

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

Holder in Due Course Summary

Frank Abagnale
President, Abagnale and Associates
www.abagnale.com

Greg Litster
President, SAFEChecks
www.safechecks.com

Holder in Due Course (HIDC) is a part of the Uniform Commercial Code (UCC) that significantly impacts an organization's liability for check fraud. After learning about HIDC claims, prudent organizations are often motivated to use high security checks and to change check disbursement procedures to protect themselves. The following is a brief explanation of Holder in Due Course.

In simple terms, a Holder in Due Course is anyone who accepts a check for payment. On the face of the check there cannot be any evidence of fraud, nor can the person accepting the check have knowledge of any underlying fraud related to the check. Under the UCC, the recipient of the check is an HIDC and is entitled to be paid for the check. This remains true even if the drawer placed a stop payment on the check, or if the check was rejected at the bank as a Positive Pay exception item.

Section § 3-302 of the Uniform Commercial Code defines a Holder in Due Course as "...the holder of an instrument if: (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument...has been dishonored, (iv) without notice that the instrument contains an unauthorized signature or has been altered...." The UCC allows a Holder in Due Course full transferability of rights to assure the holder a free market for the instrument (§ 3-203). A Holder in Due Course has three years from the date a check was dishonored or ten years from the date the check was issued, whichever period expires first, to sue the maker for recoupment (§ 3-118).

If a recipient (the Holder) is unable to negotiate the check, the Holder can sue the drawer (the check issuer) for the full face value of the check, and get a judgment against the drawer. The statute of limitations for a Holder to sue the drawer is 10 years from the issue date, or three (3) years from the date the check was deposited and returned unpaid, whichever comes first. A Holder can assign, sell, give, or otherwise transfer its rights to another party, so long as the third party wasn't involved with any underlying fraud pertaining to the check.

The new Holder has the same legal rights to the check as the original Holder, and can sue the drawer of the check for the full face value of the check, provided that the check has not "expired" prior to the original Holder accepting the check for payment. If the check has expired (due to the statute of limitations or due to a statement on the face of the check specifying when the check expires, e.g. "Void After 30 Days"), the recipient/purported "Holder" has no legal standing as an HIDC, and can't claim that legal status.

Following are three cases decided by the Superior Court of New Jersey, Appellate Division. All involve Robert J. Triffin, a Pennsylvania resident who is in the business of purchasing dishonored instruments (checks), acquiring Holder in Due Course status and suing the drawer/maker for recoupment. These cases illustrate the far-reaching power of Holder in Due Course.

To receive a complete version of these cases, email Pam Washington at pam@safechecks.com.

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

ROBERT J. TRIFFIN V. CIGNA INSURANCE COMPANY

297 N.J. Super. 199, 687 A.2d 1045 (App. Div. 1997)

<http://lawlibrary.rutgers.edu/courts/appellate/a4000-95.opn.html>

Issue: Placing a Stop Payment DOES NOT eliminate your obligation to pay the check

In this case, Mr. Triffin appealed a trial court's summary judgment decision dismissing his complaint for payment of a Cigna Insurance Company check that was transferred to Triffin by a Holder in Due Course after Cigna had stopped payment on the check.

On July 7, 1993, a check for \$484.12 had been issued for workers' compensation benefits to James Mills by one of Cigna's companies, Atlantic Employers Insurance Company. Mills received the check, but falsely claimed to the issuer that he had not due to a change in his address. He requested that payment be stopped and a new check issued.

The insurer complied and stopped payment on the initial check and issued a replacement check that was received and cashed by Mills. Thereafter, Mills cashed the initial check at Sun's Market (Sun's), Triffin's assignor, before the stop payment notation was placed on the check.

Sun's presented the check for payment through its bank. Cigna's bank dishonored the check on or about July 12, 1993, stamped it "Stop Payment," and returned the check to Sun's bank. Sun's was out \$484.12. All parties agreed that had Sun's pressed its claim against Cigna as the issuer of the check, Sun's would have been entitled to a judgment because of its Holder in Due Course status.

Sun's posted the check on a bulletin board in the store where it stayed for about two years until Robert Triffin visited the store and purchased the check at a deep discount off face value. In the purchase, Sun's assigned its Holder in Due Course rights to the check to Triffin, who filed suit against Cigna on August 28, 1995, over two years after the check was returned unpaid. Although Triffin lost on summary judgment at the trial court, the Appellate Court reversed the summary judgment and instructed the lower court to enter judgment in favor of Robert Triffin, with interest.

Recommendation: Every company issues stop payments, and some have hundreds of outstanding stop payment orders on checks. There are two important items to consider about stop payments. First, as this case illustrates, placing a stop payment on a check does not necessarily terminate your obligation to pay the check. **Companies should print on the face of the check a statement declaring a date after which the check is no longer valid, e.g.: "THIS CHECK EXPIRES AND IS VOID 20 DAYS FROM ISSUE DATE."**

If a check is lost, the payee would have to wait 20 days before the check is reissued. The bank pays no attention to this kind of restriction; it's for an organization's protection against some HIDC claims.

While this practice is inconvenient for the recipient, there is no other way an organization can protect itself from a Holder in Due Course claim. Second, a stop payment is typically good for only 180 days. After that time, the stop payment drops off the bank's system and is no longer monitored.

If a checking account is not on Positive Pay, the stop payment should be re-issued. A check that is six months old becomes a stale-dated check, and a bank has the legal right but not the legal requirement to decline payment on a stale-dated check. Further, a bank cannot be held liable for paying a stale-dated check. A service offered by many banks called Positive Pay has the ability to identify stale-dated checks. Call SAFEChecks at (800) 755-2265 to learn more about Positive Pay, or call your banker.

The above case clearly illustrates what a Holder in Due Course is, but doesn't deal with check security features, or the lack thereof, as evidenced in the following two cases.

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

ROBERT J. TRIFFIN v. SOMERSET VALLEY BANK AND HAUSER CONTRACTING COMPANY v. AUTOMATIC DATA PROCESSING, INC.

Superior Court of New Jersey, Appellate Division, A-163-00T5
<http://lawlibrary.rutgers.edu/courts/appellate/a0163-00.opn.html>

In October 1998, Alfred Hauser, president of Hauser Contracting Co., was notified by a retailer and Somerset Valley Bank that several individuals were cashing what appeared to be Hauser Contracting Co.'s payroll checks. Mr. Hauser went to his bank to review the checks and ascertained that, while the checks looked like his checks, they were counterfeits because none of the payees were his employees, and he did not authorize anyone to sign those checks on his behalf.

At the time, Hauser Co. employed Automatic Data Processing, Inc. (ADP) to provide payroll services, and a facsimile signature was utilized on all Hauser Co. payroll checks.

Mr. Hauser executed affidavits of stolen and forged checks at the bank, stopping payment on the checks at issue. The Bank subsequently received over 80 similar checks drawn on Hauser Co.'s account, valued at \$25,000. The checks were returned unpaid by the bank and marked as "Stolen Check - Do Not Present Again." In February and March 1999, Robert Triffin purchased 18 of these dishonored checks totaling \$8,826.42 from four check cashing agencies.

Each agency stated that it cashed the checks for value, in good faith, without knowledge that any of the signatures were unauthorized or forged. All 18 checks bore a red and green facsimile signature stamp in the name of Alfred M. Hauser.

Mr. Triffin then sued Somerset Valley Bank and Hauser Co., contending that Hauser Co. was negligent in failing to safeguard both its payroll checks (which apparently looked like legitimate ADP checks) and its facsimile stamp, and was liable for payment of the checks.

The lower court granted Mr. Triffin summary judgment on the basis that the checks appeared to be genuine. Hauser Co. appealed the decision, arguing that summary judgment was improperly granted because the Court failed to properly address Hauser Co.'s defense that the checks were invalid negotiable instruments and therefore erred in finding the plaintiff a Holder in Due Course. However, the Appellate Court agreed with the lower court. It also found that because the checks appeared to be genuine, Hauser Co. was required, but had failed, to show that the check cashing stores had any notice that the checks were not validly drawn. The Court found that the 18 checks met the definition of a negotiable instrument. Each check was payable to a bearer for a fixed amount, on demand, and each check appeared to have been signed by Mr. Hauser, through the use of a facsimile stamp. Hauser then contended that the checks were not negotiable instruments because Mr. Hauser did not sign the checks, did not authorize their signing, and its payroll service, ADP, did not produce the checks. The Court found that lack of authorization was a separate issue from whether the checks are negotiable instruments. The Court dismissed Hauser's argument that the checks were invalid because they were fraudulent and unauthorized, reasoning that to preclude liability from a Holder in Due Course, "it must be apparent on the face of the instrument that it is fraudulent." Hauser failed to introduce any such evidence, and Mr. Triffin won.

Recommendations: This case illustrates that if a thief can acquire check stock that looks genuine, an organization can be held liable for losses that may occur from those counterfeit checks. Most companies buy check stock from vendors that sell the identical check stock entirely blank to many other customers, totally uncontrolled, thus aiding the forgers. Many organizations opt for these solutions because they are cheaper than controlled, high security checks (without considering legal fees for HIDC claims).

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

Forgers buy the identical check stock entirely blank, and, using a \$99 scanner and Adobe Illustrator, create counterfeit checks that cannot be distinguished from the account holder's original checks. This exposes the organization to a Holder in Due Course claim and its attendant legal fees.

Organizations are best served by using checks uniquely designed and manufactured for them, or by purchasing checks from SAFEChecks (safechecks.com) that customizes each customer's check order and never sells checks entirely blank. The check face is always customized for that specific customer. SAFEChecks' "secure ordering procedures" strictly control every order by confirming the account holder name, account number and shipping address with the customer's bank. SAFEChecks has never had a check replicated, chemically washed and altered, or purchased by a fraudster and used in a check fraud scam. Call **(800) 755-2265** for information.

ROBERT J. TRIFFIN V. POMERANTZ STAFFING SERVICES, LLC

370 N.J.Super. 301, 851 A.2d 100, 2004.NJ.0000281

<http://lawlibrary.rutgers.edu/courts/appellate/a2002-02.opn.html>

One of the few cases Robert Triffin lost illustrates the value of using high security, controlled check stock to protect an organization from one type of Holder in Due Course claim. In this case, the Court was asked whether an innocent party, whose check stock was replicated and whose signature was forged, can be held liable when another innocent party accepts that check in good faith. The answer is No.

On April 20 and 21, 2002, a check cashing store, Friendly Check Cashing Company, cashed 18 counterfeit checks totaling \$7,000, in amounts ranging between \$380 and \$398, purportedly issued by Pomerantz Staffing Services. Pomerantz used high security checks that included heat-sensitive (thermochromatic) ink on the back and a warning banner on the check face that read, "THE BACK OF THIS CHECK HAS HEAT SENSITIVE INK TO CONFIRM AUTHENTICITY."

A fraudster made color copies of the face of Pomerantz's checks. The copies did not have thermo ink on the back. Each counterfeit check bore Pomerantz's full name and address and a facsimile signature of "Gary Pomerantz." Without examining the checks as instructed by the warning banner, the store cashed the checks, which Pomerantz's bank returned unpaid and stamped: "COUNTERFEIT" and "DO NOT PRESENT AGAIN." (The fact that the bank caught checks of such low dollar value suggests Pomerantz was using its bank's Positive Pay service; the case did not specifically say.)

Robert Triffin bought those checks from Friendly and filed suit against Pomerantz as a Holder in Due Course. Both parties filed cross-motions for summary judgment. The trial judge granted Pomerantz's motion and dismissed the case. Triffin appealed. (Triffin almost always wins on appeal.)

In the appeal, Pomerantz claimed that it did not sign the checks, which also did not come from its check stock. Triffin presented no evidence opposing those claims. Also, Triffin did not explain why the check casher did not examine the checks for heat-sensitive ink as directed on the face of check. Their bogus nature would have been revealed by simply touching the thermochromatic ink on the checks. The Court said it was reasonable that the holder, and especially a check casher, can be expected to fully examine the front and back of the instrument to verify its authenticity when a method for doing so is available. Because the check casher failed to authenticate the checks, it did not obtain Holder in Due Course status. Triffin could not obtain what the check casher did not have (HIDC status), and lost the appeal.

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

Recommendations: To help prevent check fraud losses, including some Holder in Due Course claims, use high security checks with overt and covert security features, including explicitly worded warning banners. Mr. Abagnale designed the warning bands for SAFEChecks. Call (800) 755-2265 for a sample.

Holder in Due Course and Stop Payment Checks

Many checks have verbiage printed on the face that says: VOID AFTER 90 DAYS or VOID AFTER 180 DAYS. Based upon a New Jersey Appellate Court decision over a stopped payment check over two years old, 90 or 180 days is too long. In our opinion, an Accounts Payable check should expire in 20 or 25 days. Payroll checks should expire in 10 days or less.

Consider this scenario: Good Company issues check #12345 for \$5,000 and mails it to Dishonest Dave. Dishonest Dave receives the check, holds onto it, and two weeks later calls Good Company claiming he never received the check. He actually did, but he is "Dishonest Dave." Good Company places a stop payment on check #12345 and issues a second check for \$5,000 payable to Dishonest Dave, who now has two \$5,000 checks payable to himself.

Dishonest Dave cashes the second check. Later, he cashes the first check #12345 at a check cashing store. Although a stop payment was placed on check #12345, there is no evidence on the face of check #12345 of that stop payment being placed. Dishonest Dave indorses check #12345 to the check casher, which accepts and negotiates the check. At that moment the check cashing store becomes the new Holder in Due Course, with all the legal rights Dishonest Dave held as the original HIDC.

Check #12345 hits Good Company's bank account, and is returned "payment stopped" to the check cashing store. But, the store is not out the money because it is a Holder in Due Course. An HIDC has 10 years from the date a check was issued, or three (3) years from the date the check was returned unpaid, to sue the drawer (Good Company) for recovery of the full face value of the check, UNLESS THE CHECK HAD EXPIRED BEFORE THE RECIPIENT OR CHECK CASHING STORE ACCEPTED IT. A HIDC can sell his or her rights to that check to anyone, at any time, and at any price.

As indicated in the New Jersey Appellate Court case between Robert Triffin and Cigna Insurance, under the UCC a HIDC can legally force a company to pay them for the full face value of the check.

The lesson to learn is that "lost" checks should not be re-issued until they "expire." Most companies' checks have no expiration date (e.g.: VOID AFTER XX DAYS) and therefore are subject to the 10-year statute of limitations. Many companies' checks expire in 90 or 180 days. Regulatory and public image issues constrain a company or municipality from waiting 180 days before re-issuing a replacement check for a check that allegedly was lost.

The best way to protect your organization from losing this type of lawsuit is to cause the first check to expire before re-issuing a new check, for example, in 20 days. Re-issue the second check two days after the first check expires, just in case it was negotiated on the last day and hasn't cleared the bank yet. Verbiage could read: "THIS CHECK EXPIRES AND IS VOID 20 DAYS FROM ISSUE DATE." A short expiration time printed on the check face may help your organization avoid some HIDC claims.

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

Banks don't care or pay attention to what is printed on the check, nor does a bank have a legal responsibility to honor what is printed on the check. This is strictly to protect an organization from some HIDC claims.

Holder in Due Course and Mobile Banking Fraud

Check 21 has a Rule (“Warranty”) that expressly prohibits a check or its digital image from being presented for payment more than once, and provides a powerful recovery remedy if it occurs.

The advent of Remote Deposit Capture and mobile banking were foreseen in 2003 when Congress passed Check 21, which gives financial institutions the right to convert the paper checks they receive into electronic images, and to process those images for payment instead of the original paper checks. Organizations or individuals using Remote Deposit Capture (RDC) or Mobile Remote Deposit Capture (mRDC) are essentially acting as an agent of the bank when they image and deposit checks remotely, and the Rules governing Check 21 apply.

Because depositing checks via a smart device is highly popular, almost all American banks offer mRDC. Fraudsters haven't directly targeted mRDC users' devices on a large scale. However, cases of mobile users double-depositing the same check at multiple banks, or cashing the check at a check cashing store after depositing that same check via a smart phone, are growing sharply.

The Federal Reserve Board predicts that almost half of all mobile users will adopt mobile banking in one capacity or another. It behooves all mobile phone users and financial institutions alike to be alert and vigilant toward fraud prevention.

Mobile Deposits and Holder in Due Course

Consider this scenario:

John Doe picks up a check made payable to “John Doe” from a business or individual. He walks outside and deposits the check remotely using his smart phone. He then walks back inside and returns the check, asking that it be replaced with a new check made payable to John Doe OR Jane Doe. The issuing person or company reissues a new check payable to John Doe or Jane Doe. The issuer doesn't consider placing a Stop Payment on the first check because the check is in their possession.

John Doe quickly cashes the second check, and waits overnight for the first check to clear before withdrawing the money from the first check. Unfortunately, the drawer that issued the check can be held liable for both checks, for the following reason: Both checks are valid checks. The first check was deposited remotely, while the second check was cashed at a bank or check cashing store. Banks often cooperate to stop fraudulent activity, but both the check cashing store and John Doe's bank are holders in due course and have no legal obligation to return the funds to the drawer/issuer.

To prevent this kind of theft, if a check leaves your possession for any length of time and is returned for a replacement check, place a Stop Payment on the check that was returned (even though HIDC trumps a Stop Payment). Require the recipient to sign an affidavit declaring the check was not deposited remotely, and that the recipient has no claim to those funds, and accepts responsibility for all expenses to recover those funds.

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

About the Authors

Frank Abagnale is one of the world's most respected authorities on the subject of forgery, secure documents, identity theft and embezzlement. For over 40 years Mr. Abagnale has advised hundreds of financial institutions, corporations and government agencies around the world, including the FBI. More than 14,000 financial institutions, corporations, and law enforcement agencies use his fraud prevention materials. He is the author and subject of *Catch Me If You Can*, a Steven Spielberg film that starred Tom Hanks and Leonardo DiCaprio.

For more information about Mr. Abagnale, please visit <https://www.abagnale.com/index2.asp> and <https://www.abagnale.com/aboutfrank.htm>.

Greg Litster is president of SAFEChecks, and a former 18-year banker. As Senior Vice President he oversaw Cash Management, Title/Escrow and Correspondent Banking. Mr. Litster is co-editor and publisher of Mr. Abagnale's Fraud Bulletins. The most recent Fraud Bulletin and prior versions can be downloaded at <https://www.safechecks.com/fraud-education/the-fraud-bulletin.php>.

Mr. Litster lectures on check fraud, cybercrime and embezzlement across the United States, and provides expert witness services in check fraud and embezzlement cases. He also gives Sight Review training for banks - teaching Central Operations staff what to look for when reviewing high-dollar checks being presented for payment. Contact Mr. Litster at greg@safechecks.com or (800) 755-2265.

SAFEChecks sells high security checks designed by Frank Abagnale, and software to create and upload Positive Pay and Payee Positive Pay files to the bank. <https://www.safechecks.com>.

Disclaimer:

This entire document is provided for informational purposes. The authors assume no responsibility or liability for the specific applicability of the information provided. If you have legal questions regarding the information, please consult an attorney.

For more information on Check 21 and Mobile Banking Fraud, contact Pam Washington at (800) 755-2265 x 3305, or email pam@safechecks.com