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IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

CERTIFICATION FROM THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WASHINGTON

TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA,

Plaintiff,

v.

WASHINGTON TRUST BANK,

Defendant.

BRIEF OF AMICUS CURIAE THE WASHINGTON BANKERS ASSOCIATION

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I. INTRODUCTION

The Washington legislature places the risk of loss from check fraud on the person in the best position to prevent that fraud. Customers know better than banks whether a person signing a customer's check has exceeded her authority or is abusing her authority for her own ends. RCW 62A.4-406 therefore requires a bank's customers to bear the risk of loss for frauds that are not detected within a reasonable time.

RCW 62A.4-406 is part of the Uniform Commercial Code. All 50 states have enacted the Uniform Commercial Code. But in its most recent substantial revision to Article 4 of the Uniform Commercial Code, the Washington legislature chose to adopt non-standard language to make it clear that customers have a full year to report unauthorized indorsements if they want to keep the risk of loss on their banks. Unlike the version of 4-406 enacted in other states, Washington's RCW 62A.4-406 specifically requires customers to look for and identify unauthorized indorsements—not just alterations and unauthorized signatures.

This Court should enforce RCW 62A.4-406 as written and answer the certified questions posed by the federal district court as follows:

First, Ms. Patterson's signatures were unauthorized indorsements—or alternatively unauthorized signatures or alterations—triggering Skils'Kin's duty to report under RCW 62A.4-406(f).

Second, Washington Trust Bank complied with and even exceeded the requirements set forth in RCW 62A.4-406 by supplying regular statements to Skils'Kin and by making available copies of the checks described in those statements through a variety of convenient alternatives, including the internet, by telephone through a toll-free number, or by inquiring at the Bank's branches.

Third, Washington Trust Bank did not fail to exercise ordinary care as a matter of law where Skils'Kin and Skils'Kin's clients supplied Ms. Patterson with actual and apparent authority to write checks on the account maintained for the benefit of Skils'Kin and its clients.

II. IDENTITY AND INTEREST OF AMICUS

The Washington Bankers Association was founded in 1889 and incorporated in 1970. Through advocacy, comprehensive programming, and information exchanges, the WBA protects, develops, and advances the business of banking in Washington. More than 97 percent of all commercial bank deposits in Washington are held through members of the WBA. The WBA represents commercial banks operating in every county of the state, ranging in size from large, multi-state financial institutions to smaller, family-owned and community-based banks.

The WBA and its members are acutely interested in the proper interpretation of Articles 3 and 4 of the Uniform Commercial Code, as enacted in Washington, because those provisions govern millions of checks drawn on accounts maintained by members of the WBA.

III. STATEMENT OF THE CASE

A. Articles 3 and 4 of the Uniform Commercial Code govern most aspects of checks and include rules for allocating risk.

This case is about checks and the laws governing them. Banks in the United States process billions of checks worth trillions of dollars every year. "By the time of the 1990 revision of Article 4, annual volume was estimated by the American Bankers' Association to be about 50 billion checks." RCW 62A.4-101, Comment 2. According to the Federal Reserve, in 2015 the aggregate volume of commercial checks collected through the Federal Reserve exceeded $8.1 trillion. Board of the Governors of the Federal Reserve System, *Commercial Checks Collected Through the Federal Reserve—Annual Data, federalreserve.gov/paymentsystems/check_commcheckcolannual.htm* (last updated Mar. 2, 2016).

The modern banking system relies on automation to process so many checks. It simply would not be possible for banks to provide efficient, low-cost service if the law required banks to manually inspect every check to determine whether it carried an unauthorized signature or indorsement or some other alteration.

Articles 3 and 4 of the Uniform Commercial Code describe how a court should distribute losses arising from unauthorized checks. These rules, which originated in pre-Code case law developed over hundreds of years, have been modified by the Uniform Commercial Code to allocate risks in light of current practices, including the automation used to handle billions of checks passing through the banking system every year.

The 1990 versions of Articles 3 and 4 were enacted in Washington during the 1993 legislative session and have remained substantially unchanged since that time. The drafters of the Uniform Commercial Code were guided by the principle that Articles 3 and 4 must help the nationwide check-clearing system function at maximum efficiency for the benefit of all its users. *See* Fred H. Miller, *U.C.C. Articles 3, 4, and 4A—A Study in Process and Scope*, 42 Ala. L. Rev. 405, 414 (1990-91).

In some cases, that means customers must bear the risk of loss caused by their disloyal employees because "removing or reducing loss with respect to customer and shifting it to the institution" would simply "spread the cost of the loss over the institution's [other] customers." *Id.* In his statement to a committee of the Washington legislature, Professor Fred H. Miller—one of the drafters of the uniform versions of Articles 3 and 4—explained that careful users of the nationwide check system should not subsidize losses generated by less careful users. *Appendix to Statement* *of Fred H. Miller Before Wash. House Fin. Inst. & Ins. Comm.*, at 4 (June 29, 1992), available in Bill File for HB 1014, 1993 Session, maintained by the State Archives (included in the appendix to this brief).

B. RCW 62A.4-406 allocates the risk of loss to customers after the end of various statutory periods.

In accordance with the principle of allocating the risk of loss to the person best able to prevent it, RCW 62A.4-406 imposes on customers the duty to examine statements, to request copies of suspicious checks, and to alert the bank within specified periods if the customer sees a suspicious check. Granted, this is a chore and one that customers may not wish to undertake. Nevertheless, the law allocates the responsibility to the customers because it recognizes that customers—not banks—are in the best position to spot fraudulent activity.

A contrary rule would imply banks have a duty to examine the statements of their customers. Given the volume of checks and other transactions handled by Washington banks, such a duty would result in higher costs for every participant in the modern banking system. *See* Fred H. Miller, *U.C.C. Articles 3, 4, and 4A—A Study in Process and Scope*, 42 Ala. L. Rev. 405, 415 (1990-91).

Customers are in a better position to prevent fraud before it occurs. A customer is always in "the best position to prevent the losses by its bookkeeping practices, by supervising its employees, by enforcing its rules, and by examining records." *Getty Petroleum Corp. v. Am. Express Travel Related Serv. Co.*, 683 N.E.2d 311, 314 (N.Y. 1997). A customer can, for example, separate its accounting functions from its check-writing functions to ensure that no person has the complete authority to commit and conceal fraud. As Moss Adams noted in this case, a customer should not give one person "the ability to write checks with minimal oversight" and could ask clients "who receive checks made out to them [to] sign for the checks when they pick them up." Brief of Wash. Trust Bank at 11 (April 14, 2016).

Customers are also in a better position to detect fraud after it occurs. Customers—equipped as they are with knowledge of their businesses and clients—can review the statements supplied by the bank and request copies of checks requiring further investigation. Customers can determine whether a signature appearing on the face or the back of a check has been placed there by someone acting outside the scope of her authority. Customers can detect deviations from their ordinary business practices. Customers will be in contact with the intended recipients of their checks, who can be expected to seek out the customers, not the bank, if they do not receive payment.

Sometimes, of course, through neglect or accident, a customer may fail to detect a fraud. Customers are in the best position to procure insurance against the consequences of the occasional undetected fraud. In a statement to the Washington legislature before the enactment of the current versions of Articles 3 and 4, Professor Miller explained that "where the risk of loss from fraud may be significant, such as the case of an employee who must be given a fair amount of freedom of operation and discretion and who may turn out to be unfaithful, an insurance system is available to protect a party at risk." *Appendix to Statement of Fred H. Miller Before Wash. House Fin. Inst. & Ins. Comm.*, at 4.

C. RCW 62A.4-406 applies to unauthorized indorsements and other frauds.

The structure of RCW 62A.4-406 reflects these practical considerations. The Uniform Commercial Code places the risk of loss on customers after certain periods have elapsed, as manifested in RCW 62A.4-406. The time limits imposed by RCW 62A.4-406 are not merely statutes of limitation that might be subject to tolling or other equitable principles. To the contrary, they are elements of substantive law. *See Wetherill v. Putnam Invs.*, 122 F.3d 554, 557 (8th Cir. 1997).

RCW 62A.4-406 applies to all types of fraud. The statute requires customers to alert the bank within 60 days of the discovery of an unauthorized signature or any alteration on the face or the back of the check, but allows a full year for fraudulent indorsements. There is a good reason for this distinction. A customer is, in the ordinary course, expected to immediately recognize whether there is an unauthorized signature or whether a check has been altered. It may, however, take more time for a customer to discover a fraudulent indorsement, which would ordinarily occur when the intended recipient of the check complains to the customer that it did not receive payment.

RCW 62A.4-406 differs in substantial ways from the standard version of UCC 4-406. Attached as an appendix to this brief is a comparison showing the differences between RCW 62A.4-406 and the most recent version of the Uniform Commercial Code. The comparison demonstrates the Washington legislature chose to expand the scope of RCW 62A.4-406. Unlike similar laws enacted in other states, Washington’s version of 4-406 expressly extends to unauthorized indorsements. In Washington, customers must discover and report unauthorized signatures, alterations, *and* unauthorized indorsements, whether those appear on the face or the back of an check.

The one-year preclusion for unauthorized indorsements in RCW 62A.4-406(f) is not found in the uniform text of the Uniform Commercial Code. The drafters of the uniform text removed the preclusion for forged indorsements from the prior version of 4-406, explaining that the *uniform* counterpart to RCW 62A.4-406 imposes no duty on the drawer to look for unauthorized indorsements. U.C.C. 4-406, Comment 5. In adopting revised Articles 3 and 4 in 1993, however, the Washington legislature not only retained the preclusion for forged indorsements (consistent with the old version enacted in Washington as RCW 62A.4-406(4)), but shortened the preclusion period from three years to one year.

The Washington legislature revised RCW 62A.4-406 again in 1997 to extend the effect of the safe harbor for statements supplied to customers. Final B. Rep. on H.B. 1400, 55th Leg., Reg. Sess. (Wash. 1997) (included in the appendix to this brief). The legislature decided that a "checking account statement will continue to provide sufficient information if it provides the check number, amount, the date of payment, and a phone number the customer may call to request a copy of the check." *Id.*

IV. ARGUMENT

If Ms. Patterson possessed actual authority to write and cash checks on behalf of Skils'Kin and its clients, then there is no need to reach RCW 62A.4-406, nor to apply any of the answers to the certified questions posed to this Court. The default rule under RCW 62A.4-401 is that a bank may charge the account of a customer if a check is "properly payable from that account," meaning that the check is "authorized by the customer and is in accordance with any agreement between the customer and the bank." A check is properly payable even if an employee is abusing or misusing her authority. *See* Brief of Wash. Trust Bank at 29-32 (April 14, 2016).

If a check is *not* properly payable under RCW 62A.4-401, then and only then is it necessary to invoke the risk-allocation rules embodied in RCW 62A.4-406. That provision applies if Ms. Patterson *lacked* authority. Judging from the record before this Court, Ms. Patterson did have authority, even if she misused it. Skils'Kin delegated authority to Ms. Patterson to draw checks on the account maintained by Skils'Kin for its clients. The clients themselves delegated to Skils'Kin and its employees the right to accept funds from the Social Security Administration and to act on their behalf in related matters. Just because Ms. Patterson abused the trust placed in her by Skils'Kin and its clients does not mean that, as a legal matter, she acted without their authority.

But this Court has not been asked to decide whether Ms. Patterson had authority over the account. Instead, it has been asked to interpret the risk-allocation mechanism built into RCW 62A.4-406, which swings into action only if Ms. Patterson lacked actual authority. That provision, like other risk-allocation mechanisms throughout the Uniform Commercial

Code, should be understood as placing the risk of loss on the persons who are in the best position to mitigate the risk.

The risk of an unauthorized indorsement under Articles 3 and 4 is initially placed on the immediate transferee of the unauthorized check. The UCC changes this result in two circumstances relevant in this case.

First, agency law may result in a determination that a “forged” signature was in fact authorized. Here, Ms. Patterson was the authorized agent of Skils’Kin and Skils’Kin was the agent of the payees of the checks. Ms. Patterson had authority to sign on behalf of drawer, authority to sign on behalf of the payee, and even authority to cross out the name of the payee, replace the payee’s name with the name of Skils’Kin, and accept payment in cash.

Second, the failure of Skils’Kin to review its customer statements and notify the bank of the alleged unauthorized indorsements within one year gives rise to an absolute preclusion from liability “[w]ithout regard to care or lack of care of either the customer or the bank” under RCW 62A.4-406(f).

In the end, RCW 62A.4-406 worked as intended by the Washington legislature. Liability for Ms. Patterson’s actions rested in the first instance with Skils’Kin, which protected itself from the acts of its faithless employee through an insurance policy issued by Travelers.

Travelers honored its policy and compensated Skils'Kin for the loss. Travelers agreed to undertake this risk and has no legal basis now to pass this liability on to the Bank.

A. RCW 62A.4-406 applies to this case because Ms. Patterson's signature on the back of the check was an unauthorized indorsement, unauthorized signature, or alteration.

If Ms. Patterson's signature was not authorized by Skils'Kin and its clients—a question that is not before this Court—then RCW 62A.4-406 applies because her signature was either an unauthorized indorsement, an unauthorized signature, or an alteration. Washington's legislature chose to impose on customers like Skils'Kin the obligation to look for and prevent exactly the kind of fraud that Ms. Patterson perpetrated.

Ms. Patterson's signature on the back of the checks was an indorsement under RCW 62A.4-406(f). An "indorsement" is defined by RCW 62A.3-204. That provision says that "regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement." It is difficult to say that Ms. Patterson's signatures on the back were "unambiguously" made for a purpose other than indorsement. They appear in the same place as indorsements. Ms. Patterson signed the checks before cashing them, which is when people usually indorse checks.

The comments to RCW 62A.3-204 dispose of the notion that Ms. Patterson signed the checks as a receipt.

> For example, suppose a depository bank gives cash for a check properly indorsed by the payee. The bank requires the payee's employee to sign the back of the check as evidence that the employee received the cash. If the signature consists only of the initials of the employee, it is not reasonable to assume that it was meant to be an indorsement. If there was a full signature, but accompanying words indicated that it was meant as a receipt for the cash given for the check, it is not an indorsement. *If the signature is not qualified in any way and appears in the place normally used for endorsements, it may be an indorsement even though the signer intended the signature to be a receipt.*

RCW 62A.3-204, Comment 1. The emphasized language applies here. Ms. Patterson signed her full name in the place normally used for indorsements and did not qualify her signature in any way. That makes it an indorsement, regardless of Ms. Patterson's intent. As the comment explains, even if Ms. Patterson testified under oath that she intended to sign the backs of the checks as a receipt (which she did not), the signatures might nevertheless be considered indorsements.

It does not matter that Ms. Patterson signed her own name rather than the name of Skils'Kin or the name of the clients that she and Skils'Kin represented. "If a person acting, *or purporting to act*, as a representative signs an instrument by signing either the name of the represented person *or the name of the signer*, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract." RCW 62A.3-402(a) (emphasis added). Agents commonly sign their own names to checks without stating that they are doing so in a representative capacity.

Although this Court has not been asked to decide any facts, Ms. Patterson was acting with the actual and apparent authority of both Skils'Kin and its clients when she signed and indorsed the checks. When she signed the front of the checks, she was acting on behalf of Skils'Kin. When she signed the backs of the checks, she was likewise acting for Skils'Kin and its clients because the clients had given Skils'Kin full authority to accept and manage funds deposited into the account by the Social Security Administration. Ms. Patterson was authorized to indorse the checks as a representative of the payee—the client. In any case, that is what she was purporting to do, which is all that matters for purposes of RCW 62A.3-402(a).

But even if Ms. Patterson's signature on the back was not an indorsement, then it necessarily would have been either an alteration or an unauthorized signature. An "alteration" includes "an unauthorized change in an instrument that purports to modify in any respect the obligation of a party." RCW 62A.3-407. There is no question that Ms. Patterson could have, for example, crossed out the name of the payee on the front and written "payable to cash." She also could have altered the checks by changing the amounts payable. Just because she affixed her signature to the back of the check does not change the significance of her act.

B. A bank satisfies RCW 62A.4-406(a) by providing a statement of account and exceeds its obligations by providing copies of the fronts of the checks.

A bank satisfies RCW 62A.4-406(a) by providing its customer with a statement of account and making available to the customer copies of the checks charged to the account.

RCW 62A.4-406 requires customers to examine their bank statements and notify banks of forgeries and alterations. As recognized by the Washington legislature, "[a] bank customer must exercise reasonable care and promptness in examining a statement of his or her account to discover an unauthorized signature or other alteration." H.B. Rep. on S.B. 5444, 52nd Leg., 1st Spec. Sess., at 1 (Wash. 1991) (included in the appendix to this brief). *See also U.S. Bank Nat'l Ass'n v. Whitney*, 119 Wn.

App. 339, 346-47 (2003) ("Bank customers are required to examine their statements and 'promptly notify the bank' of any problems, including unauthorized endorsements.").

Other courts recognize that the purpose of 4-406 is to place the burden on the customer, who is in the best position to detect unauthorized transactions. *See, e.g., Am. Airlines Emps. Fed. Credit Union v. Martin*, 29 S.W.3d 86, 94 (Tex. 2000) ("[T]he burden must fall on the customer, the one most familiar with the underlying transaction."); *Roy Supply, Inc. v. Wells Fargo Bank*, 39 Cal. App. 4th 1051, 1064 (1995) ("[S]ince a depositor should easily be able to discover and report forged or altered checks, early judicial decisions imposed a duty upon a customer to discover and report forgeries and alterations to the bank without unreasonable delay.").

A customer's duty to discover and report unauthorized signatures or alterations is triggered when a bank "sends or makes available to a customer a statement of account showing payment of items [including checks] for the account." RCW 62A.4-406(a). Banks satisfy these requirements if they provide the "item number, amount, and date of payment." RCW 62A.4-406(a). "This means that the customer's duties under subsection (c) are triggered if the bank sends a statement of account complying with the safe harbor rule without returning the paid items." *See* RCW 62A.4-406, Comment 1.

If a bank paid a check for the account of a customer, the bank may either return or make available the check to the customer, or copies thereof, or provide a description of the check sufficient to allow the customer to identify each check paid. RCW 62A.4-406(a). In Washington, if the bank does not return the checks paid, or copies of the checks, all it needs to do is "provide in the statement of account the telephone number that the customer may call to request an item [including checks] or copy of an item pursuant to subsection (b) of this section." *Id*.

Washington Trust Bank sent to Skils'Kin monthly account statements listing checks that were paid from the account in the preceding month by check number, the date the check cleared, and the amount of the check. *See* Brief of Wash. Trust Bank at 8-9. Washington Trust Bank even exceeded its obligations by including images of the face of each check with the account statements, and by making available these checks online through the internet. *Id*. *See* RCW 62A.4-406, Comment 1 ("If the bank supplies its customer with an image of the paid item, it complies with this standard."). It was Skils'Kin's duty to review the information made available to it and report any unauthorized signatures, indorsements, or alterations.

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It does not matter that Skils'Kin did not receive copies of the backs of the checks. RCW 62A.4-406(a) provides a safe harbor: "The statement of account provides sufficient information if the item is described by item number, amount, and date of payment." This information corresponds to the MICR[1] information that appears on every check, which allows banks to process checks on an automated basis. The statute does not require more, and Skils'Kin was provided with sufficient information to identify the checks paid.

Skils'Kin benefitted from other protections. The statements delivered to Skils'Kin included a toll-free number that Skils'Kin could call for assistance. *See* Brief of Wash. Trust Bank at 8-9. The Bank also provided online access to its account to review the front and back of paid checks. And Skils'Kin could have used services such as "positive pay" to monitor and instruct the Bank to pay checks as presented. Skils'Kin chose not to use those protections.

C. A bank does not fail to exercise ordinary care as a matter of law when it pays cash to a person authorized to act on behalf of the bank's customer and its clients.

A bank does not fail in its duty of ordinary care as a matter of law

[1] MICR stands for magnetic ink character recognition, referring specifically to the encoded routing and account numbers stamped at the bottom of checks. Those codes allow banks to process checks using computers, which lowers the cost of dealing with the billions of checks that pass through the U.S. banking system every year. *See* RCW 62A.4-406, Comment 1 ("This information was chosen because it can be obtained by the bank's computer from the check's MICR line without examination of the items involved.").

if it pays a check to someone other than the named payee. RCW 62A.3-406—which would apply to the extent that claims are not precluded entirely by operation of RCW 62A.4-406(f)—applies a balancing test. The examples given in comment 3 to RCW 62A.3-406 note that there are cases in which an employer's failure to exercise ordinary care by implementing appropriate controls may have substantially contributed to the loss. Those comparative issues of care are ultimately questions of fact. *See Parsons Travel Inc. v. Hogue,* 18 Wn. App. 588 (1977).

Washington Trust Bank exercised ordinary care when it made payment to Ms. Patterson, who was authorized to act on behalf of Skils'Kin and its clients with respect to the pooled account. RCW 62A.3-402 recognizes and enforces signatures made by persons "acting, or purporting to act, as a representative" even if they put their own name rather than the name of the represented person. That is what occurred here: Ms. Patterson was purporting to act on behalf of Skils'Kin and its clients when she signed the check for payment. Accepting the cash and diverting it from Skils'Kin's clients was within her actual and apparent authority, even if it was an abuse of her authority.

Standards of ordinary care did not require Washington Trust Bank to exceed normal business practices for banks in Washington by undertaking its own examinations of Ms. Patterson's checks or making inquiries among Skils'Kin's clients. By statute, that responsibility lay on Skils'Kin. To the extent that Ms. Patterson lacked authority, then it was Skils'Kin's responsibility to review its statements and to employ appropriate controls to guard itself and its clients against fraud.

Given the unique position and relationship between Skils'Kin and its clients, there was no particular reason for the Bank in this case to think that Ms. Patterson was perpetrating a fraud. She was cashing checks for persons who were clients of Skils'Kin in the first place because they were not well-equipped to cash checks on their own.

V. CONCLUSION

For the foregoing reasons, the Court should answer the first certified question "Yes," the second question "Yes," and the third question "No."

RESPECTFULLY SUBMITTED this 10th day of August, 2016.

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CERTIFICATE OF SERVICE

I certify under penalty of perjury under the laws of the State of Washington that on August 10, 2016, I caused the document to which this certificate is attached to be delivered to the following as indicated:

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Signed in Seattle, Washington, this 10th day of August, 2016.

Lauren Dorsett

Lauren Dorsett

APPENDIX

COMPARISON BETWEEN RCW 62A.4-406 AND UCC 4-406

This comparison shows the differences between RCW 62A.4-406 and the current version of UCC 4-406. Language unique to RCW 62A.4-406 is underlined. The text of each provision was procured through Westlaw.

* * *

(a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid<u>, copies of the items paid,</u> or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment.<u> If the bank does not return the items paid or copies of the items paid, it shall provide in the statement of account the telephone number that the customer may call to request an item or copy of an item pursuant to subsection (b) of this section.</u>

(b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item. A bank shall provide, upon request and without charge to the customer, at least two items or copies of items with respect to each statement of account sent to the customer. A bank may charge fees for additional items or copies of items in accordance with RCW 30.22.230. Requests for ten items or less shall be processed and completed within ten business days.

(c) If a bank sends or makes available a statement of account or items pursuant to subsection (a), 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.

(d) If the bank proves that the customer, failed~~,~~ with respect to an item, to comply with the duties imposed on the customer by subsection (c)~~,~~ the customer is precluded from asserting against the bank:

(1) ~~the~~The customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and

(2) ~~the~~The customer's unauthorized signature or alteration by the same ~~wrongdoer~~wrong-doer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding ~~30~~thirty days, in which to examine the item or statement of account and notify the bank.

(e) If subsection (d) applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (c) and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) does not apply.

(f) Without regard to care or lack of care of either the customer or the bank, a natural person whose account is primarily for personal, family, or household purposes who does not within one year, and any other customer who does not within ~~one year after~~sixty days, from the time the statement ~~or~~and items are made available to the customer (subsection (a)) discover and report the customer's unauthorized signature ~~on~~ or any alteration on the ~~item~~face or back of the item or does not within one year from that time discover and report any unauthorized indorsement is precluded from asserting against the bank ~~the~~such unauthorized signature or indorsement or such alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under ~~Section~~ RCW 62A.4-208 with respect to the unauthorized signature or alteration to which the preclusion applies.

* * *

STATEMENT OF FRED H. MILLER BEFORE WASH. HOUSE FIN. INST. & INS. COMM., INCLUDING APPENDIX (JUNE 29, 1992)

The Statement of Fred H. Miller Before Washington House Financial Institutions and Insurance Committee is available through the Washington State Archives as part of the bill file maintained with respect to House Bill 1014, 1993 Session, and was obtained by ordering the file directly from the State Archives.

Statement

of

Fred H. Miller

Before

Washington House Financial Institutions and Insurance Committee

June 29, 1992

My name is Fred H. Miller. I am a Professor of Law at the University of Oklahoma. I have taught commercial law for 26 years, including the law of payment systems and notes which includes Articles 3 and 4 of the Uniform Commercial Code that are the subject of HB 1964. I also have written numerous articles and one book on this area of the law.

I am a Commissioner from Oklahoma to the National Conference of Commissioners on Uniform State Laws and served on the drafting committee that prepared revised Articles 3 and 4 for consideration by the state legislatures. The National Conference, as you may know, is an organization of practitioners, legislators, judges, law professors and legislative drafting experts, composed of three or more members from each state, usually appointed by the Governor, to determine what areas of state law would benefit from uniformity among the states, and then to research, draft, and seek enactment of those products by the state legislatures.

I served on the Oklahoma Bar Association Committee that recommended the enactment of revised Articles 3 and 4 in Oklahoma and testified before the House and Senate Judiciary Committees when these Articles were enacted in Oklahoma, effective January 1, 1992. To date, revised Articles 3 and 4 have been enacted in 14 other states, and the prospect is good for several other adoptions before the 1992 legislative sessions conclude. Since revised Articles 3 and 4 only were completed in August 1990, this legislative activity in my judgment indicates (1) a widespread consensus that the revised Articles are a sound and needed legislative product and (2) a recognition by the states that a failure to responsibly act may cede by default yet one more area to the federal sphere.

There are a number of constituencies that have an interest in the payment system governed by Articles 3 and 4: the financial institution community, commercial users, consumer users, and federal regulators. Collectively, to the extent they saw fit, these participant interests worked with the National Conference in the drafting process, and we believe about as close to a balance and consensus as anyone could reasonably achieve was achieved as a result. Individually, each group would have wished that we had provided more for their special interests, but, overall, revised Articles 3 and 4 furnish each group with benefits that are positive and significant.

Everyone agrees that uniformity in the law covering checks and other negotiable instruments is essential. Every commercial interest, as well as traveling and mobile consumers and those transacting personal business across state lines, want their checks to be accepted and processed readily and expeditiously throughout the United States. Evidences of debt likewise often circulate beyond the border of one state. For forty years, and almost 100 years if one counts the Negotiable Instruments Law, the Uniform Commercial Code has provided that universality. But the Code, like any statute, ages. In recent years, federal law, which preempts state law, has intervened to encourage and in some cases force accommodation with modern practices and social goals. Without the revisions in HB 1964 updating Articles 3 and 4 as state law, one can anticipate more federal preemption to achieve essential uniformity and to ensure the viability of national and international systems of payments. In short, the states can cooperate, or someone else may force us to uniformity not of our choice.

The essence of uniform law revision is cooperation. Preparing a uniform law like revised Articles 3 and 4 pools the diverse experiences of the states through the participation of their Commissioners and others who may be advisers to the drafting committee. Then through the cooperation necessary to obtain a sufficient consensus and balance among the interests of the various participants, the product emerges. Cooperation and compromise are essential to obtain universal and uniform adoption by the legislatures in all 50 states.

As is the practice of the National Conference of Commissioners on Uniform State Laws, announcement of the drafting undertaking for revised Articles 3 and 4 was widely circulated in 1985. Anyone who requested received notice of all meetings and was invited to attend. Upon request, names were put on a mailing list to receive copies of drafts as they progressed. In addition, the American Bar Association Ad Hoc Committee on Payment Systems closely followed the work of the Conference and widely circulated the drafts for discussion by the interested members of the American Bar Association, and the comments made were then furnished to the drafting committee for its consideration.

The drafting committee had 3 and 4 meetings each year and by August 1990, when the work was completed, had held 20 meetings. The drafting meetings began on Friday morning and ended on Sunday at noon. All the meetings were well attended, and the average attendance was 50 or more. The discussion of the drafts was open for comment by all those who attended. In addition, the reporters received a substantial amount of comment and suggestions by written and other communications between meetings of the drafting committee. The work product was read line for line at the annual meetings of the Conference three different years. In addition, the American Law Institute circulated the drafts two or three times to its entire membership of over 2000 persons. The ALI consultative group also held a meeting to comment and make suggestions on the draft. In addition, progress reports were published annually in *The Business Lawyer* from 1985 through 1990 and in other publications. Programs on the proposals were presented for practicing lawyers.

An analysis of the revision of Articles 3 and 4 will disclose that substantial benefits accrue to each participant in the payment system. Those benefits are well balanced among the participants. On the whole, each participant has a net gain by this update and improvement. With respect to consumers, the update clearly represents improvements over current Articles 3 and 4. The benefits for each group are outlined in some detail in the materials I have made available.

Nonetheless, I notice from the materials furnished to me that Professor Rubin who, as he admits, was a participant in the revision process virtually from the beginning through the American Bar Association, although not as chair of its Ad Hoc Committee but rather as chair of its Articles 3 and 4 task force, has engaged in what amounts to a one person campaign to defeat totally the enactment of revised Articles 3 and 4. I will be happy to substantively address the stated objections at an appropriate time, if desired, but a brief response to them appears at the end of this statement as an Appendix. I wish at this juncture, however, to make one point. That point is: if the other groups who participated in the process acted as Professor Rubin has, we would have no uniform laws process. The other groups argued their perspectives and, where necessary, compromised, and they have honored the bargain struck. If any interest, after leaving the drafting table, is able to obtain more by a lobbying campaign during the enactment process, then all will try to do so, and the uniform product formed through cooperation at the drafting stage will evaporate as each interest attempts a second bite at the apple. However, so far Professor Rubin's attempts indeed have been fruitless, as the enactment record of revised Articles 3 and 4 demonstrates.

In conclusion, the National Conference believes that states should continue to play an important role in check and negotiable instruments law. To avoid further federal preemption and as a means for the states to act responsibly in governing their own affairs, the UCC must be uniformly updated to reflect modern practices and technologies, and then universally enacted. The balance achieved in the proposal embodied in HB 1964, after a long and careful process of open discussion and debate, is, and can be embraced by the states as, a suitable vehicle to accomplish this goal.

APPENDIX TO STATEMENT OF PROFESSOR FRED H. MILLER

1. CHECK TRUNCATION.

Criticism. The proposal authorizes truncation of checks without ensuring that customers will receive adequate information, or will be able to obtain a copy of their original check when needed.

The revision authorizes banks to truncate checks, that is, to transmit information electronically, rather than sending the check itself to the customer. This is potentially a good idea, because it will reduce processing costs. But the statute only requires banks to transmit three items of information: the amount, the item number and the date of payment. Thus, consumers may receive nothing more than a list of numbers each month; they will not receive either the name of the payee or a copy of the check. Yet neither is beyond the reach of current technology: Mastercard and Visa provide the name of the payee in their electronic systems, and American Express transmits an image of the check.

While the revision states that a customer may obtain a copy of the check, there is no mechanism to enforce this provision and no limit on what banks can charge for the service. The federal statutes governing credit cards and electronic fund transfers establish mechanisms to enforce their provisions; these mechanisms are familiar, and easy of draft. If banks are being given the authority to truncate checks, they should also be required to assume the responsibilities that go along with that authority.

Response. Federal law gives the Federal Reserve Board authority to encourage truncation so as to expedite check collection and it has authorized banks to do so in Regulation CC. Banks are voluntarily moving toward truncation to save costs; an article in the May 26, 1992 *American Banker* indicated First Chicago Corp. hopes to save $1.47 million over 5 years in mailing costs alone. Revised Articles 3 and 4 will facilitate truncation for these reasons.

Some truncation plans today involve carbonized checks which afford the user a record to compare with the account statement. Increasingly, as the above cited article discusses, banks are going to imaging like American Express, but while user acceptance is high the technology is very expensive and thus is not widely practical at this time. What is widely practical is the information which can be obtained from the MICR line of a check: amount, item number and date of payment. Unlike in the case of credit cards, where potential payees are members of the system and identity information on them is automatically printed or processed when the card is used, check payees are infinite in number and often their name is illegible; no feasible way exists to capture this information. But a careful user that writes information in the check register when the check is issued or who uses carbonized checks will be able easily to reconcile the statement. As Comment 1 to § 4-406 states: "The policy decision is that accommodating [customers who don't keep records] is not as desirable as accommodating others who keep more careful records at less cost to the check collection system and, thus, to all customers of the system."

Revised § 4-406 affords a customer a right to obtain a check. This is no different than under present law if the account agreement does not provide for check return. The revision, like present law, leaves any mechanism to enforce that right or to regulate a fee for exercising the right to financial institution regulatory statutes and agencies. The UCC is not a regulatory statute. The cited federal statutes are regulatory and authorize federal regulatory agencies to administer them. Such regulation is not compatible with the UCC which emphasizes flexibility through agreement and developing commercial practices.

2. **LOSS FROM FORGERY AND ALTERATION.**

Criticism. The proposal allocates too much of the loss from frauds and forgeries to consumers. This is not only unfair, but it is economically inefficient. It does not give banks sufficient incentives to take precaution against loss, or to develop new technological mechanisms for loss prevention.

Response. As did the law prior to the revision of Articles 3 and 4, revised Articles 3 and 4, nothing more appearing, initially place the loss for *all* check forgeries and alterations on the payor bank. Accordingly, every incentive to take precaution against loss and to develop technological mechanisms for loss prevention exists. However, in order to provide that same incentive for everyone so as to comprehensively guard against loss to the whole system, the UCC allocates loss ultimately to the party best able to prevent it, or to any negligent party. That may be the customer and not a bank in some cases. Even the federal system follows this design—under it a consumer bears up to the first $50 of loss without regard to care or lack of care, and in retail electronic payments a customer may lose up to the account balance if the customer is negligent. The problem with the federal system is it allocates loss unfairly: a customer bears their portion of loss even if the means of access to the account is stolen and they are without fault; and it allocates too little loss to constitute an adequate incentive: $50 today is a joke that demands upward revision of the loss figure but Congress has been unwilling to do so in over 20 years for, I submit, a pretty obvious reason. However, even the $50 figure has prompted insurance coverage plans, and no reason exists why such plans are not available in relation to checks if desired.

It is submitted, therefore, that careful users should not subsidize the losses generated by less careful users. And under revised Articles 3 and 4, most careful users need never bear such costs. Moreover, where the risk of loss from fraud may be significant, such as in the case of an employee who must be given a fair amount of freedom of operation and discretion and who may turn out to be unfaithful, an insurance system is available to protect the party at risk. In addition, revised Articles 3 and 4 allow risk to be shifted to any negligent party, such as an institution that dealt with the culprit, to the extent of the institution's failure to use exercise ordinary care. This plan not only provides the maximum incentive to protect the system as a whole, but it seems fair and it is likely to lead to settlement since the parties should desire to negotiate the proper loss division rather than leave it to the trier of fact. Settlement rather than trial is yet one more desirable probable consequence of the revision of Articles 3 and 4.

Finally, it is probably worth recognition that (1) the revision in general continues the present pattern of loss allocation under the UCC and (2) what empirical evidence there is indicates institutions do not normally assert any but the largest forgery and alteration losses against customers, even if they clearly are negligent, because of relational considerations, liability risks, and legal costs, but rather absorb them as business costs. Thus, ultimately no documented evidence exists that a real problem of resolution of loss allocation occurs under the UCC.

3. **CUSTOMER REMEDIES.**

Criticism. The proposal does not provide adequate consumer remedies. Banks, unlike other businesses, are holding the customer's money. If they decide the customer was negligent, they can simply deduct the amount at issue from the customer's account. Article 4 contains no protection against this practice. Unlike the federal legislation, it contains no error correction procedures, and no sanctions against banks for improper actions. The consumer's only recourse is litigation. This is expensive; in fact, it is economically infeasible for the amounts that are likely to be involved in consumer cases. The revisions make the problem worse by adding a comparative negligence provision. This increases the scope of the trial considerably since; even proof that the bank was negligent will not end the case.

Response. Few bank counsel would advise an institution, even if the institution has concluded that its customer is at fault and that it is not, to deduct the amount involved from accounts of the customer with the institution without more. The reason is simple:

if the institution is wrong about the customer's fault, or the degree of it in relation to the conduct of the institution, or the technical steps for valid set off, or about a number of other possible considerations, the institution risks liability for wrongful dishonor. There the damages can far exceed the amount set off. Again, no empirical evidence exists the free exercise of set off is a practice or is a problem when done, and logic tells us it is not.

Moreover, individual institution—customer relationships, prompted in part by a competitive market, address error situations, which seem infrequent, apparently quite well as, again, no significant litigation or lobbying efforts have arisen demanding error resolution legislation, as was the case for credit and debit cards. In these circumstances, since such systems involve significant costs, a system should not be imposed without empirical evidence of need.

Finally, while federal consumer legislation provides for minimum recoveries or penalties and recovery of attorney's fees to prompt and enable consumers to litigate, such systems produce a need for standardization in compliance and a rigidity that is not compatible with the innovation and flexibility that is necessary under the UCC if the banking system, by agreement and developing practice, is to continue to retain the ability to adapt to changes in practices and technology. To date published litigated cases, and experience with consumer complaints, indicate no substantial impediments to the appropriate resolution of customer complaints under the UCC.

4. DISHONORED CHECKS.

Criticism. The proposal contains no provisions to discourage banks from bouncing checks. Like the original Article 4, it allows banks to pay checks in any order they choose. Thus, they can pay one large check and bounce a number of smaller ones. The revision makes the situation worse by specifically authorizing banks to bounce checks after review without checking the account balance.

Response. This criticism does not reflect actual financial institution procedure in this regard. First, banks do not bounce checks to generate fee income. Evidence before the drafting committee indicated instead they try to pay the ones most beneficial to the customer. It is simply not possible by statute to predict whether in a given circumstance it is in a customer's interest when an account balance is insufficient to dishonor one large check or perhaps instead to dishonor several smaller ones. The UCC position on this, which has operated since the 1950's, has produced no pressure for change, which is further evidence it is not being employed for the benefit of institutions to the detriment of customers.

Moreover, the decision to dishonor must occur at a point in time, after normal processing has indicated insufficient funds, that leaves a sufficient period in which to allow the check to be returned before the midnight deadline. If a covering deposit does not arrive before the check is returned, it is too late. Revised Article 4 clarifies that a financial institution can, as a customer service, instead of returning an insufficient funds check in that same days returns, delay return long enough to seek a bank officer's clearance not to dishonor the check by treating it as an overdraft and still return it in time if that clearance is not forthcoming. If, in addition, the institution is then forced to engage in a costly and individualized second check of the account balance, that could delay return, to locate a possible covering deposit, a disincentive exists to do anything other than immediately return the check if insufficient funds exist to pay it. Thus, as this analysis demonstrates, the customer has lost nothing by allowing the institution to take the indicated additional clearance step.

5. **STOP ORDERS.**

Criticism. The revision does not change the rule that if a bank mistakenly pays a check despite a valid stop order, the loss falls upon the customer.

Response. A stop order may be entered for an invalid reason as well as a good reason. If the customer is right and a financial institution pays over a stop order which adequately gives the institution sufficient information to prevent payment of the check, the institution will bear the loss, unless it can recover, under its right of subrogation to its customer's position, the payment from the person paid. But if the customer entered the stop order in the mistaken belief payment was not due to the person to whom the check is written, ultimately the customer will have to pay either the person owed (if the check is dishonored), or the institution (if the check is paid) due to the institution's subrogation right to the position of the paid person. Thus, stopping payment is not an exculpation.

The drafting committee was advised that, if after investigation the institution concludes the customer's claim is probably valid, the institution will recredit the account of a customer which agrees to assist the institution in establishing its subrogation claim against the party paid. The institution has every incentive to do so since revised Article 4 makes it clear that, if the institution dishonors one or more checks due to a wrongful debit to the account, it is liable for wrongful dishonor and the damages for wrongful dishonor can far exceed the amount of the check in dispute. On the other hand, if the customer is of questionable financial stability and the claim of loss appears unsubstantiated after the institution has explored the matter with the merchant, the institution may require a customer to establish the loss. What valid policy should require in these circumstances an institution to automatically recredit due to a technical mistake and accept the risk of a customer's inability to later reimburse the institution when no loss is established?

FINAL BILL REPORT
HB 1400

C 53 L 97
Synopsis as Enacted

Brief Description: Removing a termination date in the bank statement rule.

Sponsors: Representatives Benson, L. Thomas, Wolfe, Zellinsky, Sheahan and Appelwick.

House Committee on Financial Institutions & Insurance
Senate Committee on Financial Institutions, Insurance & Housing

Background: In 1993, Uniform Commercial Code Articles 3 and 4 were substantially revised in accordance with recommendations of the National Conference of Commissioners on Uniform State Laws. One of the provisions in Article 4 relates to information that must be provided on a bank checking account statement. A financial institution must either: (1) provide the check paid or a copy of the check; or (2) provide information on the statement sufficient to allow the customer to reasonably define the check paid. Until January 1, 1998, the statement provides sufficient information if it provides the check number, amount, date of payment, and a phone number the customer may call to request a copy of the check.

Summary: The January 1, 1998 expiration date is deleted from the Uniform Commercial Code provision establishing what information is sufficient on a bank checking account statement. A checking account statement will continue to provide sufficient information if it provides the check number, amount, the date of payment, and a phone number the customer may call to request a copy of the check.

Votes on Final Passage:

House 95 0
Senate 47 0

Effective: July 27, 1997

SENATE BILL REPORT

SB 5444

AS PASSED SENATE, JUNE 17, 1991

Brief Description: Extending the time for a bank customer to discover and report unauthorized signatures and alterations.

SPONSORS: Senators Moore and A. Smith.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: Do pass.
Signed by Senators von Reichbauer, Chairman; Johnson, Vice Chairman; McCaslin, Moore, Owen, Pelz, Rasmussen, and Vognild.

Staff: Meg Jones (786-7416)

Hearing Dates: February 21, 1991; March 5, 1991

BACKGROUND:

A bank customer must exercise reasonable care and promptness in examining a statement of his or her account to discover an unauthorized signature or other alteration. If the customer identifies such an alteration, he or she must promptly notify the bank.

Regardless of the customer's care, he or she is prohibited from asserting such an alteration against the bank unless the customer discovers and reports the alteration to the bank within 60 days. The 60 day period is measured from the time the statement is made available to the customer.

SUMMARY:

The period of time in which a bank customer must discover and report an unauthorized signature or other alteration is changed.

A customer must discover and report any such alteration within one year in order to assert the alteration against the bank.

Appropriation: none

Revenue: none

Fiscal Note: none requested

TESTIMONY FOR:

The one year review period is consistent with the Uniform Commercial Code and should be adopted in Washington. The longer period provides a more reasonable review period for bank customers.

TESTIMONY AGAINST: None

TESTIFIED: Jon Schneidler, Wagner Estate (pro)

HOUSE AMENDMENT(S):

Limits the extension of the bank's liability for unauthorized endorsements to one year for individual accounts. Commercial accounts must still report any unauthorized endorsements within 60 days or be barred for recovering for them against the bank.