Chapter 15

**Banking in the Digital Age**

Answers to Learning Objectives/

Learning Objectives Check Questions

at the Beginning and the End of the Chapter

**Note that your students can find the answers to the even-numbered *Learning Objectives Check* questions in Appendix E at the end of the text. We repeat these answers here as a convenience to you.**

**1A.** ***What type of check does a bank agree in advance to accept when the check is presented for payment?*** The answer to this question is a certified check.

**2A.** ***When may a bank properly dishonor a customer’s check without being liable to the customer?*** A bank may dishonor a customer’s check without liability to the customer when the customer’s ac­count contains insufficient funds to pay the check, providing the bank did not agree to cover over­drafts. A bank may also prop­erly dishonor a stale check, a timely check subject to a valid stop-payment order, a check drawn af­ter the customer’s death, and forged or altered checks.

**3A.** ***What duties does the Uniform Commercial Code impose on a bank’s customers with regard to forged and altered checks? What are the consequences if a customer is negligent in performing those duties?*** The bank is responsible for determin­ing whether the signature on a customer’s check is gen­uine. If the bank pays on a forged signature, it must recredit the customer’s account. A customer must examine monthly statements and can­celed checks and report any forged signatures promptly. If a customer fails to do this, he or she is liable for any loss to the bank.

**4A.** ***What is electronic check presentment, and how does it differ from the traditional check-clearing process?*** With electronic check presentment, items are encoded with information (such as the amount of the check) that is read and processed by other banks’ computers. A check may sometimes be retained at its place of deposit, and then only its image or description is presented for payment. A bank that encodes information on an item warrants to any subsequent bank or payor that the encoded information is correct. This differs from the traditional check-clearing process because employees of each bank in the collection chain no longer have to physically handle each check that passes through the bank for collection or payment. Therefore, obtaining payment is much quicker. Whereas manual check processing can take days, electronic check presentment can be done on the day of deposit.

**5A.** ***What are the four most common types of electronic fund transfers?*** The four most common types of EFT systems used by bank customers are automated teller machines, point-of-sale sys­tems, systems handling direct de­posits and withdrawals of funds, and pay-by-Internet systems.

Answers to Critical Thinking Questions

**in the Features**

**Adapting the Law to the Online Environment—Critical Thinking**

***Does having a digital wallet in an iPhone, Android-based phone, or other smartphone entail more security risks than carrying a physical wallet? Explain.*** Obviously consumers worry about losing their smartphones and potentially having their eWallet “cleaned out.” Actually, losing a smartphone might be better than losing an actual wallet or having it stolen. All smartphones and their apps can be password protected. Moreover, security elements are built in to each phone’s chips. It is relatively easy to remotely shutdown a digital wallet if necessary. Finally, people are going to notice a missing smartphone usually faster than they notice a missing wallet.

That said, mobile charges that are linked to forms of payment other than credit or debit cards do not yet have the same legal protections as credit and debit cards do.

**Linking Business Law to Accounting and Finance—Critical Thinking**

***Imagine the United States without federal deposit insurance. What are some of the mechanisms that would arise to “punish” bank managers who acted irresponsibly?*** Mechanisms that could arise to “punish” bank managers who act irresponsibly, in the absence of federal deposit insurance, might include lawsuits, damaged reputations, and poor customer relations. There might be criminal penalties, depending on the managers’ conduct, which could include fraud, conversion, negligence, breach of contract, and other types of wrongdoing.

Answers to Critical Thinking Questions

in the Cases

**Case 15.1—Critical Thinking—Legal Consideration**

***What circumstances indicated that Herrnkind had Royal Arcanum’s authority to act on its behalf?*** An individual has apparent authority as an agent to act on behalf of another party when the other party (the principal) by words or actions, causes a third party reasonably to believe that the agent has the authority to act, even if he or she lacks actual authority. This usually occurs through a pattern of the principal’s conduct over time.

In this case, one of the circumstances that made it appear Herrnkind had Royal Arcanum’s authority to act on its behalf was the corporate resolution that all corporate checks be signed by two of three officers, of whom Herrnkind was expressly one. Other circumstances included Herrnkind’s name as one of the three signatories on the firm’s initial account with Capital One Bank and Herrnkind’s inclusion as the lone signatory on the company’s subsequent bank account. Also, the bank’s statements for the accounts were sent to Royal Arcanum “care of William Herrnkind.”

**Case 15.2—Critical Thinking—Legal Consideration**

***As a practical matter, does it make sense for the customer to bear primary responsibility for discovering instances of fraud? Which party is in a better position to detect any irregularities? Explain.*** It probably does make sense for customers to bear primary responsibility for discovering fraud. Banking has become increasingly complex, and banks handle a quickly growing volume of checks and transactions. As a practical matter, banks cannot employ people to review every indorsement for the possibility of fraud. Customers should be much more familiar with their own checks and are therefore in a better position to detect any irregularities.

**Case 15.3—Critical Thinking—Economic Consideration**

***Is $1,000 an appropriate penalty for the failure of a depository institution to comply with Regulation CC’s notice provision? Why or why not?*** Regulation CC requires a depository institution to notify its customer of an extended hold on a deposited check. An institution that fails to comply is liable to the customer for “any actual damage sustained by that person as a result of the failure” and a penalty of “such additional amount as the court may allow” to a maximum of $1,000.

The amount of $1,000 is an appropriate penalty because the regulation also allows for a customer to recoup the amount of actual damages.

The amount of $1,000 does *not* seem to be an appropriate penalty because the effect on a customer of an institution’s failure to comply with the notice provision can be more significant than this sum. A customer might have to contact many parties to resubmit payments and otherwise correct whatever circumstances result from the institution’s failure. And as a penalty, $1,000 is a mere nominal amount for a financial institution.

Answers to Questions in the Reviewing Feature

at the End of the Chapter

**1A.** ***Written stop-payment order***

A written stop-payment order (or an oral order confirmed in writing) is effective for six months, when it may be renewed in writing, under UCC 4–403(b). To prevent the cashing of the check, RPM might have asked Systems Marketing to return it.

**2A.** ***Reason for stop-payment order***

A customer-drawer must have a valid legal ground for issuing a stop-payment order on a check or a holder can sue the drawer for payment. A person who wrongfully stops payment on a check is liable to the payee for the amount of the check and can also be liable for consequential damages.

**3A.** ***Stale checks***

Under UCC 4–404, a bank is not obligated to pay a stale check, although the bank has that option. If a bank pays a stale check in good faith, the bank has the right to charge the customer’s account for the amount even without consulting the customer.

**4A.** ***Signature verification***

The failure to verify the signature will result in Bank One’s loss of the amount of the check. A bank that pays a customer’s check bearing a forged indorsement must recredit the customer’s account or be liable to the customer-drawer for breach of contract, under UCC 4–401(a). The reasoning is because the bank failed to pay the check in accord with the customer’s “order to pay.”

Banks today normally verify signatures only on checks that exceed a certain threshold, such as $1,000, $2,500, or some higher amount, but in line with standard practices and Bank One’s own policies, RPM’s check falls well outside such a limit. Assuming that Rierson’s signature was a forgery, Bank One’s failure to recognize it could also subject the bank to liability for a failure to exercise ordinary care. If Rierson altered the check to cash it, and RPM is also considered to have been negligent, the liability for the amount of the check may be apportioned between the bank and its customer.

Answer to Debate This Question in the Reviewing Feature

at the End of the Chapter

***To reduce fraud, checks that utilize mechanical or electronic signature systems should not be honored.*** If businesses were forced to always have physical person sign each check, then fraud would be reduced.  Banks and businesses would be involved in fewer lawsuits over who is responsible for such fraud.

The use of mechanical or electronic signatures systems for checks allows businesses to more cheaply carry out their operations.  Any attempt at eliminating such systems would cause businesses to use more employees.  Costs and therefore prices would rise as a result.

Answers to Issue Spotters

at the End of the Chapter

**1A.** ***Lyn writes a check for $900 to Mac, who indorses the check in blank and transfers it to Jan. She then presents the check to Omega Bank, the drawee bank, for payment. Omega does not honor the check. Is Lyn liable to Jan? Could Lyn be subject to criminal prosecution? Why or why not?*** Yes, to both questions. In a civil suit, a drawer (Lyn) is liable to a payee (Nan) or to a holder of a check that is not honored. If intent to defraud can be proved, the drawer (Lyn) can also be sub­ject to criminal prosecution for writing a bad check.

**2A.** ***Roni writes a check for $700 to Sela. Sela indorses the check in blank and transfers it to Titus, who alters the check to read $7,000 and presents it to Union Bank, the drawee, for payment. The bank cashes it. Roni discovers the alteration and sues the bank. How much, if anything, can Roni recover? From whom can the bank recover this amount?*** The drawer is entitled to $6,300—the amount to which the check was altered ($7,000) less the amount that the drawer or­dered the bank to pay ($700). The bank may recover this amount from the party who presented the altered check for payment.

Answers to Questions and Case Problems

**at the End of the Chapter**

**Business Scenarios and Case Problems**

**15–1A. *Forged checks***

The UCC requires customers to discover and report forgeries to their banks within one year of the time the checks and a statement of account showing payment of the checks are made avail­able to the customer [UCC 4-406(d)]. Thus, Roy and the two corporations can only be held liable for the amounts of any forged checks that were reported less than one year after the bank state­ment showing payment of the checks. The critical dates are (1) the date that the bank statement showing the checks were paid was sent or made available to the customer, and (2) the date that the customer discovered and reported the forgery. The date on the face of the check and the date that the check was paid by the bank are irrelevant.

**15–2A. *Customer negligence***

Citizens Bank will not have to recredit Gary’s account for the $1,000 check and probably will not have to recredit his account for the first forged check for $100. Generally, a drawee bank is responsible for determining whether the signature of its customer is gen­uine, and when it pays on a forged customer’s signature, the bank must recredit the cus­tomer’s ac­count [UCC 3–401, 4–406].

There are, however, exceptions to this general rule. First, when a customer’s negligence substantially contributes to the making of an unau­tho­rized signa­ture (including a forgery), the drawee bank that pays the instrument in good faith will not be obligated to recredit the customer’s account for the full amount of the check [UCC 3–406]. In addition, when a drawee bank sends to its customer a state­ment of account and canceled checks, the customer has a duty to exercise reasonable care and promptness in ex­amining the statement to discover any forgeries and report them to the drawee bank. Failure of the customer to do so relieves the drawee from liability to the cus­tomer to the ex­tent that the drawee bank suffers a loss [UCC 4–406(c)].

Therefore, Gary’s negligence in allowing his checkbook to be stolen and his failure to report the theft or examine his May statement will pre­clude his recovery on the $100 check from the Citizens Bank. Under UCC 3–406(b) and 4–406(e), however, the bank could be liable to the extent that its neg­li­gence substantially contributes to the loss. Second, when a series of forgeries is committed by the same wrongdoer, the customer must discover and report the initial forgery within fourteen calendar days from the date that the statement of ac­count and canceled checks (containing the initial forged check) are made available to the customer [UCC 4–406(d)(2)]. Failure to discover and report a forged check releases the drawee bank from liability for all additional forged checks in the series written after the thirty-day period. Therefore, Gary’s failure to discover the May forged check by June 30 relieves the bank from liability for the June 20 check of $1,000.

**15–3A . *Forged drawers’ signatures***

Brooks is most likely to suffer the loss for the checks paid with her forged signature. When a bank pays a check on which the drawer’s signature is forged, generally the bank suffers the loss. A bank may be able to recover some or all of the loss from the customer if the customer’s negligence substantially contributed to the forgery. A bank—or the customer—may also obtain partial recovery from the forger of the check (if he or she can be found and there are assets against which a recovery can be enforced).

A bank typically makes available to a customer a monthly statement detailing the activity in the customer’s checking account. The customer has a duty to examine promptly the statement with reasonable care on receipt and to report any forged signatures. When the same wrongdoer forges the customer’s signature on a series of checks, the customer must discover and report the first forged check to the bank within thirty calendar days of the availability of the bank statement. Failure to notify the bank within this time period discharges the bank’s liability for all forged checks that it pay before notification. The UCC places an absolute time limit on the liability of a bank for paying a check with a customer’s forged signature. A customer who fails to report his or her forged signature within one year from the date that the statement was made available for inspection loses the right to have the bank recredit his or her account.

Here, Brooks did not exercise reasonable care in handling her accounts. She did not look at any statements for five years. When she finally examined the statements and realized that Tingstrom had taken money from her account by forging Brooks’s name on checks drawn on the account, at least two years had passed since the first forged signature. Brooks’s claim against Transamerica is thus precluded. Unless Brooks can find Tingstrom and the latter has assets against which a judgment could be enforced, it is most likely that Brooks alone will suffer the loss.

In the actual case on which this problem is based, the court dismissed Brooks’s claim.

**15–4A. Business Case Problem with Sample Answer—*Honoring checks***

Wells Fargo is liable to W Financial for the amount of the check. A bank that pays a customer’s check bearing a forged indorsement must recredit the customer’s account or be liable to the customer-drawer for breach of contract. The bank must recredit the account because it failed to carry out the drawer’s order to pay to the order of the named party. Eventually, the loss falls on the first party to take the instrument bearing the forged indorsement because a forged indorsement does not transfer title. Thus, whoever takes an instrument with a forged indorsement cannot become a holder.

Under these rules, Wells Fargo is liable to W Financial for the amount of the check. The bank had an obligation to ensure that the check was properly indorsed. The bank did not pay the check to the order of Lateef, the named payee, but accepted the check for deposit into the account of CA Houston without Lateef’s indorsement. The bank did not obtain title to the instrument and could not become a holder, nor was it entitled to enforce the instrument on behalf of any other party who was entitled to enforce it.

In the actual case on which this problem is based, the court held the bank liable to pay the amount of the check to W Financial.

**15–5A. *Consumer fund transfers***

Yes, the bank’s refusal to reimburse Patterson more than $677.46 was justified. Under the Electronic Fund Transfer Act (EFTA), if a customer’s debit card is lost or stolen and used without her or his permission, the customer does not have to pay more than $50. But for this limit to apply, the customer must notify the bank of the loss or theft within two days of learning about it. Otherwise, the liability increases to $500. The customer may be liable for more than $500 if the unauthorized use is not reported within sixty days after it appears on the customer’s statement.

In this problem, Stephen Patterson held an account with Suntrust Bank. He was briefly involved in a romantic relationship with Juanita Wehrman, who stole his debit card and used it for sixteen months (well beyond the length of their relationship), spending more than $30,000. When Patterson learned what was happening, he closed his account. But of course sixteen months is much more than sixty days, and the bank refused to reimburse him more than $677.46. This was the amount of unauthorized transactions that occurred within sixty days of the transmittal of the bank statement that revealed the first unauthorized transaction.

In the actual case on which this problem is based, in Patterson’s suit in a Tennessee state court against the bank to recover the rest of the spent funds, the court upheld the bank’s refusal. A state intermediate appellate court affirmed.

**15–6A. *Forged drawers’ signatures***

Yes, Nacim is entitled to a recredit of his account for the amount of Peterson’s unauthorized withdrawal. A forged signature on a check—or other means of effecting an unauthorized withdrawal from a customer’s account—has no legal effect as the signature or authorization of a customer-drawer. When a bank pays a check in this situation, generally the bank is liable. The contract between the bank and its customer may shift the loss to the customer in some circumstances. For example, a bank may send a monthly statement that shows the activity in the customer’s account. The customer has a duty to promptly examine the statement and report any unauthorized transactions. “Promptly” may have a specific time limit, such as thirty days, depending on the terms of the account agreement between the bank and its customer.

In this problem, Nacim had a checking account at Compass Bank. When he moved to a new residence, he asked the bank to update the address on his account. But Compass continued to mail his statements to his previous address, and Nacim did not receive them. Peterson made an unauthorized withdrawal from Nacim’s account. Nacim learned what Peterson had done and asked the bank for a recredit. Compass refused on the ground that the notice was more than thirty days after it had mailed the relevant bank statement to Nacim. Under the bank’s “Deposit Agreement,” however, the duty to report an unauthorized transaction did not begin to run until the customer *received* the mailed statement. Nacim did not receive the statement because Compass failed to change his address in its system. Thus, Nacim is entitled to a recredit.

In the actual case on which this problem is based, Nacim filed a suit in a Texas state court against the bank. The court issued a judgment in Nacim’s favor. A state intermediate appellate court affirmed the judgment for the reason stated above.

**15–7A. A Question of Ethics—*Death or incompetence of a customer***

**1.** One sister’s attempt to recover funds given to another sister by their mother is not always unethical. Sandra could have had a positive motive to want to retrieve Esther’s gift to Carol. At first glance, it may appear that Sandra’s attempt to recover the funds was motivated by greed, spite, envy, resentment, rivalry, or some other unresolved acrimony between the two sisters. Conversely, there are benevolent possibilities for Sandra’s attempt to recoup the funds. For instance, she may have needed the funds to defray the costs of their mother’s funeral, medical bills, or other debts. The funds may have been hers to begin with—the balance in the joint account might have always represented her funds. There also may have been a legitimate legal or ethical reason to keep the funds out of Carol’s hands—that is, she may have had an addiction to drugs or gambling, she may have been hounded by a creditor or a spouse on a spurious ground, or she may have had some other questionable debt—and Sandra was attempting to reclaim the funds *for* her sister, not *from* her.

As for who is legally entitled to the funds represented by the check that Carol cashed in this problem, the answer is Sandra. The check was a gift from Esther to Carol. A gift by check is complete only if the check is paid during the lifetime of the drawer. If the check is not paid before the drawer's death, the gift is incomplete—no valid transfer of the funds has occurred. Carol’s check was drawn on a joint account held in the names of Esther and Sandra. Carol did not cash her check until five months after Esther’s death. But when Esther died, the funds remaining in the joint account passed to Sandra. Thus, under UCC 4–405, Sandra could recover the amount paid on the check by the bank.

In the actual case on which this problem is based, the court dismissed the suit. On Sandra’s appeal, a state intermediate appellate court reversed and issued a judgment in Sandra’s favor, on the reasoning stated above.

**2.** A forged drawer’s signature on a check has no legal effect as the signature of the drawer. When a bank pays a check on which the drawer’s signature is forged, the bank is liable and must recredit the customer’s account. The bank may be able to recover at least some of the loss from the customer if the customer’s negligence contributed to the making of the forgery. The bank may also be able to recover from the forger of the check or the holder who presented it for payment (if the holder knew the signature was forged).

In this problem, if the check that Carol cashed five months after Esther’s death had not been a gift, but instead contained a forged drawer’s signature, liability could have been imposed in the first instance on the bank. Under the facts as stated, it does not appear that Sandra or Esther were negligent in any way, however, so it is not likely that the bank could have recovered some of the loss from Sandra or Esther’s estate. The bank might have been able to recoup some of the funds from the forger, whomever he or she was and if he or she could have been found. But the bank may also have been able to recover from Carol, who presented the check for payment. If the check contained the forged signature of her mother, it is likely that she would have recognized the fake.

**Critical Thinking and Writing Assignments**

**15–8A. Critical Legal Thinking**

UCC Article 4 was revised, and Check 21 was enacted, to reflect new technol­ogy and business practices. These rules reflect a policy decision in favor of re­ducing the costs of check collection and payment. Many customers do not keep track of every check or may be unable to identify a check based on the information in a bank statement or even by viewing an electronic copy. Without seeing an original copy, some customers may be unable to determine whether an item includes an unauthorized signature. To date, however, evi­dence indicates that the procedures authorized in the revised UCC 4–406(a) and under Check 21 reduce costs, speed collection and payment, and have other practical advan­tages, but produce no significant increase in losses to custom­ers. It might also be noted that the time period within which a customer has to report a forgery or alteration under the revised UCC 4–406(a) has been in­creased from fourteen to thirty days.

**15–9A. Business Law Critical Thinking Group Assignment**

**1.** Southern Marine Bank did not act wrongfully by honoring Brian’s check and paying Shanta. The UCC pro­vides that the death of a customer does not revoke a payor bank’s authority to pay a check drawn by the customer and that even with knowledge of the cus­tomer’s death, the bank may for ten days after the date of death pay checks drawn before death [UCC 4–405]. Therefore, Southern Marine Bank’s payment on January 10, three days after Brian’s death, is a proper payment.

**2.** Joyce’s claim that Brian’s death and Southern Marine Bank’s knowledge of it re­voked Southern Marine Bank’s authority to pay is incorrect. As noted in the answer to the previous question, the UCC pro­vides that the death of a customer does not revoke a payor bank’s authority to pay a check drawn by the customer and that even with knowledge of the cus­tomer’s death, the bank may for ten days after the date of death pay checks drawn before death [UCC 4–405]. Joyce’s claim that the bank must not pay a check presented more than six months after its date is also incorrect. A check whose date and presentment are more than six months apart is a “stale check.” Although a bank is under no obligation to honor such a check, it may in good faith honor the check without liability. Normally, a bank will consult its de­positor, but this is a time of year during which many drawers mis­takenly still use last year’s date. Thus, consultation is not required and because payment in good faith is permit­ted, Southern Marine Bank is not liable [UCC 4–404].

**3.** A business partner might be in a better position to force Southern Marine Bank to recredit Brian’s account than his widow. The death of a bank’s customer does not revoke the bank’s authority to pay a check drawn by the customer. Even with knowledge of the death, the bank may for ten days after the date of death pay checks drawn before death. There is an exception, however—the bank cannot pay a check, and is liable to recredit the customer’s account, if a proper stop-payment order has been issued by a person claiming an in­terest in the account [UCC 4–405]. Therefore, if a business partner had issued a stop-payment or­der on the check drawn on the business’s account, Southern Marine Bank’s payment on January 10, three days after Brian’s death, would not be a proper payment.