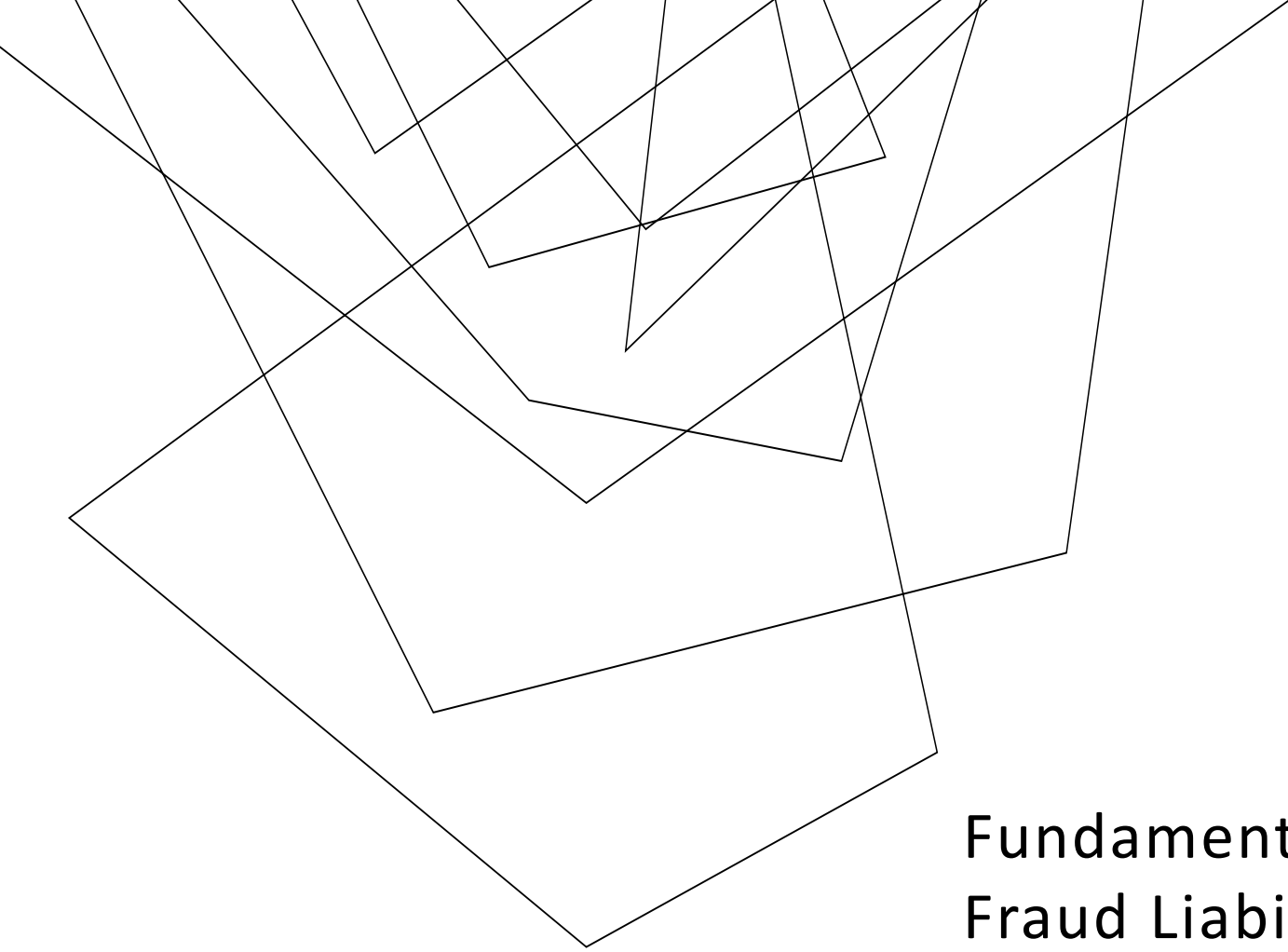


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Fundamentals of Check Fraud Liability

By Jacob Rued, 2025

Legal framework of Checks

1) State Law: The Uniform Commercial Code

- Article 3 and 4 are most Relevant
- Not the same in every state, but *mostly* the same.
- Articles 3 and 4 can be found in Title 41 of the North Dakota Century Code
 - Chapter 41-03, N.D.C.C. (Negotiable Instruments)
 - Chapter 41-04, N.D.C.C. (Bank Deposits and Collections)

2) Federal Regulations: Regulation CC and Regulation J

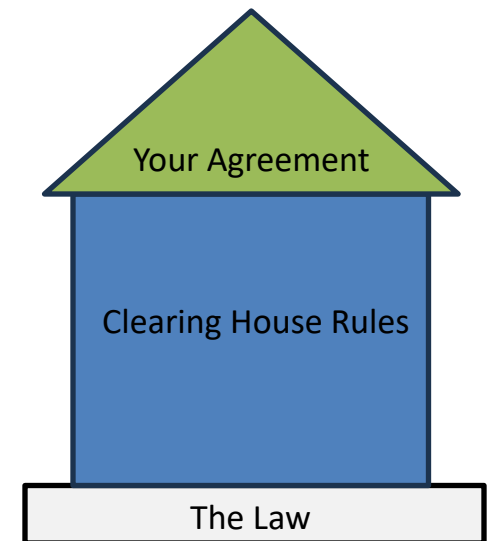
- Mostly relates to liability between banks and the Fed.
- Regulation CC – 12 C.F.R. Part 229
- Regulation J – 12 C.F.R. Part 210

3) Clearing House Image Exchange Rules

- ECCHO (Rule 9)

4) Your Account Agreement with the Customer

- Can alter default terms of the law, to a degree.



Important terms in check fraud

- **Midnight Deadline** – midnight of the banking day following the banking day which a check is presented. (N.D.C.C. § 41-04-04, UCC § 4-104)
- **Properly Payable** – any item authorized by the customer in accordance with their agreement between them and the bank. (N.D.C.C. § 41-04-32, UCC § 4-401)
- **Forgery** – an unauthorized signature made manually or by machine; includes counterfeits. (N.D.C.C. § 41-03-38, UCC § 3-401; N.D.C.C. § 41-03-40, UCC § 3-403)
- **Alteration** – an unauthorized change to a check that modifies an obligation of a party of the check, (N.D.C.C. § 41-03-44, UCC § 3-407)

Most common check fraud claims

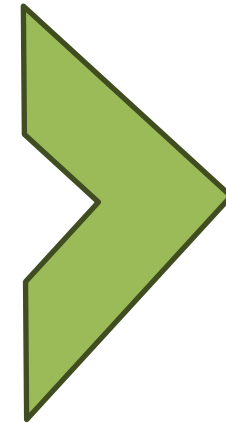
Forged Signature – an authentic check was used but the authorized signer didn't sign it.

Counterfeit – an imitation of an authentic check was used, and the authorized signer didn't sign it.

Unauthorized Alteration – an authorized signer signed a check but meaningful elements of it were changed without their consent.

Forged Endorsement – the payee claims they never received the checks, signed it, or authorized anyone to use it on their behalf.

Unauthorized Remotely Created Check – a rabbit hole for another day.



None of these are
“properly payable”

Check Fraud Ground Zero



“A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument, and the signature is binding on the represented person” (N.D.C.C. § 41-03-38, UCC § 3-401)

“an unauthorized signature is ineffective except as the signature of the unauthorized signer” (N.D.C.C. § 41-03-40, UCC § 3-403)

“A bank may charge against the account of a customer an item that is properly payable from that account” (N.D.C.C. § 41-03-38, UCC § 4-401)

Recovering from the Depository bank with leverage

1. Return the check within the Midnight Deadline!

- There is no circumstance you can return a check with impunity after the deadline.
- Yes, the deadline is likely weeks or months before your customer will see their statement. That's your problem, not the depository bank's.

2. In the case of Alteration of Forged Endorsement, serve a Presentment Warranty Violation Claim (N.D.C.C. § 41-04-20, UCC § 4-208).

- The depository promises you, for 3 years, the item was not altered and was paid to the person entitled to use it (payee).
- This process is direct and cannot be done by a standard return.

Recovering from the Depository bank without leverage

1. Ask them if they will accept a late return.

- Recognize they can still rightfully deny your return.
- Recognize this is “all or nothing”

2. Offer them indemnification for returning the funds.

- You are promising to defend them if their customer becomes upset about losing the funds.
- You may get all, or some, or none of the funds back.

Moving liability to your customer

Moving liability to your customer relies heavily on your agreement with them. You MUST be familiar with the terms of your agreements.

Defenses against reimbursing your customer, the payor:

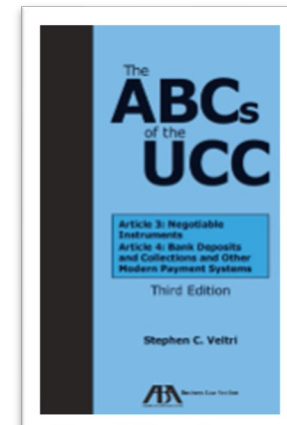
1. Customer Negligence (N.D.C.C. § 41-03-43, UCC § 3-406)
2. Failure to Review Statements (N.D.C.C. § 41-04-37(3), UCC § 4-406)
3. One-year Absolute Bar Rule (N.D.C.C. § 41-04-37(6), UCC § 4-406)
4. Same Wrong-Doer Rule (N.D.C.C. § 41-04-37(4)(b), UCC § 4-406)
5. Signature Ratification (N.D.C.C. § 41-03-40, UCC § 3-403)
6. Facsimile Signature (N.D.C.C. § 41-03-38, UCC § 3-401; N.D.C.C. § 41-03-43, UCC § 3-406)
7. Imposter Payee (N.D.C.C. § 41-03-41, UCC § 3-404)
8. Forged Indorsement by Employee (N.D.C.C. § 41-03-42, UCC § 3-405)

Managing Check Fraud Risk

1. Utilize *UCC 1-302* “Variation by Agreement” (N.D.C.C. § 41-01-16)
2. Define “ordinary care” (N.D.C.C. § 41-03-03(g), *UCC 3-103*) in your account agreements to mandate the use of Positive Pay for business customers, bolstering your use of *UCC 3-406* (N.D.C.C. § 41-03-43).
3. Require customer cooperation with your investigations in your agreements as a requisite for reimbursement. (affidavits)
4. Shorten the 1-year absolute bar rule to 30 days, or shorter for business account agreements
5. Explicitly state the terms and pitfalls of Facsimile signature use in your agreements.
6. Don’t assume things in your investigations – ask questions and ask for documentation.
7. Have Procedures – time is not in your favor – the midnight deadline is the difference between 0% and 100% loss.

Additional Learning & Resources

- **“Avoiding Check Fraud Liability: From Prevention to Loss Allocation”** *Terri Thomas*, BankWebinars.com (OnCourseLearning)
- ***The ABCs of the UCC, Article 3: Negotiable Instruments Article 4 Bank Deposits and Collections and other Modern Payment Systems, Third Edition*** (Stephen Veltri, 2015)
- ***Mastering Negotiable Instruments, UCC Articles 3 and 4 and other Payment Systems, Second Edition*** (Michael Floyd, 2017)



HELPFUL CASES – CHECK FRAUD

Provident Sav. Bank v. Focus Bank

- Facts

- Provident Bank's customer deposited a forged \$150,520 check that was drawn on Focus Bank's customer's account and paid by Focus Bank.
- Focus Bank's customer later reported the check as fraudulent and Focus Bank returned the check 20 days later, after the midnight deadline.
- The FRB credited Focus Bank's account and debited Provident Bank's account for the amount of the check.
- In relevant part, Provident Bank sued Focus Bank for strict liability under Missouri's version of UCC 4-302 (midnight deadline)
- Focus Bank claimed Provident Bank breached one or more presentment warranties.

- Court Holding

- The Court said there were only 2 exceptions to the rule of strict liability: (1) breach of presentment warranty or (2) proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank. In relevant part, the breach of presentment warranty did not apply because the check was counterfeit rather than altered.

- Key Takeaways

- An altered check is a physical modification of an original check. Altered checks are subject to breach of warranty claims.
- A counterfeit check is a copy or a new, different check (e.g., a digitally altered copy of a genuine check, modified and then printed on commercially available check stock). Counterfeit checks are not subject to breach of warranty claims.

HELPFUL CASES – CHECK FRAUD

German Am. Bank v. Navy Fed. Credit Union

- Facts
 - German American Bank (GAB)'s customer issued a \$233,386.88 check payable to CSC Indiana, LLC
 - The check was fraudulently endorsed by Akeela Redmond purportedly of "C.SC Indiana, LLC" and deposited into C.SC Indiana's at Navy Federal Credit Union (Navy Federal)
 - GAB learned of the fraud on January 4, 2023
 - On February 24, 2023, GAB made a claim for breach of presentment warranty (forged endorsement) against Navy Federal
 - Navy Federal argued the claim was barred due to untimely notice and the check's endorsement was effective
- Court Holding
 - The endorsement on the check was unauthorized, so Navy Federal did breach its presentment warranty to GAB.
 - UCC 4-208 discharges liability "to the extent of any loss caused by the delay in giving notice of the claim." "The timeliness of the notice 'may affect the amount of damages awarded, but the 30-day time limit for notice does not affect liability, and does not act as a statute of limitations for the filing of an action.'" Here, because the check had cleared and the entirety of the funds had already been withdrawn from the Navy Federal account before GAB learned of the fraud, the timing of GAB's notice of claim had no effect on Navy Federal's loss or damages.
- Key Takeaways
 - Aim to make a claim within 30 days of discovering the fraud; making a later claim may (but will not always) reduce your damages.

HELPFUL CASES – CHECK FRAUD

Chevy Chase Bank, F.S.B. v. Wachovia Bank, N.A.

- Facts
 - A \$341,187.45 check was issued to Hearst Magazines Division
 - Upon deposit at Chevy Chase, the name of the payee on the check was Kon Pesicka/CJ International
 - Wachovia paid the check, made a digital copy, and destroyed the original check
 - Wachovia sought repayment of the check from Chevy Chase based on breach of presentment warranty
 - Chevy Chase was unable to determine with certainty what type of fraud was committed (i.e., altered vs. forgery/counterfeit)
- Court Holding
 - Wachovia could not recover on its claim for breach of warranty because it did not prove that the check it received from Chevy Chase was altered. The Court noted that Wachovia could have shown the check received was the original check issued with an altered payee by:
 - Presenting witnesses who could testify regarding Wachovia's receipt of the check/the condition of the check when it was presented for payment
 - Producing the actual check
- Key Takeaways
 - It is the burden of the party making a claim for breach of presentment warranty to establish that a check was altered versus counterfeit.
 - Best practice would be to keep the originals.

**POSITIVE PAY:
COMMERCIALY
REASONABLE FRAUD
PREVENTION**

**NDBA FRAUD FORUM
OCTOBER 20, 2025**

Presented by Tracy A. Kennedy, Dakota Law Group P.C.

Introduction:

The Rising Threat of Check Fraud

- FinCEN 2023 analysis: Check fraud reports more than doubled between 2021 and 2023.
- Of stolen checks reported, 44% were altered, 26% were counterfeited, and 20% fraudulently signed.
- AFP 2024 Payments Fraud Survey: 65% of organizations experienced check fraud in the past year.
- Check fraud remains the most common and costly payment fraud method in U.S. banking.
- Positive Pay programs are the frontline control banks use to prevent alteration and counterfeit losses.

Why Positive Pay Matters

- Positive Pay detects check alterations, counterfeit items, and mismatched payee data before posting.
- It prevents loss and supports UCC §4-406 NDCC §41-04-37 (customer duty to examine statements).
- With documented exceptions and audit trails, banks show 'ordinary care' compliance under UCC §4-103 NDCC §41-04-03.
- Check fraud volume and sophistication have surged, driven by mail theft and digital forgery.

Legal Framework

- UCC §4-103(a) NDCC §41-04-03 : Banks may vary duties by agreement if acting in good faith and ordinary care.
- UCC §4-406: Customer duty to examine statements; 30-day repeater and 1-year bar rules.
- Reg CC §§229.30 & 229.34: Same-day return and presentment warranty framework.
- Clearing House Rules: Image exchange warranties; duplicate indemnity requirements.

Why Positive Pay Cannot Be Required for Consumer Accounts

- Reg E (12 C.F.R. §1005.11(e)): Prohibits waiver of consumer error-resolution rights.
- EFTA § 909(c): Prevents contractual waiver of protections for personal accounts.
- CFPB and OCC classify such conditioning as unfair or deceptive under UDAP.
- Only commercial/business accounts may be required to use Positive Pay (UCC §4-103).

How Positive Pay Works

1. Business uploads issue file with check #, payee, and amount.
2. Bank matches presented items to issue file.
3. Exceptions flagged for customer review prior to posting.
4. Customer approves or rejects exception items.
5. Rejected items are returned under Reg CC §229.30 same-day rules.

Liability Allocation and Benefits

- Without Positive Pay: Bank may bear loss under §4-406 if it pays altered items.
- With Positive Pay: Customer bears loss if they fail to review flagged exceptions timely.
- Contractual allocation is valid if commercially reasonable and disclosed.
- Creates defensible protection under UCC and industry best practices.

Deposit Account Agreement Considerations

- Commercial accounts: May require Positive Pay via UCC §4-103 variation clause.
- **Agreements must preserve bank's duties of good faith and ordinary care.**
- Consumer accounts: Cannot condition access or fraud liability on Positive Pay.
- Add disclaimer: 'Positive Pay is optional and does not alter Reg E rights.'

HELPFUL CASES - POSITIVE PAY

Cincinnati Ins. Co. v. Wachovia Bank, Nat. Ass'n

- Facts

- Schultz Foods had commercial checking account with Wachovia Bank
- Wachovia offered Positive Pay, but Schultz Foods declined to implement it
- Schultz Foods was the victim of check fraud on 4 separate occasions
- The deposit agreement provided:
 - You agree that if you fail to implement any of these products or services, or you fail to follow these and other precautions reasonable for your particular circumstances, you will be precluded from asserting any claims against [Wachovia] for paying any unauthorized, altered, counterfeit or other fraudulent item that such product, service, or precaution was designed to detect or deter, and we will not be required to re-credit your account or otherwise have any liability for paying such items.

- Court Holding

- Under the plain language of the deposit agreement, Schultz Foods was precluded from asserting claims against Wachovia for making the payment and Wachovia was not required to recredit the account. However, the release in the deposit account was overbroad and invalid to the extent that they would apply to claims that Wachovia failed to exercise ordinary care in paying unauthorized checks. Here, they were not overbroad and invalid because there was no allegation that Wachovia failed to exercise ordinary care, and there was a severability clause which made the valid parts of the provision remain in effect.
- The requirement for Schultz Foods to either implement Positive Pay or assume liability for any fraud losses caused by its failure to implement Positive Pay was not “manifestly unreasonable” and was “reasonable under the circumstances” because (i) it was technically feasible for Schultz Foods to implement Positive Pay and (ii) the cost of installing and participating in Positive Pay was reasonable because Schultz Foods could have configured its existing computer system to work with Positive Pay for less than \$500 and, although implementation would have required Schultz Foods to pay modest monthly and per-check fees, the fees would have been more than offset by credits that Wachovia extended to Pennsylvania customers in lieu of interest.

- Key Takeaways

- Include requirement that bank exercise ordinary care in positive pay release
- Include severability clause
- Ensure Positive Pay costs are not unreasonable

HELPFUL CASES – POSITIVE PAY

Thompson v. First BankAmericano

- Facts
 - JWT was a customer of Bank of America (BoA) and subscribed to its positive pay program
 - When fraud was discovered, BoA refused to credit JWT's account.
 - JWT sued BoA, and BoA filed third-party claims against First BankAmericano (FBA) and the Atlanta Fed for transfer/presentment warranty breaches.
 - FBA argued JWT was negligent for failing to respond appropriately after learning of previous check fraud on its account.
 - On appeal the primary issue was whether JWT's inaction after previous fraud (namely, JWT's failure to close the Account and institute a payee matching system to detect future fraud) constituted negligence which "substantially contributed" to the alteration of check
- Court Holding
 - JWT was not negligent, and even if failing to close the account or utilize fraud detection technology did constitute negligence, such actions did not *substantially contribute* to the fraud:
 - Ordinary care did not compel JWT to close its account. Prior fraud losses were minimal compared to the significant costs JWT would have incurred by closing the Account and there was no evidence showing had JWT closed the Account and drawn checks on a different account, the new account would have been less susceptible to check theft.
 - Ordinary care did not compel JWT to implement payee matching. Payee matching was not available to JWT and BoA at the time. JWT's failure to utilize an unavailable technology could hardly be said to constitute a 'failure to exercise ordinary care'.
 - Furthermore, a defense based on a drawer's alleged post-alteration negligence is foreclosed by the plain language of UCC 3-406. A payee matching mechanism identifies check fraud when an altered check is presented for payment *after* the alteration has already occurred. Payee matching does not prevent alterations in the first instance, so failure to implement the same cannot have "substantially contributed to" or "set the stage" for the alteration.
- Key Takeaways
 - A customer's failure to implement Positive Pay does not constitute negligence substantially contributing to alteration

HELPFUL CASES – POSITIVE PAY

Drees Co. v. Fifth Third Bank

- Facts

- Drees was a customer of Fifth Third Bank with a Positive Pay Agreement which provided:
 - Bank Review of Item Issue Information. Bank will compare all Items presented to Bank for payment against all Item Issue Information that is in Bank's files as of the Information Deadline. Customer agrees that if the Item number and amount of a Presented Item conforms to the Item Issue Information, then Bank may consider that Item validly issued and authorized and Bank may pay the Item without contacting Customer. Customer agrees that if Bank acts in accordance with this Agreement in paying Items, Bank will be deemed to have acted in good faith and exercised ordinary care with respect to that Item.
- Fifth Third Bank paid a fraudulent check and posted the money as a debit against Drees' account.
- The check number, date, and amount matched the information provided by Drees; it was the payee that was different.

- Court Holding

- Because the check number and amount conformed to the information provided by Drees, Fifth Third could properly consider the check “validly issued and authorized” and charge it to Drees' account pursuant to the Positive Pay Agreement.
- The court further stated:
 - The Court recognizes that Drees may be in a worse position than it would have been had it had no positive pay agreement with Fifth Third (and not paid for the additional fraud protection service). However, the language of the positive pay agreement is clear and unambiguous and is not prohibited by the UCC. The Court further recognizes that the agreement in this case turns a check that was not properly payable into one that was. The agreement between the parties is clear, however, and the Court may not re-write it. By virtue of the positive pay agreement, Drees authorized Fifth Third to pay a check if the item number and amount conformed to the information provided by Drees.

- Key Takeaways

- Your Positive Pay Agreement can make checks that are not properly payable into checks that are.
- Make sure your Positive Pay Agreement is clear on the conditions for a check being deemed properly payable/authorized.

Compliance Takeaways

- Require Positive Pay only for commercial and analyzed accounts.
- Keep service voluntary for consumer accounts.
- Train staff to distinguish consumer vs. business accounts.
- Maintain issue file logs, exception reports, and customer approvals.
- Document program rationale and periodic control testing.

Model Policy Language

- Commercial Accounts: 'Enrollment in Positive Pay is required as a condition of account opening.'
- Consumer Accounts: 'Positive Pay is optional and does not alter your rights under Reg E.'
- General Clause: 'Bank retains obligations of good faith and ordinary care under UCC §4-103.'
- Maintain signed agreements, exception logs, and audit reports for examiner review.