



# A Primer on Applying Articles 3 and 4 to THE TEN MOST COMMON CHECK DISPUTES

By Gregory C. Cook and John D. Pickering

This article will provide an overview of the law relating to disputes over payments of checks.<sup>1</sup> We focus on what are likely the 10 most common scenarios and the common facts and arguments for those 10. Litigation over checks usually falls into one or more of three categories: (1) unauthorized drawer<sup>2</sup> signatures, (2) forged endorsements<sup>3</sup> and (3) employee wrongdoing (which might include creating fictitious payees for checks, forging drawer signatures, forging endorsements or altering received checks). Often, the wrongdoer is not solvent and therefore the Uniform Commercial Code (“U.C.C.”)<sup>4</sup> attempts to allocate the loss by placing it upon the party best able to avoid the loss. This may be the depository bank<sup>5</sup> (the bank that took the check), the payor bank (the customer’s bank) or the customer. Often, the liability rules change based upon the due care of the parties and based on the drawer’s deposit agreement with its bank. Lawsuits can arise between the drawer and its bank, as well as between the depository and payor banks.

## DISPUTE ONE (Drawer vs. Its Bank): Drawer’s Signature Unauthorized

The starting point for disputes between a drawer and its bank is *Ala. Code* § 7-4-401(a), which provides that a bank may only charge a customer’s account for an item if it is

“properly payable,” which means: (1) “authorized by the customer and” (2) “in accordance with [the deposit agreement].”

An unauthorized signature can be either a forgery or simply one made without actual, implied or apparent authority. *Ala. Code* § 7-1-201(43); *Ala. Code* § 7-3-402 (signature by representative). In general, a check signed by an unauthorized third person as drawer is not properly payable and the customer’s bank may not charge the customer’s account and must re-credit the account of the customer. The three most common questions that arise in such circumstances are: (1) whether there were repeated forgeries by the same wrongdoer before notice by the customer to its bank (known as the “repeat wrongdoer” rule), (2) when the customer provided notice to its bank (even if no repeat wrongdoer) and (3) whether the customer was negligent in causing the unauthorized signature. The question of whether the check was signed by a human or by automated or facsimile will usually not change the outcome.<sup>6</sup>

### Repeat Wrongdoer Rule; Comparative Negligence Standard Unlikely to Help

Section 7-4-406(c) states that if a bank sends its customer a periodic account statement, the customer must (1) “exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized” and (2) must promptly notify the bank if a payment was not authorized. Under § 7-4-406(d)(2), if the customer fails to exercise such reasonable promptness, it is precluded from asserting an unauthorized signature by the *same wrongdoer* on any other items paid in good faith after a reasonable period of time for the customer to examine the previous unauthorized

item or a statement listing such item (not exceeding 30 days). Normally, this requirement of good faith will not assist the customer who has failed the repeat wrongdoer test, because Alabama (unlike some states) follows a subjective test for “good faith” for purposes of U.C.C. Articles 3 and 4. *Ala. Code* § 7-3-103(a)(4) defines “good faith” as “honesty in fact in the conduct or transaction concerned.” *Cagle’s, Inc. v. Valley National Bank*, 153 F. Supp. 2d 1288 (M.D. Ala. 2001); *Continental Casualty Co. v. Compass Bank*, 2006 WL 644472 (S.D. Ala. March 9, 2006). The defenses in § 7-4-406 must be pled as affirmative defenses. *Pinigis v. Regions Bank*, 942 So. 2d 841 (Ala. 2006).

This “repeat wrongdoer” rule is often important because it is common for the same wrongdoer to submit multiple checks over several months or even years. *E.g.*, *Cagle’s Inc. v. Valley National Bank*, 153 F. Supp. 2d 1288 (M.D. Ala. 2001).

Notwithstanding this rule, if the customer can show a lack of “ordinary care” by the bank that substantially contributes to the loss, the liability will be determined comparatively. *Ala. Code* § 7-4-406(e). In the case of an unauthorized drawer signature, it is very unlikely that a customer could succeed on such an argument. Section 7-3-103(7) defines “ordinary care” as the observance of reasonable commercial standards prevailing in the area. In the case of a payor bank that processes checks by automated means (which would likely be most banks today), the *Code* expressly recognizes that reasonable commercial standards would normally not require the bank to examine instruments (a possible exception could exist if the customer’s bank was also the bank that accepted the check from the wrongdoer and there is some further indication of negligence). *Ala. Code* § 7-3-103(7).

Further, it is becoming more and more common for no physical checks to be transmitted between merchants and banks, and between the depository and payor bank. Increasingly, physical checks are not transferred for collection (this is known as “check truncation”), rather there are electronic transmissions of instructions or images.<sup>7</sup> Under such an electronic system, it will be even less likely that the customer’s bank could be found comparatively negligent when there is an unauthorized/forged customer signature.

## Late Report by Customer after Receiving Statement

In addition to the repeat wrongdoer rule, *Ala. Code* § 7-4-406(d)(1) provides that a customer’s failure to comply with its duty under § 7-4-406(c) of reasonable promptness in examining its statement or items and promptly notifying the bank of relevant facts can shift liability to the customer, if the customer’s failure causes a loss to its bank because of an unauthorized drawer signature. As with the “repeat wrongdoer” rule, *Ala. Code* § 7-4-406(e)’s comparative negligence standard can shift a portion of this liability back to the bank. Because the “repeat wrongdoer” rule often applies in the same circumstances and because it does

not require proof of a loss “by reason” of the customer’s delay, *Ala. Code* § 7-4-406(d)(1) is not often relevant.

Section 7-4-406(f) goes even further and provides that (1) without regard to due care, (2) without regard to repeat wrongdoer and (3) without regard to loss “by reason” of the delay a customer who does not discover and report such unauthorized drawer signatures is precluded from recovery unless the customer provides notice within (1) 180 days after the statement *and* the items (or a copy or image of the items) are *sent* to the customer, or (2) within

one year after the statement *or* items are otherwise *made available*.<sup>8</sup> Further, there is no good-faith requirement for the application of this defense. *Pinigis v. Regions Bank*, 977 So. 2d 446, 452 - 55 (Ala. 2007).

However, in virtually every case the customer’s bank will have a deposit agreement which shortens both the 180-day and one-year periods, typically to 30 days.<sup>9</sup> While some commentators have objected to shortening this period and argued that such a provision may not be enforceable, it is very likely that it would be enforced in Alabama. The customer is clearly in the best position to determine an unauthorized or forged signature and they are unlikely to examine their statement after 30 days if they have not examined it before 30 days—and there are public policy reasons to encourage early reporting.<sup>10</sup>

## Negligence Substantially Contributes to Making

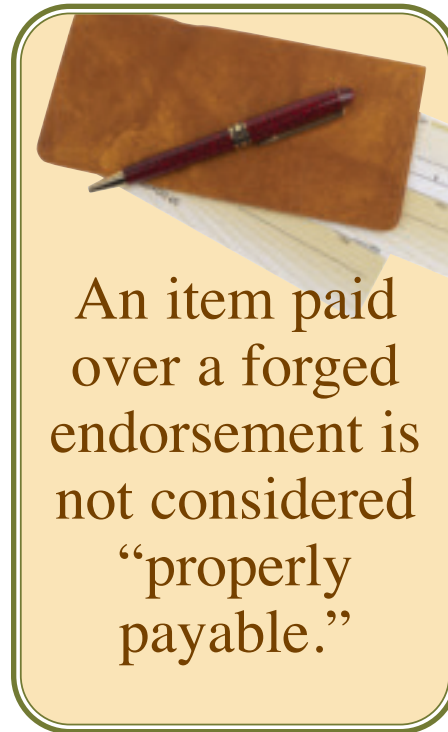
Section 7-3-406 states that a person whose “failure to exercise ordinary care substantially

contributes” to the making of a forged signature (not unauthorized<sup>11</sup>) is precluded from asserting such forgery against their bank. The burden of proving this lack of ordinary care is upon the bank. The Official Comments provide an example where an employer uses a rubber stamp to add signatures to a check and leaves the rubber stamp and blank check forms in an unlocked drawer; an unauthorized person then uses the rubber stamp to forge checks.

Conversely, the customer can again argue under § 7-3-406(b) that the bank failed to exercise ordinary care and such failure “substantially contributes to the loss.” Under § 7-3-406(c), the customer would bear the burden of proof on such an argument and it is unlikely that the customer will succeed on such an argument against its bank for an unauthorized drawer signature.

## DISPUTE TWO (Customer vs. Bank): Forged Endorsement

Again, only those checks that are “properly payable” may be charged against a customer’s account. An item paid over a forged endorsement<sup>12</sup> is not considered “properly payable.” With this said, there are a number of exceptions that recognize a bank’s ability to shift the loss to the customer.



## “Face-To-Face” Imposter Rule

If an imposter causes a customer to issue a check, then the endorsement of the imposter is deemed not to be a forgery and therefore the customer bears the loss. *Ala. Code* § 7-3-404(a). However, the bank must have paid the instrument in good faith. Further, if the person paying the instrument failed to exercise ordinary care then the person “bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.” *Ala. Code* § 7-3-404(d).

## “Fictitious Payee” Rule

If the payee is a fictitious person, then the endorsement of the payee is not deemed to be a forgery. *Ala. Code* § 7-3-404(b). For example, if an employee issues a check to a fictitious person and then forges the name of the payee and cashes the check, the customer’s bank would not be required to bear the loss (assuming it acted in good faith). The same rule applies if the employee writes the check to a real person but then forges the payee’s name.<sup>13</sup> In both cases, the forgery is deemed to be a legitimate endorsement. Note again the possibility of the customer claiming comparative negligence on the part of others. *Ala. Code* § 7-3-404(d).

## “Entrusting” Rule

If an employee wrongfully endorses a check, the employer will normally bear the loss if the employer has entrusted the employee with certain responsibilities. *Ala. Code* § 7-3-405. The entrusting rule covers both (1) an employee’s endorsing a check payable to the employer, or (2) an employee’s wrongful endorsement of a check issued by the employer.

For purposes of the “entrusting” rule, § 7-3-405 defines responsibility broadly, thus the employer may likely bear the loss. However, the employer must have done more than merely allowing access to checks, such as through the handling of the mail. Responsibility normally means the authority to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer or to control the disposition of instruments to be issued in the name of the employer. Further, “employee” is defined broadly to “include[] an independent contractor and employee of an independent contractor retained by the employer.”

If the person paying the instrument fails to exercise ordinary care and that substantially contributes to the loss, the person bearing the loss may recover to the extent that such failure contributed to the loss. *Ala. Code* § 7-3-405(b).

## Negligence Substantially Contributes to Making

As with unauthorized drawer signatures, § 7-3-406 states that a person whose “failure to exercise ordinary care substantially contributes” to the making of a forged endorsement is precluded from asserting such forgery.

## Standard Exception Requiring Consumer to Review Bank Statement—Rule Different for Endorsements


As with unauthorized drawer signatures, *Ala. Code* § 7-4-406 requires a customer to review its statement, but the standards are

somewhat different—requiring that notice of forged endorsements be provided within one year after statements or items are sent or made available (without regard to any negligence by the bank). Again, the deposit agreement may also have altered the rules for forged endorsements.

## DISPUTE THREE (Customer vs. Bank): Altered Checks

Normally, if a check is altered after it is written (for instance, the amount is changed), the customer’s bank may charge the account only according to the original terms. “‘Alteration’ means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.” *Ala. Code* § 7-3-407(a). However, the rules listed above can alter this outcome, including negligence by the customer that substantially contributes to the alteration (subject to a comparative negligence defense—*Ala. Code* § 7-3-406), failure to provide notice after receiving a bank statement (the rules from *Ala. Code* § 7-4-406 for unauthorized signatures apply to alterations also), or the deposit agreement.

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## DISPUTE FOUR (Theft Victim vs. Depository Bank): Forged Endorsement

Sometimes a thief steals a check made payable to the victim and forges the endorsement of the victim. Such a victim may have a conversion claim against a depository bank (although there may be some uncertainty if a physical check is not involved).<sup>14</sup> *Ala. Code* § 7-3-420(a) provides:

An instrument is converted under circumstances which would constitute conversion under personal property law. The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment.

## DISPUTE FIVE (Depository Bank vs. Payor Bank): Forged Endorsement or Alteration (Send the check back or warranty claim)

Because there are typically only two banks<sup>15</sup> involved in a checking dispute (the bank that takes the check and the bank that ultimately pays the check), the dispute is often over which bank must bear the loss. In general, there are two basic questions for allocating the loss—(1) may the payor bank return the check through the Federal Reserve System (or some other “clearing house”<sup>16</sup> system) to the bank which presented it, or (2) may the payor bank allege a breach of presentment or transfer warranty?

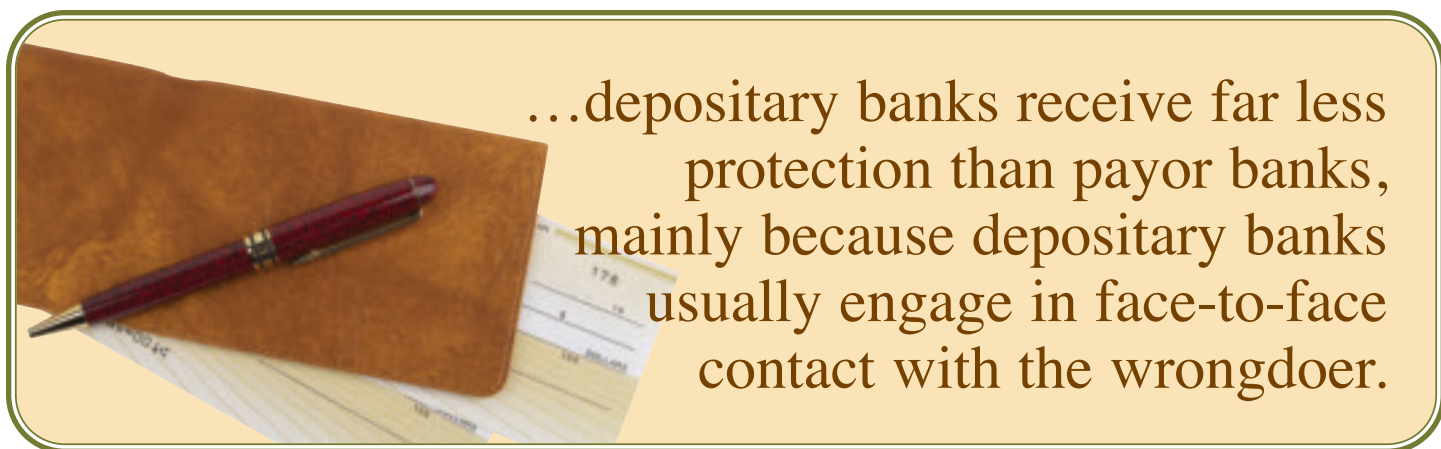
Returning the check through the Federal Reserve System is essentially a self-help remedy of the customer’s bank. It is very unlikely to occur without the customer’s bank being on the lookout for improper endorsements or alterations. The customer’s bank has very little time to exercise this remedy and may not do

so if it “retains the item beyond midnight of the banking day of receipt without settling for it or, whether or not it is a depository bank, does not pay or return the item or send notice of dishonor until after its midnight deadline.” *Ala. Code* § 7-4-302. The same result occurs under the Federal Reserve’s regulations. Under 12 CFR § 229.30(a), the payor bank must expeditiously return items it decides not to pay. Under 12 CFR § 229.30(a), this duty is satisfied only if the payor bank meets one of two tests: (1) under the two-day/four-day test, it returns an item in an expeditious manner if it sends the returned item in a manner such that it would be received by the depository bank not later than 4:00 p.m. on the second business day after presentment of local items, or not later than 4:00 p.m. on the fourth business day after presentment of non-local items, or (2) under the “forward collection test.” Under this second test, a payor bank returns an item in an “expeditious manner” if the bank sends the item in a manner that a similarly situated bank would normally handle an item, which is deposited for forward collection in the similarly situated bank by noon on the banking day following the banking day on which the check was presented to the payor bank.

In the alternative, the customer’s bank may assert a breach of presentment warranty against the depository bank if it is required to re-credit its customer’s account.<sup>17</sup> A transfer warranty claim may also be available to other entities in the chain. Typically, the presentment warranty would allow the customer’s bank to recover against the depository bank if (1) the check has been altered, or (2) the endorsement is forged but may not allow a recovery against the depository bank for an unauthorized drawer signature.<sup>18</sup>

In short, the two types of warranties that may be relevant are: (1) presentment warranties made by transferors to the payor (also sometimes known as the drawee) (*Ala. Code* §§ 7-3-417, 7-4-208),<sup>19</sup> (2) transfer warranties made by transferors to transferees other than the drawee or payor (*Ala. Code* §§ 7-3-416, § 7-4-207)<sup>20</sup>. If there are only two banks involved, the transfer warranty may therefore not apply; however if there have been transfers prior to the check reaching the banking system this warranty might apply or if there have been more than two banks involved, it may apply. Notice of a claim for a presentment warranty must be “within 30 days after the claimant has reason to know of the breach” or the warrantor is discharged “to the extent of any loss caused by the delay.”<sup>21</sup>

In sum, depository banks receive far less protection than payor banks, mainly because depository banks usually engage in face-to-face contact with the wrongdoer.<sup>22</sup>



...depository banks receive far less protection than payor banks, mainly because depository banks usually engage in face-to-face contact with the wrongdoer.

## DISPUTE SIX (Depository Bank vs. Payor Bank): Unauthorized Drawer's Signature

As between banks, the customer's bank is likely to bear the loss for the forged drawer's signature. The presentment warranty provides only a very narrow warranty of the authenticity of the drawer's signature by the earlier bank. This warranty is almost never applicable. The transferor only warrants that it "has no knowledge that the signature of the . . . drawer . . . is unauthorized." *Ala. Code* § 4-208(a)(3). Thus, in the case of an unauthorized drawer signature, where no defenses are available to the bank, the losses most often rest on the payor bank.<sup>23</sup> The justification for such liability is that a payor bank is in the best position to ascertain a forged drawer's signature, as the payor bank possesses the signature card of the drawer.

Of course, the customer's bank could send the check back through the Federal Reserve System (or other clearing house), but only if it meets the strict deadlines discussed earlier. Because the customer's bank is unlikely to meet this requirement, it will bear the loss.

There is also the possibility that both the drawer's signature and the endorsement have been forged. The *Code* and relevant case law treat "double forgeries" "as forged drawer's signature cases and impose liability solely on the payor bank."<sup>24</sup>

Finally, the drawer's bank might argue that the depository bank has been negligent in dealing with the wrongdoer. There is typically no duty to question customers in transactions,<sup>25</sup> but the customer's bank might argue that the depository bank failed to exercise ordinary care (for instance, depending upon the facts, arguments might be made where a bank accepts repeated checks without endorsements, or does not require identification, or the pattern of check-cashing (size, teller, date, etc.) indicates possible wrongdoing).

## DISPUTE SEVEN (Depository Bank vs. Payor Bank): Payable to Fictitious Person or to Person Not Intended to Have an Interest

Absent knowledge, it is not a breach of the presentment or transfer warranties for a depository bank to present a check to a payor bank which is payable to a fictitious person or to a person not intended to have an interest in the check. This is because the depository bank is considered a holder entitled to enforce the check. *Ala. Code* § 7-3-404(b). However, since a depository bank may sometimes be in a position to prevent fraud, the U.C.C. applies comparative fault with respect to such endorsements. *Ala. Code* § 7-3-404(d) (failure must "substantially contribute to loss"). For instance, it might be argued that a portion of the loss should be shifted to the depository bank if it allowed the opening of a corporate account in the name of the fictitious

party and made no effort to verify that depositors may act on behalf of such fictitious party by requiring corporate resolutions or other evidence of authorization.<sup>26</sup>

## DISPUTE EIGHT (Depository Bank vs. Endorser): Dishonored Check

If the check is returned to the depository bank (or if the depository bank is forced to pay under a presentment warranty), the endorser (if found) will be required to pay the depository bank. *Alabama Code* § 7-3-415 imposes liability on an endorser if an instrument is dishonored, and "the endorser is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the endorser endorsed an incomplete instrument, according to its terms when completed." See *Ala. Code* § 7-3-415. Endorsement includes signing the reverse of the check, stamping the reverse of the check or even simply depositing the check. *Ala. Code* § 7-3-204.

Typically the endorser will have a bank account at the depository bank. The deposit agreement will usually allow the depository bank to charge back the endorser's account if a check is returned. The *Alabama Code* also provides for a right to charge back the account or receive a refund, but limits this right if the depository bank delays and the right terminates once the depository bank receives final settlement of the item from the payor bank.<sup>27</sup>

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A depository bank must exercise ordinary care by providing such notice before midnight of the next banking day following receipt of a returned check or “within a reasonably longer time.”



The U.C.C. also imposes a duty upon a depository bank to notify its customer of a returned check in many circumstances. *Ala. Code* § 7-4-202(a)(2). A depository bank must exercise ordinary care by providing such notice before midnight of the next banking day following receipt of a returned check or “within a reasonably longer time” (but the bank must show this was reasonable). *See Ala. Code* § 7-4-202(b); 12 CFR § 229.33(d). However, the customer’s recoverable damages for such delay under 12 CFR § 229.33(d) are reduced by the amount of any loss they would have incurred even if the depository bank had provided the notice before its deadline to do so. *See* 12 CFR § 229.38(a).

## DISPUTE NINE: *What Common-Law Claims Can Customers or Banks Bring?*

Although articles 3 and 4 contain no express “displacement” provision, *Ala. Code* § 7-1-103 can be interpreted to reject the use of common law actions, given the concerns that the certainty and predictability of the U.C.C. would be undermined by allowing common-law claims to be raised and allowing different types and sizes of damages than allowed by the U.C.C. “The certainty which the Uniform Commercial Code seeks to achieve in respect to commercial transactions would quickly dissipate if *ad hoc* exceptions to its commands were too eagerly crafted to accommodate the occasional ‘hard case.’”<sup>28</sup> Thus, a large number of courts refuse to allow any common law torts such as conversion claims or negligence actions when not expressly authorized by the U.C.C.,<sup>29</sup> although there is a scattering of contrary precedent. Alabama appears to have adopted displacement.<sup>30</sup>

## DISPUTE TEN: *Drawer Customer vs. Depository Bank*

Although some states appear to allow a drawer to maintain a direct action against a depository or collecting bank for breach of presentment warranty (for instance, where the depository bank presented a check over a forged endorsement), Alabama does not.<sup>31</sup> Moreover, an issuer (that is, drawer) may not maintain a conversion claim; some plaintiffs have asserted a money had and received claim in such circumstances but there does not appear solid precedent on this claim yet.<sup>32</sup>

## CONCLUSION

There are a number of exceptions to the conclusions listed above. Because the U.C.C. is drafted with the intent of addressing most every situation possible, it is not always easy to find the answer to the recurring and more simple disputes. However, the basic rule of thumb is to assume the U.C.C. will place liability on the party who has the best opportunity to avoid liability and assume that the account agreement will likely alter the default U.C.C. rule. ▲▼▲

## Endnotes

1. For a detailed analysis of check fraud claims, *see* A. Brooke Overby, “Check Fraud in the Courts after the Revisions to U.C.C. Articles 3 and 4,” 57 *Ala. L.Rev.* 351 (2005).
2. The “drawer” of a check is the “person who signs or is identified in a draft as a person ordering payment.” *Ala. Code* § 7-3-103(a)(3).
3. An “endorsement” is “a signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of . . . negotiating the instrument.” *Ala. Code* § 7-3-204(a).
4. Both Article 3 and 4 of the U.C.C. have relevant provisions for disputes over checks. For the purposes of this article, no distinction is necessary between these U.C.C. provisions. Article 3 is directed at negotiable instruments (which include, but are not limited to, checks). Article 4 is directed at bank deposits and collections.
5. A “depository bank” is “the first bank to take an item.” *Ala. Code* § 7-4-105(2). The “payor bank” is “a bank that is the drawee of a draft.” *Ala. Code* § 7-4-105(3); *Ala. Code* § 7-3-103(c).
6. *Ala. Code* § 7-1-201(37) (signature is “any symbol executed or adopted with present intention to adopt or accept a writing,” comments note that court should “use common sense and commercial experience in passing” on whether a symbol is a signature); *Ala. Code* § 7-3-401(b) (“signature may be made . . . by means of a device or machine, and (ii) by the use of any name . . . or by a word, mark or symbol”). Moreover, banks today typically address facsimile signatures in their deposit agreements, allowing the drawee bank to rely on facsimile signatures as authorized. Such agreements regarding facsimile signatures should not violate the rule of *Ala. Code* § 7-4-103.
7. Congress recently passed “Check 21” (codified at 12 U.S.C.A. §§ 5001-5018 (Supp. 2005)). Check 21 encourages check truncation by allowing “substitute checks”—or electronic images of checks. Under the Act, substitute checks have legal status as checks.
8. The Official Comments to § 7-4-406 note that banks should provide information sufficient to allow the customer reasonably to identify the items paid. If the bank uses the minimum amount of information that is sufficient, the customer may argue that it could not have reasonably been able to discover the unauthorized payment. Such an argument may be relevant to *Ala. Code* § 7-4-406(d)(1) or possibly to other relevant provisions of 7-4-406. Of course, if the customer made a record of the issued checks on the check stub or carbonized copies, the customer should be able usually to verify the paid items and discover any unauthorized checks. There could be exceptional circumstances if a check is altered by changing the name of the payee; the customer could not detect this fraud normally without seeing the check.
9. *Ala. Code* § 7-4-103(a) provides that an agreement may vary the U.C.C. rules, but cautions that the parties cannot disclaim any applicable responsibility of a bank “for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure.”
10. Among the many reasons to encourage early reporting is the ability to mitigate the loss, and not just for repeated wrongdoers. For instance, if the proceeds from the check are deposited into another bank account (surprisingly often the case), there is no real loss until those funds are withdrawn. *See Ala. Code* § 7-4-214; *Ala. Code* § 7-

- 3-418. Further, the bank's customer agreement will likely provide the bank the right of setoff to recover such funds.
11. The Official Comments to *Ala. Code* § 7-3-406 explain that negligence contributing to the making of an unauthorized signature (as opposed to a forged signature) are handled under agency law and therefore *Ala. Code* § 7-3-406 is not necessary for such cases.
  12. For purposes of this rule, endorsement includes both (1) an endorsement in a substantially similar name as the payee, and (2) the deposit into an account in a name substantially similar to the payee (no matter how the actual endorsement appears on the check). *Ala. Code* § 7-3-404(c).
  13. *Ala. Code* § 7-3-110 states that the identity of the person to whom an instrument is payable is determined by the intent of the person who signs on behalf of the issuer of the instrument. Section 7-3-404 states that if a person whose intent determines to whom an instrument is payable does not intend the person identified as payee to have any interest, then the endorsement by any person in the name of the payee is effective in favor of a person who in good faith pays the instrument or takes it for value or for collection.
  14. *Compare Southtrust Bank v. Donely*, 925 So. 2d 934, 941-2 (Ala. 2005) (refusing to recognize conversion claim where bank refused to pay CD and distinguishing other cases where a physical CD form was involved).
  15. The exception to this rule that only two banks are involved is when there is an "intermediary bank" which is a bank handling an item for collection—normally acting for smaller banks. *Ala. Code* § 7-4-105(2). Typically, the warranty rules simply treat this bank as another link in the chain and it would likely be relevant only if there were insolvency involved or if the intermediary bank somehow failed to act appropriately (for instance, lost the check) or with reasonable promptness.
  16. A "clearing house" is an association of banks that regularly clears items between those banks. *Ala. Code* § 7-4-104(a)(4). Such a "clearing house" can occur in large metropolitan areas with several very large financial institutions.
  17. *See Ala. Code* § 7-3-417; *Longview Bank and Trust Co. v. First National Bank of Azle*, 750 S. W. 2d 297, 6 U.C.C. Rep. 2d 447 (Tx. Ct. App. 1988) (failure to return the check does not stop a breach of warranty action).
  18. *Ala. Code* §§ 7-4-207, 7-4-208. If an employee has wrongfully endorsed the check under *Ala. Code* § 7-3-405, the result may change and there may have been a breach of the presentment warranty by the depository bank because of § 7-3-405(b), which states that such an endorsement is "effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person"; however, comparative negligence may prevent such a result. *Ala. Code* § 7-3-405(b) ("fails to exercise ordinary care...and that failure substantially contributes to loss").
  19. A party who presents an item to the payor bank warrants in good faith:
    - (1) they are a "person entitled to enforce the draft" or authorized to obtain payment on behalf of a person entitled to enforce;
    - (2) the draft has not been altered;
    - (3) they have no knowledge that the signature of the drawer is unauthorized.

*Ala. Code* § 7-4-208. A "person entitled to enforce" normally means a "holder." *Ala. Code* § 7-3-301. To be a holder, a party must have obtained the check via "negotiation" which means a transfer of possession by a person who is not the issuer. Negotiation can only occur from a holder. *Ala. Code* § 7-3-201(b). Therefore, a depository bank which cashes a check from a thief is not a holder and therefore breaches its presentment warranty by presenting the check to the payor bank.
  20. A party who transfers an item (other than to the drawer bank or drawer) warrants in good faith, the same three items for a presentment warranty. *Ala. Code* § 7-4-207. In addition, they warrant that the item is not subject to a claim of recoupment that can be asserted against the warrantor and that the warrantor has no knowledge of any insolvency proceeding commenced against the maker or acceptor or, in the case of an unaccepted draft, the drawer.
  21. *AOD Federal Credit Union v. State Farm Fire and Cas. Co.*, 931 So. 2d 31, 36 (Ala. Civ. App. 2005) (citing 4-208(e) and 4-207(d) and refusing breach of warranty claim because issuer of check failed to provide notice of breach (failure to have all payees endorse) within 30 days; court noted need for a causal connection between delay and loss by the depository bank from untimely notice).
  22. Sometimes even a depository bank uses automated means for deposit. *See, e.g., Grand Rapids Auto Sales, Inc. v. MBNA Am. Bank*, 227 F. Supp. 2d 721, 726 (W.D. Mich. 2002) (credit card bank used wholly automated means to process checks sent for payment of credit card bills).
  23. No presentment warranty is created as to the genuineness of the drawer's signature. *See, e.g., Raymond Nimmer, Hawkland, Uniform Commercial Code Series*, Sec. 3-417.7 and 3-418.2 (2006); *see also Decibel Credit Union v. Pueblo Bank & Trust Co.*, 996 P.2d 784 (Co. Ct. App. 2000) (holding presenting bank did warrant forged maker's signature); *Ala. Code* § 7-3-417, Official Comment 3 ("drawee takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized"); *Ala. Code* § 7-3-301 ("A person may be a person entitled to enforce the instrument even though the person... is in wrongful possession.").
  24. *Perini Corp. v. First Nat. Bank of Habersham County*, 553 F.2d 398, 402 (5th Cir. 1977); *Cumis Ins. Society, Inc. v. Girard Bank*, 522 F. Supp. 414, 419 (E.D. Pa. 1981).
  25. *Smith v. AmSouth Bank, Inc.*, 892 So. 2d 905, 912 (Ala. 2004) (finding that a bank's failure to follow its established policy was insufficient evidence of failure to exercise ordinary care); *Schmitz v. Firststar Bank Milwaukee*, 664 N.W.2d 594, 596 (Wis. 2003); *but see Am. Parkinson Disease Assoc. v. First Nat'l Bank of Northfield*, 584 N.W.2d 437, 439 (Minn. Ct. App. 1998) (not a commercially unreasonable practice to accept checks without payee's endorsement).
  26. *Ala. Code* § 7-3-404(d) and Official Comment 3 (cross-referencing Official Comment 4 to 3-405); *Ala. Code* § 7-3-405(b) & Official Comment 4.
  27. *Ala. Code* § 7-4-214(a) (allowing depository bank to recover when there is a "provisional" settlement but establishing a delay rule subject to reasonableness inquiry); Official Comment 3 (right to refund terminates upon final settlement); *see generally Ala. Code* § 7-4-215 (defining when final payment occurs).
  28. *Brown v. Cash Mgmt. Trust of Am.*, 963 F. Supp. 504, 506 (D. Md. 1997).
  29. *See Cagle's Inc. v. Valley Nat'l Bank*, 153 F. Supp. 2d 1288, 1298 (M.D. Ala. 2001) (holding that embezzlement victim's common law and gross negligence claims were displaced by the U.C.C.); *Gress v. PNC Bank*, 100 F. Supp. 2d 289, 292 (E.D. Pa. 2000) ("[D]isplacing common law tort liability . . . is vital to [the U.C.C.] project."); *Lee Newman, M.D., Inc. v. Wells Fargo Bank*, 104 Cal. Rptr. 2d 310, 317 (Cal. Ct. App. 2001) ("We therefore conclude that the common law cause of action for negligence has been displaced."); *but see Bucci v. Wachovia Bank, N.A.*, 591 F.Supp.2d 773, 780-81 & n.7 (E.D.Pa. 2008) (allowing negligence claim to survive 12(b)(6) but indicating displacement might apply at summary judgment).
  30. *See, e.g., SpanCom Services, Inc. v. SouthTrust Bank, N.A.*, 744 So. 2d 931 (Ala. Civ. App. 1999) (holding that, where the bank has a defense under § 7-4-406(f), the plaintiff "is absolutely barred from recovering damages, regardless of whether SouthTrust [the depository bank] was negligent in cashing the checks and regardless of whether Compass [the payor bank] was negligent in drawing money from SpanCom's account"); *AOD Federal Credit Union v. State Farm Fire and Cas. Co.*, 931 So. 2d 31, 36 & n.3 & n.4 (Ala. Civ. App. 2005) (noting that UCC displaces common law conversion claims but noting the "split of authority" about common law negligence for drawers against depository banks).
  31. *See Ala. Code* § 7-3-417 and Official Comment 2 ("There is no warranty made to the drawer under subsection (a) when presentment is made to the drawee"); *Cassello v. Allegiant Bank*, 288 F.3d 339, 341 (8th Cir. 2002) (determining that warranties do not extend to the drawer).
  32. *Ala. Code* § 7-3-420(a); *AOD Federal Credit Union v. State Farm Fire and Cas. Co.*, 931 So. 2d 31, 36 (Ala. Civ. App. 2005) (stating that issuer may not bring conversion claim); *Continental Casualty Co. v. Compass Bank*, 2006 WL 566900 (S.D. Ala. March 6, 2006) (refusing to dismiss a money had and received claim brought by an issuer because of factual dispute over whether depository bank still had any funds from such checks).



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