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Understanding the Legal Issues of Endorsements

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What Is a "Negotiable Instrument"?

UCC 3-104 (a)

Unconditional promise to pay fixed amount of money that: (a) is payable to bearer or to order at time it is issued or first comes into possession of a holder; (b) is payable on demand or at definite time; and (c) does not state any undertaking or instruction to do any act in addition to paying the money, but promise may contain an undertaking or power to "give, maintain, or protect collateral to secure payment."

Types of Instruments - Checks

Check – An "order" (also known as a "draft"). An "order" is a written instruction to pay money signed by person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. UCC §3-103(a)(8).

A check is draft payable on demand and drawn on a bank, including a cashier's check or teller's check, and also including a substitute check. A draft may be a check even though it is described on its face by another term, such as "money order," if it is drawn on a bank. UCC §3-104(f).

- **Cashier's check** - a draft where the drawer and drawee are the same bank or branches of the same bank. UCC §3-104(g).
- **Teller's check** - a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank. UCC §3-104(h).

Types of Instruments - Notes

Note – An instrument that it is a promise to pay, but is not an "order," meaning it is not an instruction to pay someone. UCC §3-104(e).

A "promise" is a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation. UCC §3-103(a)(12).

Holder

- The person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession. UCC §1-201(b)(21).

Negotiation

Transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder. UCC §3-201(a).

If an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder.

If an instrument is payable to bearer, it may be negotiated by transfer of possession alone. UCC §3-201(b).



Who Is Who?

- **Customer** - A person having an account with a bank.
- **Drawer** - A person drawing a check on a bank.
- **Payee** – A person to whom or to whose order a check is made payable.
- **Drawee or Payor Bank** - Bank on which a check is drawn or by which it is payable.
- **Depository Bank** - First bank in which a check is deposited for collection and includes a bank that cashes a check. May also be the payor bank, if the check is drawn on or payable by the depositary bank.
- **Collecting Bank** - Any bank handling a check for collection. May include depositary bank, but not payor bank.

Other Basics

A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office, or account number. UCC 3-110(c).

If an instrument is payable to an identified person, negotiation requires **transfer of possession** of the instrument and its **indorsement by the holder**. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone. UCC 3-201(b).

Who May Enforce?

Section 3-301 provides three ways in which a person is entitled to enforce an instrument:

a) A person who qualifies as holder of the instrument;
b) A person who is a non-holder in possession of the instrument, but with the rights of a holder; or
c) A person is attempting to enforce a lost, stolen or destroyed instrument.

What Is a Holder?

A person qualifies as a ***holder*** if that person is in possession of original instrument, and either: (a) instrument is payable to that person; or (b) instrument is payable to bearer. UCC1-201(b)(21)(A)

Requires examination of instrument and any indorsements.

Party to whom an instrument is made payable can be changed by indorsements.



Indorsements

A "signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of negotiating the instrument, restricting payment of the instrument or incurring indorser's liability on the instrument." UCC 3-204(a). "A signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement." *Id*. In determining whether a signature is made on an instrument, a paper affixed to instrument is a part of it. An indorsement generally appears on the back of the check.

Indorser

An indorser is a person making an indorsement. UCC 3-204(b).

Wrong Name?

If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection. UCC 3-204(d).

Definition of "Signature"

- "Any symbol executed or adopted with present intention to adopt or accept a writing." UCC 1-201(b)(37), Official Comment 37
- Complete signature is not necessary.
- May be printed, stamped or written; it may be by initials or by thumbprint.
- May be on any part of the document.
- "No catalog of possible situations can be complete, and the court must use common sense and commercial experience in passing upon these matters."
- Question is whether symbol was executed or adopted by party with present intention to adopt or accept the writing.

Special Indorsement

Section 3-205(a) provides for a special indorsement, which "identifies a person to whom it makes the instrument payable." Thus, when specially endorsed, "an instrument becomes payable to identified person and may be negotiated only by the indorsement of that person." Id.

Example – Pay To Order of Eric Hurwitz, /s/ Michelle Badolato

Blank Indorsement

- Indorsement that is not a special indorsement is a "blank indorsement." UCC 3-205(b).
- "When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed." Id.
- Example - /s/ Michelle Badolato
- Holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable. UCC 3-205(c).

Restrictive Indorsement

- Indorsement attempting to limit payment to particular person or prohibiting further transfer or negotiation of instrument.
- Not effective to prevent further transfer or negotiation of instrument. UCC 3-206(a) (an indorsement that purports to limit further transfer or negotiation is ineffective to prevent further transfer or negotiation). *Id*., Official Comment 2.
- Example – Pay Only to Eric Hurwitz; No One Else May Enforce, /s/ Michelle Badolato

Joint Payees

- If instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. UCC 3-110(d)
- If instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them.
- If instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.
- If check lacks an endorsement of one of the joint payees, or if the endorsement of one of the joint payees is forged or unauthorized, there is a forged or unauthorized endorsement for purposes of the UCC.

“For Deposit” and “For Collection”

If instrument bears an indorsement using words “for deposit,” “for collection” or other words indicating a purpose of having instrument collected by a bank for the indorser or for a particular account, depositary bank or the payor bank, if it takes check for immediate payment over counter, must act consistently with the indorsement. UCC 3-206(c) and Official Comment 3.



Unauthorized Endorsement

A forged or unauthorized endorsement is made without the express, implied or apparent authority of the person whose name is signed and includes a forgery. See UCC §1-201(b)(41).

Unauthorized Signatures

An unauthorized signature is ineffective, except as the signature of the unauthorized signer in favor of a person who in **good faith** pays the **instrument** or takes it for value. An unauthorized signature may be ratified for all purposes of this Article. UCC 3-403(a).

Under UCC 3-403(b), if the signature of more than one person is required to constitute the authorized signature of an **organization**, the signature of the organization is unauthorized if one of the required signatures is lacking.

> Example: The resolutions of ABC Corporation on file with the payor bank require a check to be signed by two officers. A check is signed by only one officer and is paid by the payor bank. The signature of ABC Corporation on the check is unauthorized.

Dow City Cemetery Ass'n v. Defiance State Bank, 596 N.W.2d 77, 38 U.C.C. Rep. Serv. 2d 1267 (Iowa 1999) (check as to which account agreement required two signatures bore unauthorized signature where only one of two signatures was authorized).

"Organization"

- Definition of "organization" in Section 1-201(25) is broad.
- Covers not only commercial entities but also "two or more persons having a joint or common interest."
- Hence, UCC 3-403(b) would apply when a husband and wife are both required to sign an instrument.

Failure to Deny Authentic Signature

In an action with respect to an instrument, authenticity of, and authority to make, each signature on the instrument ***is admitted*** unless specifically denied in pleadings. If validity of a signature is denied in pleadings, burden of establishing validity is on person claiming validity, but signature is presumed to be authentic and authorized ***unless*** action is to enforce liability of the purported signer and signer is dead or incompetent at the time of trial of the issue of validity of the signature. UCC 3-308 *See also PHH Mortgage Corp. v. Powell*, No. 1899 WDA 2013, 2014 Pa. Super 197 (Sept. 10, 2014) (granting summary judgment in favor of servicer where borrower failed to come forward with evidence to rebut the presumption of a valid signature).



General Rules

Section 3-110(c)(2) states rules for determining identity of person to whom an instrument is initially payable if instrument is payable to an identified person. Official Comment 1.

If an instrument is payable to:

(i) a trust, an estate or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative, or a successor of either, whether or not the beneficiary or estate is also named.

General Rules, cont'd

(ii) a person described as agent or similar representative of a named or identified person, the instrument is payable to represented person, representative, or a successor of the representative.

(a) Example - Under subsection (c)(2)(ii), if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument.

(iii) a fund or organization that is not a legal entity, instrument is payable to representative of members of fund or organization. This subsection concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of members of the organization can act as holder.

General Rules cont'd

(iv) an office or to a person described as holding an office, instrument is payable to named person, incumbent of office, or a successor to incumbent.

This subsection applies principally to instruments payable to public offices such as a check payable to County Tax Collector. UCC-3-110, Official Comment 3.

Enforcement of Instrument vs. Owner of Proceeds

These rules merely determine who can deal with an instrument as a holder.

They do ***not*** determine ownership of the instrument or its proceeds.

The owner of a note or check may be different than the holder.

Owner – person ultimately entitled to proceeds of funds.

Holder – who can enforce the instrument.

Breach of Fiduciary Duty

UCC § 3-307 governs misappropriation of checks by agents, partners, corporate officers, and "other representative[s] owing a fiduciary duty." 3-307(a)(1).

Applied when someone takes an instrument from a fiduciary and has "knowledge of the fiduciary status of the fiduciary." Section 3-307 also interacts with 3-404, 3-405, and 3-406 in various situations, such as where the embezzling person is a corporate employee.

a. 3-307 applies where a check is made payable to, e.g., an "individual, as trustee" or an "individual, as agent of X Corp." 3-307(b)(2).

Breach of Fiduciary Duty, cont'd

b. 3-307 also applies where a check made payable to a trust is indorsed by the trustee and deposited into the trustee's own personal account, or in payment of a personal debt, or for use in a transaction known by the taker to be for the personal benefit of the trustee. *Id.*
c. 3-307(b)(3) applies where the check is made payment to the trustee or agent personably. The case is not covered by 3-404 or 3-405 because the trustee or agent is the payee, signs his own name and does not forge the indorsement.
d. If the check is made payable to a corporation and is indorsed by an employee, then any fraud would fall within 3-405, as well as 3-307(b)(2).
e. 3-404 applies where the employee or trustee makes a check which is payable to a fictitious payee, and the employee or trustee indorses the fictitious payee's name and his own and deposits it in his personal account.

Breach of Fiduciary Duty, cont'd

f. 3-307(b)(2) applies where the check is made payable to the corporation or the trust, the employee or agent forges the indorsement and receives the proceeds. Section 3-404 will apply if the embezzler formed the intent to steal the check before it was written. If on the other hand, the embezzler formed the intention to steal the check only after they had been properly written, then 3-405 might apply. Section 3-406 might apply to either.
g. Where there is a fraudulent indorsement by an employee, the fraud falls within 3-405, as well as 3-307(b)(2)

Breach of Fiduciary Duty, cont'd

One who has knowledge specified in 3-307(b) has notice of a "claim" and fails to be a holder in due course (3-302). Such a person will be "subject to" that and other "claims." 3-306.

The drawee of the check can assert a claim for restitution against the depository bank. However, if the depository bank took the check with knowledge pursuant to 3-307, then the depository bank cannot claim in good faith under 3-418(c) that it took the instrument in good faith and for value.

The drawee does not appear to have a warranty claim under 4-208(a) because the check has not been altered, and the signature of the drawer is authorized



Overview

- An allonge is another form of affixing an indorsement, most commonly to promissory notes. UCC § 3-204(a).
- An allonge is an additional page physically attached to the instrument.
- "For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument." *Id.*
- An indorsement on an allonge is valid even though there is sufficient space on the instrument for an indorsement. *Id.*, Official Comment 1.

Must Be Physically Attached

"The allonge which was presented, however, was not affixed to the note, but rather was a separate sheet of paper, clipped to the note by a paper clip. Since the purported allonge was not firmly affixed to the note so as to become a part of the note, it is insufficient to make the note a negotiable instrument. Thus, ownership of this note could not be transferred by mere delivery. The delivery to Plaintiff would have to have been accompanied by an indorsement made on the face of the note, or an allonge actually securely affixed to the note." *HSBC Bank USA Nat. Ass'n v. Roumiantseva*, 2013 WL 2500829, at *6-7 (N.Y. Sup. Ct. June 11, 2013). Most courts find that allonge must be actually attached to the instrument, meaning "some form of physical connection securing the paper to the instrument." *See Wells Fargo Bank*, *N.A. v. Settoon*, 2013 WL 2476563, at *3 (La. Ct. App. June 7, 2013).

Attachment, cont.

- The term “firmly” affixed has however been removed from revised version of section 3-204 of the UCC.
- *Christiana Trust, a Division of Wilmington Savings Fund Society FSB for Normandy Mortgage Loan Trust, Series 2013-9 v. Barth, 93 U.C.C. Rep. Serv. 2d 244* (Ohio Ct. App. 9th Dist. Lorain County 2017) (the fact that an allonge is attached by a paperclip rather than a staple has no effect on the validity of the indorsement)



General Rules

- 31 CFR 240.1 *et seq*. prescribe the requirements for indorsements and condition for payment of checks drawn on the United States Treasury. Treasury checks must be indorsed by the named payee or by another on behalf of such named payee. 31 CFR 240.13(a).

Treasury Checks - Proper Indorsements

(i) Check is indorsed by payee in a form recognized by general principles of law and commercial usage for negotiation, transfer or collection of negotiable instruments.

(ii) Check is indorsed by another on behalf of named payee, and sufficiently indicates that indorser has indorsed check on behalf of payee pursuant to authority expressly conferred by or under law or other regulation. Example -- "John Jones by Mary Jones." This example states the minimum indication acceptable. However, §§ 240.14, 240.15, and 240.17(f) specify the addition of an indication in specified situations of the actual capacity in which the person other than the named payee is indorsing.

(iii) Absent a signature, the check is indorsed "for collection" or "for deposit only to the credit of the within named payee or payees." The presenting bank shall be deemed to guarantee good title to checks without signatures to all subsequent indorsers and to Treasury.

(iv) The check is indorsed by a financial institution under the payee's authorization. 31 CFR 240.13(b)(1).

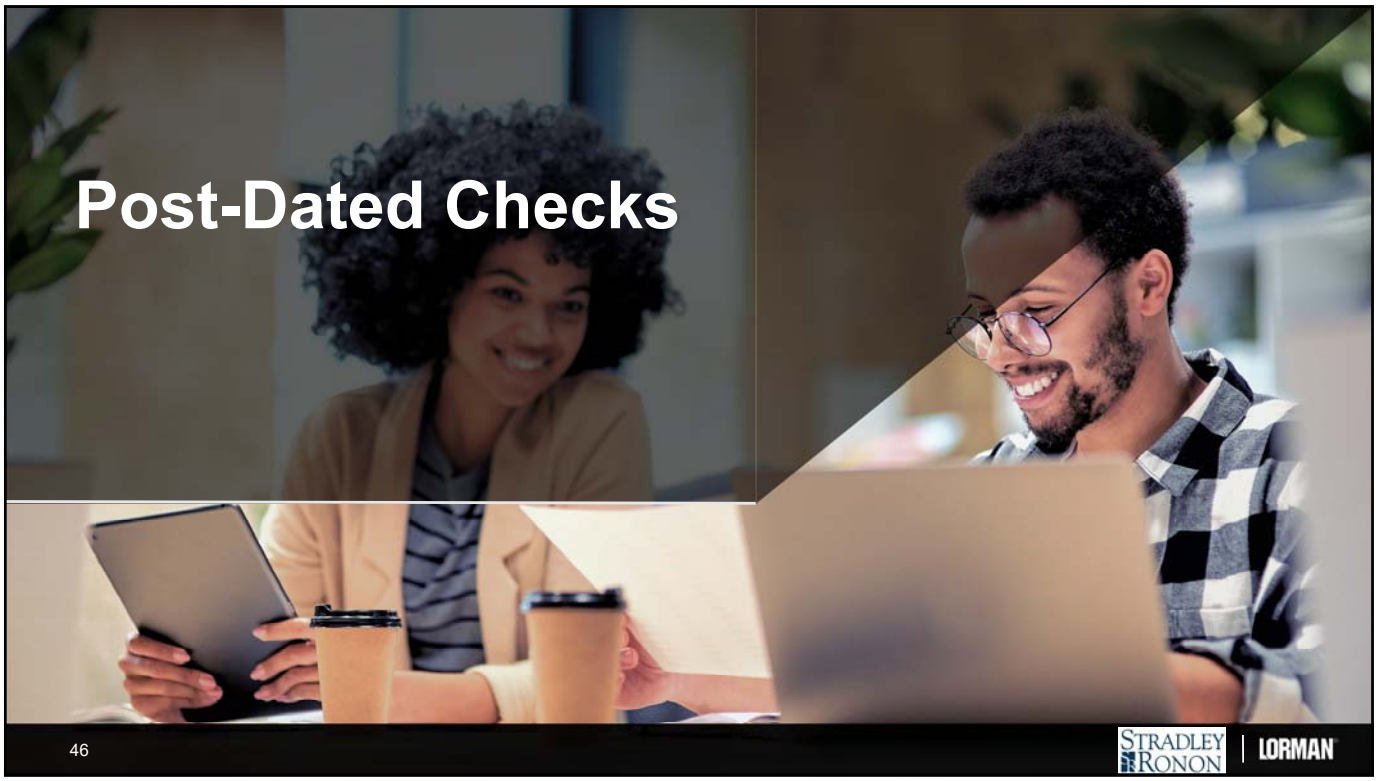
Indorsement by Duly Authorized Fiduciary or Representative

Individual or institution accepting a check from a person other than the named payee is responsible for determining whether such person is authorized and has the capacity to indorse and negotiate the check. Evidence of the basis for such a determination may be required by Treasury in the event of a dispute. 31 CFR 240.13(b)(2).

31 CFR 240.14 - .16 govern individual requirements for Treasury checks issued to incompetent payees, deceased payees, and minor payees.

No Private Right of Action

31 C.F.R. § 240.1 does not provide a federal private cause of action. *See Harris v. United States*, No. 15-1026C, 2016 WL 6427661, at *5 (Fed. Cl. Oct. 31, 2016), reconsideration denied, No. 15-1026C, 2016 WL 7330560 (Fed. Cl. Dec. 16, 2016); and Hamburg v. *Santander Bank*, N.A., No. CV 16-5142, 2016 WL 7404482, at *2 (E.D. Pa. Dec. 21, 2016).



General Rule

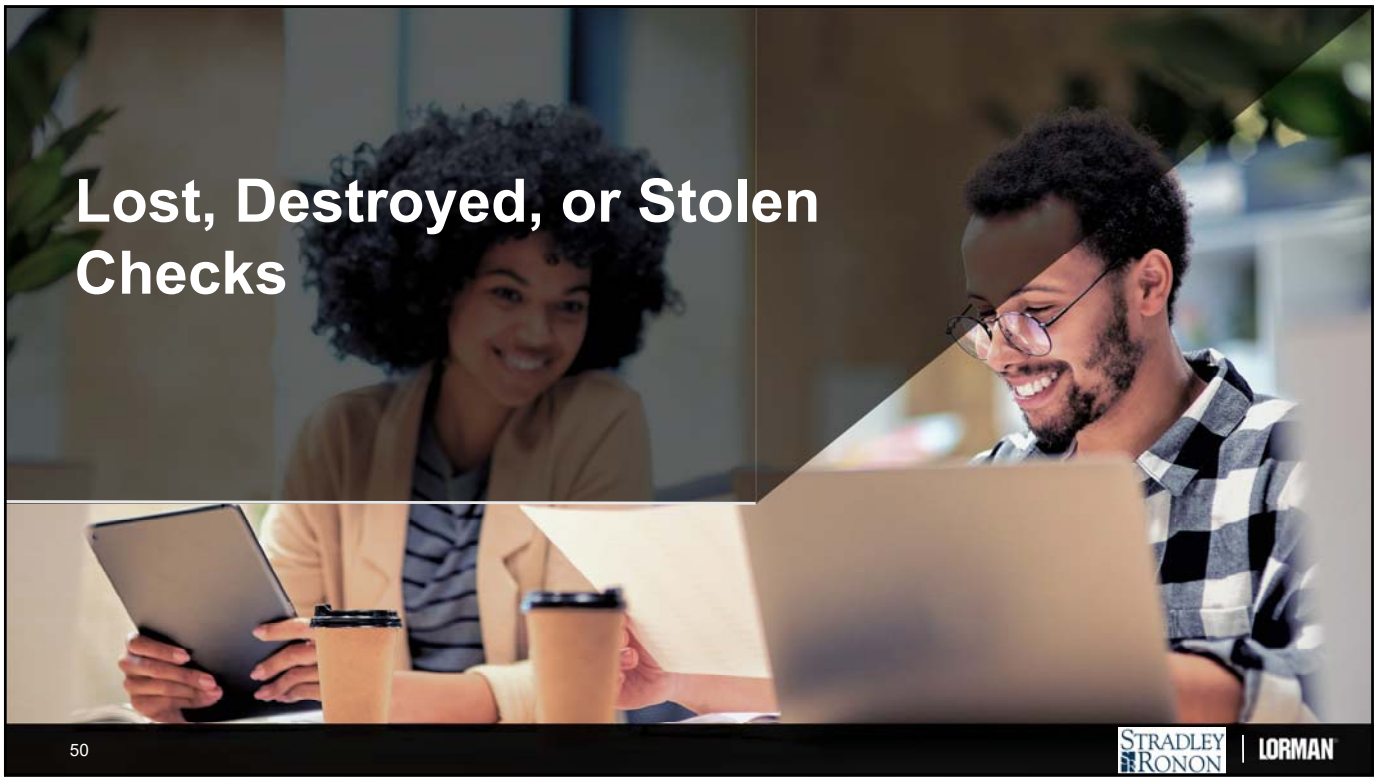
Bank may charge against account of a customer a check that is otherwise properly payable from the account, even though payment was made before the date of the check, ***unless*** the customer has given notice to the bank of the postdating describing the check with reasonable certainty. UCC § 4-401(c).

Remedies

If a bank charges against the account of a customer a check before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. UCC § 4-401(c)

Timing of Notice

The notice is effective for six months, as set forth in UCC § 4-403(b) for stop-payment orders and must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it before the bank takes any action with respect to the check.



Requirements

- Person may enforce lost or destroyed instrument when “person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or 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.” UCC § 3-309(a)(3).
- Person seeking to enforce must also demonstrate terms of instrument and that person was formerly in possession of instrument, entitled to enforce it when loss of possession occurred, and loss of possession was the not result of a “transfer” or a lawful seizure.
- Many states have specific statutes that specifically define what a party must demonstrate to satisfy this category.

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Cashier's, Teller, and Certified Checks

Person may also enforce a lost, destroyed or stolen cashier's check, teller's check or certified check. UCC § 3-312. "A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check, (ii) the communication contains or is accompanied by a declaration of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration." UCC § 3-312(b).



Liability

Liability of drawer. If payee's endorsement is forged before check is delivered to payee, underlying obligation of drawer to payee is not discharged by the check, and payee can require drawer to pay obligation a second time. UCC §3-310, Official Comment 4 ("If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the check has not been paid.")

Liability of payor bank. A forged or unauthorized endorsement of payee is ineffective as payee's endorsement. UCC §3-403(a). Consequently, a check bearing a forged or unauthorized endorsement is not "properly payable" and drawee or payor bank may not charge amount of check against drawer's account. UCC §4-401(a).

Liability, cont'd

- Drawee or payor bank is liable to drawer even though it may have acted in good faith and exercised ordinary care.
- Generally, liability of drawee or payor bank to drawer will be the amount of the check.

Example

John Jones draws a check payable to the order of Bob Bell. Before the check is delivered to Bob Bell, it is stolen. The thief forges the endorsement of Bob Bell on the back of the check and presents the check directly to the payor bank for payment. The payor bank pays the check.

The payor bank is liable to John Jones for the amount of the check.

Claim of Payor Bank Against Collecting Bank

- A drawee or payor bank that pays a check bearing a forged endorsement may recover proceeds of check from a prior collecting bank (including the depositary bank) or other person taking check or receiving payment.
- Breach of warranty of "entitlement" -- prior collecting bank (including depositary bank) or other person taking a check and receiving payment warrants to drawee or payor bank that it was entitled to enforce check or authorized to obtain payment on behalf of a person entitled to enforce the check. UCC §§3-417(a)(1) and 4-208(a)(1).
- Applies even if prior collecting bank has not endorsed check or guaranteed prior endorsements. [Regulation CC of the Federal Reserve Board provides that a guaranty of prior endorsement is unnecessary and is discouraged.]

Payor Bank Rights

- Rules apply even though the prior collecting bank was not negligent and exercised ordinary care.
- Also applies even though the drawee or payor bank may have failed to exercise ordinary care and was negligent, so long as the drawee or payor bank acted in good faith - *i.e.*, with honesty in fact and in accordance with reasonable commercial standards of fair dealing. UCC §§3-417(b) and 4-208(b).
- Drawee or payor bank may recover not only proceeds of check but also "expenses and loss of interest" - which may include attorneys' fees according to some courts and commentators. UCC §§3-417(b) and 4-208(b).

Example

A thief steals a check and forges the endorsement of the payee. The thief cashes the check at the depositary bank, which presents the check to the payor bank for payment. The payor bank pays the check. The payor bank is liable to the drawer for the amount of the check and recredits the drawer's account. The payor bank may recover the amount of the check from the depositary bank for breach of the warranty of "entitlement."

Timing of Warranty Claim

- Drawee or payor bank must make a claim for breach of warranty based on a forged endorsement within 30 days after it has reason to know of the breach.
- If drawee or payor bank fails to make a claim within 30 days, prior collecting banks will be discharged from liability to extent of any loss caused by delay. UCC §§3-417(e) and 4-208(e).
- For example, if a payor bank delays making claim on a forged endorsement, and person committing forgery is able to withdraw proceeds of the check from prior collecting bank during delay, prior collecting bank will be discharged from liability to the extent of withdrawn proceeds.

Drawer's Negligence

When drawee or payor bank brings a claim for breach of warranty based on a forged endorsement, prior collecting bank may defend by proving that drawer's negligence substantially contributed to forged endorsement and, therefore, that drawer could not recover from the drawee or payor bank. UCC §§3-417(c) and 4-208(c).

Other Defenses

When a drawee or payor bank brings a claim for breach of warranty based on a forged endorsement, a prior collecting bank (including the depositary bank) may defend by proving that endorsement is effective under the "imposter" and "fictitious payee" rules (and related rules) of the UCC. UCC §§3-417(c) and 4-208(c).

Thus, drawee or payor bank cannot waive defenses that it has against the drawer (on checks bearing a forged endorsement) and simply reimburse the drawer and bring suit against a prior collecting bank for breach of warranty.

Claim of Collecting Bank Against Depositary Bank

- Where a collecting bank is liable to the drawee or payor bank on a check bearing a forged endorsement, collecting bank may recover amount of the check from depositary bank or another prior collecting bank or other party transferring the check.
- The theory of recovery also is breach of warranty. UCC §§3-416 and 4-207.
- Ultimately, the loss resulting from the forged endorsement comes to rest with the party dealing with the forger, typically, the depositary bank

Example

- A thief steals a check and forges the payee's endorsement. The thief cashes the check at the depositary bank. The depositary bank sends the check to a collecting bank, which presents the check to the payor bank for payment. The payor bank pays the check. The payor bank is liable to the drawer for the amount of the check and recredits the drawer's account. The payor bank may recover the amount of the check from the depositary bank or the collecting bank. If the payor bank recovers from the collecting bank, the collecting bank may recover from the depositary bank

When Drawer Sues Payor Bank

- When drawer of a check bearing a forged endorsement seeks recovery from drawee or payor bank, drawee or payor bank can give notice to depositary or other collecting bank or join depositary or other collecting bank as a third-party defendant. UCC §3-119.
- The person notified may then give similar notice to any other person who is answerable over.
- If notice states that person notified may come in and defend and that failure to do so will bind person notified in an action later brought by person giving the notice, person notified is so bound unless after seasonable receipt of the notice person notified does come in and defend. *Id.*

Claim Of Drawer Against Depositary Bank

- Drawer of a check bearing a forged endorsement sometimes seeks direct recovery against depositary bank rather than drawee or payor bank.
- Drawer of a check bearing a forged endorsement should have no direct action for conversion against the depositary bank. UCC 3-417, Official Comment 2.
- A warranty of presentment is available only to a drawee against a depositary bank. *Innovative Hosp. Sys., L.L.C. v. Abe's Inc*., 2010 WL 4961809 (La. App. 3 Cir. December 2010).

But See

Some courts have held that drawer has a direct right of action against depositary bank accepting checks on forged endorsements of the payees when the drawer has obtained assignments from the payor bank of its claims against the depositary bank. *See, e.g., Progressive Cas. Ins. Co. v. PNC Bank*, N.A., 73 F. Supp. 2d 485, 489 (E.D. Pa. 1999) ("It is not settled law in Pennsylvania that a drawer cannot state a negligence claim against a depository bank. Courts in other jurisdictions are split on the matter.") citing *Wymore State Bank v. Johnson International Co*., 873 F.2d 1082, 1087 (8th Cir. 1989) (holding that a drawer may sue a depository bank).

Defenses - Negligence

- If drawer is negligent and negligence substantially contributes to forged endorsement, the drawee or payor bank has no liability to drawer. UCC §3-406(a).
- For example, drawee or payor bank may escape liability where drawer follows careless office procedures, which enable someone to steal checks drawn by drawer and forge endorsements of payees.
- If the drawee or payor bank fails to act in good faith - *i.e.*, if it fails to act with honesty in fact and in accordance with reasonable commercial standards of fair dealing - it remains liable to the drawer, notwithstanding negligence on the part of the drawer. UCC §3-406(a).

Comparative Fault

- If drawee or payor bank fails to exercise ordinary care and such failure substantially contributes to loss, loss is allocated between drawer and the drawee or payor bank based on comparative negligence. UCC §3-406(b).
- Burden is on drawer to establish that drawee or payor bank failed to exercise ordinary care. UCC §3-406(c).

More Defenses

Ratification. If drawer ratifies a forged endorsement, drawee or payor bank has no liability to drawer. UCC §3-403(a).

Statute of limitations. UCC requires drawer to exercise reasonable promptness to examine bank statements or canceled checks and to report forged drawer's signatures which drawer should reasonably have discovered. This rule does not apply, however, to discovery and reporting of forged endorsements, and UCC has no provision imposing any duty on the drawer to look for forged endorsements. UCC does contain, however, a statute of limitations of three years after accrual of cause of action of a drawer against drawee or payor bank for payment of check with a forged endorsement. UCC §4-111. Should bar a claim by drawer against drawee or payor bank more than three years after payment of check bearing a forged endorsement.

Checks Payable in Blank or to Cash

If check is drawn payable to order of "cash" or in blank, no endorsement is necessary to negotiate check and, therefore, a forged endorsement will result in no liability to the payor bank

(a)Example: A check is drawn payable to the order of "cash". A thief steals the check and forges the endorsement of a third person (Bob Bell) on the back of the check. The payor bank pays the check. The drawer has no claim against the payor bank. Since the check was payable to "cash" or to bearer, no endorsement by Bob Bell was necessary to negotiate the check.

(b)Compare: A check is drawn payable to the order of John Jones. John Jones specially endorses the check to the order of Bob Bell. A thief steals the check and forges the endorsement of Sam Smith on the back of the check. The payor bank pays the check. The drawer may recover the amount of the check from the payor bank. Since the check was specially endorsed to the order of Bob Bell, a valid endorsement of Bob Bell was necessary to negotiate the check.

Imposter Rule

- If imposter induces a drawer to issue a check to him or a confederate, an endorsement by any person in the name of the named payee is an effective endorsement. UCC §3-404(a). The impersonation may be face-to-face, by mail, or otherwise
- Known as "imposter" rule and relieves bank from liability so long as it acts in good faith.
- Example - Imposter represents that he is Bob Bell and, by impersonation, induces John Jones to issue a check to him payable to the order of Bob Bell. An endorsement by imposter or any other person in the name of Bob Bell (the named payee) will be an effective endorsement. John Jones will have no claim against the payor bank or any collecting bank.

More Imposter Rule

- Imposter rule applies not only in cases involving impersonation, but also in cases involving impersonation of another's agent. UCC §3-404, Comment 1.
- Example: Imposter impersonates Bob Bell, the president of ABC Corporation, and induces John Jones to issue a check payable to the order of ABC Corporation. An endorsement by the imposter or any other person in the name of ABC Corporation (the named payee) will be an effective endorsement. John Jones will have no claim against the payor bank or any collecting bank
- However, if bank failed to exercise ordinary care and such failure substantially contributed to the loss -- *e.g.*, depositary bank opens an account in name of the impersonated payee without obtaining proper identification, and wrongdoer deposits check into account and withdraws the proceeds -- the drawer may shift the loss back to the bank to the extent that the bank's failure contributed to the loss. UCC §3-404(d).

Fictitious Payee Rule

- If person signing a check as or in the name or on behalf of drawer intends the payee to have no interest in the check, or if the payee is a fictitious person, an endorsement by ***any person*** in the name of the named payee will be an effective endorsement. UCC §3-404(b).
- Relieves the bank from liability so long as it acts in good faith.
- Rule applies not only where named payee is fictitious, but also where named payee is a real person but person signing check as or in the name or on behalf of the drawer intends that person to have no interest in the check.

Example

A treasurer of the drawer signs checks payable to the order of ABC Corporation. ABC Corporation is a non-existing corporation. The treasurer delivers the check to a confederate, who endorses the check in the name of ABC Corporation and deposits the check into a deposit account opened by the confederate in the name of ABC Corporation at the depositary bank. The payor bank pays the check. The endorsement in the name of ABC Corporation is an effective endorsement, and the drawer has no claim against the payor bank or the depositary bank.

Fictitious Payee Defense

Rule applies even though drawer was not negligent. However, if bank failed to exercise ordinary care and such failure substantially contributed to the loss -- *e.g.*, depositary bank opens an account in the name of fictitious payee without obtaining proper identification, and wrongdoer deposits check into account and withdraws proceeds -- the drawer may shift the loss back to the bank to the extent that the bank's failure contributed to the loss. UCC §3-404(d).

More Fictitious Payee

Rule also applies whether or not person signing as, or in the name or on behalf of the drawer, is an authorized signer of the drawer.

Example - A thief steals blank checks of XYZ Corporation, forges the signature of an authorized signer of XYZ Corporation, makes the check payable to ABC Corporation, and endorses the check in the name of ABC Corporation. The endorsement of ABC Corporation is an effective endorsement. [The check bears, however, a forged signature of XYZ Corporation or, in other words, a forged drawer's signature.]

Responsible Employee

- If employer entrusts an employee with responsibility with respect to checks - *e.g.*, to sign checks or to prepare checks for issue in the name of the employer - and the employee or a confederate of the employee forges the endorsement of the payee on a check issued by the employer, the endorsement will be an effective endorsement if it is made in the name of the payee. UCC §3-405(b).
- Known as the "expanded fictitious payee" rule and relieves bank from liability so long as it acts in good faith.
- Example: An employee of the drawer prepares payroll for the drawer's treasurer with additional names on the payroll (both real and fictitious). The treasurer signs checks payable to the additional persons named on the payroll. The employee obtains the checks and endorses the checks in the names of the additional persons. The endorsements in the names of the additional persons will be effective endorsements and the drawer will have no claim against the payor bank.

Responsible Employee, Take Two

- This applies even though drawer was not negligent. However, if bank failed to exercise ordinary care and such failure substantially contributed to the loss, drawer may shift the loss back to the bank to the extent that bank's failure contributed to the loss. UCC §3-405(b).
- Rule applies only where employee has been entrusted by employer with "responsibility" with respect to checks. UCC §3-405(a).
- Where employee has not been entrusted with responsibility with respect to checks, bank may still be able to avoid liability by establishing that employer was negligent -- *e.g.*, followed careless office procedures and that such negligence substantially contributed to the forged endorsement made by the employer. UCC §3-406(a).

Rights of Payee Against Drawer

- If payee's endorsement is forged before check is delivered to payee, the underlying obligation of drawer to payee is not discharged and payee can require the drawer to pay a second time.
- The drawer, in turn, can recover amount of the check from drawee or payor bank, which in turn can recover from the prior collecting banks (including the depositary bank).
- The payee, however, cannot obtain recovery from the drawee or payor bank, or the depositary or other collecting bank, because it did not receive delivery of the check.

Conversion – Payee vs. Payor Bank

- When payee does not seek a second payment from drawer - because payee's endorsement was forged after check had been delivered to payee - payee often seeks recovery from the drawee or payor bank.
- Theory is "conversion" of the check owned by the payee. The measure of liability is presumed to be the face amount of the check. UCC §3-420(b).
- If the drawee or payor bank reimburses the payee, the drawee or payor bank may in turn recover from the depositary or other collecting banks for breach of their warranties of "entitlement."
- Example: A thief steals a check from the payee and forges the payee's endorsement. The thief cashes the check at the depositary bank, which presents the check to the payor bank for payment. The payor bank pays the check. The payor bank is liable in conversion to the payee for the amount of the check. The payor bank may recover the amount of the check from the depositary bank for breach of the warranty of "entitlement."

Negligence of Payee

- Recovery by the payee against the drawee or payor bank or against the depositary or other collecting bank will be denied where payee is negligent, and the negligence substantially contributes to the forged endorsement. UCC §3-406(a).
- For example, a bank may be able to escape liability when payee was negligent on supervising the activities of the employee who makes the forged endorsements.
- Example: ABC Corporation uses a signature stamp to sign checks made payable to it. The stamp is routinely left on a desk and unlocked. A janitor steals the stamp and uses it to endorse checks, which he then deposits into his own account. Neither the drawee or payor bank, or the depositary or other collecting bank, are liable to ABC Corporation.

Comparative Fault

- If bank fails to act in good faith - *i.e.*, if it fails to act with honesty in fact and in accordance with reasonable commercial standards of fair dealing - the payee may recover from bank, notwithstanding any negligence on part of payee.
- If bank fails to exercise ordinary care - *i.e.*, if it also is negligent - and such failure contributes to the loss, loss is allocated between payee and bank based on comparative negligence. UCC §3-406(b). The burden is upon payee to establish that bank failed to exercise ordinary care. UCC §3-406(c).
- Example: John Jones draws a check payable to the order of ABC Corporation. An employee of ABC Corporation obtains the check and, with-out authority, endorses the check on behalf of ABC Corporation. The employee deposits the check into his personal account at the depositary bank. By allowing a check payable to the order of a corporation to be deposited into a personal account, the depositary bank may have acted negligently, so that the loss is allocated between ABC Corporation (assuming ABC Corporation was negligent) and the depository bank based on their relative degrees of fault.

Responsible Employee, Deja Vu

- Recovery by payee against drawee or payor bank or against depositary or other collecting bank will be denied where the forged endorsement is made by certain employees of the payee.
- If an employer entrusts an employee with responsibility with respect to checks - *e.g.*, to sign or endorse checks, to deposit checks, etc. - and if the employee or a confederate of the employee forges the endorsement of the employer on a check, the endorsement will be an effective endorsement if the endorsement is made in the name of the employer. UCC §3-405(b).
- Example: The bookkeeper of ABC Corporation is responsible for posting checks payable to the ABC Corporation against the accounts of customers of ABC Corporation. The bookkeeper steals a check payable to ABC Corporation, forges the endorsement of ABC Corporation, and deposits the check in an account in the name of ABC Corporation. The endorsement is an effective endorsement of ABC Corporation, and no bank handling the check is liable in conversion to ABC Corporation.

More on Responsible Employee

- An endorsement is made in the name of the employer if it is made in a name substantially similar to the name of the employer, or if the check, whether or not endorsed, is deposited in a depositary bank in an account in a name substantially similar to the name of the employer. UCC §3-405(c).
- If, however, bank fails to exercise ordinary care and such failure substantially contributed to the loss, employer may shift the loss to the bank to the extent that the bank's failure contributed to the loss. UCC §3-405(b).
- Effect of this rule is to shift losses due to forged endorsements by responsible employees, from banks to employers.

Rights of Payee, cont'd

Ratification. Recovery by the payee against the drawee or payor bank or against the depositary or other collecting bank will be denied where the payee has ratified the forgery. UCC §3-403(a).

Statute of limitations. Recovery by the payee against the drawee payor bank or against the depository or other collecting bank may be barred by the statute of limitation. The applicable statute of limitations is three years. UCC §3-118(g). The statute begins to run when the check is paid and is not subject to the discovery rule exception.

The End!

THANK YOU!



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