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## Checking in and Cashing out: Cashier's Check Fraud, Depository Liability and Proposed Solutions

### I. INTRODUCTION

Cashier's checks are utilized by con-artists to defraud gullible consumers who accept these checks as payment for a product or service.<sup>1</sup> The depositor is instructed to keep part of the check's amount as compensation, and to wire the remainder outside of the country.<sup>2</sup> The original cashier's check is returned to the payee bank when found to be counterfeit, and the full amount of the check is charged back to the depositor's account.<sup>3</sup> The net result is a loss for the consumer in the amount of money wired to the con-artist and the value of the product or service for which he did not receive any payment.<sup>4</sup> If the fraudster cannot be found and held accountable for the funds, the Uniform Commercial Code (UCC) explicitly places any liability for the fraudulent cashier's check on the depositor.<sup>5</sup>

Yet, what if prior to wiring the funds out of the country, the depositor recognized the possibility of risk, and first made an inquiry with the bank's staff regarding the propriety of the instrument he deposited? What if, even after being assured by an officer of the depository bank as to the availability of funds represented by the cashier's check, the depositor again asks a different officer to confirm what the first had said and is again assured of this impending availability? Who then should bear the liability of the fraudulent check?

The point of contention here concerns the underlying difference between funds made available, and funds actually

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1. See *OCC Issues Special Bulletin on Fraudulent Cashier's Checks*, 15 CLARK'S BANK DEPOSITS AND PAYMENTS MONTHLY #9, Feb. 2007, at 2.

2. *Id.* at 3.

3. *Id.*

4. *Id.*

5. U.C.C. § 4-201 (2005).

collected, by the depository bank.<sup>6</sup> Under the Expedited Funds Availability Act (EFAA),<sup>7</sup> funds are first made available to the depositor, but are not considered collected until payment is received from the payor bank at final settlement.<sup>8</sup> This creates the present liability conundrum because the UCC mandates that liability remain with the depositor, not the depository bank, until final settlement is made.<sup>9</sup> The question then becomes whether the bank should bear a portion of the loss where the depositor, as well as the bank teller, are confused about this distinction between available funds and collected funds, and if not, whether the bank should have an affirmative duty to advise the depositor about these differences.

On November 8, 2006, the Montana Supreme Court decided in *Valley Bank of Ronan v. Hughes*<sup>10</sup> that despite the UCC, a bank could bear some liability for negligently misrepresenting the status of funds to their customers.<sup>11</sup> Part II of this Note provides an overview of how cashier's checks function, details the various fraud scenarios employed by scam artists, and lists some of the reasons fraud has increased in recent years.<sup>12</sup> The relationship between the depositor and the depository bank under the UCC is examined in Part III.<sup>13</sup> Part IV analyzes *Valley Bank* and the cases the *Valley Bank* court relied upon in reaching its conclusion.<sup>14</sup> Part V looks at the consequences of the *Valley Bank* decision for banks and consumers.<sup>15</sup> Possible solutions to the liability problem exposed by *Valley Bank* are explored in Part VI.<sup>16</sup>

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6. See *Bank Liability for Misrepresenting that a Check is "Good,"* 15 CLARK'S BANK DEPOSITS AND PAYMENTS MONTHLY #10, Mar. 2007, at 3-4.

7. 12 C.F.R. § 229.10 (2007).

8. *Id.* Final settlement occurs when the depository bank receives payment from the payee bank for an item, relieving the depositor of the liability that he carries when there has only been a provisional settlement, which is that between the depositor and the depository bank. See 12 C.F.R. § 229 app. E (2007).

9. U.C.C. § 4-201 cmt. 6 (2005) (noting that Section 4-201 recognizes the "prima facie status of most banks as agents" who will generally not be liable for the actions of their depositor-principle).

10. 147 P.3d 185 (Mont. 2006).

11. See *id.* at 193.

12. See *infra* Part II.

13. See *infra* Part III.

14. See *infra* Part IV.

15. See *infra* Part V.

16. See *infra* Part VI.

This Note ultimately concludes that a bank-imposed education program is the best means of preventing the confusion associated with available versus collected funds.<sup>17</sup>

## II. AN OVERVIEW OF CASHIER'S CHECK FRAUD AND COMMON FRAUD SCENARIOS

### A. *Cashier's Checks – Common Practice*

A cashier's check is one "issued by a bank, and sold to its customer" to be payable to a third party.<sup>18</sup> Federal law establishes the following criteria for creating a valid cashier's check: that it be "drawn on a depository institution," "signed by an officer or employee of such depository institution," and "a direct obligation of such depository institution."<sup>19</sup> Because it functions as an express liability of the issuing bank and not the purchaser, a cashier's check is traditionally afforded a presumption of reliability.<sup>20</sup> This relative safety makes a cashier's check a common medium in transactions where the seller and purchaser do not know each other and where prices are often high and time is a premium, such as an agreement to purchase real estate or an automobile.<sup>21</sup>

The EFAA sets forth the general rule that the funds represented by a cashier's check will be available for withdrawal the day after deposit.<sup>22</sup> Hold limits under the EFAA were originally contemplated in part because "ninety-nine percent of all checks are paid the first time a bank seeks to collect on them," and bank holding policies at the time the EFAA was passed were

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17. See *infra* notes 161-70 and accompanying text.

18. OCC Consumer Advisory No. 2007-1, at 1 (Jan. 16, 2007), available at <http://www.occ.treas.gov/ftp/ADVISORY/2007-1.html>.

19. 12 U.S.C. § 4001(5) (2000).

20. See OCC Consumer Advisory No. 2007-1, *supra* note 18.

21. Justin Pritchard, *Cashier's Checks – Overview*, ABOUT.COM, <http://banking.about.com/od/checkingaccounts/a/cashierschecks.htm> (last visited Jan. 12, 2007).

22. 12 U.S.C. § 4002(a)(2)(F) (2000). Conditions for next-day availability include that the check was deposited into an account held by a payee of the check, in person to an employee of the depository bank, and with a special deposit slip or envelope where required by the depository bank. *Id.* Cashier's checks not meeting these conditions are extended to two business days for local and six business days for non-local articles. *Id.* § 4002(c)(1-2).

creating millions in losses for consumers.<sup>23</sup> It was a clear tradeoff of economic efficiency in exchange for a heightened exposure to fraud.<sup>24</sup> When fraud victims confuse funds made available by EFAA implementation regulations with funds that have been collected, they will be more prone to withdraw and dispense them in compliance with the scammer's plan.<sup>25</sup>

Further, the EFAA only allows a bank to place an extended hold on the availability of funds in a few specific instances.<sup>26</sup> The bank can place a hold on deposits greater than \$5,000 for a reasonable time, but the \$5,000 ceiling must be made available to the depositor.<sup>27</sup> Similarly, a hold may be placed on redeposited checks unless the check was returned for missing an endorsement, as well as deposits to accounts that suffer repeated overdrafts.<sup>28</sup> Where there is "reasonable cause to believe that the check is uncollectible from the paying bank," the payee bank may also hold a check.<sup>29</sup> However, the "well-grounded belief in the mind of a reasonable person" that the statute requires may not be based on the class of the check.<sup>30</sup> Lastly, the regulations allow for a depository bank to hold a cashier's check for new accounts opened less than thirty days, and in emergency conditions such as a natural disaster.<sup>31</sup> In the absence of any hold, the customer will be able to draw upon the deposit almost immediately, despite the potential that the check is a fake and the deposit will be reversed.<sup>32</sup>

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23. William R. Greer, *Speeding Crediting of Checks*, N.Y. TIMES, Feb. 22, 1986, at 48 (noting many losses were due to penalty charges for bounced checks because the bank had placed an excessively long hold on an instrument that would otherwise prevent the penalty). In the banking context, a hold period refers to that time during which the depository bank maintains possession over funds prior to releasing them to the depositor. *Id.*

24. Emma Coleman Jordan, *Ending the Floating Check Game: The Policy Arguments for Delayed Availability Reform*, 36 HASTINGS L.J. 515, 520 (1985).

25. OCC Issues Special Bulletin on Fraudulent Cashier's Checks, *supra* note 1, at 3.

26. 12 C.F.R. § 229.13 (2007).

27. *Id.* § 229.13(b).

28. *Id.* § 229.13(c).

29. *Id.* § 229.13(e).

30. *Id.* A cashier's check is considered a class of check.

31. *Id.* § 229.13(a), (f).

32. OCC Issues Special Bulletin on Fraudulent Cashier's Checks, *supra* note 1, at 3.

B. *Common Fraud Scenarios*

Fraudulent cashier's check complaints generally fall into five fact patterns.<sup>33</sup>

The first pattern involves a consumer who sells goods in person or over the Internet.<sup>34</sup> When the buyer gives or sends the fraudulent check to the seller, the seller ships the goods to the buyer.<sup>35</sup> The scammer gets valuable goods while the seller is left holding a bad check.<sup>36</sup>

In the second scenario, the fraudulent check sent to the seller is actually in excess of the amount agreed upon for the goods.<sup>37</sup> The seller agrees to wire the excess to the buyer who is often located in another country and sometimes offers the seller additional compensation for the transfer.<sup>38</sup>

In a third scam, the consumer receives notice that he or she is the recipient of a windfall – usually either an inheritance or the proceeds of a foreign lottery.<sup>39</sup> The notice then instructs the consumer to wire a sum of money outside the country to pay for processing fees or taxes on the windfall, and includes a fraudulent cashier's check to reimburse the consumer for those costs.<sup>40</sup>

In the fourth scenario, the consumer is selected to work as a mystery shopper, and is provided with a fraudulent cashier's check to be used to purchase goods from various stores.<sup>41</sup> The consumer is then instructed to wire the remainder of those funds to a third party outside of the country.<sup>42</sup>

Finally, the consumer is contacted to act as a money transfer agent between a party inside the United States and a foreign party.<sup>43</sup> The consumer receives a fraudulent cashier's

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33. OCC Bulletin No. 2007-2, at 1 (Jan. 8, 2007), available at <http://www.occ.treas.gov/ftp/bulletin/2007-2.html>.

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. See OCC Bulletin No. 2007-2, *supra* note 33.

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

check from the domestic party, is instructed to keep a commission as compensation for the service, and wires the remainder to the foreign party.<sup>44</sup>

Each of the five scenarios carries a similar pattern of loss for the bank customer.<sup>45</sup> Believing the check to be valid, the customer deposits the check into a depository account.<sup>46</sup> When the funds are made available, the customer transfers either goods or funds to a third party as requested.<sup>47</sup> At some point, the check is found to be fraudulent, and the depository bank reverses the credit to the customer's account.<sup>48</sup> Because the customer has already mailed his goods or wired funds to what are typically foreign entities, there is almost no possibility of recovery from the actual perpetrator of the fraud, and the well-intentioned depositor is made to suffer the burden of loss alone.<sup>49</sup>

### C. *Fraud Stimuli*

The recent proliferation of cashier's check fraud has been compounded by the domestication of mainstream computing.<sup>50</sup> Widely available and easy to use desktop publishing software was first used to forge a new generation of counterfeit checks in the mid-1990s.<sup>51</sup> Similar techniques allow a fraudster to duplicate cashier's checks, placing a replica of an official bank officer's authorizing signature onto what would otherwise appear to be a perfectly valid commercial article.<sup>52</sup> Furthermore, the proliferation of Internet-based sales and exchange websites, such as eBay, has created an entirely different avenue for potential fraud to prosper.<sup>53</sup> Many victims are only occasional sellers operating

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44. *Id.*

45. OCC Bulletin No. 2007-2, *supra* note 33, at 2.

46. *Id.*

47. *Id.*

48. *Id.*

49. OCC Consumer Advisory No. 2007-1, *supra* note 18, at 1.

50. Saul Hansell, *New Breed of Check Forgers Exploits Desktop Publishing*, N.Y. TIMES, Aug. 15, 1994, at 1, available at <http://query.nytimes.com/gst/fullpage.html?res=9902E6DE1030F936A2575BC0A962958260>.

51. *Id.*

52. *Fraudulent Cashier's Checks from the Payor Bank's Viewpoint*, 15 CLARK'S BANK DEPOSITS AND PAYMENTS MONTHLY #9, Feb. 2007, at 4.

53. Susan Stellan, *Online Sellers Fall Victim to Counterfeit Cashier's Checks*, N.Y.

alone, with little knowledge of cashier's check fraud or reason to suspect deception.<sup>54</sup> In addition, mass-email has become a cost effective means for fraudsters to communicate with potential victims on an international level, and is often the first step towards perpetrating a scheme.<sup>55</sup> Lastly, in reference to the aforementioned "mystery shopper" scenario, websites such as Monster and CareerBuilder have become prime fishing grounds for potential victims, where false employers are provided with a vast pool of willing targets innocently posting contact information to attract employment.<sup>56</sup>

### III. THE DEPOSITOR AND THE DEPOSITORY BANK UNDER THE UCC

When a customer deposits a check with a bank, the bank generally credits the customer's account and makes the funds available for withdrawal almost immediately, pursuant to the EFAA.<sup>57</sup> The UCC refers to this as a "provisional settlement," because the depository bank has not yet collected the funds from the paying bank.<sup>58</sup> Until final settlement is made, "the risk of non-collection remain[s] with the customer."<sup>59</sup> This policy reflects the UCC objective of "promoting certainty and predictability in commercial transactions" by pre-assigning which party bears liability in case a check is deemed fraudulent.<sup>60</sup> This policy also reflects the problem of placing liability on the depository bank, as the sheer volume of items handled daily would make proper inspection a virtual blockade on efficient banking.<sup>61</sup> Further, the

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TIMES, May 15, 2003, available at <http://query.nytimes.com/gst/fullpage.html?res=9900E2D71F3FF936A25756C0A9659C8B63>.

54. *Id.*

55. David Magliano, *Scammers Can Find Clever Ways to Fool Their Victims*, WALTON SUN, Mar. 24, 2007.

56. Miranda Marquit, *Consumer Alert: Fraudulent Cashier's Checks*, ALL BUS., May 16, 2007, <http://www.allbusiness.com/4058099-1.html>.

57. U.C.C. § 4-214(a) (2005).

58. *Valley Bank of Ronan v. Hughes*, 147 P.3d 185, 190 (Mont. 2006).

59. *Amthor v. Commerce Bank*, No. 06-3311, slip op. at 2 (N.Y. Misc. 2007).

60. *Call v. Ellenville Nat'l Bank*, 774 N.Y.S.2d 76, 78 (N.Y. App. Div. 2004). This contrasts with common law comparative fault principles that would otherwise not be in line with UCC objectives. *Id.*

61. U.C.C. § 4-201 cmt. 6 (2005).



UCC places liability with the depositor as “the party best able to prevent the loss by the exercise of care” because he is the closest party to the scammer.<sup>62</sup> The net result of these policies serves dual objectives of promoting market efficiency, as well as extending predictability to the resolution of possible disputes.<sup>63</sup>

The UCC reserves the right of “charge back” for the depository bank where a cashier’s check is found to be fraudulent and returned by the paying bank, allowing the depositor’s bank to debit the depositor’s account by the amount unpaid by the paying bank.<sup>64</sup> This is because before final settlement is made on the check, the collecting bank is acting essentially as the agent for the owner of the check, and accordingly will not be held personally liable for the losses of the owner.<sup>65</sup>

The UCC also makes explicit that the right of charge back will not be affected by a “failure by any bank to exercise ordinary care with respect to the item.”<sup>66</sup> By preventing litigation based on “the depository bank’s own negligence,” the UCC is trying to circumvent “difficult questions of fact” that would only serve to bog down the banking industry in arduous litigation.<sup>67</sup>

Finally, the fact that the bank makes funds available and the customer uses those funds also has no effect on the right of charge back.<sup>68</sup> This reflects the treatment of traditional “cash items,” which enjoy an over ninety-nine percent final payment rate after provisional settlement is made.<sup>69</sup>

#### IV. DISPLACING THE UCC – THE *VALLEY BANK* CASE

In *Valley Bank of Ronan v. Hughes*, Mr. Hughes was contacted by fraudsters offering between \$3 million to \$4.5 million

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62. *Call v. Ellenville Nat'l Bank*, 774 N.Y.S.2d at 78 (quoting *Putnam Rolling Ladder Co. v. Manufacturers Hanover Trust Co.*, 74 N.Y.2d 340, 349 (1989)).

63. *Id.*

64. U.C.C. § 4-214(a) (2005) (noting that charge back must be done by the “midnight deadline or within a longer reasonable time after” the depository bank learns of the return or is sent notification of that fact).

65. *See* U.C.C. § 4-201 (2005).

66. U.C.C. § 4-214(d)(2) (2005).

67. *See* U.C.C. § 4-214 cmt. 5 (2005).

68. U.C.C. § 4-214(d)(1) (2005).

69. U.C.C. § 4-214 cmt. 1 (2005); *see Greer, supra* note 23.

as a commission for facilitating the exportation of farm equipment to Africa.<sup>70</sup> Hughes was sent four checks on March 22, 2002 – two “official checks” and two personal checks – and was expected to wire \$800,000 to a third party as “advance fees.”<sup>71</sup> Before he deposited the checks, Hughes consulted with a bank officer at Valley Bank as to their validity; with regard to the “official checks,” the bank official said that “official checks” were “same as cash,” and “just like cashier’s checks,” and that Hughes may do with the funds as he wished.<sup>72</sup> A second bank official corroborated the guidance of the first.<sup>73</sup> Hughes’ wife later testified at trial that he told her that “everybody at the bank assured him that the checks would be good.”<sup>74</sup> On March 26, 2002, Valley Bank wired \$800,000 to an accountholder in Amman, Jordan, pursuant to a written request received from Hughes on that same day.<sup>75</sup> Approximately ten minutes later, Hughes and Valley Bank learned that one of the personal checks was being returned for non-sufficient funds, and they immediately tried to stop the wire transfer.<sup>76</sup> Efforts to cancel the wire transfer were unsuccessful, and it was later learned that the remaining checks were counterfeit.<sup>77</sup> When Valley Bank exercised its right of charge back against Hughes, resulting in an overdraft of \$800,000, Hughes was forced to withdraw \$600,000 from a retirement account and set up a trust by mortgaging his home to pay off the remainder.<sup>78</sup> When the trust failed to make the required payments, Valley Bank moved to foreclose on October 15, 2002.<sup>79</sup> Hughes then counter-claimed for a number of common law wrongs, including negligent misrepresentation based on claims made by a bank teller regarding the clearance of a check that had in fact not reached final

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70. *Valley Bank of Ronan v. Hughes*, 147 P.3d 185, 188 (Mont. 2006).

71. *Id.* (discussing “official checks,” which are generally the same as “cashier’s checks”).

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Valley Bank of Ronan v. Hughes*, 147 P.3d 185, 188 (Mont. 2006).

77. *Id.*

78. *Id.* at 189.

79. *Id.*

settlement.<sup>80</sup>

The trial court dismissed all of Hughes' counterclaims, stating that because the UCC occupies the realm of check collections, there is no place to assert common law.<sup>81</sup> The UCC states that unless "displaced by particular provisions of the UCC," principles of common law will "supplement its provisions."<sup>82</sup> In the absence of a contrary section, "the UCC preempts principles of common law and equity that are inconsistent with either its provisions or its purposes and policies."<sup>83</sup> Thus, any claim Hughes might have had under common law negligence was preempted by the UCC provision that allows charge back even where the depository bank is negligent.<sup>84</sup>

The Montana Supreme Court agreed with the trial court that the UCC governed check processing.<sup>85</sup> However, because Hughes' claim encompassed the "bank's communications" in addition to check processing, and "[b]ecause such communications are not addressed with specificity by the UCC," the Supreme Court held that common law principles may be applied to the bank's communications to Hughes.<sup>86</sup> Therefore, the court reasoned that it was at least possible to obtain a judgment against Valley Bank for the amount of the charge back.<sup>87</sup> Although the Montana Supreme Court remanded this issue to the trial court for further proceedings, it did highlight three cases which may lend some credence to future recoveries for negligent misrepresentation.<sup>88</sup>

A. *Chase v. Morgan Guarantee Trust Co.*

In *Chase v. Morgan Guarantee Trust Co.*,<sup>89</sup> the court considered the question of when a bank could be held liable for

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80. *Id.*

81. *Id.*

82. U.C.C. § 1-103(b) (2005).

83. U.C.C. § 1-103 cmt. 2 (2005).

84. U.C.C. § 4-214 (2005).

85. *Valley Bank of Ronan v. Hughes*, 147 P.3d at 191.

86. *Id.*

87. *Id.* at 192.

88. *See id.* at 192-93.

89. 590 F. Supp. 1137 (S.D.N.Y. 1984).

negligence when it fails to exercise ordinary care with respect to the check under UCC section 4-214(d).<sup>90</sup> The facts of the case centered around three representations allegedly made by the bank.<sup>91</sup> First, the bank did not warn of a well-known collection delay associated with Cayman Island checks.<sup>92</sup> Second, the bank claimed that if the check was in fact bad, the bank would know within ten business days; in fact, it was eleven days before the bank learned that the check was dishonored.<sup>93</sup> Finally, based on his conversation with the bank's vice president, the depositor believed that the check had cleared even though the vice president did not specifically say collection had occurred.<sup>94</sup>

The opinion noted that although the UCC will "not hold liable for charge[ ]back a bank whose employee inadvertently in some remark misleads a customer as to the precise likelihood that an item will clear . . . the outcome might be different if a bank expressly informed a customer that it had made a final settlement on the account."<sup>95</sup> This was interpreted by the Supreme Court in *Valley Bank* to demonstrate that other courts recognize the possibility of applying common law principles to negligent bank communications, as long as the appropriate facts are present.<sup>96</sup>

#### B. *Allen v. Carver Federal Savings & Loan Ass'n*

In *Allen v. Carver Federal Savings & Loan Ass'n*,<sup>97</sup> the court considered a parallel question of liability for a depository bank where there were allegations of negligence in the handling of the charged-back item.<sup>98</sup> However, there was no distinction made between a bank's duties in processing the check and its communications with the depositor.<sup>99</sup> The facts in *Allen*, consisting

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90. *Id.* at 1138; U.C.C. § 4-214(d) (2005); N.Y. U.C.C. LAW § 4-212 (Consol. 2007).

91. *Chase*, 590 F. Supp. at 1138-39.

92. *Id.* at 1139.

93. *Id.*

94. *Id.*

95. *Id.*

96. *See Valley Bank of Ronan v. Hughes*, 147 P.3d 185, 192 (Mont. 2006).

97. 477 N.Y.S.2d 537 (N.Y. App. Term 1984).

98. *See id.*

99. *See id.*

of statements made by a “depositor that an unidentified teller told her that a check had ‘cleared,’ when in fact it had not,” did not constitute the “quantum of proof” to prevail against the bank.<sup>100</sup>

From this, the Supreme Court in *Valley Bank* noted that there remains some “quantum of proof” that would be sufficient to substantiate a common law claim against the bank if different facts were present.<sup>101</sup>

### C. *Call v. Ellenville National Bank*

Lastly, in *Call v. Ellenville National Bank*,<sup>102</sup> the court, in discussing the proper allocation of liability under the UCC for fraudulent checks, noted that the “carefully drawn balance” of the UCC should not be interrupted by common law, and that liability is allocated to the bank customer because the customer is “the party best able to prevent the loss by the exercise of care.”<sup>103</sup> It followed that this allocation should not be altered because of the alleged representation by the bank to Mr. Call that the check had cleared.<sup>104</sup> The court noted that “the term ‘cleared’ is not employed in the UCC and, as commonly used, is not the equivalent of ‘final settlement.’”<sup>105</sup> Further, while Mr. Call may have believed these terms to be synonymous, he never alleged “that this was a result of any inquiry with or representation to that effect by the defendant bank.”<sup>106</sup>

The Supreme Court in *Valley Bank* believed this alone left open the issue of whether the “bank’s misrepresentation of the status of the check settlement process could lead to liability for the bank.”<sup>107</sup>

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100. *Id.* at 538.

101. *Valley Bank*, 147 P.3d at 193.

102. 774 N.Y.S.2d 76 (N.Y. App. Div. 2004).

103. *Id.* at 78 (quoting *Putnam Rolling Ladder Co. v. Mfrs, Hanover Trust Co.*, 546 N.E.2d 904, 908 (N.Y. 1989)).

104. *See id.* at 78.

105. *Id.* at 79. The *Valley Bank* court questioned this assertion by stating “we pause to express bewilderment at this statement of the *Call* court. If the term ‘cleared’ means anything in common banking usage, it is that final settlement has occurred.” *Valley Bank*, 147 P.3d at 193.

106. *Call*, 774 N.Y.S.2d at 79.

107. *Valley Bank*, 147 P.3d at 193.

D. *Valley Bank Revisited*

Examining the specific facts in *Valley Bank*, however, it seems unlikely that there was evidence sufficient to impose liability on the bank for negligent misrepresentation.<sup>108</sup> Hughes' evidence that the "official checks" were the "same as cash" is far from saying that they had "cleared" or were "good," and more likely refers to the expedited funds availability requirement that rewards cashier's checks for their traditional reliability.<sup>109</sup> The only mention that the checks were "good" comes from Mrs. Hughes' deposition testimony, which would likely be inadmissible in court as hearsay<sup>110</sup> and would probably do little to further the claim.<sup>111</sup> Therefore, the bar for negligent misrepresentation liability will probably not be set until a stronger fact pattern arises in a subsequent controversy.

V. STATE OF BANKING AFTER *VALLEY BANK*

A. *Concerns for the Depository Bank*

*Valley Bank* demonstrates that negligent misrepresentation could become a very real financial threat to depository banks in cases of cashier's check fraud where future courts find facts sufficient to impose liability under common law negligence.<sup>112</sup> The Office of the Comptroller of the Currency (OCC), in a bulletin dated January 8, 2007, highlights several additional concerns for depository banks.<sup>113</sup>

Preeminent among these additional concerns is possible reputation damage arising from complaints and litigation.<sup>114</sup> Without regard to the legitimacy of victims' claims, it is perfectly reasonable to assume that the inability to recover from the true

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108. *Bank Liability for Misrepresenting that a Check is "Good," supra* note 6, at 4.

109. *Id.* (citing *Valley Bank*, 147 P.3d at 188).

110. *See* FED. R. EVID. 801; *see also Bank Liability for Misrepresenting that a Check is "Good," supra* note 6, at 4.

111. *Bank Liability for Misrepresenting that a Check is "Good," supra* note 6, at 4 (citing *Valley Bank*, 147 P.3d at 188).

112. *See supra* Part IV.

113. OCC Bulletin No. 2007-2, *supra* note 33, at 3.

114. *Id.*

perpetrator of the fraud would leave victims trying to recover from the only party left – their banks.<sup>115</sup> In addition, malcontent, often high net-worth bank customers might turn to other banks for future business once soured by what they view as losses caused in part or in whole by their depository banks.<sup>116</sup> While this may not be much of a concern for large national and multinational banking institutions, small, local banks probably cannot afford to lose their wealthier patrons.<sup>117</sup>

The OCC bulletin also makes note of possible credit concerns where reversals may result in negative balances that would become a virtual loan that would then require recovery.<sup>118</sup> This is considered a virtual loan because it is not the product of any formal lending agreement, but instead comes from circumstances where a charge back results in an overdraft.<sup>119</sup> The bank may then have to deal with a customer without the means – or the intent – to repay the loan, leading to either costly litigation or a mutual loss through settlement.<sup>120</sup>

#### B. *Valley Bank Comments*

In the *Valley Bank* case, the Montana Supreme Court presented an imaginative analysis of three seemingly contrary cases to suggest that, when bank communications are separated from check processing, it is possible to displace UCC protections and hold a depository bank liable for negligent misrepresentation.<sup>121</sup> The court distinguished bank communications from check processing to promote the possibility of applying common law negligence in cases where bank personnel provided erroneous information to customers victimized by

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115. *See id.*

116. *Cf. id.* (expanding on the idea that losses due to cashier's check fraud may create a divide between customers and their depository banks).

117. *Cf. id.* (inferring that the previous assertion would understandably have a greater effect on smaller depository banks which may rely on the deposits of only a few wealthy individuals that they could not afford to lose).

118. *See id.*

119. OCC Bulletin No. 2007-2, *supra* note 33, at 3.

120. *See id.*

121. *See supra* Part IV.

fraudulent cashier's checks.<sup>122</sup> Yet, it remains to be seen whether *Valley Bank* will be cited in support by courts outside of Montana, or whether it will remain an outlier reaching for principles without subsequent legal support.

In *Amthor v. Commerce Bank*,<sup>123</sup> a case decided after *Valley Bank*, the plaintiff deposited a cashier's check for \$6,470 on September 7, 2005.<sup>124</sup> At the time of the deposit, the plaintiff was advised by a bank teller that the check would clear in two to three days.<sup>125</sup> On September 9, the plaintiff withdrew \$5,050, asserting that representations made by bank employees assured him that the check would clear by September 10.<sup>126</sup> On September 10, the plaintiff was assured by a customer service representative that the check had in fact cleared, and sent a money gram for \$5,050 to a third party outside of the United States.<sup>127</sup> On September 12, the deposit was coded as a high risk return check.<sup>128</sup> The check was subsequently dishonored and the funds represented by the check were charged back to the plaintiff's account.<sup>129</sup>

The wealth of communication between the plaintiff and the defendant bank in *Amthor* could easily be compared to that between Hughes and Valley Bank.<sup>130</sup> And yet, there is no mention of bank communications as separate from check processing, and no discussion of applying common law negligence rules by displacing the UCC.<sup>131</sup> Instead, the *Amthor* court cited *Call* in mandating that the liability remained with the depositor while any payment upon the cashier's check was provisional.<sup>132</sup> Further, it

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122. *See id.*

123. No. 06-3311, slip op. at 1 (N.Y. Misc. May 1, 2007).

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.* at 2.

129. *Amthor*, slip op. at 1.

130. *See id.*; *see also* Valley Bank of Ronan v. Hughes, 147 P.3d 185 (Mont. 2006).

131. *See Amthor*, slip op. at 3. "Plaintiffs argue that the alleged negligent misrepresentations made by employees of the defendant-bank, relied upon to their detriment, entitle them to a recovery not withstanding the provisions of the UCC." *Id.* From this language, it is unclear whether the plaintiff actually argued a non-UCC negligence claim; this may be the reason that the court neglects any discussion of common law negligence. *See id.*

132. *Id.* at 2.



cited the *Allen* decision to explicitly show that liability could not be shifted simply because there was some reliance on statements made by tellers that the checks had “cleared” or that the funds were made available for withdrawal.<sup>133</sup> This might suggest, then, that the reliance of the Supreme Court in *Valley Bank* on seemingly abstract derivatives of the *Call* and *Allen* opinions may have been in reality too distant a stretch for mainstream jurisprudence to accept.<sup>134</sup>

## VI. POST *VALLEY BANK*: PROPOSED SOLUTIONS

If the *Valley Bank* decision signals a new renaissance of judicial activism aimed at shifting liability to depository banks, the next logical point of analysis concerns the impact of that liability on those banks. This Part outlines three alternative solutions to the problem of allocating liability in situations of confusion parallel to *Valley Bank*.

### A. *Recommended Bank Protocol and Consumer Education*

Banks can most effectively minimize the effect of any subsequent reformation in judicial philosophy by exercising proper caution in communicating with their customers to prevent fraud from ever occurring.<sup>135</sup> Banks not already practicing formal education programs for officers and employees need to begin training those employees with direct contact with the public.<sup>136</sup> A broad sweeping statement like the check is “good” or will “clear” should never be made until final settlement has occurred.<sup>137</sup> In addition, the banking staff should educate depositors about the complicated area of law governing their deposits, and should advise them that there is always a chance, whether due to fraud or other cause, that the check will be dishonored by the drawee

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133. *Id.* at 3.

134. *See Valley Bank of Ronan v. Hughes*, 147 P.3d at 185.

135. *See Bank Liability for Misrepresenting that a Check is “Good,” supra* note 6, at 4 (citing *Valley Bank*, 147 P.3d at 188).

136. *Cf. id.* (expanding on the suggestion that the best practice is to make clear that there is always “a chance that any check will be dishonored” by a drawee bank).

137. *Id.* at 4.

bank.<sup>138</sup> Consumer education perhaps offers the greatest means of preventing and detecting fraud, because consumers manifest the loss and are initially held liable for it.<sup>139</sup>

In light of this paradigm of confusion, one suggested approach to alleviate mutual stress could be a cooperative institution of formal loan agreements between depository banks and victims of fraud, allowing the customer to repay over a period of time rather than to force payment immediately.<sup>140</sup> Such an arrangement would serve to reduce the stress and litigiousness inherent to situations of confusion and uncertainty that can follow where depositors face a substantial negative balance due to fraud.<sup>141</sup> In addition, it is in the best interests of all parties involved to work together to combat the divisiveness of fraud victimization, and to buttress existing relationships threatened by the potentially corrosive effects of arbitrarily allocated liability.<sup>142</sup>

#### *B. Legislative Solution – Uniform Commercial Code*

A second possible, and less attractive, solution to the problem of allocating depository liability where teller and depositor are both confused about the applicable law is the formal separation of check processing from bank communications under the UCC. Because the depositor is often an occasional seller, rather than a merchant, he may not be aware of the fraud scenarios that are all too familiar to merchants and banks alike.<sup>143</sup> All of the depositors in the aforementioned cases, including *Valley Bank*, displayed a lack of familiarity with the terminology and inner workings of banking law in their attempts to confirm their actions with multiple members of the bank.<sup>144</sup> This implicates the

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138. *See id.*

139. Thecla Fabian, *ABA Survey Finds Rapid Check Scam Rise, Off-Shore Criminals 21<sup>st</sup> Century Bandits*, 89 *BANKING REP.* 900 (Dec. 3, 2007).

140. OCC Bulletin No. 2007-2, *supra* note 33 at 3.

141. *See id.*

142. *Cf. id.* (recommending that a cooperative lending solution, in addition to providing assistance to the depositor in their claims against the fraud perpetrators, may be in the best interest of the depository bank).

143. *See, e.g., Valley Bank of Ronan v. Hughes*, 147 P.3d 185 (Mont. 2006); *Amthor v. Commerce Bank*, No. 06-3311, slip op. at 1 (N.Y. Misc. May 1, 2007).

144. *See, e.g., Valley Bank*, 147 P.3d at 185; *Amthor*, slip op. at 1.

UCC contention that until final settlement is made, liability rests with the depositor;<sup>145</sup> it seems perfectly reasonable to suggest that a bank, having both a familiarity with cashier's check fraud and the resources with which to combat it, would be in a better position than the once-a-year online auctioneer to prevent the fraud. If a state legislature amended its respective UCC provisions in a way that acknowledged the common law remedy for negligence related to bank communications, there would no longer be a preemption defense when such claims are brought.<sup>146</sup> Where recognized, the negligence would occur when a bank employee is specifically asked about whether a particular check is good; to avoid any liability, the bank employee should ideally explain the legal implications of available versus collected funds, and avoid any ambiguous or misleading statements about the validity of a depository instrument.<sup>147</sup>

For this solution to be effective, however, every jurisdiction would have to recognize this cause of action, as one common law finding in a given state will not definitively bind a court in another.<sup>148</sup> This method could be incredibly time consuming, and may result in inconsistent application where enacted based on the specific wording or interpretation of such amendments.<sup>149</sup> In addition, a simultaneous state legislative act would understandably foster the need for considerable organization and funding, and may become financially more demanding than the cost effective, hands-on approach of educating both bank employees and customers.<sup>150</sup> Also, this solution is contrary to the idea that bank

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145. See *Call v. Ellenville Nat'l Bank*, 5 A.D.3d 521, 523 (N.Y. App. Div. 2004).

146. U.C.C. § 1-103 cmt. 2 (2005).

147. Cf. Red Tape Chronicles, <http://redtape.msnbc.com> (Oct. 3, 2007, 15:29 EST) (depicting a scenario where one bank began training its tellers to educate their clients about check fraud and how that reduced the amount of check fraud by eighty-five percent).

148. Cf. Monica Kilian, *CISG and the Problem with Common Law Jurisdiction*, 10 FLA. ST. J. TRANSNAT'L L. & POL'Y 217 (discussing the difficult divide of jurisdiction when striving for a uniform application of law).

149. Cf. Andrew Beckerman-Rodau, *Computer Software Contracts: A Review of the Case Law*, 21 AKRON L. REV. 45 (1987) (discussing how different courts disagree about the scope of Article 2 of the UCC).

150. Cf. Robert Tanner, *State-Level Lobbying Costs \$570M*, <http://www.commonreams.org/headlines02/0501-08.htm> (last visited Jan. 12, 2007) (discussing that businesses, unions, and others spent \$570,000,000 in 2002 hoping to influence their state legislatures).

customers should not rely upon all statements made by bank employees, and instead should seek out formal bank officers or managers rather than just a teller.<sup>151</sup> Therefore, this solution is inferior to the initial proposal of preventing fraud losses through education.<sup>152</sup>

C. *Legislative Solution – Expedited Funds Availability Act*

A more immediate and uniform solution to the problem of allocating depository liability where teller and depositor are both confused about the applicable law requires action from the Federal Reserve Board (Board).<sup>153</sup> Within the EFAA, Congress granted the Board discretion to adopt exceptions to the EFAA's hold limits if the Board determines that depository institutions are experiencing an "unacceptable level of losses due to fraud" and that such exceptions would be necessary to "diminish the volume of such fraud."<sup>154</sup> The extension of hold periods could grant potential victims an adequate window through which available funds make the transition into collected funds without first being transferred to a third party.<sup>155</sup> Therefore, the Board could help curb fraud by deciding that current losses exceed an acceptable level and utilizing the power granted by Congress to adopt explicit means of correcting that problem.<sup>156</sup> The invocation of this exception would require a formal regulation or an order by the Board, as well as the preparation of a regular report justifying the hold before Congress.<sup>157</sup>

While this solution would have the immediate effect of curbing fraud, it would also act as a hindrance to commerce by inserting an impediment to the efficient transfer of funds under the

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151. *Cf. Allen v. Carver Federal Sav. And Loan Ass'n*, 477 N.Y.S.2d 537, 538 (N.Y. App. Term 1984) (discounting the weight of a "mere statement of a depositor that an unidentified teller told her [mistakenly] that a check had "cleared," when in fact it had not").

152. *See supra* notes 135-42 and accompanying text.

153. *See* 12 C.F.R. § 229.13 (2007).

154. 12 U.S.C. § 4003(e) (2000).

155. *Cf. id.* (postulating that where hold limits are extended, depositors will wait longer periods to access possibly fraudulent deposits).

156. *See Magliano, supra* note 55.

157. 12 U.S.C. § 4003(e).

current regime.<sup>158</sup> Decisions about hold limitations under the EFAA were carefully crafted to promote economic efficiency and commerce, and a reversal here would essentially destroy that purpose.<sup>159</sup> Therefore, this solution is also inferior to a basic prescription of education and prevention.<sup>160</sup>

## VII. CONCLUSION

The UCC's preference for black and white assignments of liability for bank deposits finds its motives in promoting an "ease-of-business" philosophy in the marketplace.<sup>161</sup> Yet, the massive proliferation of check fraud in the recent past has muddled previously clear waters, bringing pause to the mechanical cadence of UCC drummers.<sup>162</sup> The reality of the situation is that the divide between predator and prey is too great where hunters employ technology, experience, and cunning to assault victims who, while perhaps too trusting, cannot even derive protection in the laws of their homeland.<sup>163</sup> It can be argued that victims like Mr. Hughes were careful, and while they may not have understood the intricacies of an especially complicated banking law, they relied upon the guarantees made by banking personnel in conducting their affairs to their detriment.<sup>164</sup> Accordingly, the *Valley Bank* court was the first to postulate that it is possible to shift some or all of this liability to the depository bank where it can be found negligent for bank communications, since such communications are outside the scope of the UCC.<sup>165</sup>

However, the *Valley Bank* decision should not be the savior for Mr. Hughes and thousands of annual victims like him. The court's reasoning, while angelic, is muddled and will probably not be respected by other courts.<sup>166</sup> Furthermore, banks and depositors, as parallel victims of rampant cashier's check fraud,

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158. See *Jordan*, *supra* note 24, at 553.

159. See *supra* notes 22-25 and accompanying text.

160. See *supra* Part VI.A.

161. See *supra* Part III.

162. See *supra* Part II.C.

163. See *id.*

164. See *supra* Part IV.

165. See *id.*

166. See *supra* Part V.

can look outside the judicial system for a final determination of liability allocation where both parties are confused as to the true status of funds ending in a loss.<sup>167</sup> For example, the parties could lobby individual state legislatures for changes to the UCC or the EFAA.<sup>168</sup> Yet, both parties would be best served by the formal institution of bank-sponsored consumer education programs.<sup>169</sup> Such programs could help prevent fraud, losses, and subsequent disputes by eliminating any confusion over the applicable law at the time of deposit.<sup>170</sup>

ALEX Y. LIEBERMAN

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167. *See supra* Part VI.B-C.

168. *See id.*

169. *See supra* VI.A.

170. *See id.*

