

Check Claims

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Bob Bookkeeper worked for ABC Widgets, Inc., a relatively small company that manufactured widgets. It was a dream job for Bob Bookkeeper because his boss trusted him to manage the company's books and finances with little supervision, giving Bob Bookkeeper a real sense of autonomy and accomplishment.

Bob Bookkeeper did it all. He managed all of ABC's deposit accounts and reconciliations, handled all accounts payable and receivable, and handled ABC's corporate credit card accounts. He kept ABC's finances running smoothly so that management could focus its time on developing more and better widgets.

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One day, Bob Bookkeeper found himself in an unexpected and difficult situation. He was a bit short on funds for the month and needed an extra \$200 to pay his rent. Unable to borrow money from friends or family, Bob Bookkeeper started to panic. He tried to calm his nerves by placing deeper focus on his job, and he started to review the pile of accounts receivable on his desk:

\$148 from Charlie Customer
\$396 refund from Victor Vendor
\$200 from Kevin Kustomer

\$200? \$200! Ugh, the exact amount of money needed to pay his rent.

Bob Bookkeeper went to his bank and sat down with a business banker. Bob explained that he wanted to open a business checking account in the name of ABC Widgets, LLC. After the bank obtained the necessary paperwork to ensure it had complied with its Know Your Customer protocols¹ (for more on this, see “Forged Payee Checks” in this chapter), Bob walked out of the bank with a shiny new checking account in the name of ABC Widgets, LLC.

Bob Bookkeeper took the \$200 check from Kevin Kustomer, conveniently payable only to “ABC Widgets” instead of “ABC Widgets, Inc.” and deposited it into his new ABC Widgets, LLC account. One day later, Bob transferred the money to his personal checking account and successfully paid his rent. Crisis averted.

Despite feeling some guilt, Bob Bookkeeper took comfort in knowing that it was highly unlikely he would ever get caught. After all, it is *just* \$200, and he handled all of ABC’s finances. Some time passed, and when Bob’s car broke down, he needed an extra \$800 for the repairs. He got away with taking \$200. Could he get away with \$800 as well? Bob devised another plan. He told his boss that ABC had a rodent problem in one of its warehouses, and he needed a check for \$800 to pay the exterminator. Bob’s boss presented Bob with a signed check for \$800 with the payee line left blank. Bob returned to his office, wrote his own name on the payee line, deposited the check, and paid for the repairs to his vehicle with the funds.

1. The paperwork includes, but is not necessarily limited to, the LLC’s formation documents and ownership agreements, any necessary business license, and the Employer Identification Number (EIN).

But what happens when ABC's bank issues a monthly account statement? Wouldn't a copy of the \$800 check payable to Bob be included? Not to worry. Bob got the mail and had exclusive control over reconciling the accounts. Bob would simply dispose of the check, and ABC would be none the wiser.

Additional time passed, and Bob started to dwell on how easy it was to take the money, and the fact that he had gotten away with taking \$1,000 from his employer. He developed other schemes and created fake vendors. More boldly, Bob began to forge his boss's signature on certain checks made payable to himself. Bob engaged in each of these scams each month, and with each passing month of not getting caught, his confidence grew, and eventually he was siphoning thousands of dollars away from ABC Widgets each month . . . for years.

One day, Oliver Owner, the owner of ABC Widgets, read on his favorite local news website that Evan Exterminator passed away. But wait, Oliver remembered signing a check yesterday that Bob Bookkeeper said was intended for Evan Exterminator. How could that be if Evan passed away a few days ago? Oliver went to speak with Bob, and Bob's entire scheme fell apart. Oliver hired a forensic accountant to examine their books, and Oliver learned that Bob had stolen over \$500,000 from ABC Widgets over the course of more than two years.

Oliver is furious and wants Bob to be imprisoned. Oliver wants to sue anyone and everyone under the sun: Bob, Bob's bank, and even ABC's own bank. How could this happen? Oliver trusted Bob, and now his business has suffered this enormous loss. This loss certainly wasn't his fault—after all, he hired Bob to handle his company's finances. What else could he have done? Or was it his fault? Should he have supervised Bob Bookkeeper and placed tighter controls over his company's finances? It is time to go see Lisa Lawyer.

Lisa Lawyer is sitting at her desk when Oliver Owner walks in. Lisa has been representing Oliver for a long time and considers Oliver to be one of her favorite clients. She is eager to help. Oliver explains everything—how he did a full criminal background check on Bob Bookkeeper that came back clean, how he hired Bob to take care of ABC's finances, and that he trusted that Bob was an honest person who would handle ABC's finances responsibly. How could Bob do this and get away with it? Why didn't ABC's bank notify Oliver of potentially suspicious activity? Lisa Lawyer dug in.

I. CLAIMS AGAINST ABC'S BANK: THE GENERAL RULE

Lisa Lawyer explains to Oliver Owner the general rule that a customer is not liable for a check drawn on his account if he did not sign the check or otherwise benefit from its proceeds, a rule that dates back centuries.² Perfect, Oliver exclaims! He did not sign any of these checks, and ABC certainly did not benefit from any of the proceeds. Will ABC's bank reimburse ABC for its losses?

Well, not so fast, cautions Lisa Lawyer. It is not quite that easy. Oliver cannot simply walk into ABC's bank, inform a banker that he did not personally sign or benefit from \$500,000 in checks, and expect the bank to reimburse him. Lisa Lawyer explains there are many considerations and defenses.³

A. The Account Agreement

Lisa Lawyer explains to Oliver Owner that his relationship with ABC's bank is founded on contract, and that the contract will, at least in part, determine the extent to which, if any, he can recover against ABC's bank. The contractual relationship between a bank and its depositors (i.e., customers) is memorialized by a signature card that the depositor signs upon opening an account.⁴ The signature card identifies all of the authorized signers (owners) of the account and is provided by the bank to the depositor concurrent with a standard deposit account agreement (typically referred to as the DAA). Although the specific language varies from bank to bank, the signature card will include language to the effect that by signing the signature card and/or by utilizing the account, the customer agrees to be bound by the terms of the DAA. The DAA outlines the rights and responsibilities of the bank and the depositor.

B. Forged Check Claim Procedure

Anxious to get started, Oliver Owner asks Lisa Lawyer how he should commence a claim against ABC's bank for payment on the forged checks. The

2. Price v. Neal, 97 Eng. Rep. 871 (K.B. 1762).

3. The claims and defenses discussed in this chapter are not in any way meant to be exhaustive. Rather, this chapter is meant to be explorative and touches upon many of the most common issues presented in a typical check claim case.

4. See, e.g., Chazen v. Centennial Bank, 61 Cal. App. 4th 532, 543 (1998).

first step in the process is typically to obtain, fill out, and sign an Affidavit of Forgery, as will be explained in the customer's DAA. A typical Affidavit of Forgery will identify the customer, the account number, and provide detailed descriptions of the allegedly forged checks. The customer must provide a declaration affirming that the checks are forged, and the forms will typically include a space for the customer to highlight if there are any persons suspected of the wrongdoing.

Lisa Lawyer advises that Oliver Owner should immediately obtain original copies, both front and back, of all forged checks (if available). Oliver Owner must identify the time period over which the loss occurred—i.e., the date of the first allegedly forged check and the date of the most recent allegedly forged check.

It is a relatively painless procedure, after which the bank will begin its investigation into the customer's forgery claim. It is possible, although not required, that the bank will issue the customer a provisional credit during its investigation. If the bank concludes that the customer is a victim of fraudulent activity, the bank may elect (with or without notice to the customer) to close or suspend the account to prevent further fraudulent activity. Under certain circumstances, the bank may simply give the customer the *option* of closing the account to prevent future fraudulent activity. It should be noted that if the customer refuses to close the account for whatever reason (e.g., if the customer insists that changing account numbers would be too big of a burden), then the bank will likely refuse to honor any potential future fraud claims, arguing that such losses were preventable if the customer had elected to close the account. Lisa Lawyer explains that the bank will look to the DAA and the applicable provisions of the Uniform Commercial Code as defenses to the claim.

C. Duty to Review Monthly Account Statements

One of the most routine duties placed upon depositors in *every* DAA is the duty to timely review monthly account statements. Lisa Lawyer asks Oliver to provide her with a copy of the DAA governing ABC's business checking account. Sure enough, there is a provision that customers are required to review their monthly account statements and report any abnormalities to the bank within thirty days of the date the account statement is made available. The "made available" language is particularly important in the internet age, because a depositor may no longer receive actual paper copies of its monthly account statements by mail. Instead, the customer may simply

receive an email or other notification that the monthly account statement is available for viewing online. This notification is enough to trigger the commencement of the customer's thirty-day time period within which to review its statements and report abnormalities to the bank.

In addition to the contractual requirement in the customer's DAA, this duty has also been codified in the Uniform Commercial Code, which has been largely adopted (subject to, in most cases, relatively minor revisions) in all states.⁵ Section 4-406 of the Uniform Commercial Code provides that if a bank "sends or makes available a statement of account or items" the

customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.⁶

Lisa Lawyer looks cautiously at Oliver Owner and asks, "Did you review your monthly account statements provided by ABC's bank?" Upset, Oliver explains that he has never looked at a single monthly account statement issued by ABC's bank. After all, he hired Bob Bookkeeper to take care of that responsibility.

Bookkeeper Knowledge Is Imputed to Account Holder

Lisa Lawyer explains that this is a common position taken by most business owners—i.e., that they hired an otherwise qualified bookkeeper who they trusted to take care of the company's finances. Unfortunately for Oliver, this argument will get him nowhere. It has long been settled that where the wrongdoer (in this case, Bob Bookkeeper) has been vested with authority concerning the bank account, any knowledge that a faithful employee would have gleaned from the information available to

5. See *Uniform Commercial Code Adoption*, WIKIPEDIA, https://en.wikipedia.org/wiki/Uniform_Commercial_Code_adoption.

6. See UNIFORM COMMERCIAL CODE § 4-406(c). Depending on the state, there may be some slight variations in a state's references to sections of the Uniform Commercial Code. For example, California does not utilize dashes in statutory section numbers. Therefore, Section 4-406 is referred to as Section 4406 in the California Commercial Code.

the wrongdoer is imputed to their principal.⁷ This has been plainly and unequivocally stated by many courts:

When the agent to whom the duty of examination is intrusted [*sic*] is a dishonest employee who by forgery has obtained funds of his employer from the bank, and whose consequent adverse interest causes him to conceal from his employer the circumstances which would naturally have been disclosed in the course of a proper verification, the employer, though not imputed with knowledge of the fraud of his faithless agent, is, as principal, chargeable with such information as an honest employee, unaware of the wrongdoing, would have acquired from an examination of the cancelled checks and bank statements.⁸

Accordingly, even though Oliver Owner hired Bob Bookkeeper to handle ABC's finances, Oliver Owner, as the principal of ABC, is imputed with the knowledge that a *faithful* employee would have obtained from an examination of the monthly account statements issued by ABC's bank.⁹ Oliver Owner's argument that he personally failed to review his monthly account statements because he had hired Bob Bookkeeper to handle that function is a losing argument.

Balance of Duties

Recognizing that Oliver Owner is starting to squirm at the thought of losing \$500,000 due to Bob Bookkeeper's conduct, Lisa Lawyer quickly moves on to a discussion regarding the impact of Section 4-406(c). Uniform Commercial Code § 4-406(d) provides that if the bank can prove that the customer failed to comply with the requirements of Section 4-406(c) by failing to timely review its monthly account statements and report any abnormalities to the bank, the customer is precluded from asserting a claim against the bank for that item.¹⁰ However, if the customer can establish that the bank failed to exercise ordinary care in paying the item *and* that

7. See, e.g., *Kiernan v. Union Bank*, 55 Cal. App. 3d 111 (1976).

8. See, e.g., *Basch v. Bank of America*, 22 Cal. 2d 316, 327 (1943).

9. Note that, unlike California, certain jurisdictions carve out an exception if the employee was acting solely in their own interest, so be sure to check how strictly this rule is applied in your state.

10. See UNIFORM COMMERCIAL CODE § 4-406(d)(1).

the failure substantially contributed to the loss, the loss may be allocated between the customer and the bank according to the extent to which each contributed to the loss.¹¹ Oliver Owner starts to perk up a bit.

Oliver Owner reaches into his briefcase and pulls out a handful of checks forged by Bob Bookkeeper and lays them out on Lisa Lawyer's desk. He then shows Lisa Lawyer an exemplar of his own signature. Oliver believes that Bob Bookkeeper did a pretty poor job of forging his signature and believes ABC's bank should have been able to determine that the signatures were forgeries. "Ordinary care" is defined at Uniform Commercial Code § 1201(b)(2) as the observance of reasonable commercial standards prevailing in the area. In the case of a bank that takes checks for processing via automated means (such as acceptance via an Automatic Teller Machine [ATM]), reasonable commercial standards *do not* require the bank to examine each check so long as the bank's failure to do so does not violate the bank's internal policies and procedures and the bank's procedures do not vary unreasonably from general banking usage.¹² Because most banks accept checks via automated means, and because most banks accept at least several thousand checks per day via such means, it is generally accepted that most banks are not required to examine each check.¹³ As such, the notion that the signatures may be obvious forgeries does not equate with a finding that the bank failed to exercise reasonable commercial standards in processing the check. Lisa Lawyer therefore advises Oliver Owner that it will be vitally important to determine the manner in which each check was deposited, whether electronically or over the counter.

The Repeater Rule

Lisa Lawyer then delivers information on the next hurdle—the Repeater Rule. Building on the rule set forth at Uniform Commercial Code § 4-406(d)(1) that a customer cannot recover against a bank if the customer failed to timely review the monthly account statements, Uniform Commercial Code § 4-406(d)(2) provides that if the same wrongdoer forges a series of checks over a period of time, and the customer fails to identify and report the first of such checks to the bank within a reasonable amount

11. See *id.* § 4-406(e). Further, depending on the state, this analysis can be one of contributory negligence, comparative negligence, or a straight bar to recovery.

12. See, e.g., *Story Road Flea Market, Inc. v. Wells Fargo Bank, N.A.*, 42 Cal. App. 4th 1733 (1996).

13. *Id.*

of time, not exceeding thirty days following the provision of the first statement reflecting the forgery, the customer is precluded from recovering as to any of the subsequent checks.¹⁴

Bob Bookkeeper was forging Oliver Owner's signature on checks for more than two years, and Oliver Owner's ability to recover will be substantially limited by the fact that Oliver Owner failed to identify and report the first of such checks to ABC's bank. Lisa Lawyer explains that the logic behind this rule is quite simple: if Oliver Owner had properly examined his monthly account statements in a timely manner, he would have learned of Bob Bookkeeper's forgeries after a very short amount of time had passed—at a time when the total loss was minimal. Instead, Oliver Owner's failure to review his monthly account statements allowed Bob Bookkeeper to continue his forgery scheme for more than two years. Hence, what could have been a *de minimus* loss has ballooned into a \$500,000 loss.¹⁵

Issue Preclusion

Oliver Owner is growing tired of hearing bad news and asks Lisa Lawyer to shift back to the discussion about apportionment of losses. Oliver wonders if he can recover against ABC's bank if they can demonstrate that ABC's bank did fail to follow reasonable commercial standards. Uniform Commercial Code § 4406(f) provides that

[w]ithout regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (subsection (a)) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration.¹⁶

14. See UNIFORM COMMERCIAL CODE § 4-406(d)(2). This thirty-day period can be reduced by the bank's account agreement with its customers. For example, in New York many banks use a fourteen-day period. If a bank lists a period of less than fourteen days, such a restriction may be difficult to enforce.

15. See, e.g., *Espresso Roma Corp. v. Bank of America*, 100 Cal. App. 4th 525 (2002).

16. See UNIFORM COMMERCIAL CODE § 4-406(f). Practitioners should note that Section 4-406(f) is not a statute of limitations; it is an issue-preclusion statute. As such, equitable tolling does not apply. Further, it is a separate affirmative defense and must be pled separately from the statute of limitations. If the bank fails to plead it as a separate affirmative defense, it is possible that a court will deem it waived. See, e.g., *Pinigis v.*

Here, because Oliver Owner failed to detect Bob Bookkeeper's forgeries and report the unauthorized transactions to ABC's bank for more than two years, Oliver Owner will be precluded from recovering against ABC's bank regardless of ABC's bank's alleged lack of care.

Statute of Limitations

Another timing defense is a traditional statute of limitations defense. California, for example, added forged check claims to its broader one-year statute of limitations statute: "[w]ithin one year . . . [a]n action . . . by a depositor against a bank for the payment of a forged or raised check, or a check that bears a forged or unauthorized endorsement . . ."¹⁷ While many statutes of limitations can be tolled or otherwise extended by, for example, a delayed discovery rule, California courts have consistently interpreted Section 340 to mean exactly what it says: the statute of limitations is one year, without exception.¹⁸

At this point, Lisa Lawyer must deliver the unfortunate news that, absent some other extraordinary facts, Oliver Owner has no viable claims against ABC's bank for the forged maker checks.

II. CLAIMS AGAINST BOB BOOKKEEPER'S BANK

Convinced that his claims against his own bank likely lack merit, Oliver Owner now shifts the discussion to Bob Bookkeeper's bank. Can Oliver Owner pursue any claims against Bob Bookkeeper's bank?

Lisa Lawyer dives in. She explains that claims by Oliver Owner against the depository bank (the term used to describe Bob Bookkeeper's bank, as the bank of first deposit) are governed by an entirely different set of rules, and for obvious reasons. Bob Bookkeeper's bank does not provide account statements to Oliver Owner, so Oliver Owner is not obligated (or able) to

Regions Bank, 977 So. 2d 466 (Ala. 2007). Practitioners should also note that this one-year time period can be reduced by the bank in the applicable DAA, as permitted by Uniform Commercial Code § 4-103(a). Such reductions have been upheld by numerous courts throughout the country. *See, e.g., American Airlines Employees Fed. Credit Union v. Martin*, 29 S.W.3d 86 (Tex. 2000).

17. *See* CALIFORNIA CIVIL CODE § 340(c).

18. *See, e.g., Roy Supply, Inc. v. Wells Fargo Bank, N.A.*, 39 Cal. App. 4th 1051 (1995); *Kiernan*, 55 Cal. App. 3d 111.

review any set of documents to determine if Bob Bookkeeper is engaged in wrongdoing. And certain types of fraud committed by bookkeepers would never be disclosed in an account statement. Remember that Bob Bookkeeper took a \$200 check from Kevin Kustomer payable to ABC Widgets and deposited that check into an account he opened in the name of ABC Widgets, LLC. It is possible (although unlikely) that Karl Kustomer might discover this fraud, but Oliver Owner will be unable to discover this fraud because such a check would never be presented to Oliver Owner for review—the negotiated check did not flow through ABC’s account. Because of this and other such facts, claimants will frequently attempt to shift a loss from themselves to the depository bank.

A. Forged Payee Checks

Bob’s forgery represents the classic example of a forged payee check. Kevin Kustomer issued a check payable to ABC Widgets. He, of course, intended the check to be payable to ABC Widgets, Inc., but only wrote ABC Widgets on the check itself. Bob Bookkeeper capitalized on that limitation by opening a business checking account in the name of ABC Widgets, LLC and deposited the check into that account for his own use. Kevin Kustomer’s bank would not be liable for such a loss because the payor bank does not have a duty to check payee endorsements.¹⁹ And Oliver Owner’s bank would not be liable for that loss because that check was never presented to Oliver Owner’s bank. But what about Bob Bookkeeper’s bank?

If Bob Bookkeeper’s bank accepted the check presented by Bob Bookkeeper into Bob’s ABC Widgets, LLC, account in good faith and in accordance with reasonable commercial standards, recovery may be precluded. The primary issue here is whether Bob Bookkeeper’s bank followed reasonable commercial procedures in allowing Bob to open an account in the name of ABC Widgets, LLC. Did Bob have the proper and necessary documents to establish his ownership or control of an entity by that name? Did Bob provide the bank with the LLC’s formation documents and ownership agreements? Did Bob provide a copy of any necessary business license? What about the necessary Employer Identification Number (EIN)? If all the paperwork was in order, Bob Bookkeeper’s bank likely acted in accordance with reasonable commercial standards in allowing the account to be opened, and recovery is precluded. However, if any of these items were

19. See, e.g., *Guardian Life Ins. Co. of America v. Weisman*, 223 F.3d 229 (3d Cir. 2000).

missing and/or if any of these items contained obvious defects, recovery becomes a possibility.

Lisa Lawyer further explains to Oliver Owner that Bob Bookkeeper's bank may not be liable for accepting the checks payable to ABC Widgets into Bob Bookkeeper's ABC Widgets, LLC, account if the payor bank (in the above example, Kevin Kustomer's bank) is not liable to its customer. Accordingly, all the issues discussed above regarding the duty to examine monthly account statements, the duty to timely report unauthorized activity, and potential statutes of limitations come into play here as well.

B. Checks Payable to a Fictitious Payee

Another common scheme by bookkeepers is inducing the employer to properly endorse a check payable to a fictitious payee. The scheme operates like this: Bob Bookkeeper tells Oliver Owner that ABC Widgets needs to retain the use of Vivian Vendor for a specific purpose. Vivian Vendor does not exist; however, trusting Bob's representation, Oliver Owner actually signs a check payable to Vivian Vendor in the amount of \$10,000. Bob Bookkeeper now opens a business checking account in the name of Vivian Vendor and deposits the check into that account for his own use.

Fictitious payee claims are governed by Uniform Commercial Code § 3-404. In this situation, no bank is liable in most circumstances because Oliver Owner's signature on the check is legitimate, and because he intended to issue a check payable to Vivian Vendor. The fact that Vivian Vendor does not exist does not translate to liability as against any bank unless, again, it can be established that Bob Bookkeeper's bank did not follow reasonable commercial standards in allowing an account to be opened in the name of Vivian Vendor.²⁰

C. Claims Sounding in Negligence

The broader category of claims against Bob Bookkeeper's bank will sound in negligence based on the theory that Bob Bookkeeper's bank failed to follow reasonable commercial standards in processing the items. In addition to facing the same types of issues detailed above, claims sounding in negligence face a host of issues pertaining to the establishment of a duty.

20. See UNIFORM COMMERCIAL CODE § 3-404.

Banks Owe a Duty of Care Only to Their Depositors

A bank owes a duty to use ordinary care in its transactions with depositors.²¹ The duty is created by implication in the contract (the DAA) between the bank and its depositors.²² Notably, “[t]his contractual relationship does not involve any implied duty ‘to supervise account activity’ or ‘to inquire into the purpose for which the funds are being used.’”²³ Although a bank owes a duty to use ordinary care in its transactions with depositors, the California Court of Appeal also recently clarified that such duty extends only to utilizing care in transactions with the depositor’s own account(s)—i.e., a bank does not owe a duty of care to a customer to monitor other depositors’ accounts.²⁴

In the context of check claims cases, Oliver Owner might wonder why Bob Bookkeeper’s bank did not monitor Bob Bookkeeper’s account usage or notice that Bob Bookkeeper would deposit money into his ABC Widgets, LLC, account only to then subsequently transfer the funds to his personal checking account. While there might be reasons why Bob Bookkeeper’s bank was monitoring Bob Bookkeeper’s account (e.g., for anti-money laundering purposes), such monitoring would be for the bank’s own benefit, as required by the vast number of regulations imposed upon bank activity. There is no argument that Bob Bookkeeper’s bank should have been monitoring Bob Bookkeeper’s account for suspicious activity for the benefit of Oliver Owner or for any third party.

Banks Do Not Owe a Duty of Care to Noncustomers

Another general principle, sort of a corollary to the principle that banks owe duties only to depositors, is that banks do not owe a duty of care to noncustomers.²⁵ Banks do not even owe a duty of care to the officers or shareholders of a corporation that holds an account.²⁶ Taking this concept further, courts have likewise held that “a bank owes no duty to non-depositors to investigate or disclose suspicious activities on the part of an

21. *See, e.g.*, *Chazen v. Centennial Bank*, 61 Cal. App. 4th 532, 543 (1998).

22. *Id.*

23. *See, e.g.*, *Barclay Kitchen, Inc. v. California Bank*, 208 Cal. App. 2d 347 (1962).

24. *Kurtz-Ahlers, LLC v. Bank of America, N.A.*, 48 Cal. App. 5th 952 (2020).

25. *See, e.g.*, *Karen Kane, Inc. v. Bank of America Nat’l Trust and Savings Assoc., Inc.*, 67 Cal. App. 4th 1192 (1998).

26. *See, e.g.*, *Roy Supply*, 39 Cal. App. 4th 1051.

account holder.”²⁷ The reasoning behind the refusal to recognize a duty by banks to inform on suspicious customers is the public policy of “avoid[ing] the loss of privacy, expense and commercial havoc that would result from such a holding.”²⁸

These concepts can often apply to check claims as well. For example, imagine that during the discovery phase it was revealed that Bob Bookkeeper’s bank did suspect Bob Bookkeeper of fraud, and had, even temporarily, placed a freeze on Bob Bookkeeper’s ABC Widgets, LLC, account. Neither that suspicion nor the account freeze would result in any *obligation* being imposed upon Bob Bookkeeper’s bank to notify Oliver Owner of the suspected fraud.

Banks Do Not Owe Common Law Duty of Care to Protect Against Purely Economic Losses

In check fraud cases, it is relatively common to see a plaintiff attempt to assert a common law negligence claim against the depository bank—i.e., a claim not based on the Uniform Commercial Code. However, courts have established a bar to the creation of a tort duty of care to protect against purely economic losses, otherwise known as the Economic Loss Rule.²⁹

Outside the realm of contractual duties of care, in certain circumstances a defendant may owe a plaintiff a tort duty of care. However, the California Supreme Court has definitively held as a matter of law that a defendant does not owe a plaintiff a tort duty of care to protect against purely economic losses. “Purely economic loss” is shorthand for

“pecuniary or commercial loss that does not arise from actionable physical, emotional or reputational injury to persons or physical injury to property.” And although [defendant] of course had a duty to guard against the latter kinds of injury, we conclude it had no tort duty to guard against purely economic losses.³⁰

27. See, e.g., *Casey v. U.S. Bank Nat’l Ass’n*, 127 Cal. App. 4th 1138, 1149 (2005). Indeed, this goes beyond the issue of duty because a vast universe of bank regulations and privacy laws actually prevents a bank from disclosing activity to third parties, even if the bank wanted to make such a disclosure.

28. *Id.*

29. See, e.g., *Southern California Gas Leak Cases*, 7 Cal. 5th 391 (2019).

30. *Id.*

Because Oliver Owner's losses are purely economic—i.e., neither he nor his company suffered any sort of physical, emotional, or reputational injury—it will be challenging to establish that Bob Bookkeeper's bank, or any bank, owed Oliver Owner a tort duty of care.

Banks Do Not Owe Fiduciary Duty to Customers or Noncustomers

In check claims cases, a plaintiff will frequently assert that the bank owed them some sort of fiduciary duty to protect against embezzlement and other financial crimes. It is black letter law that a bank does not even owe a fiduciary duty to its own depositors.³¹ If a bank does not owe a fiduciary duty to its own depositors, there can be no colorable argument that it owes such a duty to a third party.

The Limited Duty of Care Owed to Third Parties

Perhaps the most popular case cited by plaintiffs in check claims cases, at least in California, is *Sun 'n Sand, Inc. v. United California Bank*.³² Due to the case's prevalence, it is worth discussing in some detail. As an initial matter, it should be noted that the *Sun 'n Sand* decision is not considered precedential authority. The dispute in *Sun 'n Sand* was determined by only five justices (instead of the standard seven justices), and the lead opinion had the support of only two.³³ As such, courts have rejected the idea that *Sun 'n Sand* is precedential authority.³⁴

Despite this fact, it is still heavily relied upon by plaintiffs and is still considered persuasive, if not binding, by many courts. The facts in *Sun 'n Sand* are similar to those involving Bob Bookkeeper. The plaintiffs were sister corporations that had the same shareholders and operated from the same premises. They hired an employee, Eloise Morales, whose duties involved preparing checks for signature by a corporate officer. Over a three-year period, Morales prepared nine checks payable to United California Bank. Each check was for a different, but relatively small, dollar amount. She obtained authorized signatures for each of the nine checks by representing that these small sums of money were actually owed by the corporation to United California Bank. After obtaining the authorized

31. See, e.g., *Price v. Wells Fargo Bank*, 213 Cal. App. 3d 465 (1989).

32. *Sun 'n Sand, Inc. v. United California Bank*, 21 Cal. 3d 671 (1978).

33. *Id.*

34. See, e.g., *Roy Supply*, 39 Cal. App. 4th 1051.

signatures, Morales altered the checks by increasing the dollar amounts represented, and then deposited the checks into her own personal account at United California Bank. Although United California Bank remained the named payee on the checks, the bank “caused or permitted” the proceeds of the checks to be deposited into Eloise Morales’s personal account.³⁵

Following a detailed analysis of the facts, the two California Supreme Court justices that prepared the lead opinion articulated a “minimal” and “narrowly circumscribed rule”: “it is activated only when checks, not insignificant in amount, are drawn payable to the order of a bank and presented to the payee bank by a third party seeking to negotiate checks for his own benefit.”³⁶ Although originally limited to checks drawn payable to a bank—i.e., United California Bank—subsequent decisions have followed *Sun ’n Sand* and extended the rule to apply to any third party.³⁷ Courts have articulated the resulting minimal rule as follows: a bank may be liable for “allowing a person to deposit a check, payable to someone else, into a personal account, under circumstances that should have alerted the bank to the possibility of fraud.”³⁸

Oliver Owner wonders if Lisa Lawyer has finally articulated a possible basis for recovery against Bob Bookkeeper’s bank. To make this determination, it is necessary to examine each of the forged checks in detail. If Bob Bookkeeper had asked Oliver Owner to sign checks payable to Fake Factory, Inc., by representing that ABC Widgets owed money to Fake Factory, Inc., and then was able to deposit those checks—again, payable to Fake Factory, Inc.—into his personal account at Bob Bookkeeper’s bank (i.e., an account in the name of Bob Bookkeeper), then *Sun ’n Sand* and its progeny would provide some potential support for recovery against Bob Bookkeeper’s bank. And because *Sun ’n Sand* provides for a three-year statute of limitations on the negligence claim and Bob Bookkeeper’s fraud was discovered within less than three years, Oliver Owner would have a basis for recovery.³⁹ If, on the other hand, Bob Bookkeeper deposited checks into business accounts with names that closely resembled the named payees—for example, the checks he deposited into the ABC

35. *Sun ’n Sand*, 21 Cal. 3d 671.

36. *id.* at 695 (emphasis added).

37. See *Joffe v. United California Bank*, 141 Cal. App. 3d 541 (1983); *E. F. Hutton & Co. v. City Nat’l Bank*, 149 Cal. App. 3d 60 (1983); *Sehremelis v. Farmers & Merchants Bank*, 6 Cal. App. 4th 767 (1992).

38. See, e.g., *Chazen*, 61 Cal. App. 4th at 543.

39. *Sun ’n Sand*, 21 Cal. 3d at 698.

Widgets, LLC, account—then the analysis reverts to that detailed earlier in this chapter. Bob also tricked Oliver into signing checks allegedly payable to Evan Exterminator, but the payee line was blank at the time Oliver signed the checks, and Bob subsequently added his own name. Neither of these scenarios are those envisioned by *Sun 'n Sand* and would not provide Oliver Owner a basis for pursuing a common law negligence claim against Bob Bookkeeper's bank.

III. WHAT DOES LISA LAWYER RECOMMEND?

Lisa Lawyer realizes that due diligence will require that she sit down with Oliver Owner and carefully analyze each and every check that was in any way forged or altered by Bob Bookkeeper before she can determine definitively if any claims can be properly stated against anyone other than Bob Bookkeeper himself. For now, Lisa Lawyer shifts from litigation mode into counseling mode. She suggests that if ABC Widgets, Inc., intends to proceed with hiring a new bookkeeper, then Oliver Owner, or another officer, should review and approve all check requisitions (and require the presentation of documentation supporting both the payee and the dollar amount). Oliver should directly receive monthly bank account statements and should consider retaining an outside accountant to conduct bank reconciliations. And, most importantly, no employee should ever be given complete authority over a company's entire business account apparatus.