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Arthur M. Magaldi

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prompt and appropriate remedial action.

120. Burns, Sarah. "Grounds of Action for Sexual Harassment," Sexual Harassment in the Workplace Litigation, (New York: NOW LDEF 1990) p. 2.

121. Moskal, Brian. "Sexual Harassment: An Update." Industry Week. November 18, 1991.

122. "Sexual Harassment Manual for Managers and Supervisors," CCH Business Law Editors, Commercial Cleaning House Inc. (1992) (hereinafter "Sexual Harassment Manual")

123. Bravo, Ellen and Cassidy, Ellen. The 9 to 5 Guide to Combating Sexual Harassment. (New York) John Wiley and Son, Inc. (1992) p. 101.

124. "Guidelines to Advocates: Effective Complaint and Investigation Procedures for Workplace ." Sexual Harassment. (New York: NOW LDEF) p. 4.

125. Although the Supreme Court decision in Meritor rejected the employer's contention that the mere existence of a grievance procedure and a policy against discrimination, coupled with [the plaintiff's] failure to invoke that procedure, must insulate [the employer] from liability. (Meritor, 477 U.S. at 72). Courts have denied such claims on that basis. See eg. Monroe-Lord v. Hytche, 668 F. Supp 979 (D. Md. 1987), aff'd, 854 F 2d 1317 (4 Cn 1988).

126. For samples of sexual harassment policies see Approaches to Affirmative Action The Bureau of National Affairs (1992) p. 47-48, "Sexual Harassment Manual" supra note 87 p. 46.

COMMERCIAL PAPER FORGERIES: A COMPLETE

ONE-HOUR LESSON

by

Arthur M. Magaldi*

The members of the Academy of Legal Studies in Business have increasingly turned their attention and emphasis to the pedagogical aspect of our profession. This increased interest in the actual teaching of our material has given rise to many initiatives, for example, the publication of the Journal of Legal Studies Education and a teaching symposium at the annual convention of the Academy. In that collegial spirit of sharing teaching ideas which have been effectively used in the classroom, the following material is submitted as a lesson which students have found to be worthwhile. No suggestion is made that it is a model lesson. It is a lesson, however, which develops in a concise manner a number of principles concerning commercial paper forgeries. The lesson also develops a number of learning aids for students.

Implicit in the writing of this paper is the strongly held belief of the author that it is valuable for teachers of business law/legal environment courses to make available to colleagues approaches that have been found pedagogically effective. The lesson includes some mild attempts at levity, but they are not essential to the structure of the lesson. An outline of the lesson is provided in Appendix A.

The lesson on forgeries begins with the instructor asking the students a rather simple question: "What does the bank contract to do, in general terms, when a depositor opens a checking account?" After eliciting a number of responses, the instructor leads the students to the conclusion that the bank agrees to pay properly drawn checks on the account to the holders of the checks up to the balance in the account. The instructor may write the terms "properly drawn" and "holders" on the chalkboard for emphasis.

*Professor of Business Law, Pace University

Forgery of Drawer's Signature

The instructor then suggests that, while they are speaking, a thief breaks into the instructor's home and is greatly disappointed because there appears to be nothing worth stealing. As the thief dejectedly begins to leave, the thief sees the instructor's checkbook. The thief decides that perhaps the instructor may keep all his/her money in the bank because there is certainly no evidence of anything else valuable in the home. The thief then takes several checks from the bottom of the checkbook, steals a handwriting sample, and leaves the same way the thief came in so that the crime will be undetected. The thief proceeds to forge a check signing the instructor's name to the check. The forgery is masterfully done and clears the drawee bank, which pays the item in good faith following normal check verification procedures.

The students are asked the following questions. Answers are provided in parentheses.

- a. What type of forgery is this? (Forgery of drawer's signature.)
- b. How will I, the depositor, learn of this? (Upon receipt of bank statement and preparation of a bank reconciliation.)
- c. Upon notification, is the bank liable to recredit the drawer's account? (Yes; not a properly drawn check.)
- d. How long does the depositor have to notify the bank? (One year, if there is only one forgery in question.)
- e. Is the quality of the forgery a factor, e.g., a very good forgery which is extremely difficult to detect? (No, a forgery is a forgery.)

The instructor writes "UCC Sec. 4-406(2)(b)" on the chalkboard to indicate the source of the rule.

The instructor then asks how many of the students promptly balance their checking accounts upon receipt of the statement. The students are asked to visualize a situation, continuing the previous example, where the instructor does not detect the forgery of the instructor's name as drawer when the statement bearing the forgery is received in August. Another forged check arrives in the September statement and that also goes undetected. Likewise, forged checks are received in the October and November statements, but the instructor/depositor does not notice these either. Finally, it is New Year's Eve. The instructor decides he/she does not want to go out and eat

and drink too much, wear party hats, go to wild parties, and have fun. No, the instructor decides that New Year's Eve is a perfect time to set financial affairs in order and to balance the checking account. All of the aforementioned statements are reviewed and the horrified instructor now finds the forgeries and immediately notifies the drawee bank.

The students are asked the following questions:

- a. Has the bank lived up to its responsibilities? (No, the bank paid on checks that were not properly drawn.)
- b. Has the instructor/depositor acted responsibly? (No, the account should have been promptly reconciled, thus precluding the possibility of the bank paying on all forgeries after those contained in the first statement.)
- c. How much, if anything, is the bank liable to the instructor/depositor for? (The amount of the first check only.)

As a reference, the instructor may refer to "UCC Sec. 4-406(2)(b)" previously written on the chalkboard. This alerts the students to the 14-day rule from receipt of the statement for subsequent checks.

The students are asked to consider another aspect of forged checks. They are told to suppose that another forger steals the instructor's checks and issues one of those checks to the Pope in exchange for a book. The students are advised that the Pope has been selected as standing for any honest person and that the example might have used Arnold Atheist or Agnostic, the Archbishop of Canterbury, the principal rabbi of Jerusalem, etc. In our example, the Pope in good faith deposits the check in his bank for collection and the forged check is cleared by the drawee bank. This time, however, the instructor promptly discovers the forgery upon receipt of the statement, informs the bank, and demands reimbursement from the bank. The students are aware that the instructor/depositor is entitled to reimbursement.

The question for the students is, "Must the Pope return the money if sued by the drawee bank, i.e., is an honest person who cashed a check bearing a forgery of the drawer's signature liable to the drawee bank for the amount of the check?" The answer which the students generally find interesting is that the bank alone bears the loss when an honest person cashes a check bearing a forgery of the drawer's signature. When one presents a check to the drawee bank for payment, the presenter warrants all indorsements are genuine but does not warrant the authenticity of the drawer's signature to the drawee bank. The bank has the depositor's

signature on file and it is its responsibility to determine authenticity. As between the two honest parties, the person who presented the check for payment and the bank which paid the check, the loss is borne by the bank as one of the risks of doing business.

This prompts the instructor to write on the chalkboard, "The worst thing that can happen to a bank is to pay on a forgery of the drawer's signature." UCC Sec. 4-207(1)(b)(ii) is given as the reference.

Forged Indorsements

The students are then asked to change gears and consider properly issued checks where there is a forgery of an indorsement, e.g., the payee's signature is forged. The following scenario is constructed. An uncle mails a check payable to the order of his niece, Sara Student, as a college graduation gift. The uncle encloses a note asking his niece to tell him what she buys for herself with the money from the check. The check never reaches Sara Student because a thief steals it from the mailbox, forges the indorsement of Sara, and transfers it to Honest Al in purchase of a suit of clothes. Honest Al deposits the check in Al's account at Al's bank which proceeds to collect the check from the drawee. The drawee bank verifies the drawer's signature, which is genuine, and not knowing the student's signature has been forged, pays the check. The check is then returned to the uncle along with the monthly statement. More than a year later, the uncle asks his niece what she bought for herself with his graduation gift. To the uncle's surprise, he learns the facts as indicated above. Finally, the uncle notifies the bank that it has paid a check on which the holder's (payee's) indorsement has been forged and demands reimbursement for the amount. The bank protests that it had no way of knowing the genuineness of the payee's signature and should not be held liable in this instance.

The students are asked their opinion of the matter. Some questions for the students:

- a. Should the bank be held liable when the forgery is that of an indorser? (Yes, reference is made to the opening determination of the bank's responsibility to pay holders of properly issued checks.)
- b. How much time does the drawer/depositor have to notify the drawee bank of its error? (Three years; "UCC Sec. 4-406(4)" is written on the chalkboard.)
- c. Why does the law grant the drawer/depositor so much time for notification? (As in our example, it may be difficult for the drawer to learn of the forgery.)

Whether the bank can recover from the honest person who cashed the check is the next logical question. Reminded of the Pope's earlier adventures, Honest Al notes that he has acted as honestly as the Pope. Once again, we have two parties who have acted honestly and in good faith, i.e., the bank that cashed the check and the party who presented it for payment. The students are referred to the prior discussion concerning the warranties made by those who present checks for payment.

Unfortunately for Honest Al, UCC Sec. 4-207(1)(a) makes the party who presented a check for payment with a forged indorsement liable for return of the money. One who presents a check for payment does not warrant the authenticity of the drawer's signature to the drawee bank, but the presenter does warrant that all other necessary indorsements on the instrument are genuine and authorized. By way of explanation, it may be suggested that here there is no reason to protect the presenter inasmuch as the presenter was not entitled to the money. The presenter is not the holder of the instrument since it bears the forged indorsement. Moreover, we are not dealing in the forged indorsement case with a situation where the bank has the better opportunity to determine the forgery. The latter situation would apply where there is a forgery of the drawer's signature because the bank has the sample on file. Here, the presenter would seem to have the better opportunity to determine authenticity by establishing the identity of all indorsers before accepting the instrument.

The above discussion prompts the instructor to mention the First Fool Rule, i.e., in the case of a forged indorsement there is no fool like the first fool who took the instrument after the forgery. The so-called first fool should ultimately bear the loss no matter how many times the instrument has been passed on after leaving the first innocent victim's hands. The instructor may conclude this portion of the discussion by simply writing "first fool" and "UCC Sec. 4-207(1)(a)" on the chalkboard.

The Fictitious Payee Rule

The students are asked to speculate as to the reaction of a person on the street to the following situation. The student has received a transfer of an instrument on which the payee's signature has been forged and the student wonders if he/she will be recognized as the holder or owner of the instrument entitled to receive payment. The student stops and asks a person on the street for advice. The point that is being developed is that even those without training will probably recognize that as a general rule one who claims ownership of an instrument through a forgery will not be entitled to enforce payment of the instrument. A forged indorsement in effect is no indorsement. The instructor suggests that this rule is certainly reasonable but there are

several exceptions to the rule that the students need to consider. These exceptions are loosely called the "Fictitious Payee Rule."

The students are told that an individual presents him/herself at the home of the student and claims to be a cousin from the "old country." It is suggested that virtually all of us have an old country. The student and the student's family do not know this cousin, but the cousin is convincing and the student's family is generous. They open their home to their relative. Later, the cousin asks for a loan and they generously issue a check to the cousin in the name that he/she has been using.

Some months later and long after the check has been cashed, the family learns that it has been duped because this person was not a relative but a fraud. Realizing they have been victimized, searching for a way to recoup the loss, and being unable to locate the "cousin," a claim is made against the drawee bank for paying a check on the basis of the forged indorsement of the payee.

Some questions for the students:

- a. Is this a criminal matter for which the alleged cousin could be prosecuted? (Yes, clearly.)
- b. Should the bank be held liable for paying on the basis of a forged indorsement? (No, UCC Sec. 3-405(1)(a) places the loss on the drawer when the drawer is duped into issuing an instrument to an impostor or impersonator.)

The second version of the Fictitious Payee Rule, sometimes called the "dishonest employee" rule, may be illustrated by the following hypothetical. A student in the class retains the instructor to represent the student in the purchase of a home. At the closing of title, the student is told to issue various checks for expenses of the closing. Months later, the student is reading the newspaper and sees a headline, "Professor Indicted." Below the headline is a somewhat blurry picture of the instructor. A quick reading of the article reveals that the instructor's favorite scam was to have clients issue checks to the order of persons not entitled to any payment. The student then goes back to verify all payments made in connection with his/her closing only to find that a check written to New York Abstract ostensibly for a survey was unnecessary. In fact, no survey was made and New York Abstract did not cash the check. Instead, it was cashed by the instructor in an account which was maintained for this criminal purpose. The account is now empty, and the instructor is either destitute or judgment-proof.

After the students have heard both hypotheticals, they will readily agree that both matters are criminal in nature and the perpetrators subject to arrest. The students are reminded that in both of these situations, however, the law must decide which honest person must absorb the loss. Should the drawer who was duped into issuing the check by the impersonator or dishonest agent or employee suffer the loss, or must the honest person who took it from the fraudulent party, e.g., the bank, suffer the loss? The students are advised that as between these two honest parties, the drawer, the party who most contributed to the loss by issuing the check, sustains the loss. Under the Fictitious Payee Rule, the one who was first duped into issuing the check loses. What about the forgery of the fraudulent party? For criminal law purposes it is treated as a forgery, but for commercial paper purposes the signing of the payee's name in the aforementioned situations is treated as an effective indorsement. Therefore, all honest persons who take the instrument after the fraudulent party signs are protected as holders of the instrument. To give a reference for the second situation, the instructor may write "UCC Sec. 3-405(1)(c)" on the chalkboard.

Finally, the students are advised to be careful to distinguish the case where a drawer issues a check to a party to whom a debt is actually owed. In such a case, if an employee of the drawer steals the check, forges the indorsement of the payee, and cashes the check, the Fictitious Payee Rule does not apply and the bank is not protected. The essence of the rule is that the drawer/employer is liable under the dishonest employee exception when it allows itself to be fraudulently induced into writing checks to parties who are not owed debts. But if the drawer/employer has properly issued a check to a party to whom an obligation is owed, there is no reason for holding the drawer/employer liable. In the case of a check to an actual creditor, the party (usually the bank) which takes the check from the thief who forged the indorsement suffers the loss.

As a final note on the chalkboard, the instructor may add, "Beware check to actual creditor."

Cautionary Note

Slight modifications in the above material may be necessary for those who wish to alert the students to the 1990 revisions of the UCC which have been passed in a number of states. The above lesson focuses on the general rules.

APPENDIX A

OUTLINE FOR COMMERCIAL PAPER FORGERIES: A COMPLETE

ONE-HOUR LESSON

- I. What does bank contract to do when you open a checking account?
 - A. Pay properly drawn checks to holders of the checks.
- II. While we speak, a thief breaks into my home and steals my checkbook.
 - A. Forges one of my checks.
 1. What type of forgery?
 2. How will I learn of this?
 3. If I notify bank, must bank recredit?
 4. How long to notify bank? (UCC Sec. 4-406(4)).
 5. Quality of forgery a factor?
 - B. Fail to balance account and detect forgery, crook forges checks in each of next 3 months.
 1. Notify bank on New Year's Eve.
 2. Must bank recredit? (UCC Sec. 4-406(2)(b)).
 - C. Same thief issues check to the Pope.
 1. Suppose bank cashes check for Pope, must Pope return money to bank? (UCC Sec. 4-207(1)(b)(ii)).
 2. Worst thing that can happen to bank is to pay on forgery of drawer's name.
 - D. Drawer issues check to you, stolen from you and your signature forged.
 1. How will depositor learn of this?
 2. Must bank recredit?
 3. How long to notify bank? (UCC Sec. 4-406(4)).
 4. May bank recover if honest person cashed check? (UCC Sec. 4-207(1)(a)).
 - E. Impostor or impersonator induces drawer to issue check in name of assumed identity.
 1. Bank cashes check.

2. May drawer recover from bank? (UCC Sec. 3-405(1)(a)).
- F. Agent or employee induces drawer to issue check to one not a creditor.
 1. Bank cashes check.
 2. May drawer recover from bank? (UCC Sec. 3-405(1)(c)).
 3. Beware check to actual creditor stolen and cashed by employee. Fictitious Payee Rule does not apply.