inc.*, 2006 WL 625970 (D. Kansas); *Bank One, N.A. v Friedman*, 66 U.C.C. Rep. Serv. 2d 170, 2008 WL 2096787 (clearly erroneous payoff letter). Previous bad faith actions do not necessarily taint a current tender. *Ross Brothers Construction Co., Inc. v. Markwest Hydrocarbon, Inc.*, 196 Fed. Appx. 412, 61 UCC Rep. Serv. 2d 102, 2006 WL 2952773 (6th Circuit 2006). Good faith requires "honesty in fact" and the "observance of reasonable commercial standards of fair dealing." UCC § 1201(b)(20). Printing "Payment in full" routinely on all checks, whether or not there is a dispute, may be evidence of bad faith. *Jones v. Allstate Ins. Co.*, 146 Wash.2d 291, 45 P.3d 1068 (2002); comment to UCC § 3311.

356 UCC § 3311. *MQVP, Inc. v. Keystone Automotive Industries, Inc.*, 66 U.C.C. Rep. Serv. 2d 146, 2008 WL 937486; *Petty v. Citibank (South Dakota) N.A.*, 218 S.W. 3d 242 (2007). Note: California Civil Code § 1526 has been superseded by this UCC provision. *Woolridge v. JFL Electric, Inc.*, 117 Cal.Rptr.2d 771, 96 Cal.App.4th Supp. 52 (2002). See also UCC § 1308 (performance under reservation of rights does not apply to full satisfaction checks).

357 If payment is stopped on the check, there is no "satisfaction." *O Bar Cattle Co. v. Owghee Feeders, Inc.*, 71 UCC Rep.2d 68 (D.Ida. 2010)

358 This could be accomplished by a notice in the billing statement to a customer. Comment 5 to UCC § 3311.

359 "Conspicuous" is defined at UCC § 1201(b).

360 The payment must be returned within 90 days after it is paid by the drawee bank. UCC § 3311(c) (2).

[361] "Notice" and "knowledge" are defined at UCC § 1202 and described in Comment 7 to UCC § 3311. *XCEL Mold & Machine, Inc. v. DeVault Industries, LLC,* 146 Ohio Misc. 2d 32 (Payee deposited check knowing it was tendered as payment in full, but returned the amount with its own check; accord and satisfaction found by court).

12. ACCOUNT TERMS THAT PROTECT THE BANK

The effect of the provisions of the UCC may be varied by agreement.[362] The obligations of good faith, diligence, reasonableness, and care may not be disclaimed by agreement, however, although the parties may determine the standards by which the performance of those obligations are measured – if those standards are not manifestly unreasonable.[363] Persons have an obligation to exercise ordinary care.[364]

(a) Setting the standard UCC § 3103(a)(7) – Duty of "ordinary care"	**Our Relationship**. Unless otherwise expressly agreed in writing, our relationship with you will be that of debtor and creditor. No fiduciary, quasi-fiduciary or other special relationship exists between you and us.[365] *We owe you a duty of ordinary care.*
Raising the bar for customers under UCC § 3406	**Checks.** If you arrange for the printing of your own checks, the form, encoding and format of the checks must follow our check specification requirements and be approved by us in advance. *We make checks available that include fraud prevention features. If you choose not to use them or other checks that include fraud prevention features, you agree to assume a heightened degree of responsibility for safeguarding your checks, and for reviewing all returned checks and statements as soon as you receive them.*
See *Kaiser Aluminum & Chemical Corporation v. Mellon Bank*, 1997 WL 361354. A bank may not disclaim liability for its own lack of good faith or failure to exercise ordinary care (UCC § 4103(a))	**Cash Management.** We make our Positive Pay service available to all business customers. Positive Pay can be extremely helpful in preventing fraudulent checks from being charged against your account. If you choose not to use our Positive Pay service, you agree to assume a heightened degree of responsibility for safeguarding your checks, supervising persons who have access to your checks and statements, reviewing all returned checks and statements, and immediately reporting any unauthorized check transactions involving your account. *[Note: Depending on the facts, the following may or may not be enforceable[366]]* If you do not enroll for the Positive Pay service and a fraudulent check loss occurs despite our exercise of good faith and ordinary care, you agree to assume responsibility for the loss to the extent that it could have been prevented by your use of the service.
Sharing responsibility for lost items	**Checks Lost or Stolen**. You agree to safeguard your blank and canceled checks, and to take reasonable steps to prevent their unauthorized use. If you are a business, you should store them under dual control in a secure, locked location that is accessible only to authorized personnel. If your checks are lost or stolen, you

362 UCC §§ 1302(a), 4103(a) and 4A-501 (UCC § 11501 in California).

363 UCC §§ 1302(b), 4103(a). Good faith is required by UCC § 1304 and defined at UCC § 1201 as honesty in fact and the observance of reasonable commercial standards of fair dealing.

364 UCC § 3406. "Ordinary care" is defined at UCC § 3103(a).

365 But see *Brown Family Trust v. Wells Fargo Bank*, 168 Cal.App.4th 938 (special relationship arose, placing bank in a fiduciary position).

366 See *Cincinnati Ins. Co. v. Wachovia Bank, N.A.*, 2010 WL 2777478 (CD Minn. 2010); *Kaiser Aluminum & Chem Corp. v. Mellon Bank, N.A.*, 43 UCC. Rep.2d 928 (CWD Pa 1997) (loss shifted for facsimile signatures; *Cumis Insurance Society, Inc. v. Girard Bank*, 522 F.Supp. 414 (E.D.Pa. 1981) (loss not shifted by facsimile agreement); *J. Walter Thompson, USA, Inc. v. First Bank Americano*, 518 F.3d 128 (2d Cir. 2008).

	agree to notify us immediately. For security reasons, we reserve the right to close your account and transfer the balance to a new account. If we do, all checks written but not yet paid may be returned to payees as "Account Closed" or "Refer to Maker." You will be responsible for issuing any replacement checks. When you cash or deposit a check or other item with us, we act as your agent to collect the item. You assume all risk of loss of an item in the process of collection. We may reverse any credit given and any interest earned or accrued for a deposited item that is lost in transit, and we may recover from any account you maintain with us the funds given to you for a cashed item which is lost in transit. *You will do everything reasonably within your ability to promptly assist us to find, identify or replace a lost item, including but not limited to maintaining a record of the maker of items delivered to us for deposit and collection.* We will not be liable to you if an item is lost in the process of collection, provided that we exercised ordinary care in handling the item. In no event will we be liable to you if you cannot identify the maker of the lost item.
Customer care under UCC § 4406, Financial Code § 1409, and then some . . . Moving up the period to notify the bank under UCC § 4406(d)(2) Moving up the preclusion time period under UCC § 4406(f) Consider impact of UCC § 4208(c) defense by depository bank to warranty claim	**Statements, Notices and Checks**. If we provide you with a statement, electronically or otherwise, you must promptly and carefully review it to determine if any errors or problems exist. You agree to notify us immediately of any error, discrepancy or unauthorized transaction you discover on any statement, notice or check. If you fail to do so, you may become responsible for the losses resulting from such failure. *If you are a business, you agree not to entrust the writing of checks and the reconcilement and review of your account statements and notices to the same person without frequent monitoring.* We may deny a claim for monetary loss due to forged, altered or unauthorized checks if you fail to follow these procedures. **Unauthorized Transactions.** You are in the best position to discover and report any unauthorized charge to your account. If you fail to notify us within a reasonable time (*not exceeding 21 days after your statement date*) of an unauthorized signature, alteration, forgery, counterfeit check, or other unauthorized debit to any of your accounts, we will not be responsible for subsequent unauthorized transactions by the same wrongdoer if we act in good faith. *Without regard to care or lack of care of either you or us, if you do not discover and report any such error or unauthorized transaction within [60 days] [six months] after the date of your statement or the date information about the item or transaction is made available to you, whichever is earlier, you are precluded from asserting the error or unauthorized transaction against us.* (Note: Different notification and liability rules apply to certain electronic fund transfers. See page ___.)
(b) Managing expectations/Not shooting oneself in the foot May not work under § 3103(a)(7) with respect to bulk filing, but may be helpful elsewhere.	**Policies and Procedures.** Any internal policies or procedures that we may maintain in excess of reasonable commercial standards and general banking usage are solely for our own benefit and shall not impose a higher standard of care than otherwise would apply in their absence.[367]

[367] *Gossels v. Fleet Nat'l Bank*, 902 N.E.2d 370, 68 UCC Rep. 2d 217 (Mass. 2009) (Neither the UCC nor common law impose liability by elevating a bank's internal policies on a par with the requirements of the UCC).

Issue of negligence still there.	
(c) KYC/CIP California Civil Code § 1788.21 (Notice to creditors)	**Changes In Account Ownership, Address and Authorized Signers**. You agree to notify us immediately in writing of any change in your name, address, business capacity (e.g., sole proprietor to corporation), or the authorized signers on your account. We may require a new signature card before any change in ownership or authorized signers becomes effective. You authorize us to obtain information on your residence address from the Department of Motor Vehicles and waive your rights under California Vehicle Code § 1808.21. If the authorized persons on your account change, we may continue to honor items and instructions given earlier by any previously authorized person(s) until we receive specific notice from you in writing not to do so. (Note: A new or updated signature card, by itself, does not constitute notice to terminate any pre-existing payment or transfer plan.) In some instances, we may require you to close your account or provide us with stop payment orders in order to prevent transactions from occurring. There may be a delay in implementing a change in the authorized persons on our records, and you agree that we will be given a reasonable opportunity to make the changes necessary. You agree to provide us with your current e-mail address for notices at the address or phone number indicated [above] [below] [on page ___]. If your e-mail address changes, you must send us a notice of the new address by writing to us or sending us an e-mail, using secure messaging, at least __ days before the change.
Undisclosed previous trust contribution at time of death. California Probate Code §§ 5100 *et seq.* Disputes can arise upon the death of a tenant. How does the Bank determine what constitutes half of the account when the Bank learns of the death well after the fact? (See UCC § 4405, as well)	We may rely solely on our account records to determine the ownership of your account. **Joint Tenancy**. Unless you designate otherwise on your signature card or application, we will assume that personal accounts opened by two or more individuals are intended to be joint tenancy accounts with the right of survivorship. **Tenants In Common**. If your account is opened with others as "tenants in common," each owner will have an ownership interest in the account, but not necessarily an equal interest. When an owner dies, his or her share does not pass automatically to the surviving owner(s). Instead, it goes to the estate or other legal successor of the deceased owner. Upon the death of any owner, we may continue to follow the instructions of any surviving owner or the personal representative of the deceased owner. If there is a dispute over the account or its funds, however, we may freeze funds in the account until the surviving owner(s) and the heir(s) or legal representative of the deceased owner agree on the account's disposition. **Community Property**. If you and your spouse open a "community property" account, each of you will have an equal interest in the account. To open a community property account, you must clearly indicate on your signature card or application that the account is held as "Community Property;" otherwise the account will be considered a joint tenancy account. If one of you dies, one-half of the account will belong to the surviving spouse; the deceased

This certification should not take the place of a separate, notarized certification under California Probate Code § 18100.5. It is sometimes added since branch personnel may fail to obtain (or may lose) the certification form.	spouse's share of the account will go to his or her estate and may be affected by a will. We may freeze some or all of the funds in the account until the surviving owner and the personal representative or heir(s) of the deceased owner agree on the account's disposition. **Documented Trust Accounts.** If you establish an account in connection with a written trust, you certify and declare under penalty of perjury under the law of the State of California that: (a) you are the only current trustee(s) of the trust; (b) you are authorized to enter into this and other agreements with us in connection with the trust; (c) no other person's authorization or court order is required for the actions you take and/or the instructions you give in connection with the account; (d) the correct name of the trust is reflected on the signature card or application for the account; and (e) the trust has not been revoked, modified, or amended in any manner that would cause these representations to be incorrect. You agree to provide us with reasonable advance notice of any amendments made to the trust, any change in trustees or beneficiaries, and any other event that might affect any right, duty or authorization of any person (including us) with respect to the trust account. We will not be required to know, understand, interpret or enforce the terms of any trust document that may be provided to us. We may require you to sign a separate trust certification form in order to open or maintain an account.
To resolve disputes over whether the attorney notified the Bank regarding an account's IOLTA status	**Attorney-Client Trust Accounts.** If you want to open an IOLTA account, you must indicate that on your signature card. Otherwise, we may assume that it is not an IOLTA account.
(d) Changing the period for processing items UCC § 4108 – When today is tomorrow UCC § 4303(a) (5) – Undoing yesterday's posting	**Cutoff Hour.** If we receive an item for payment on a weekend, a holiday, or after [2:00 p.m.] [our cutoff hour] on a business day, we may treat it as if we had received it on the next business day. **Check Processing Cutoff Hour**. Our processing cutoff hour with respect to any knowledge, notice, stop payment order, or legal process received by us involving a check is [(insert the hour) on the banking day] (one hour after the opening of the banking day) following the banking day on which we receive the check]. The cutoff hour with respect to setoffs exercised by us is [midnight] [the close] of the banking day following the banking day we receive a check, or such later time by which we must return the check. The cutoff hour determines our obligation under state law to pay or return certain checks that have been received (but not finally paid) by us on the previous banking day.
(e) Hedging one's bets	**Accepting Items For Collection**. We and other institutions may refuse to accept an item for deposit or may accept it on a collection basis only. This often occurs with foreign, questionable or damaged items. If we accept an item for collection, we will send it to the institution upon which it is drawn, but will not credit your account for the amount until we receive the funds from the other institution. If we elect to credit your account before then, we may charge the amount back against your account if we do not receive payment for any reason. We may impose a fee in connection with sending and receiving items for collection (e.g., by charging your account or deducting the fee from the amount remitted). Other institutions that send or receive items for collection involving your

	account also may impose a fee for their services. [Note: Disclose any fee imposed for incoming collections.]
The hand is quicker than the eye	**Verification and Collection**. Any item that we accept for deposit or encashment is subject to later verification and final payment. We may deduct funds from your account if an item is lost, stolen or destroyed in the collection process, if it is returned to us unpaid, or if it was improperly paid, even if you have already used the funds. Cash deposits are also subject to later verification.
The calm before the storm	**Inactive Accounts**. For security reasons, we may refuse a withdrawal or transfer from accounts we internally classify as dormant if we cannot reach you in a timely fashion to confirm the transaction's authorization.
(f) The two-signature shuffle	**Authorized Signers**. Your signature card identifies who is authorized to make withdrawals, write checks, transfer funds, stop payments, obtain ancillary services, and otherwise give us instructions regarding your account. Although your card may indicate that more than one signature is required on checks and for the withdrawal or transfer of funds, that notation is principally for your own purposes. We do not assume a duty to support multiple signature requirements. As such, <u>we assume no duty to confirm that two or more (or any combination) of authorized signers have approved any transaction. Unless we enter into a separate written agreement to the contrary, we may act upon the instructions of any one authorized signer</u>. Although we may attempt on occasion to enforce the multiple signature requirement shown on your card (e.g., by refusing to permit a transaction by less than the stated number of authorized signers), we may cease doing so at any time and without prior notice to you.
Broad authority to give instructions	
No duty to police multiple signature requirement	
But still may honor if discovers less than the designated number	
Special checks for multiple signature accounts	If we agree in writing to enforce a multiple signature requirement for check withdrawals, you agree to order checks that bear a legend above the signature lines that two signatures (or more, if applicable) are required. We may pay any check that bears a signature or endorsement (including a facsimile signature) resembling an authorized signature on file with us.
(g) Limitations	**Deposits**. We may refuse to accept a deposit or an addition to an account, limit its size, or return all or part of it to you. We reserve the right to limit the amount of funds that may be maintained in an account. **Withdrawals.** We may refuse to honor any withdrawal or order if funds on deposit are insufficient or unavailable to cover the request or order (See page ___) or there is a dispute or question as to the ownership of account funds (See page ___).
Stopping the pain	**Limitation on Time to Sue**. An action or proceeding by you to enforce an obligation, duty or right arising under this agreement or by law with respect to your account or any account service must be commenced within one-year after the cause of action accrues.
(h) Third party claims	**Account analysis.** If you deposit funds that belong to others

Old Republic Title issues	("beneficial owners") in an analyzed account, you represent to us that: (a) you are authorized by the beneficial owners to benefit from the use of any associated earnings credit, and (b) your use of the earnings credit will not violate any contract, law or regulation. You also agree to indemnify and hold us harmless from and against any and all claims, actions, proceedings, losses, costs (including attorney fees and other charges), liabilities and/or damages that arise from your use of the service or the manner in which you compensate or charge the beneficial owners for your use of our services. This provision shall survive the termination of this Agreement. **Indemnification.** Except as otherwise set forth in this Agreement, you agree to indemnify, defend and hold us harmless from all claims, actions, proceedings, fines, costs and expenses (including, without limitation, attorney fees) related to or arising out of: (a) your actions and omissions in connection with your accounts or our services, and (b) our actions and omissions, provided that they are taken/omitted in accordance with this Agreement or your instructions. This provision shall survive the termination of this Agreement. There are no third party beneficiaries to this agreement.
(i) Setoff	**Setoff.** We may charge or set off funds in your account for any direct, indirect and/or acquired obligations that <u>any</u> owner owes us now or in the future, regardless of the source of the funds in the account, to the fullest extent permitted by law. This provision does not apply to IRA or tax-qualified retirement accounts, to consumer credit card obligations, or where otherwise prohibited by law.
(j) No duty to determine regularity of check use Calif. Financial Code § 1451	We may honor checks drawn against your account by authorized signers, even if the checks are made payable to them, to cash, or for deposit to their personal accounts. We have no duty to investigate or question withdrawals or the application of funds.
(k) Business Exceptions (Reg. E)	**Business and Other Non-personal Accounts.** The provisions in this Electronic Fund Transfers section dealing with "Our Liability for Failing to Make Transfers," "Your Liability for Unauthorized Electronic Fund Transfers," and "In Case of Errors or Questions About Your Electronic Fund Transfers" (and related provisions on the back of periodic statements) do not apply to business or other non-personal accounts. You should notify us immediately if you discover any unauthorized transactions or errors involving your Card or account. You must send us a written notice of the problem within a reasonable time, not to exceed 14 days from the date of discovery or your receipt of the first statement or notice reflecting the problem, whichever occurs first. You are liable for all unauthorized transactions made with your Debit Card or the PIN associated with your Card that occur prior to the time you notify us to cancel your Card, that an unauthorized transaction has taken place, or that your Card or PIN has been lost or stolen. There is one exception to this liability: *[Unless you are grossly negligent or fraudulent in the handling of your Debit Card or account, you will not be liable for unauthorized signature-based Debit Card transactions processed through the Visa network.][If*

	your account is in good standing, you have exercised reasonable care in safeguarding you card from any unauthorized use, and you have not reported two or more unauthorized events in the past 12 months, you may not be liable for unauthorized signature-based activity under MasterCard's rules for small businesses.] It is important that you review your statements closely, however. If your statement shows transactions you did not make, contact us at once. If you fail to notify us of unauthorized transactions within 60 days after the first statement or report showing unauthorized activity was sent or made available to you, you will be liable for unauthorized transactions that occur after the 60-day period. Debit Card transactions are not considered unauthorized if they are made by a business co-owner or any other person with an interest in or authority to transact business on your account, even if the person exceeds any authority given by you.
(l) Avoiding Juries -- Dispute Resolution	California. If your account is maintained at a branch in California and a dispute involving $50,000 or more (including all claims of all parties) arises between us with respect to the account, this agreement, its enforcement or our account services, either of us may require that it be resolved by judicial reference in accordance with California Code of Civil Procedure, Sections 638, et seq. The referee shall be a retired judge, agreed upon by the parties or appointed by the court. The costs of the reference procedure, including the fee for the court reporter, shall be paid equally by all parties as the costs are incurred. The referee shall hear all pre-trial and post-trial matters, including requests for equitable relief, prepare an award with written findings of fact and conclusions of law, and apportion costs as appropriate. Judgment upon the award shall be entered in the court in which such proceeding was commenced and all parties shall have full rights of appeal. Other States. If your account is not maintained in California, **you and we each waive our respective rights to a trial before a jury in connection with disputes related to this agreement, your account or account services to the fullest extent permitted by law**. This waiver shall not apply if, at the time an action is brought, your account is maintained in a state where a jury trial waiver is not permitted by law. In that circumstance, if the claims of all parties are not limited to $100,000 or less, you and we agree that all decisions of fact and law in any action brought in connection with this agreement, your account or account services shall be decided, at the option of either party, by binding arbitration, administered by the American Arbitration Association, in accordance with Title 9 of the United States Code (Federal Arbitration Act) and the Commercial Arbitration Rules of the American Arbitration Association. You and we agree that the arbitrator(s) may conduct some or all of the arbitration by telephone if the arbitrator(s) find that doing so is appropriate given the location of the parties and the amount in question. A single arbitrator will be chosen for any dispute that involves a total claim of less than $250,000. In that case, the arbitrator will only have the authority to award up to $250,000, including all damages and costs of every kind. A submission to a single arbitrator will be deemed a waiver of any right to recover more than

Note: Jury trial waivers are not permitted in California as a result of the *Grafton Partners* decision.	that amount. A dispute involving total claims exceeding $250,000 will be decided, upon the request of either party, by a majority vote of a panel of three arbitrators. An arbitrator must be an attorney with 15 or more years of practice or a retired judge. Neither you nor we may join or consolidate disputes as a representative or member of a class in any arbitration, or act in any arbitration in the interest of the general public or in a private attorney general capacity. All States. This provision will not be deemed to limit or constrain either party's right to exercise self-help remedies such as set off, to obtain provisional or ancillary remedies such as injunctive relief or the appointment of a receiver, to interplead funds in the event of a dispute, to exercise any right or remedy as a secured party against any collateral pursuant to the terms of a security agreement, or to comply with legal process involving accounts or other property. Venue for any action or arbitration brought in accordance with this provision shall be in the state where your account is maintained by us. Disputes in an amount subject to the jurisdiction of that state's small claims court shall not be subject to an arbitration or judicial reference proceeding.
(m) Passing the buck, when it is helpful	Unless otherwise provided in this Agreement, we may comply with applicable clearinghouse, Federal Reserve Bank and correspondent bank rules in processing transactions. You agree that we may act in accordance with those rules and that we do not have to notify you of a change in such rules, except to the extent required by law. *[Note: Insert additional depositor warranties.]*
(n) Prestidigitation -- or -- The Incredible Bulk	**Check Signature Verification.** We may process certain checks mechanically, based on the information encoded on the items. This means that we may not visually examine each of your checks to determine if they are properly completed and endorsed. Although we may review checks from time to time, you understand that reasonable commercial standards do not require us to do so. [Another version: We process certain checks by automated means based on information encoded on the checks. As such, we may not physically examine all checks to determine if they are properly signed or completed. You agree that we may rely on such a process and that it will be deemed an acceptable standard of care on our part.[368] **Remotely Created Checks and Demand Drafts.** If you provide your account number to a third party in order to charge your account by means of one or more remotely created checks or demand drafts (i.e., items which do not bear the maker's signature, but purport to be drawn with the maker's authorization), you authorize us to pay such items, even though they do not contain your signature and may exceed the amount you authorized to be charged. This provision shall not obligate us to honor such items. We may refuse to honor such items without cause or prior notice,

[368] Bank that does not have a written policy for verifying depositor signatures (under a bulk filing procedure) may be liable for failing to act with ordinary care. *Bank of Texas v. UR Electric, Inc.*, 276 S.W.3d 671 (Tex.Ct.App. 2008) (case criticized by Clark's Bank Deposit and Payments Monthly).

UCC §§ 3104, 3417(a) (4), and 4207(a) (6) Regulation CC §§ 229.2(fff) and 229.34(d)	even if we have honored similar items in the past. You may not deposit remotely created checks or demand drafts to an account with us without our prior written consent. Upon our request, you agree to provide us with evidence of your authorization to create and/or deposit such items. You also agree to indemnify, defend and hold us harmless from every loss, expense, cost (including attorney's fees), claim and liability related to or arising from such items, including (without limitation) claims that they were not authorized by the persons on whose accounts the items were drawn.
(o) Breathing room Note the limitation inherent in Calif. Probate Code § 5405(c) ("other than a checking account")	**Conflicting Demands/Disputes**. If there is any uncertainty or conflicting demands regarding the ownership of an account or its funds, we are unable to determine any person's authority to give us instructions, we are requested by [Adult Protective Services][any state or local agency] to freeze the account or reject a transaction due to the suspected financial abuse of an elder or dependent adult, or we believe a transaction may be fraudulent or may violate any law, we may, at our sole discretion: (1) freeze the account and refuse transactions until we receive written proof (in form and substance satisfactory to us) of each person's right and authority over the account and its funds; (2) refuse transactions and return checks, marked "Refer to Maker" (or similar language); (3) require the signatures of all authorized signers for the withdrawal of funds, the closing of an account, or any change in the account regardless of the number of authorized signers on the account; (4) request instructions from a court of competent jurisdiction at your expense regarding the account or transaction; and/or (5) continue to honor checks and other instructions given to us by persons who appear as authorized signers according to our records. The existence of the rights set forth above shall not impose an obligation on us to assert such rights or to deny a transaction. **Compliance.** You agree not to violate the laws of the United States, including without limitation, the economic sanctions administered by the U.S. Treasury's Office of Foreign Asset Control. You agree to comply with applicable law. You may not use your account or any account-related service to process Internet gambling transactions or conduct any activity that would violate applicable law. If we are uncertain regarding the legality of any transaction, we may refuse the transaction or freeze the amount in question while we investigate the matter. **Returned Items/Transactions**. If we are notified that an item you cashed or deposited is being returned unpaid, we may attempt to reclear the item, place a hold on the funds in question (see "Funds Availability") or charge your account for the amount (and any interest earned on it), whether or not the return is proper or timely.[369] This also applies to checks drawn on us which are not paid for any reason. We may assess a fee for each returned item

[369] *See Lema v. Bank of America, N.A.*, 826 A.2d 504, 50 UCC Rep.2d 955 (Md. Ct. App. 2003) (Bank may vary UCC timing by agreement). But also see *United States v. Payment Processing Center*, 461 F.Supp.2d 319 (E.D. Pa., 2006) (bank's agreement can alter the legal consequences of final settlements, but not the fact of final settlements; as such, the government could assert a claim against the funds in question).

	and notify you of the return orally, electronically, or in writing. If we receive an affidavit or a declaration under penalty of perjury stating that an endorsement on an item deposited to your account is forged (or that the item contains an alteration), we may charge the item back against your account or place a hold on the funds pending an investigation, without prior notice to you. **Unauthorized Transactions**. If you claim a credit or refund because of an unauthorized transaction, you agree to provide us with a declaration containing whatever reasonable information we require regarding your account, the transaction and the circumstances surrounding the claimed loss. We must receive your declaration within 10 days of our request. You also agree to make a report to the police and to provide us with a copy of the report, upon request. We will have a reasonable period of time to investigate the circumstances surrounding any claimed loss. During our investigation, we will have no obligation to provisionally credit your account, unless otherwise required by law (e.g., in connection with certain consumer electronic fund transfer services).
(p) Limiting Liability	Our maximum liability will never exceed the amount of actual damages proven by you. Our liability will be reduced: (a) by the amount of the loss that is caused by your own negligence or lack of care; (b) to the extent that damages could not have been avoided by our exercise of ordinary care; and (c) by any loss recovery that you obtain from third parties (apportioned in accordance with this provision). We will not be liable for any loss that is caused in part by your negligence if we acted with ordinary care. Unless otherwise required by law, we will not be liable for incidental, special or consequential damages, including loss of profits and/or opportunity, or for attorney's fees incurred by you, even if we were aware of the possibility of such damages. You agree to pursue all rights you may have under any insurance policy you maintain in connection with any loss associated with your account and to provide us with information regarding coverage. Our liability will be reduced, proportionately in accordance with our responsibility for any loss, by the amount of any insurance proceeds you receive or are entitled to receive for the loss. If we reimburse you for a loss and the loss is covered by insurance, you agree to assign us your rights under the insurance policy to the extent of our reimbursement, in accordance with this provision.
(q) Substitute Check – Intro. to Reg. CC Disclosure	**Substitute Checks**. You agree not to deposit substitute checks (described below) or checks bearing a substitute check legal equivalence statement ("*This is a legal copy of your check. You can use it in the same way as you would use the original check.*") to your account without our prior written consent. Unless we agree otherwise in writing, our acceptance of such checks shall not obligate us to accept such items at a later time, and we may cease doing so without prior notice. If we approve the deposit of substitute checks, you agree to indemnify, defend and hold us harmless from all losses, costs, claims, actions, proceedings and attorney's fees that we incur as a

	result of such checks, including without limitation, any indemnity or warranty claim that is made against us because: (a) the check fails to meet the requirements for legal equivalence, (b) a claimant makes a duplicate payment based on the original check, the substitute check, or a paper or electronic copy of either; or (c) a loss is incurred due to the receipt of the substitute check rather than the original check. Upon our request, you agree to provide us promptly with the original check or a copy that accurately reflects all of the information on the front and back of the original check when it was truncated. You agree not to issue checks with features or marks that obscure, alter or impair information on the front or back of a check or that otherwise prevents us or another bank from capturing such information during automated check processing The following notice applies to consumer accounts and supersedes, where inconsistent, other terms in this agreement with respect to substitute checks.
(r) Scams	**Protecting Your Identity**. Never disclose your PIN or password to anyone. Our employees will never ask you for your PIN, and we will not send unsolicited emails to you that request personal information. **Cashing Checks for Others**. Do not use your account to cash checks for others who are not well known to you. Although we may make funds provisionally available to you and may take steps to verify that a check will be paid,[370] you are responsible for any loss that occurs if the check is returned to us for any reason (e.g., because it is counterfeit). Our employees are not authorized to represent that checks drawn on or issued by other institutions will be paid.[371]

[370] *Chino Commercial Bank, N.A. v. Peters*, 190 Cal.App.4th 1164 (2010) (Bank used ordinary care in accepting altered check; ordinary care defined by UCC, rather than common law negligence).

[371] *Advanta Federal Credit Union v. Shupak*, 223 P.2d 863 (Mont. 2009); *Greengerg, Trager & Herbst, LLP v. HSBS Bank USA*, 2011 WL 4834474 (N.Y. 2011) (Bank owed no duty to plaintiffs to detect counterfeit checks; statements that check "cleared" did not support negligence claim).

13. CASHIER'S CHECKS AND OTHER REMITTANCE ITEMS

A financial institution that issues a cashier's check is obligated to pay the check according to its terms[372] to a "person entitled to enforce the instrument."[373] The issuing bank may assert its own defenses in limited circumstances[374] and may refuse to pay the check for someone who does not qualify as a holder in due course.[375] If a bank wrongfully refuses to pay its cashier's check, it may become liable for expenses, loss of interest and consequential damages.[376]

A. Differences Between Various Remittance Items.

(1) Cashier's Check.

- Defined as "a draft with respect to which the drawer and drawee are the same bank or branches of the same bank."[377]
- Although these checks, technically, should be executed by the bank's cashier or chief financial officer, they are often signed by other officers with signing authority.
- May sometimes be referred to as, and may bear the words, "Official Check."
- Note that the purchaser (or "remitter") is not a party to the instrument unless he is named as the payee.
- Considered accepted by the bank upon its issuance (similar to a promissory note in this respect).
- Often regarded, erroneously, as the equivalent of cash (e.g., in terms of whether an obligation has been paid by the remitter – since the bank substitutes its obligation for that of the remitter and cannot offset the instrument for any debt of the remitter).

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372 As to the ability of a bank to impose fees for cashing, *see: NNDJ, Inc. v. National City Bank*, 540 F.Supp.2d 851 (E.D. Mich. 2008) (national banks may impose a fee); *NNDJ, Inc. v. Comerica, Inc.*, 570 F.Supp.2d 940 (E.D. Mich. 2008) (state bank fee violated UCC); *NDNJ, Inc. v. Comerica, Inc.*, 584 F. Supp. 2d 957 (E.D. Michigan. 2008) (state bank may change fee for teller's check); *Murphy v. National City Bank*, 560 F.3d 530 (6th Cir. 2009) (fee may be imposed for teller's check drawn on another institution).

373 UCC § 3412.

374 *EA Management v. JP Morgan Chase Bank*, 67 UCC Rep.2d 818 CE D. Mich. 2008).

375 A bank that accepts a cashier's check for value becomes a holder in due course at that time. If it discovers that the check was obtained from the issuing bank by fraud before it presents the check for payment, that knowledge does not affect its HDC status, and it is entitled to payment. *Southern Bank of Commerce v. Union Planters National Bank*, 67 UCC Rep. Serv. 2d 410 (Ark. 2008).

376 UCC § 3411(b). A bank generally cannot refuse payment based on the defense of its customer. *South Central Bank of Daviess v. Lynnville Nat'l. Bank*, 901 N.E.2d 576 (Ind.App. 2009); *Midamerica Bank, FSB v. Charter One Bank, FSB*, 901 N.E.2d 576 (Ind.App. 2009); *Midamerica Bank, FSB v. Charter One Bank, FSB*, 905 N.E.2d 839 (Ill. 2009).

377 UCC §3104(g). See also 12 USC § 4001(5).

- The statute of limitations is three years after demand for payment is made to the issuer.[378]

- The remitter may not place a stop payment order on the check in connection with a dispute with the payee.[379]

- Unless otherwise agreed, if taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation.[380]

- If lost, stolen or destroyed, the person claiming a right to the item may submit a declaration of loss to the Bank under UCC §3312 and obtain payment 90 days following the date of the item.

- Subject to faster availability under Regulation CC than regular checks. Availability is one business day after the banking day of deposit if deposited in an account held by the payee, delivered in person to an employee of the depository bank, and deposited with a special deposit slip or envelope (if required and provided by the depositary bank).[381]

- The owner of the instrument becomes a "depositor" for FDIC insurance purposes upon its issuance.

- The issuing bank may be liable for consequential damages if it wrongfully refuses to pay its cashier's check.[382]

(2) <u>Personal Money Order</u>.[383]

- There are three parties to a money order: the remitter (payor), the payee, and the drawee (the Bank). The distinction between a personal money order and a check is that the former is frequently issued with the amount preprinted on its face by the drawee. Money orders, unlike regular checks

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378 UCC §§ 4111, 3118(d). Cashier checks are subject to Calif. CCP § 348 (statute of limitations. *Bank of America v. Cranston*, 252 Cal.App.2d 208 (1967).

379 Any defense to payment that the remitter may raise cannot be raised by the bank that issued the check. UCC § 3602. The bank may refuse payment to a person who is not a holder in due course if it has its own defense, however, such as fraud against the bank or the failure of the remitter to pay for the check. UCC § 3411(c)(ii) and § 3305.

380 UCC §3310.

381 12 CFR 229.10(c)(v). See § 229.13 for exceptions. Although funds may be made available to the depositor, they are not considered collected until payment is received from the payor bank at final settlement.

382 UCC § 3411(b).

383 Personal money orders are "checks." UCC § 3104(f). They are not treated like cashier's checks. *Meridian Bank v. Merchants Express Money Order Co.*, 34 UCC Rep Serv 2d 18 (Pa. Ct. Com. Pl., 1997).

are prepaid. Money orders may contain the term "Money Order" on their face.

- Unlike cashier's checks, personal money orders are not signed by a bank officer. The bank is not a direct obligor on personal money orders.

- Most courts treat the bank as merely a drawee or payor bank (like any other customer check) and not liable on the order until it accepts or certifies it.

- Funds behind the order are, presumably, subject to levy.

- The purchaser may place a stop payment order on the order.[384] The Bank also may stop payment of the order if it does not receive payment for the instrument.[385]

- Sometimes referred to as a "one check checking account."

- The statute of limitations is three years after dishonor of the order or 10 years after the date of the draft, whichever period expires first.[386]

- Unless otherwise agreed, if taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken. Suspension of the obligation continues until dishonor of the order or until it is paid. Payment of the order results in discharge of the obligation to the extent of the amount of the order.[387]

- If lost, stolen or destroyed, a person claiming a right to the item may have to submit a bond and/or indemnity agreement to obtain the funds.

- Unlike cashier's checks, bank money orders, and teller's checks, personal money orders are not subject to faster availability under Regulation CC than regular checks.

- Unlike cashier's checks, bank money orders, and teller's checks, the payee of a personal money order does not becomes a "depositor" for FDIC insurance purposes upon the order's issuance or delivery to the payee.[388] Technically, the "deposit" belongs to the drawer, not the payee. Once the

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384 *Garden State Check Cashing Serv. v. First Nat. City Bank* (App. Div. 1966) 267 N.Y.S.2d 698.

385 *Trump Plaza Associates v. Haas*, 692 A2d 86, cert. denied, 697 A2d 547 (NJ 1997).

386 UCC § 3118(c).

387 UCC § 3310(b).

388 See UCC § 3408

check is paid by the Bank, it becomes accountable for the funds and the payee becomes the "depositor" for insurance purposes.

(3) <u>Bank Money Order</u>.

- Not defined by the UCC. Basically, a cashier's check with the words "Money Order" or "Bank Money Order" instead of "Cashier's Check" on its face.

- The functional equivalent of a cashier's check.

- The remitter may not place a stop payment order on the order. The Bank also may not stop payment except under very limited circumstances (e.g., the person presenting the item for payment defrauded the Bank when purchasing the item). If the Bank "wrongfully" refuses to pay the item, it could be liable for consequential damages that far exceed the amount of the item.[389]

- Unless otherwise agreed, if taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation.[390]

- If lost, stolen or destroyed, the person claiming a right to the item may submit a declaration of loss to the Bank and obtain payment 90 days following the date of the item.[391]

- Subject to faster availability under Regulation CC than regular checks.

- The owner of the instrument becomes a "depositor" for FDIC insurance purposes upon its issuance.

(4) <u>Official Check</u>.

- Not defined by the code. The equivalent of a cashier's check.[392] It sometimes meets the definition of a cashier's check, but could be drawn by the bank on another bank (in which case, it would meet the definition of a teller's check).

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389 UCC § 3411.

390 UCC § 3310.

391 UCC § 3312.

392 *Abilities, Inc. v. Citibank, N.A.* (1982) 87 App. Div.2d 831, 449 N.Y.S.2d 242; *Trenarg, C.A. v. Banca Commerciale Italiana* (1977) 90 Misc.2d 829, 396 N.Y.S.2d 761; *Burke v. Mission Bay Yacht Sales* (1963) 214 Cal.App.2d 723, 29 Cal.Rptr. 685.

- The remitter may not place a stop payment order on the check. The Bank also may not stop payment except under very limited circumstances (e.g., the person presenting the item for payment defrauded the Bank when purchasing the item). If the Bank "wrongfully" refuses to pay the item, it could be liable for consequential damages that far exceed the amount of the item.[393]

- Unless otherwise agreed, if taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation.[394]

- If lost, stolen or destroyed, the person claiming a right to the item may submit a declaration of loss to the Bank and obtain payment 90 days following the date of the item.[395]

- Subject to faster availability under Regulation CC than regular checks.

- The owner of the instrument becomes a "depositor" for FDIC insurance purposes upon its issuance.

(5) <u>Teller's Check</u>.

- Defined as "a draft drawn by a bank (1) on another bank, or (2) payable at or through a bank."[396] Under Regulation CC, it is a "check provided to a customer of a bank or acquired from a bank for remittance purposes, that is drawn by the bank, and drawn on another bank or payable-through or at a bank.[397]

- Unlike a cashier's check, a teller's check is not an obligation of the drawee bank prior to its acceptance.

- The statute of limitations is three years after demand for payment is made.

- The remitter may not place a stop payment order on the check. The Bank also may not stop payment except under very limited circumstances (e.g., the person presenting the item for payment defrauded the Bank when purchasing the item). If the Bank "wrongfully" refuses to pay the item, it

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393 UCC § 3411.

394 UCC § 3310.

395 UCC § 3312.

396 UCC § 3104(h)

397 12 CFR § 229.2(gg).

could be liable for consequential damages that far exceed the amount of the item.[398]

- Unless otherwise agreed, if taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation.[399]

- If lost, stolen or destroyed, the person claiming a right to the item may submit a declaration of loss to the Bank and obtain payment 90 days following the date of the item.[400]

- Subject to faster availability under Regulation CC than regular checks.

- The owner of the instrument becomes a "depositor" for FDIC insurance purposes upon its issuance.

- A bank may be liable for consequential damages if it refuses to pay a teller's check.[401]

B. Counterfeits. A bank that pays a counterfeit check which appears to have been issued by it may be liable for its own loss.[402] A depository bank is not required to place a hold on funds deposited by means of a cashier's check.[403]

Disputes typically arise over what bank employees say (or are alleged to say) regarding the status of the deposit. Until final settlement occurs, the risk of non-collection (chargeback)[404] remains with the depositor. A bank may be liable for negligently representing that funds are "good," however, when it really means "available for

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398 UCC § 3411.

399 UCC § 3310.

400 UCC § 3312

401 UCC § 3411.

402 *Northern Trust Co. v. Chase Manhattan Bank*, 582 F. Supp. 1380, aff'd per curium, 748 F.2d 803 (2d Cir. 1984) (depository bank was a holder in due course of a finally paid item). See *Brady on Bank Checks, Revised Edition* §28.11[2] and the UCC Comment to § 3417. For a discussion of risk management involving counterfeit cashier's checks, see OCC Bulletin 2007-2, dated 1/8/07. Cashier's checks are not "unaccepted drafts" for purpose of the UCC § 4208(a) warranty.

403 It does not fail to "mitigate its damages" by immediately releasing funds to its customer. The purpose of Reg. CC is to expedite availability, not to delay it. *South Central Bank of Daviess County v. Kynnville Nat'l. Nat'l Bank*, 901 N.E.2d 576 (Ind.App. 2009).

404 The depository bank must charge back the item by its "midnight deadline or within a longer reasonable time after" it knew of the return or is sent notice of the return. UCC § 4214(a). Note that the right of chargeback is not affected by a "failure by any bank to exercise ordinary care with respect to the item." UCC §4214(d)(2). The fact that the customer uses the funds does not prevent the bank from charging back the item when it is returned. UCC § 4214(d)(1).

withdrawal."[405] Banks should consider a disclosure in their account agreements that can help avoid "he said/she said" disputes over what is discussed about checks. For example:

> **Cashing Checks for Others.** You should not use your account to cash checks for others who are not well known to you. Although we may make funds provisionally available to you and may take steps to determine whether a check will be paid, you are responsible for any loss that occurs if the check is returned to us for any reason (e.g., because it is counterfeit). *Our employees cannot promise that checks drawn on or issued by other institutions, including cashier's checks, will be paid.* (Emphasis added)

C. Lost, Destroyed or Stolen.[406] Purchasers and payees of a cashier's check, teller check, or certified check that was lost, destroyed or stolen may be able to obtain a refund or replacement check under certain circumstances by filing a declaration of loss with the bank.[407] See the next page for a sample declaration.

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[405] *Valley Bank of Ronan v. Hughes*, 147 P.3d 185 (Mont. 2006)(bank employee referred to official checks as the "same as cash" and said "the checks would be good"); *Call v. Ellenville National Bank*, 774 N.Y.S.2d 76 (N.Y App. Div. 2004)(bank's representation that check "cleared" is not enough to find against bank).

[406] *John Deere Co. v. Boelus State Bank*, 448 N.W.2d 163(Neb. 1989)(Bank was liable to a holder in due course who took a stolen cashier's check for value in good faith. Although the stolen check was signed by only one bank employee [bank policy required two signatures], it appeared regular on its face).

[407] See UCC § 3312 for details.

Claim For Refund After 90 Days
(Cashier's or Bank Check)

Name of Claimant		
Claimant's Address		Telephone No.
Check Type: [ ] Cashier's Check [ ] Bank Check		Claimant is the: [ ] Purchaser [ ] Payee of Check
Check No.	Date Issued	Amount (**Exact** Dollars and Cents)
Name of Payee		

Declaration of Loss and Claim For Payment

I declare under penalty of perjury under the laws of the State of California that the following is true and correct with respect to the check described above:

1. The information set forth above is correct.
2. I am the purchaser or payee of the check.
3. I lost possession of the check.
4. I did not lose possession of the check as a result of a lawful seizure or by transferring it to someone else.
5. I cannot reasonably obtain possession of the check because (a) it was destroyed, (b) its whereabouts cannot be determined, or (c) it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

Please pay me the amount of the check when my claim becomes enforceable. I understand that:

6. **This is a claim for funds, NOT a stop payment order. My claim will not become enforceable until the <u>later</u> of (i) the date you receive my written claim, or (ii) the 90th day following the date of the check. Until then my claim has no legal effect, and the check may be honored if presented for payment.**

7. My claim may not be effective if I fail to provide you with complete and accurate information. You also may refuse to honor this claim if I fail to show you reasonable identification upon request.

8. If you honor this claim and the check is later presented to you for payment by a person having rights of a holder in due course, I am obliged to (i) refund the payment to you if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

_____ Date: _____

Signature of Claimant

Bank Use Only
Claim Rec'd by_____ on ___/___/___ at _____ __.m.
Claimant ID: Drv. Lic. No._____; Other ID:_____
Claim paid by _____ on ___/___/___ (Must be at least 90 days after date of check)

On occasion, a bank may be willing to accept and act upon a stop payment order for cashier's checks (e.g., when the claimant provides the bank with a bond or the bank believes the check has been destroyed and is willing to risk paying its customer before the end of the 90-day period described above. The following procedure describes how this practice might be described.

SAMPLE PROCEDURE

Cashier's Check – Stop Payment Orders and Claims for Refund

I. Summary. The Bank has two procedures for dealing with cashier's checks that are lost, stolen or destroyed:

(1) Claims for Refund. A purchaser or payee of a cashier's check may be able to claim a refund from the Bank 90 days after the cashier's check has been issued if the claimant completes a "Claim for Refund after 90 Days" (Form _____), confirming that:

- the claimant lost possession of the check;
- the claimant did not lose possession of the check as a result of a lawful seizure or by transferring it to someone else; and
- the claimant cannot reasonably obtain possession of it because it was destroyed, lost, or in the wrongful possession of someone who is unknown, cannot be found or is not amenable to service of process.

This procedure is **NOT** a stop payment order, and the Bank may have to pay the check if it is presented to it for payment by a person entitled to enforce the check prior to the date the Claim for Refund becomes enforceable (i.e., 90 days after the check was issued).

(2) Stop Payment Orders. Although cashier's checks generally are not subject to stop payment orders, the Bank may agree under certain limited circumstances to stop their payment if:

- the claimant completes the Bank's "Stop Payment Request" (Form ____);
- the claimant agrees to reimburse the Bank if the Bank pays the check for someone it believes (correctly or otherwise) is entitled to enforce the check;
- the claimant indemnifies the Bank and, if requested by the Bank, provides a bond to protect the Bank from claims; and
- 90 days have passed since the check was issued (unless the Bank waives this requirement based on the strength of the customer's indemnity or a bond).

All stop payment orders must be approved in advance by _____.

A stop payment order should never be taken in situations where the check has been delivered to the payee and the purchaser simply wants to stop its payment due to a dispute. The Bank may be liable for consequential damages if it wrongfully refuses to pay its cashier's checks.

II. Claim for Refund After 90 Days (Form _____).

Purchasers and payees of lost, stolen or destroyed cashier's checks may be able to claim a refund 90 days following the issuance of the check. To obtain a refund, a claimant must complete Form _____ ("Claim For Refund After 90 Days"), describing the check with reasonable certainty. This procedure may only be used if the claimant can confirm the following three facts:

1. The claimant is the purchaser or payee of the check;

2. The claimant lost possession of the check other than as a result of a transfer by the claimant or a lawful seizure; and

3. The claimant cannot reasonably regain possession of the check because (i) it was destroyed, (ii) its whereabouts cannot be determined, or (iii) it is in the wrongful possession of someone who is unknown, cannot be found or is not amenable to service of process.

Once 90 days have passed from the date the check was issued, the Bank may pay the claimant the amount of the check, assuming the check hasn't already been paid to a person entitled to enforce its payment.

> **Note: This is not a stop payment order;** it is simply a claim for reimbursement. If the check is presented to the Bank for payment prior to the time the claim becomes enforceable (i.e., the date the claim is received or 90 days following the date the check was issued, whichever is later), the claim has no legal effect.

Until the claim becomes enforceable, the Bank must honor the check for anyone entitled to enforce its payment (e.g., the payee or a depositary bank, assuming the Bank is not aware of a forgery or alteration). Payment to a person entitled to enforce the check relieves the Bank from any further responsibility to the claimant. If another claim is made to the check during the 90-day period, contact _____ for instructions.

If the claim becomes enforceable and the Bank pays the claimant (i.e., after 90 days), the Bank does not have to pay the check for another person, even if it is later presented by a holder in due course.

> **Note:** If the Bank pays the claimant (after the 90 days) and later mistakenly pays the amount again to a holder in due course, the claimant is obligated by law to return the amount to the Bank.

III. Stop Payment Request (Form ____)

Cashier's checks generally are not subject to stop payment orders. The reason for this is that the Bank is directly responsible for the item if it is presented for payment by a holder in due course. This holds true whether or not the check has been lost, stolen or is the subject of a dispute between the purchaser and payee.

> **Note:** The Bank may refuse to honor its cashier's checks for persons who are not holders in due course (e.g., where the payee acquired the item through fraud from the Bank or paid for the item with an NSF check). If presented for payment by such persons, mark the check "Payment Stopped" — to prevent anyone else from becoming a holder in due course of the check.

If a purchaser or payee of a cashier's check claims that the check has been lost, stolen or destroyed, the Bank will stop payment on the check only under the following circumstances:

1. Person Making the Request. The person requesting the stop payment must be the

purchaser (if the item was never received by the payee) or the payee (if the payee or its agent received the check).

2. Use of Form. The party making the request must complete Form ____, "Stop Payment Request". Do not use the Bank's usual stop payment form for customer checks, Form ____. Do not use Form ____ ("Claim For Refund After 90 Days") unless the customer qualifies for a refund under the terms of that form and can wait 90 days from the date the check was issued before receiving payment.

(a) Part 1. Part 1 of Form _____ must always be completed. If (a) the amount in question is relatively small (e.g., under $500), (b) the check has not been endorsed by the payee or made payable to bearer, (c) the person making the request is creditworthy, and (d) the circumstances warrant, only Part 1 of the form needs to be completed.

(b) Part 2. The other party to the check (the remitter if the payee is placing the stop payment order, or the payee if the remitter is placing the order) must complete Part 2 of the form, confirming that the check has been lost, stolen or destroyed. The signature should be notarized if it is not signed in the presence of a Bank employee who has confirmed the identity of the signer.

(c) Part 3. If the person placing the order is not sufficiently creditworthy to support the indemnification of Part 1, the indemnification of a third party acceptable to the Bank may be taken by completing Part 3.

(d) Part 4. If (a) the amount in question is significant, (b) the financial strength of the party indemnifying the Bank is insufficient and/or (c) the circumstances otherwise warrant (e.g., the stolen check was payable to "Bearer"), complete Part 4 of the form. The amount of the bond and its duration should take into consideration that the Bank may be liable for consequential damages for refusing to pay its check. Factors that should be considered:

- the likelihood that the check may later be presented for payment;
- whether the check was made payable to "Bearer," was received by the payee, or was endorsed by the payee;
- the amount involved ($500 vs. $500,000);
- the amount of time which has elapsed [Note: persons who present checks more than 90 days after their issuance do not qualify as holders in due course. As such, it is safer for the Bank to accept a stop payment order after 90 days have passed];
- whether the customer can obtain a "Lost Instrument Bond," as opposed to the more expensive "Indemnity Bond";
- the likelihood for consequential damages;
- whether the check was lost, stolen or destroyed; and
- the credit-worthiness of the person(s) requesting the stop payment or

indemnifying the institution.

3. Approval. The Branch Manager must approve the stop payment request.

4. Timing of Reimbursement. Follow *[cite to procedure manual]* to place the stop payment. Do not pay the amount of the item to the person placing the stop payment order until the latest of:

- The completion of Form _____.
- The Bank's receipt and approval of any required bond or third-party indemnity.
- A minimum of 30 days following the issuance of the check if it is alleged to have been lost or destroyed (the period should be increased up to 90 days for large items, unless a bond is obtained or the indemnifying party is capable of paying consequential damage claims asserted against the Bank).
- 60 days following the issuance of the check if it was stolen, but not payable to bearer or endorsed by the payee. (This may be shortened to 30 days if a bond is obtained).
- 90 days following the issuance of any check over $500 if it is stolen or lost and has been endorsed by the payee or made payable to "Bearer" (unless a bond is obtained, in which case it may be shortened to 30 days).

5. Presentment of Original Cashier's Check. If a stop payment order is placed on a check, contact _____ immediately if the check is later presented for payment.

D. Alterations. The warranty against alterations applicable to regular checks (i.e., "unaccepted drafts")[408] does not apply to cashier's checks.[409] As such, the party presenting an altered cashier's check does not warrant the signature of the issuing bank or the amount of the check (both of which should already be known to the issuing bank).[410] However, persons who obtain payment for cashier's checks (and prior transferors) do warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a "person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item."[411]

E. Stopping Payment. An issuing bank generally may not stop payment of its own cashier's check (e.g., at the request of the remitter).[412] The bank may assert its own

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408 UCC § 4208(a)((2).

409 See UCC Comment 4 to § 3417 (referenced in the UCC Comment to § 4208).

410 *Northern Trust Co. v. Chase Manhattan Bank*, 582 F. Supp. 1380, aff'd per curium, 748 F2d 803 (2d Cir. 1984). See *Brady on Bank Checks: The Law of Bank Checks* (2010) ¶ 28.11[2].

411 Defined at UCC § 4208(d). Arguably, a thief who alters the payee name may not be a "holder" for § 1201(b)(21) purposes (i.e., a person in possession of the negotiable instrument that is payable either to a bearer or, to an identified person that is the person in possession). According to *Brady on Bank Checks:* Revised Edition, ¶ 27.06, when an alteration consists of "removing the name of the payee and substituting the name of another person as payee, there can be no holder in due course unless the original payee has indorsed the instrument. The indorsement of the substituted payee, even if it is his genuine signature, is actually a forgery of the payee's indorsement; and no subsequent acquirer of the instrument can be a holder of any kind without the original payee's indorsement." See the UCC Comment 2 to § 3417 ("... a warranty that there are no unauthorized or missing indorsements").

412 UCC §§ 3305(c) and 3602. UCC § 4403 provides that a customer may only stop payment on an item drawn on the customer's account. A bank may pay a cashier's check over a stop payment received from a customer who led the bank to believe the check was still in the

defense to payment, however, such as the fraud of the remitter/payee.[413]

If a bank wrongfully refuses to pay its cashier's check, the person asserting the right to enforce the check[414] is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the bank continues its refusal after receiving notice of particular circumstances giving rise to the damages.[415] Expenses and consequential damages are not recoverable if the refusal occurs because: (a) the bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available; (b) the bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the check,[416] or (c) payment is prohibited by law.

Stop payment orders should be rare, especially for larger checks. The next two pages show a sample stop payment form that might be used for cashier's checks. See the procedure described in the preceding section regarding how the form should be completed and used.

customer's possession and would be returned to the bank. *Weldon v. Trust Co. Bank of Columbus, N.A.*, 35 UCC Rep Serv2d 1291 (Ga. App. 1998); *Seman v. First State Bank of Eden Prairie*, 394 N.W.2d 557 (1986).

413 UCC § 3411(c)(ii). The bank cannot refuse payment if the check is presented by a holder in due course, however, even if the remitter has committed fraud or failed to pay for the cashier's check. *Flatiron Linen, Inc. v. First American State Bank*, 23 P.3d 1209 (Colo. 2001)(bank must pay cashier's check to third party even though purchased with a bad check); *Godat v. Mercantile Bank of Northwest County*, 884 S.W.2d 1 (Mo. App. 1994)(bank could not stop payment unless claimant was not a holder in due course because he gave no value); *Genter and Company, Inc. v. Wells Fargo Bank*, 90 Cal.Rptr.2d 904 (Cal. App. 1999)(bank erroneously issued cashier's check in exchange for a check whose payment had been stopped; payee was a holder in due course; but see commentary 2 to UCC 3418 regarding situations where the holder of the check does not qualify as a holder in due course); *National City Bank v. Citizens National Bank of Southwest Ohio*, 55 UCC Rep. Serv.2d 233 (Ohio App. 2004)(bank could not stop payment of cashier's check to third party even though paid with a bad check that was part of a check kite); *Carriages, Inc. v. International Bank of Commerce*, 37 S.W.3d 69 (Tex. App. 2000)(bank's refusal to cash check payable to corporation was not "wrongful"). Charging a fee to cash a cashier's check for a non-customer may be considered a wrongful dishonor *(NNDJ, Inc. v. Comerica, Inc*., 570 F.Supp.2d 940 (E.D. Mich, 2008), but see *NNDJ, Inc. v.. National City Bank*, 540 F.Supp.2d 851 (E.D. Mich. 2008). A bank that is forced to honor its cashier's check may be subrogated to the rights of the remitter against the payee under UCC § 4407(c). *Stringfellow v. First American National Bank*, 878 S.W.2d 940 (1994). A bank that takes an assignment of a claim against an issuing bank from someone who is not a holder in due course cannot qualify for HIDC status. MidAmerica Bank, FSB v. Charter One Bank, FSB, 889 N.E.2d 1187 (Ill. 2008)(bank charged back the amount against its customer's account and sued the issuing bank; customer was not a holder in due course).

414 This may include the remitter if (s)he has not yet delivered the check to the named payee. UCC § 3301.

415 UCC § 3411.

416 See UCC § 3301 for the definition of "person entitled to enforce." *Associated Carriages, Inc. v. International Bank of Commerce*, 43 UCC Rep.2d 489 (Tex. Ct. App. 2000) (Bank refused to cash check payable to a corporation when presented by an individual; bank could not determine his authority to act).

STOP PAYMENT REQUEST
(Lost, Stolen or Destroyed Cashier's Check)

NAME OF PURCHASER		TELEPHONE NO.
PURCHASER'S ADDRESS		
NAME OF PAYEE		TELEPHONE NO.
PAYEE'S ADDRESS		
CHECK NO.	DATE ISSUED	AMOUNT (STATE EXACT DOLLARS AND CENTS)

Please Read Before Completing Form

Stop Payment Request. Cashier's checks generally are not subject to stop payment orders. If we agree to stop payment on a Cashier's check, it is with the understanding that: (1) we may still honor it if it is it is presented to us by someone we believe (correctly or otherwise) is entitled to enforce it; (2) we may require you to provide us with an indemnification or a bond which protects us; and (3) we may delay paying you the amount of the item for upwards of 90 days following the date the check was issued.

Alternate Claim Procedure. A purchaser or payee of a Cashier's check may be able to claim a refund 90 days after its issuance under certain circumstances (Commercial Code §3312). You can make a claim under this procedure if: (1) you lost possession of the check; (2) you did not lose possession of the check as a result of a lawful seizure or by transferring it to someone else; and (3) you cannot reasonably obtain possession of it because it was destroyed, lost, or in the wrongful possession of someone who is unknown, cannot be found or is not amenable to service of process. This alternate procedure is **NOT** a stop payment order, and we may pay the check if it is presented to us for payment prior to the date the claim for refund becomes enforceable. Please speak with us if you want further information regarding this procedure.

Instructions. Please complete the following parts of this form:

[X] Part 1—Request
[ ] Part 2—Second Party Statement
[ ] Part 3—Indemnification by Third Party
[ ] Part 4—Bond

1

Request: I am the □ purchaser □ payee of the check described on the reverse side. Please stop payment on the check and pay me the amount of the item. I understand that the Bank may delay making payment for up to 90 days following the date of the check if it agrees to stop its payment.

Reason: The check was □ lost □ stolen □ destroyed under the following circumstances:

_____

_____

_____

Payee Information: The check □ was □ was not received by the payee(s). The check □ was □ was not endorsed by the payee(s).

Representations: I am the sole owner of the check and am not aware of any claim to the check or its proceeds by others. I am entitled to the proceeds of the check and am authorized to make this request. I agree to return the original check to the Bank if it comes into my possession or under my control. I also agree to notify the Bank immediately if I learn any information regarding the whereabouts of the check.

Indemnification: I agree to indemnify, defend and hold the Bank and its employees harmless from all claims, demands, actions, proceedings, losses, damages and costs (including attorneys' fees) which relate to or arise out of its stopping payment on the check or otherwise acting in accordance with this request.

Effective Date: I understand that this stop payment request may not be acted upon until the Bank receives the signature of the Second Party (below), any required indemnification by third parties and satisfactory evidence of any required bond. **I agree that the Bank will not be responsible for failing to stop payment on the check if my description of the check is incomplete or incorrect in any respect.**

Rights of Holders: I understand that the Bank may not stop payment on the check if it is presented to the Bank by a person it believes (correctly or incorrectly) is entitled to enforce payment. I also understand that anyone holding the check, including the Bank, may be entitled to enforce payment of the check despite this stop payment request. I agree that the Bank may pay the check if it is endorsed by the payee (or is otherwise negotiable) and presented to the Bank by someone whom it believes to be a holder in due course, notwithstanding (a) the existence of any indemnification or bond given by me, or (b) my payment of any fee in connection with this request. If the Bank makes payment to someone it believes is a holder in due course, I agree to pay the Bank the amount of the check. If I fail to pay the Bank the amount of the check upon request, I agree that the Bank may, to extent permitted by law, charge any account I maintain with it for that amount.

I (we) declare under penalty of perjury under the laws of the State of California that the foregoing is true and complete.

_____ _____
SIGNATURE DATE

2 **Second Party's Statement:** I declare under penalty of perjury that: I am the ☐ purchaser ☐ payee of the check described on the reverse; the check is not in my possession or under my control; I believe it to be lost, stolen or destroyed and agree to return it immediately to the Bank it if ever comes into my possession or under my control; and I have read the information set forth on this form and believe (to the best of my knowledge) that it is complete and correct.

_____ _____
SIGNATURE DATE

[NOTE: Please have your signature notarized if this is not signed in the presence of a Bank employee.]

3 **Indemnification by Third Party:** I/We agree to indemnify, defend and hold the Bank and its employees harmless from all claims, demands, actions, proceedings, losses, damages and costs (including attorneys' fees) which relate to or arise out of the Bank's actions in stopping payment on the check or otherwise acting in accordance with the foregoing request. I/we have received valid consideration for this agreement from the person making the stop payment request.

_____ Phone: _____
SIGNATURE(S)

ADDRESS: _____

4 **Bond:** I agree to provide the Bank with an indemnity bond, a surety bond or a lost instruments bond, issued by a company and in a form and on terms acceptable to the Bank, for an amount not less than $_____ and a duration of at least __ years within _____ days. The Bank may refuse to stop payment on the check until it receives evidence of the bond. I agree to reimburse the Bank for any loss or damage it incurs if it pays the check to someone it believes to be a holder in due course if the bond terminates, is cancelled or is not honored for any reason whatsoever.

_____ _____
SIGNATURE DATE

BANK USE ONLY

Request Received ___/___/___ at _____ __.m. by _____ Second Party's Stmt. Rec'd. ___/___/___ at _____ __.m. by _____

Indemnification Received ___/___/___ at _____ __.m. by _____ Bond Received ____/____/____ at _____ __.m. by _____

Stop Payment Placed ___/___/___ at _____ __.m. by _____ Approved by Manager _____ on ___/___/___

NOTE: **Do not: (a) accept telephone requests; (b) approve a request if the check is not lost, stolen or destroyed (e.g., where it is merely subject to a dispute); or (c) use this form in place of a "Claim for Refund After 90 Days" (if applicable) unless the customer wishes to stop payment on the item and/or receive the funds earlier than the 90-day claim period.**

14. DEFINITIONS

Alteration	An unauthorized change in a check that purports to modify in any respect the obligation of a party. An unauthorized addition of words or numbers or other change to an incomplete check relating to the obligation of a party. UCC § 3407(a).
Bank	A bank, savings bank, savings and loan, credit union, or trust company. UCC §§ 1201(b)(4) and 4105(1)
Banking Day	The part of a day on which a bank is open to the public for carrying on substantially all of its banking functions. UCC § 4104(a)(3)
Blank Endorsement	The signature of the holder on the back of a check without other words. When endorsed in blank, a check becomes payable to bearer and may be negotiated by transfer of possession alone until specially endorsed. UCC § 3205(b)
Cashier's Check	A draft where the drawer and drawee are the same bank. UCC § 3105(g)
Check	A draft (other than a documentary draft) that is payable on demand and drawn on a bank. Cashier's checks, teller's checks and demand drafts are checks. UCC § 3104(f)
Collecting Bank	A bank handling a check for collection, but not including the payor bank. UCC § 4105(5)
Contradictory Terms	If a check contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers. UCC § 3114
Customer	A person having an account with a bank or for whom a bank has agreed to collect checks, including a bank that maintains an account with another bank. UCC § 4104(a)(5)
Demand Draft	A check that is not signed by a customer that is created by a third party under the purported authority of the customer for the purpose of charging the customer's account with the bank. Demand drafts must contain the customer's printed or typewritten name, a notation that the customer authorized the draft, and a statement such as "No Signature Required." Demand drafts do not include drafts purportedly drawn by a fiduciary. UCC § 3104(k).
Depositary Bank	The bank that takes a check for deposit or collection. UCC § 4105(2)
Documentary Draft	A draft to be presented for acceptance or payment if specified documents, securities, statements, certificates, or the like are to be received by the drawee or other payor before acceptance or payment of the draft. UCC § 4105(a)(6)
Draft	An order to pay money. A check is a draft (other than a documentary draft). UCC § 3104(e)
Drawee	The person ordered to pay the check. Also referred to as the "payor bank."
Drawer	The person who signs the check. Also referred to as the "maker" or

"issuer." UCC § 3103(a)(3)

Encoding Warranty — A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. UCC § 4209

Fiduciary — An agent, trustee, partner, corporate officer or director, LLC manager, or other representative owing a fiduciary duty with respect to a check. UCC § 3307(a)(1)

Final Payment — A check is finally paid by a payor bank when it has: (a) paid the check in cash; (b) settled for the check without having a right to revoke the settlement under statute, clearing house rule, or agreement; or (c) made a provisional settlement for the check and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule, or agreement. UCC § 4215

Forgery — An unauthorized signature. UCC § 3403(a)

Good Faith — Honesty in fact and the observance of reasonable commercial standards of fair dealing. UCC § 1201(b)(20)

Holder — A person in possession of a check if it is payable to bearer or, in the case of a check payable to an identified person, if the identified person is in possession. UCC § 1201(b)(21)

Holder in Due Course — A holder of a check is an HDC if both of the following apply: (1) the check when issued or negotiated to the holder did not bear such apparent evidence of forgery or alteration or was not so irregular or incomplete as to call into question its authenticity; and (2) the holder took the check (a) for value, (b) in good faith, (c) without notice that the instrument was overdue [note: for a check, this is 90 days after its date per UCC § 3304(a)(2)] or has been dishonored or that there is an uncured default with respect to the payment of another instrument issued as part of the same series, (d) without notice that it contains an unauthorized signature or has been altered, (e) without notice of any claim to the check under UCC § 3306, and (f) without notice that any party has a defense or claim in recoupment. UCC § 3302

Endorser — The person who signs the back of the check (not the person who signs as the maker on the front). UCC § 3204

Intermediary Bank — A bank to which a check is transferred in the course of collection, but not including the depositary or payor bank. UCC § 4105(4)

Item — An instrument or a promise or order to pay money handled by a bank for collection or payment (e.g., a check). It does not include a wire transfer order or a debit or credit card slip. UCC § 4104(a)(9)

Knowledge — Notice, 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 his or her attention if the organization had exercised due diligence. 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. UCC § 1202
Late Return	A check (whether or not properly payable) that is returned after the bank's midnight deadline. UCC § 4302
Maker	The person who signs the front of the check -- who undertakes to pay the check. UCC § 3103(a)(5)
Midnight Deadline	Midnight of the next banking day following the banking day on which a bank receives a check. UCC § 4105(a)(10)
Negotiable Instrument	An unconditional promise or order to pay a fixed amount of money that: (a) is payable to bearer or to order at the time it is issued or first comes into the possession of a holder; (b) is payable on demand or at a definite time; and (c) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money (with some exceptions). UCC § 3104(a)
Notice	A person "notifies" or "gives" a notice to another by taking those steps that may be reasonably required to inform the other in the ordinary course whether or not the other actually comes to know of it. A person "receives" a notice if: (1) it comes to his or her attention; or (2) it is duly delivered at the place designated for such communications. UCC § 1202. See "Knowledge."
Ordinary Care	The observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that processes checks by automated means, reasonable commercial standards do not require the bank to examine checks if the failure to do so does not violate its internal procedures and those procedures "do not vary unreasonably from general banking usage." UCC § 3103(a)(7)
Payable At Bank	The bank identified on a check as a collecting bank at which a check may be presented, but which is not authorized by the check to pay the item. UCC § 4106(b)
Payable Through Bank	The bank identified on a check as the collecting bank (but not as the payor bank) through which the check may be presented. UCC § 4106(a)
Payee	The person to whom a check is payable.
Payor Bank	The drawee of a check. The bank upon which a check is drawn. UCC § 4105(3)
Person Entitled to Enforce	This term includes: (a) the holder of a check, (b) a non-holder of a check who has the rights of a holder, and (c) a person not in possession of a check who is entitled to enforce it pursuant to certain provisions of the UCC. A person may be a person entitled to enforce the check even though the person is not the owner of the check or is in wrongful possession of it. UCC § 3301
Postdated Check	A check that bears a date later than the date it is drawn. UCC § 3113
Presenting Bank	The bank that presents a check to the payor bank for payment, but not the payor bank itself. UCC § 4105(6)

Presentment	A demand to pay a check made by or on behalf of a person entitled to enforce a check to the drawee or a party obliged to pay the check. UCC § 3501(a)
Presentment Warranties	The person presenting a check to the drawee for payment (and any previous transferor) warrants the following as of the time of transfer: (1) the warrantor is or was, at the time of transfer, a person entitled to enforce the draft or authorized to obtain payment on behalf of another person entitled to enforce the check; (2) the check has not been altered; and (3) the warrantor has no knowledge that the signature of the purported drawer of the check is unauthorized. In California, the warrantor also warrants that, if the check is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as the drawer. UCC § 4208
Send	To deposit in the mail or deliver for transmission by any of the usual means of communication. UCC § 1201(b)(36)
Signed	Includes using any symbol executed or adopted with the present intention to adopt or accept a writing. UCC § 1201(b)(37)
Remitter	The person who purchases an instrument (e.g., cashier's check) from its issuer if the instrument is payable to someone other than the remitter. UCC § 3103(a)(11)
Special Endorsement	If an endorsement is made by the holder of a check, whether payable to an identified person or payable to a bearer, and the endorsement identifies a person to whom it makes the instrument payable, it is a "special endorsement." UCC § 3205(a)
Stale Dated Check	A check which is presented more than 6 months after its date. UCC § 4404
Statute of Limitations	The time within which an action to enforce an obligation, duty, or right must be commenced. UCC §§ 4111 and 3118
Teller's Check	A draft drawn by a bank on another bank or payable at or through a bank. UCC § 3104(h)
Transfer Warranties	Customers and collecting banks that transfer items make five warranties to the transferee and any subsequent collecting bank: (1) the warrantor is a person entitled to enforce the item (i.e., there are no forged or missing indorsements); (2) all signatures on the item are authentic and authorized; (3) the item has not been altered; (4) the item is not subject to a defense or claim in recoupment of any party that can be asserted against the warrantor; and (5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer. In California, the warrantor also warrants that, if the item is a demand draft, creation of the item according to the terms on its face was authorized by the person identified as the drawer. UCC § 4207
Transferor	Someone who transfers a check (e.g., a depositor).
Traveler's Check	An instrument that is payable on demand, is drawn on or payable at or through a bank, contains "traveler's check" (or a similar term) on its face, and requires a countersignature by a person whose specimen signature appears on the instrument. UCC § 3104(j)

Unaccepted Draft	A check (as used in UCC § 4208)
Warranties	Representations made by the person presenting or transferring a check. UCC §§ 3416, 3417, 4207 and 4208. Warranty by depositary bank to collecting banks, payor bank and drawer. UCC § 4205. Warranty by person who encodes information on check. UCC § 4209

15. UCC INDEX

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