

## Question 11 – July 2015 – Selected Answer 1

Question 11:

1) Metro Bank will be able to use Stanley's negligence (under (b)) and Metro Bank's lack of breaching any duty of ordinary care (under (d)) to refuse to recredit Stanley's account. Metro Bank, however, will not be able to use the Fraudulent entrustment of an employee defense (under (a)) or the bank statement defense (under (c)). At issue is whether Metro will succeed in its attempts to defend against re-crediting Stanley's account for the \$500 forged check.

Generally, when a person forges a drawer's check, the drawer is not liable for the amount drawn from his account. Furthermore, drawers normally are entitled to a re-credit of the amount because it was not properly payable. The Payor bank normally cannot shift liability for breach of presentment warranties because the people down the chain normally haven't breached any presentment warranties. Therefore, the Payor bank's best way to defend against this sort of fraud is to not recredit the drawer's account and assert a defense to recredit.

a) This defense will not support Metro Bank's refusal to recredit Stanley's account. Generally, a bank will assert that a person negligently entrusted an employee with handling the financials of the business, and as such is estopped to assert forgery because that person should be supervising the forger better. However, this defense is not available when the person forges the drawer's check. This defense is available for forging a payee's endorsement. This defense is available for an employer who receives checks from various drawers, entrusts an employee with these checks, and forges the payee's signature and cashes the check. This is not available here because Susan forged Stanley, the drawer's, check. Susan did not forge his endorsement. Thus, this defense is unavailable.

b) This defense will support Metro Bank's refusal to recredit Stanley's account. The negligence defense is available for a payor bank to refuse a recredit when the drawer was negligent with his checkbook, substantially contributing to the forgery. Here, Stanley left Susan in charge of managing his checking account at Metro, balancing the account each month, and preparing checks in payment of bills for Stanley's signature. Susan was essentially involved in every aspect of Stanley's bank account. Not only that, Stanley also knew Susan had experienced financial problems several times during his employment of her. Therefore, Stanley's negligent entrustment of Susan with every aspect of his checking account, along with his knowledge of Susan's financial troubles, amounts to a substantial contribution to the forgery. As such, Bank will likely be entitled to refuse a recredit to Stanley's account.

c) This defense will not support Metro Bank's refusal to recredit Stanley's account. A bank is entitled to assert the bank statement defense against a drawer of an account who had a check forged. This defense states that drawers have a duty to inspect their bank statement for any fraud that might be happening to their account. However, drawers are given 1 year to report any fraud to the bank. If a drawer reports fraud to the bank within a year, they are entitled to a recredit, unless the bank can prove that waiting almost a year substantially contributed to the bank not being able to find the forger. Here, Susan cashed the forged check on December 15, 2014. Stanley received the bank statement on January 3, 2015. Stanley had until January 2, 2016 to report the fraud, and he did so within that time. While he did not open the bank statement until March 15, 2015, he realized at that time Susan forged the check and immediately reported the forgery to Metro. Unless Metro Bank can show that but for the 3 month delay they would have caught Susan for forgery, the bank will not be able to use this defense because Stanley reported the fraud within 1 year.

d) This defense will support Metro Bank's refusal to recredit Stanley's account. Metro being able to show it was not negligent will support its claim that it does not have to recredit Stanley's account. Metro bank will be able to show that it did not breach any duty of ordinary care in processing the check because it followed its own policy, assuming Metro's policy is standard in its industry, which is all that is required of banks. Here, Metro Bank has a policy that it does not compare the signature on the check with the signature card on Stanley's account. If this is standard procedure of Banks in Texas, especially for a check as small as the forged one (\$500), then not comparing the signatures is not a breach of any duty of ordinary care, even if the signatures did not look alike. Therefore, Metro will be able to support its refusal to recredit with this defense.

2) Ace does not have any rights against Suburban for paying the \$10,000 check to Stanley. At issue is whether Ace's oral stop order and subsequent overdraft can be remedied against Suburban Bank for paying the \$10,000 check.

Oral stop orders are not enforceable in Texas. A stop order is enforceable on a bank only if it is in writing, signed,

dated, and describes with particularity the check that is being asked to put a hold on. Here, Ace called Suburban Bank and instructed it to stop payment on the check. Assuming Ace described it with particularity, it was not in writing, signed, dated, or described in the writing. Therefore, Bank had discretion to follow through with the stop order or not. Suburban decided to pay the check despite Ace's oral stop order. Because Suburban had discretion to stop or not stop payment, they cannot be held liable for payment on the check.

The fact that the check was stale and that the subsequent payment over drafted Ace's account does not make Suburban liable. Banks have discretion to pay a check when a check is stale (over 6 month old and hasn't been cashed) and pay a check knowing it will overdraft an account. Here, the check is stale because Stanley received the check on October 1, 2014, forgot about it in his desk drawer, and deposited it on June 15, 2015, which is more than 6 months old. Suburban's payment of a stale check and subsequent overdraft creates no liability for Suburban because they had discretion to pay the check

Therefore, Ace does not have any rights against Suburban for paying the \$10,000 check to Stanley.

### **Question 11 – July 2015 – Selected Answer 2**

(1)

(a) Stanley is probably not estopped from asserting the forgery because Susan was his assistant. A drawer may be estopped from asserting the forgery if it was committed by his agent. Here, Susan did have authority to manage his checking account and prepare checks, however, she did not have authority to sign checks for him. She was not an authorized drawer on the account. Therefore, her signature exceeded her authority and she cannot be said to be Stanley's agent such that the forgery can be attributed vicariously to him. This defense is not likely to be successful.

(b) Stanley was probably negligent in failing to secure his checkbook. A bank may defend itself from a charge of improper payout by a drawer if it can show that the forgery was caused by the drawer's own negligence. For example, if the drawer did not supervise his employee who perpetrated the fraud, or if he left blank spaces on the check making it susceptible to alteration, he could be found negligent, relieving the bank from liability. However, here, Stanley signed every check before it went out, he did not give Susan authority to sign checks. But the Bank will probably assert that he should have noticed a missing check because he should have been keeping track of the check numbers, especially after Susan, because presumably Stanley himself took over the checking account in her absence. The Bank may also claim that Stanley knew Susan had had financial trouble in the past and therefore should have been on notice that she might try to steal from his checking account out of desperation, and therefore he should have supervised her better than he did. Because of these factors, the bank will probably establish that Stanley was negligent in failing to secure his checkbook and succeed on this defense.

(c) Stanley did not fail to timely report the forgery. This defense will not work. A drawer has a duty to timely inspect his statements and report forgeries to the bank in a reasonable time. One year from the time the forgery appeared on a statement has been held reasonable. There is an exception to this time for a repeat offender. Where the same forger commits forgeries on a drawers account more than once, the drawer must report the first forgery within 30 days of it being on the statement, and if he does not, the bank is not liable for payouts after that 30 day mark. This exception does not apply here; nothing in the facts indicates that Susan is a repeat offender. Stanley received his statement with the forgery on January 3, 2015 and inspected it and notified the bank less than 3 months later, on March 15. This is timely. Because of this, the bank will not succeed on this defense.

(d) Metro bank did not breach its duty of ordinary care in processing the check. A drawee (bank) has a duty to pay out all check with reasonable care. The bank need not inspect every signature and compare it with a signature card, as long as it authenticates signatures pursuant to a reasonable policy and that policy is similar to other banks in the area. Reserving close inspection to checks for large amounts is considered a reasonable policy. Although the signature did not closely resemble Stanley's signature, there is no indication that the teller noticed this or should have noticed. Therefore, Metro bank's policy itself is reasonable as to this check for

\$500 and Metro will probably succeed on this defense.

(2) Ace will not recover from Suburban Bank for paying the check over his instruction. A bank has an obligation to pay out checks on the drawer's account, however, it must do so with reasonable care. A bank must issue a stop payment on a check where a drawer requests the stop payment in writing and specifically describes the check so that it is identifiable to the bank (for example, a drawer can send a letter asking to stop payment, including the amount and check number). Here, Ace's stop payment request was oral and did not appear to adequately identify the check with any kind of particularity, so it was not binding on the Bank and the Bank could properly pay the check.

The length of time between Ace's writing the check and Stanley's cashing it does not effect Suburban's liability. A check is stale after 90 days, and a bank is not onger obligated to cash it after that time. However, it is not prohibited from cashing it, even more than 6 months later as in this case.

The fact that the check overdrew Ace's account also does not bring liability on the Bank. A bank is permitted, but not required, to make payment on a check that will overdraw a drawer's account.

Note that a stop payment, even where valid, is only good for 90 days. So even if Ace's request were valid, the bank could properly pay out on the check 90 days later.