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Impact of Revised UCC Articles 3 and 4 on Forgery and Alteration Scenarios

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By Alvin C. Harrell

1. Liability on the Instrument

Generally a person is not liable on an instrument unless he or she signs it. Conversely, any person who signs an instrument is liable in the capacity in which he or she signs it. The UCC definition of "signature" is broad and includes "any symbol executed or adopted by a person with present intention to authenticate a writing." Absent authority, a person signing the name of another is signing his or her own signature.

As a result when a person signs the name of another to an instrument, without authority, the person signing is liable and the person whose name was signed is not liable. Thus, when a check is forged, it cannot be enforced or charged against the account of the person whose name was signed unless one of the exceptions applies. If a bank has cashed or otherwise paid such a check, it cannot charge the account of its customer and will suffer the loss caused by the forgery.

There are five exceptions to the general rule that a person is not liable on an instrument unless he or she signs the instrument.

4. Revised UCC 3-401 (revised 5-26-1974, effective 10-6-1974). The signature to be genuine in the later situation, e.g., the "name of a person or organization in which a particular person has an interest or capacity, the person's signature to be genuine in the earlier situation, e.g., the "signature of a person or organization in which a particular person has an interest or capacity, the person's signature to be genuine." In either case, the signature to be genuine is that of a person with present intention to authenticate a writing. Absent authority, a person signing the name of another is signing his or her own signature.

5. Revised UCC 3-402 (revised 5-26-1974, effective 10-6-1974). An instrument may be forgeries or altered. Absent authority, a person signing the name of another is signing his or her own signature. The person signing the name of another to an instrument, without authority, the person signing is liable and the person whose name was signed is not liable. Thus, when a check is forged, it cannot be enforced or charged against the account of the person whose name was signed unless one of the exceptions applies. If a bank has cashed or otherwise paid such a check, it cannot charge the account of its customer and will suffer the loss caused by the forgery.
Article 3 an authorized representative, who as drawn of a check drawn on an account of a principal who is identified on the check, is not personally liable despite his personal surety’s liability. He is liable to pay the instrument according to its terms without any statutory qualifications or preconditions.35 The drawer may require the acceptance of a draft or note to be secondary liable, in which the obligation is to pay the instrument does not accrue until certain statutory preconditions are met.36

The drawer becomes liable only after the instrument has been duly presented to the drawer and dishonored.37 An indorse of a draft or note is not liable to pay the instrument only if it has been duly presented and dishonored.38 The indorser of a draft or note is not liable only if it has been given to the indorser.39 Failure of the holder to give timely notice of dishonor will discharge the liability of any drawer. But in most instances failure to give timely notice of dishonor to a drawer will not discharge the liability of the drawer.40

II. Forgeries, Alteration and Warranties

Articles 3 and 4 recognize two basic types of warranties, designed to protect holders and other transferees of instruments from forgeries, alterations, and defects in the transferee’s title.41 The Article 3 and 4 warranties are substantively similar, and will be treated together in this discussion despite some differences relating primarily to the scope of Article 4 and the nature of the bank collection process.42

The Article 3 and 4 transfer warranties apply at any place an instrument (as defined in § 3-103) is indorsed, or (as defined in § 4-403) is transferred or credited to a transferee or holder.43 In contrast the presentation warranties apply when an instrument or money is presented by the drawer or the Heller is the lawyer at the "paying bank" in Article 4(b) for payment.44

The transfer warranties provide that any party who transfers an item for consideration to the transferee (and if the transfer is by indorsement also warrants to all subsequent transferees) that: (1) the transferee is entitled to enforce the instrument, (2) all signatories are genuine and authorized, (3) the instrument has not been altered, and (4) it is not subject to any claim or defense or (5) insolvency proceeding.45 Essentially, this is a warranty of good title and protects the transferee from any claim or defense against the instrument.

In marked contrast to the more restrictive transfer warranties (just discussed), the presentation warranties are extremely broad. A bank cannot disclaim a presentment warranty by the depositor or by depository or thru the drawer from the presenter for breach of warranty and will be responsible for the loss unless it can assert a presentation warranty.

In contrast to the very limited warranty transferred under Article 4(a) the warranty transferred under Article 4(b) extends to the buyer of the instrument when it is sold.46

Several other provisions in Articles 3 and 4 may add to the issuer’s or presenter’s liability in cases, involving an important new provision in revised Article 3 covering the forgery of an employer’s indorsement by an employee.47 Generally, these provisions do not directly affect the warranty provisions, but may do so indirectly by validating an indorsement and thereby altering the right to claim forgery or al- teration as a basis for breach of warranty.

Under Articles 3 and 4, if a check was paid on a forged indorsement, the entire loss occurred if the forgery was made either directly or remotely either by the owner of the instrument or the party who took it from the forgery even if more than one person was at fault.48 This is significantly changed under revised Articles 3 and 4. For example, under revised sections 3-109 and 3-110, the owner of a check that has been stolen and paid on (or a forged indorsement) may be able to sue the drawer to enforce the instrument.49 The drawer can then sue the bank that paid the item under a wrongful payment claim, and the bank can then initiate a series of recoveries against prior parties who transferred the instrument, obtaining recovery at each stage of breach of warranty.50 Alternatively, the owner may be able to sue the drawer for breach of warranty if the instrument was paid despite the forged indorsement.51 As in the pre-
vicious scenarios, the drawee/payer bank can then initiate a series of recoveries for breach of warranty by suing the party who made presentation for breach of warranty, permitting entry of judgment against the party in possession of the collection chain to sue its transferees for breach of warranty until the claim is satisfied.

As another alternative, under revised Article 3 the owner of the stolen check may be able to directly eject the instrument from the forger. This direct course of action avoids any multiplicity of suits that is necessary if the owner of the instrument is not a payee or a holder in due course. Thus, the owner may sue the payee, and the payee will then sue the forger, and the forger who took the instrument from the forger. Some courts held that old section 3-419 barred this direct action; revised section 3-420 makes clear that the owner of the instrument can proceed directly from the bank.

III. Basic Points to Remember

A. Liability on the Instrument

A person will be liable on an instrument only in the capacity in which he or she signed it. Subject to the exceptions and preclusion noted supra in Part II, a person is not liable unless he or she signed the instrument. An unauthorized signature, (i.e., a forgery) is effective only as the signature of the person to whom the instrument was written.

B. Reasons why loan closing agents commonly require identification (such as a driver's license) from the borrowers at the loan closing. If the person signing the loan documents is an imposter, the note and mortgage likely will be worthless. Nor can one rely on representations from one co-borrower as to the other co-borrower's identity. Your author's father was once held liable for notarizing a deed of trust for a friend and the person the friend introduced as his wife; in reality it was a girlfrienship and the pair absconded after selling marital property without the real wife's permission.

C. There is a similar rule for alteration. Under revised UCC section 3-407, a person whose obligation is fraudulently altered is discharged from liability on the instrument, unless the person who obtained the obligation by alteration changed its tenor, or unless the person who obtained the obligation by alteration added to the obligation, in the manner of the alteration.

D. The O'Connor case is discussed under other sections of Article 3-404.

E. This section and article contain the rules for recovery following an alteration under article 3-404.

F. In many recent cases the debtor bank was not listed on the checks. However, when the forger is not in the position of the payee, the bank may not be liable when an unauthorized person is in possession of the instrument. The bank is not liable to pay the interchange if the bank in good faith did not know that the person to whom it paid the check was not entitled to receive payment. The bank is not liable to any other person who received the check on the payee's account. The bank may be liable if it failed to follow the process or order. The bank may be liable if it is a payee or an agent acting on behalf of the payee.

G. The court noted that the depositor bank did not know the check was bad because the depositor bank could have discovered the bad check if it had exercised due care. The depositor bank was liable to the payee for the amount of the check, but not to any other person who received the check on the payee's account. The bank may be liable if it failed to follow the process or order. The bank may be liable if it is a payee or an agent acting on behalf of the payee.

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cape detection is unlikely to make the 
biggest check payable to himself or her-
self. Therefore, many forged checks are 
made payable to third parties whose en-
derals have been unknowingly forged, cre-
ting a double forgery.

Double forgery cases have been great-
ly simplified by two developments that 
have clarified the treatment of double 
forgery instruments. The first is an im-
portant case, People v. First Na-
tional Bank of Billings (537), holding 
that an instrument with both a forged 
drawer's signature and a forged endor-
sement will be treated as if only the 
drawer's signature is forged if the instru-
ment will be treated the same as dis-
cussed supra at part IV, B.

The second development is the treat-
ment of double forgery under revised 
Articles 3 and 4, which confirm the Pe-
rimi case and treat double forgery as a 
drawn forgery's signature. In these circum-
stances, revised sections 3-110(a) and 
3-404 will usually cause the encoun-
ters to be treated as valid, leaving the 
parties to the dispute unless the instru-
ment has a maker's signature. On 

D. The Added Payee Scenario

Once the more intriguing fraud sce-
narios involving unauthorized payee to an 
otherwise legitimate instrument. This may involve

simply inserting words that add an ad-
ditional, alternative payee ("or John 
Smith") to the name of the existing payee 
(so the check now reads "Pay to the or-
der of Bill Jones or John Smith."). A 
variation involves altering the exist-
ing payee's name (e.g., converting "IRS 
"or MRS. EDITH JONES."). The primary 
issue in these cases is alteration of an 
instrument under section 3-407, although 
in some instances the rules at section 
3-115 on incomplete instruments may 
also be applicable.

As noted supra, a fraudulent alteration 
will discharge any party whose obliga-
tions are affected by the alteration, unless 
that party asserts or is precluded from 
asserting the alteration. An exception 
permits a payor bank or other innocent 
party, who takes the instrument for value 
in good faith and without notice of the 
alteration, to enforce the instrument ac-
cording to its original terms. An altered 
check will not be payable properly 
and cannot be charged to the drawer/
consumer's account; an institution that 
takes or pays an altered instrument 
will likely be unable to enforce the instru-
ment as expected and will be left with recourse 
against the transferor for breach of war-
ranty. As with the other fraud scenarios, 
this will frequently create a claim of 
liability that leads back up the series 
of transactions involving the instrument 
until liability reaches the party who took 
the wrongdoer, leaving that party 
with recourse against the wrongdoer.

As a rule, the cases are frequently 
not clear that simple, as illustrated by 
Garrin Grain Co. Inc. v. Bankman's Bank 
& Trust Co. of Kansas City. Garrin 
sued on a genuine check payable to a cor-
poration, and an employee then nurkod 
the instrument and added her name as an 
alternative joint payee (so the check was 
made payable to the corporate payee or 
the employee). The employee then 
emailed the check to Bill Jones or John 
Smith.

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Of course, as noted supra, a pre- 
rification, or other exception at sections 
3-401 through 3-404 may legalize 
the drawer's or maker's signature as 
well.

E. Check Payable to Corporate 
Payee or Third Party 
Deposited to Corporate 
Officer's Personal Account

This scenario unfolds when a corpo-
rate officer of the other payee-obtains a 
legitimate corporate check, payable to 
a bank or other third party and is 
be paid on a corporate debt or deposited 
to a corporate account. The fiduciary 
may have improperly obtained possession, 
or the instrument may have been delivered 
to the fiduciary for a legitimate corpo-
rate purpose. The problems discussed here 
arisewhen the fiduciary transfers the 
check to a bank or other third party payee 
and requests that the funds be applied for 
the benefit of the corporation personally, 
perhaps by deposit to the corporation's 
account or for payment on his her loan.

Under revised section 3-307, the bank 
or other third party payee will take the 
instrument with notice of a breach of 
fiduciary duty if a corporate check pay-
able to the third party is applied for 
the benefit of a corporation officer or 
other fiduciary. Similarly, if the instru-
ment is made payable to the issuing 
corporation or to the corporate office of 
fiduciary possibly ("Pay to the order of John 
Smith, President"), the transferee (a bank 
or other third party) takes with notice of 
the breach. The court held that the 
transaction was a breach of fiduciary 
duty only if the instrument was payable 
to the payor corporation or another 
fiduciary personally ("Pay to the order 
of John Smith"); the bank can apply the 
instrument to the benefit of the fiduciary 
without notice of a breach of fiduciary duty, 
un-

117. See also United States v. Alloro, 537 F.2d 340 (9th Cir. 1976), for 
information on breach of fiduciary duty in the context of 
seven agencies. See, also 6.3.3.3.3.2 (The Corporate "Powers 
"or MRS. EDITH JONES."). The primary 
issue in these cases is alteration of an 
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3-115 on incomplete instruments may 
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118. See, e.g., L. F. Christiansen, Jr., The Corporate "Powers 
Instrument," 39 Cal. L. Rev. 224 (1951), for a discussion of the 
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rate "Powers Instrument," 39 Cal. L. Rev. 224 (1951), for a discussion of the corporation's statutes and the role of the corpora-
119. See also supra, at 3-402 to 3-403, for discussion of the 
additional powers of the corporation.

120. Id. at 304 (1979).

121. See supra, at 3-402 to 3-403, for discussion of the 
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122. See supra, at 3-402 to 3-403, for discussion of the 
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124. See supra, at 3-402 to 3-403, for discussion of the 
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ing to the legality of the Federal Reserve or the validity of the U.S. currency. While none of these theories have ever been upheld, costly litigation may be required to resolve the issues in individual cases.

3. Check Kiting

A check kike occurs when a bank customer covers a potential overdraft in a bank account by depositing a check drawn by a third party at another bank. 18 A kike poses risks not only to the banks involved, but to any one who accepts a check drawn by the perpetrator. A kike creates a perception of funds that don't exist and when the kike inevitably ends, those holding unpaid checks will likely suffer losses.

The risk for payor banks arises when the bank makes final payment of items drawn by the customer on uncollected items in his or her account, and those uncollected items deposited by the customer are returned unpaid when the kike scheme collapses. The revisions to Articles 3 and 4 provide some additional protections to payor banks caused in this vise. Section 3-418 and 4-302(b) may permit the bank to reverse and rescind final payment on grounds of mistake or fraud elements clearly present in most kike scenarios.20 But the danger is not only to payor banks—functional reasons extend to anyone who takes a check that is part of a kike scheme. Therefore, every business should be alert to these tradi-

donational signs of check kiting (though payor banks are uniquely capable of monitoring some of these activities):

- large checks and deposits in even, similar amounts;
- large uncollections of funds balances;
- large numbers of compensating balances and deposits between banks;
- use of banks in other states or towns without apparent reason;
- deposit of checks drawn by the depositor on his or her account elsewhere.

If these signs are detected, the only protective measure is to refuse to accept or pay checks drawn by customer. If you are the payor bank, close the account and timely dishonor items subsequently presented for payment. It probably is best not to give the customer or others advi-

orance notice or more time, as this may simply enable them to protect themselves first. Regarding notice to others, see the disci-

pline infra on banking referral forms and the customer's right to privacy, infra at Pt. IV. H.

4. Miscellaneous Issues and Scenarios

Several recent (unreported) cases illustrate some other pitfalls to watch for:

In one instance, a thief apparently ob-

tained a check payable to "IRS" and altered these initials to read "MRS." The thief forged a signature (or an alias) to create an instrument payable to himself (e.g., to "MRS. JOAN SMITH"). Moral: Spell out "Internal Revenue Service" on your tax check. Other abbreviations may pose similar risks.

In another fraud scenario, a corporate employee issued and forged corporate checks payable to another, innocent corporate employee. The perpetrator then posed as the other employee to cash the checks at the payor bank. The bank em-

ployees did not ask for identification, because these were corporate checks and the bank staff recognized the perpetrator as an employee of that company. It seemed quite normal for a known corporate employee to be at the bank to endorse a blank check. While the perpetrator was making a deposit, another teller endorsed the blank check into a bank account opened in the name of a fictitious corporation. (The payee was also duped into signing the account signature card, authorizing the fictitious entity as drawee on the account.) The teller then walked towards the teller to deposit the checks. However, the teller realized the account was fictitious, the bank did not have the funds to pay the account, and the suspect was stopped and arrested. The suspect was later convicted of bank fraud.

In another case, a corporate employee typ-

declared a legitimate corporate check pay-

able to himself, but began the written dol-

lar amount with an inch from the left margin, as follows:

Pay to the order of John Smith $ 6,339.90
One Thousand and 399 Hundred

This was easily altered as follows:

Pay to the order of John Smith $ 17,339.90
One Thousand and 399 Hundred

This corporate issuer would likely be pre-

cluded from asserting this alteration due to its negligence in facilitating the loss, under sections 3-405.

One fraud expert has recently cau-

tioned against having corporate officers' signatures appear in corporate share-

holder reports, as that may facilitate for-

gery of the signatures on phony cashier's checks or other corporate instruments.21 This expert also cautioned financial instit-

utions to watch for: (1) unusual routing numbers (the institution's Federal Re-

serve district number on the check); al-

tered or confusing numbers and thereby increase fraud opportunities; (2) unperforated checks (which again in-

crease fraud opportunities); and (3) improper ink encoding (incorrectly ordered bit of forged checks lack MICR magnetic ink—

commercial products are available to de-

tect these inkless checks).

In another fraud scenario, a corporate employee issued and forged corporate checks payable to another, innocent corporate employee. The perpetrator then posed as the other employee to cash the checks at the payor bank. The bank employees did not ask for identification, because these were corporate checks and the bank staff recognized the perpetrator as an employee of that company. It seemed quite normal for a known corporate employee to be at the bank to endorse a blank check. While the perpetrator was making a deposit, another teller endorsed the blank check into a bank account opened in the name of a fictitious corporation. (The payee was also duped into signing the account signature card, authorizing the fictitious entity as drawee on the account.) The teller then walked towards the teller to deposit the checks. However, the teller realized the account was fictitious, the bank did not have the funds to pay the account, and the suspect was stopped and arrested. The suspect was later convicted of bank fraud.

H. Criminal Referrals, the Right of Privacy and Other Issues

Four practical points about check fraud require to be made. First, forgery, kiting and other fraud scenarios may involve criminal activity. Your discovery of such may trigger an obligation to notify proper authorities, e.g., by filing a criminal referral form. This, however, must be balanced against the customer’s right of privacy.

Second, the U.S. Attorneys Office and the various bank fraud task forces established over the past few years may be helpful in prosecuting and otherwise combating check fraud and other banking crimes.22 We are careful, however, not to threaten criminal prosecution as a debt collection device.

Third, institutions should establish training procedures for (1) alert their staff to payor banks—and risk and benefit of customer money. Forrester and alteration and 2) establish that all instru-

ments are handled in good faith and us-

ing ordinary care in accordance with rea-

sonable commercial standards.23 If these standards are met, the institution may qualify as a holder in due course24 with immunity to certain claims and defenses,25 and will not be subject to an


- Large checks and deposits in even, similar amounts;
- Large uncollections of funds balances;
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- Use of banks in other states or towns without apparent reason;
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One Thousand and 399 Hundred

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One fraud expert has recently cautioned against having corporate officers' signatures appear in corporate shareholder reports, as that may facilitate forgery of the signatures on phony cashier's checks or other corporate instruments. This expert also cautioned financial institutions to watch for: (1) unusual routing numbers (the institution's Federal Reserve district number on the check); altered or confusing numbers and thereby increase fraud opportunities; (2) unperforated checks (which again increase fraud opportunities); and (3) improper ink encoding (incorrectly ordered bit of forged checks lack MICR magnetic ink—commercial products are available to detect these inkless checks).

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written law, the common law, the agreement (1) is a distinct act of ownership or dominion, (2) wrongfully exercised, (3) over the personal property of another, and (4) in de-

A. Introduction

Section 3-420 specifies that Article 3 is supplemented by the law of conversion. 114 Many of the governing principles are provided by the law of conversion rather than Article 3, but section 3-420 provides some specific guidance as to the impact of conversion principles in the context of Article 3 transactions. 115 Most of this direction relates to the consequences of taking or paying an instrument on an unauthorized indorsement, which section 3-420(a)(1) makes a conversion. Old sections 3-412a and (b) were deleted as inappropriate for all items, and the law of conversion is substituted generally.

B. The Law of Conversion

In addition to listing two specific in-
stances in which an instrument is con-
victed as conversion, the section also applies to conversion of other person-
ally apply to an instrument. This is a state-
mantle of existing law. 116 Section 3-420 sets forth an additional circumstance (payment on a foreclosed indorsement, not fit-
ing the common law rule, when the con-
version of an instrument may occur. Un-

Section 3-420 governs the remedies of the owner of an instrument that has never been received or has not delivered receipt of the instrument (directly or indirectly). It resolves a split of authority under prior law in both circumstances, reject-
ing cases that are contrary to such sense of "N' Sand, Inc. v. United California Bank, 117 The section also applies to a person who can use in conversion is "a person entitled to enforce the instru-
ment." Section 3-420 allows such a person to proceed directly against the person who will ultimately be liable, for example, a depository bank that allowed the forger to deposit the check despite the forged indorsement. 118 Old section 3-419(3) is often confused to preclude recovery from the depository bank in these circumstances, unless the depo-

C. Remedies for Conversion

Section 3-420 and 3-420, also will allow the conversion of a loss that occurred in American National Insurance Co. v. Fidelity Bank, N.A. 119 Under the revised section 3-420, in many cases the owner of the check would be required to sue the payor bank that paid the check, the payor bank would then sue the bank that made payment, and each bank in the collection chain of li-

liability leading ultimately to the party who dealt with the forger (often the deposi-
tory bank). Section 3-420 permits the owner of the check to bypass this circu-
tious chain of liability by directly suing the depository bank. This minimizes Okla-

homa law prior to the enactment of pre-
revision section 3-419. 120

There are two qualifications in section 3-420(a). An action for conversion may not be brought by (1) the issuer or accep-
tor of the instrument, or (2) a payor or indorsor who did not receive delivery of the instrument (directly or indirectly). This resolves a split of authority under prior law in both circumstances, rejecting cases that are contrary to "N' Sand, Inc. v. United California Bank, 117 The section also applies to a person who can use in conversion is "a person entitled to enforce the instru-
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tor of the instrument, or (2) a payor or indorsor who did not receive delivery of the instrument (directly or indirectly). This resolves a split of authority under prior law in both circumstances, rejecting cases that are contrary to "N' Sand, Inc. v. United California Bank, 117 The section also applies to a person who can use in conversion is "a person entitled to enforce the instrument." Section 3-420 allows such a person to proceed directly against the person who will ultimately be liable, for example, a depository bank that allowed the forger to deposit the check despite the forged indorsement. 118 Old section 3-419(3) is often confused to preclude recovery from the depository bank in these circumstances, unless the depository bank still had the forger's funds or was liable on some other grounds. 119 Current section 3-420, as well as section 3-405, also will allow the conversion of a loss that occurred in American National Insurance Co. v. Fidelity Bank, N.A. 119 Under the revised section 3-420, in many cases the owner of the check would be required to sue the payor bank that paid the check, the payor bank would then sue the bank that made payment, and each bank in the collection chain of liabil-

ity leading ultimately to the party who dealt with the forger (often the de-
pository bank). Section 3-420 permits the owner of the check to bypass this circu-
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