

HOLDER IN DUE COURSE and CHECK FRAUD:

Summary and Detailed Explanation

Holder in Due Course Summary

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

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

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

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

Three Federal Appellate Court cases illustrate the far-reaching power of Holder in Due Course. To receive the long version of these cases, email Robin Johnson: robin@safechecks.com.

ROBERT J. TRIFFIN v. CIGNA INSURANCE COMPANY

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

In July 1993, Cigna Insurance issued James Mills a Worker's Compensation check for \$484. Mills falsely claimed he did not receive it due to an address change, and requested a replacement. Cigna placed a stop payment on the initial check and issued a new check. Mills nevertheless cashed the first check at Sun's Market, and Sun presented the check for payment through its bank.

Cigna's bank dishonored the check, stamped it with "Stop Payment," and returned the check to Sun's bank. Had Sun's Market filed a claim against Cigna as the issuer of the check, Sun would have been entitled to be paid because of its status as a Holder in Due Course. However, Sun either did not know about the law or chose not to pursue it, because it merely tacked the check up on its bulletin board.

Robert J. Triffin obtained the check from Sun's Market, became the new HIDC, and filed this lawsuit against Cigna in August 1995, over two years after the check was returned unpaid. The Court ultimately ruled in favor of Robert Triffin, and Cigna had to pay him \$484, plus interest.

Recommendation: Make a check "expire" before replacing it, or you can be held liable for both checks. Print an expiration statement on the face of checks such as, "THIS CHECK EXPIRES AND IS VOID 20 DAYS FROM ISSUE DATE." If a check is lost, wait 20 + 2 days from the initial issue date before reissuing. Many companies print "Void After 90 Days" or longer, but cannot reasonably wait that long before re-issuing a check. A party that accepts an expired check has no HIDC basis if the check is returned unpaid.

While the above case clearly illustrates what a Holder in Due Course is, the case does not deal with check security features, or the lack thereof. The two cases on the following pages do.

ROBERT J. TRIFFIN V. SOMERSET VALLEY BANK AND HAUSER CONTRACTING CO.

Issue: You May Be Held Liable For Checks You Did Not Issue or Authorize

Hauser Contracting Co. used ADP for payroll services. A thief obtained check stock that looked identical to ADP's checks and created 80 counterfeit payroll checks identical to Hauser Contracting Co.'s, and cashed them all over town.

A retailer who knew Mr. Hauser became suspicious and called him. Somerset Valley Bank also called. Mr. Hauser reviewed the checks, which looked just like his, and confirmed the checks were unauthorized and the payees were not his employees. The bank returned the checks marked as "Stolen Check - Do Not Present Again."

Mr. Triffin bought 18 of these checks totaling \$8800 from four check cashing agencies, claimed HIDC status, and sued both Mr. Hauser and his bank for negligence for not safeguarding the payroll checks and facsimile stamp. Because the counterfeit and authentic checks looked identical, the lower court ruled for Triffin. Hauser appealed, but the Federal Appellate Court upheld the lower court. The Court said the counterfeit check met the definition of a negotiable instrument, and because the check and signature were identical to an authentic check, the check cashing agency could not have known it was not authentic.

Recommendation: Use a controlled check stock, which means using checks that are uniquely designed or customized for your organization and are not available blank to others. SAFEChecks and the Abagnale SuperBusinessCheck, designed by Frank Abagnale and available through SAFEChecks, are both strictly controlled check stock. First designed in 1994 and through current period, these checks have never been replicated or used in a check fraud scam.

ROBERT J. TRIFFIN V. POMERANTZ STAFFING SERVICES, LLC

Issue: High Security Checks May Protect You From Some Holder in Due Course Claims

Pomerantz Staffing Services used high security checks that included heat sensitive (thermochromatic) ink on the back and a warning banner on the front that said, "THE BACK OF THIS CHECK HAS HEAT SENSITIVE INK TO CONFIRM AUTHENTICITY." Someone made copies of Pomerantz's checks, but without the thermo ink on the back. They cashed 18 checks totaling \$7000 at Friendly Check Cashing Company. Friendly's cashiers failed to heed the warning on the check face, and did not look for the thermo ink. All 18 checks were returned unpaid, likely caught by Positive Pay.

Mr. Triffin bought the checks, claimed Holder in Due Course status and sued Pomerantz. Pomerantz counter-sued and won! The judge correctly asserted that if Friendly had looked for the thermo ink as

instructed, they could have determined the checks were counterfeit. Because they were provided a means to verify authenticity and failed to do so, they were not an HIDC and had no rights to transfer to Mr. Triffin.

This case clearly illustrates the value of check security features, a properly worded warning band, and a controlled check stock. Pomerantz was protected by his checks.

Recommendation: Use high security checks with overt and covert security features, including explicitly worded warning bands. Such security features will also help prevent other kinds of check fraud.

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Commentary on Holder in Due Course and Stop Payment Checks

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

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

Dishonest Dave cashes the second check. Later, he cashes the first check #12345 at a check cashing store. Although a stop payment was placed on check #12345, there is no evidence on the face of check #12345 of that stop payment. The check cashing store accepts and negotiates the check. At that point the check cashing store becomes a Holder in Due Course.

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

As you will read in the New Jersey Appellate Court case between Robert Triffin and Cigna Insurance, under the UCC a Holder can force a company to pay them the face value of the check.

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

The best way to protect your company from losing this type of lawsuit is to cause the first check to expire before re-issuing a new check, for example, in 25 days. Re-issue the new check two days after the first check expires, just in case it was negotiated on the last day and hasn't cleared yet. Verbiage could read: "THIS CHECK EXPIRES AND IS VOID 25 DAYS FROM ISSUE DATE." A short expiration time printed on the face of the check may help your organization avoid HIDC claims.

Continue reading for detailed court cases involving Holder In Due Course:

HOLDER IN DUE COURSE, CHECK FRAUD, and MOBILE BANKING FRAUD

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Every company that issues stop payments on checks or uses generic check stock that is available entirely blank is vulnerable to a Holder in Due Course lawsuit. Litigation expense and Holder in Due Course judgments can cripple a company financially and should be feared and avoided, especially in light of some Appellate Court rulings.

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

Following are three cases decided by the Superior Court of New Jersey, Appellate Division. All involve Robert J. Triffin, a Pennsylvania resident who is in the business of purchasing dishonored instruments (checks), acquiring Holder in Due Course status and suing the maker for recoupment. The complete cases can be downloaded and viewed at www.FraudTips.Net/holder.htm.

ROBERT J. TRIFFIN V. CIGNA INSURANCE COMPANY

297 N.J. Super. 199, 687 A.2d 1045 (App. Div. 1997)
<http://lawlibrary.rutgers.edu/courts/appellate/a4000-95.opn.html>

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

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

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

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

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

Recommendation: Every company issues stop payments, and some have hundreds of outstanding stop payment orders on checks. There are two important items to consider about stop payments. First, as this case illustrates, placing a stop payment on a check does not necessarily terminate your obligation to pay the check. Companies should print on the face of the check a statement declaring a date after which the check is no longer valid, such as "**THIS CHECK EXPIRES AND IS VOID 20 DAYS AFTER ISSUE DATE.**" If a check is lost, the payee would have to wait 20 + 2 days before the check is reissued.

While this practice would be very inconvenient for the recipient, there is no other way a company can protect itself from a Holder in Due Course claim. Second, a stop payment is typically good for only 180 days. After that time, the stop payment drops off the bank's system and is no longer monitored. If the checking account is not on Positive Pay, the stop payment should be re-issued. A check that is six months old becomes a stale-dated check, and a bank has the legal right (but not the legal requirement) to decline payment on a stale-dated check. Further, a bank cannot be held liable for paying a stale-dated check. A service offered by many banks called Positive Pay will catch stale-dated checks. Visit www.PositivePay.Net to learn more about Positive Pay.

ROBERT J. TRIFFIN V. SOMERSET VALLEY BANK AND HAUSER CONTRACTING COMPANY

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

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

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

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

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

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

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

Recommendations: It is clear from this case that if a thief can get check stock that looks genuine, your company can be held liable for losses that may occur from those counterfeit checks. Most companies buy check stock from vendors that sell the identical check stock entirely blank to other companies, totally uncontrolled, thus aiding the forgers. Many companies opt for these solutions because they are less expensive than controlled, high security checks (excluding legal fees and Holder in Due Course judgments). Forgers buy the check stock, and using a \$99 scanner and Adobe Illustrator, create counterfeit checks that cannot be distinguished from the account holder's original checks. This is how legal exposure to a Holder in Due Course claim can be and is created.

Companies should use checks uniquely designed and manufactured for them, or buy from vendors such as SAFEChecks (safechecks.com) that customizes every company's check and never sells check stock entirely blank without it first being customized for the end user.

ROBERT J. TRIFFIN V. POMERANTZ STAFFING SERVICES, LLC

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

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

This is one of the few cases Robert Triffin lost. It illustrates the value of using high security, controlled check stock to protect oneself from some Holder in Due Course claims. In this case, the Court was asked whether an innocent party, whose check stock was replicated and whose signature was forged, can be held liable when another innocent party pays that check in good faith. The answer is No. On April 20 and 21, 2002, a check cashing store cashed 18 counterfeit checks, in amounts ranging between \$380 and \$398, purportedly issued by Pomerantz Staffing Services. Each check bore

Pomerantz's full name and address and a facsimile signature of "Gary Pomerantz." Printed on the face of each check was a warning: "THE BACK OF THIS CHECK HAS HEAT SENSITIVE INK TO CONFIRM AUTHENTICITY." Without examining the checks as suggested by this warning, the store cashed the checks, which the bank returned unpaid and stamped: "COUNTERFEIT" and "DO NOT PRESENT AGAIN." (The fact that the bank caught checks of such low dollar value suggests that Pomerantz was utilizing its bank's Positive Pay service. Visit www.PositivePay.Net.)

Robert Triffin bought those checks and filed suit against Pomerantz. Both parties filed cross-motions for summary judgment. The trial judge granted Pomerantz's motion and dismissed the case. Triffin appealed because Triffin almost always wins on appeal.

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

Recommendations: Use high security checks that include properly worded warning bands and overt and covert security features to help prevent check fraud losses, including some Holder in Due Course claims. The **SuperBusinessCheck** contains 16 security features, including heat sensitive ink, a true watermark and explicit warning bands. **SAFEChecks** has 12 security features. Both are strictly controlled, high security check stock that were designed with Frank Abagnale, one of the world's foremost authorities on fraud prevention. Visit www.safechecks.com to view them online, and call SAFEChecks at (800) 755-2265 ext. 3304 to receive samples of both checks.

MOBILE BANKING FRAUD AND HOLDER IN DUE COURSE

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

Because depositing checks via a smart device (Mobile Remote Deposit Capture, aka mRDC) is highly popular, almost all banks offer, or plan to offer, MRDC. Fraudsters haven't directly targeted mRDC users' devices on a large scale; however, cases of mobile users double-depositing the same check at multiple banks, or cashing the check at a check cashing store after depositing via a smart phone, are growing significantly.

Check 21 has a rule ("Warranty") that specifically prohibits a check or its image from being presented for payment more than once, and, when combined with Holder In Due Course laws, provides a powerful recovery remedy if it occurs.

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

MOBILE DEPOSITS AND HOLDER IN DUE COURSE

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

John Doe quickly cashes the second check, and waits overnight for the first check to clear before withdrawing the money from the first check. Unfortunately, the drawer issuing the check can be held liable for both checks. This is because the second check was cashed at the bank, and the first check was deposited remotely. While banks often cooperate to stop fraudulent activity, John Doe's bank is a Holder In Due Course and has no obligation to return the funds to the issuer.

To prevent this kind of theft, if a check leaves your possession for any length of time and is returned for a replacement, place a Stop Payment on that check. Cause the recipient to sign an affidavit declaring the check was not deposited remotely, and accepts liability for all expenses to recover any stolen funds.

MOBILE DEPOSITS, DOUBLE DEBITS AND HOLDER IN DUE COURSE

Consider this example, which is becoming more common: John receives a check and deposits the check (its electronic image) via his smart phone app. He still has the physical check, which he later cashes at a check-cashing store. When the check cashier deposits the original paper check, and its image is presented to the drawer's bank for payment, the second presentment breaches the Warranty that John made when the first electronic image was deposited via John's smart phone.

Under Check 21, the first presentment of the check (via smart phone) can be charged back to the bank of first deposit (BOFD) under a Breach of Warranty claim (because of the second presentment) for up to one year from the date the injured party discovers the loss, even if he doesn't discover the loss for 6 months or more.

**For additional information on check fraud prevention, contact Robin Johnson
(800) 755-2265 x 3311, robin@safechecks.com**

Since our founding in 1996, our checks have never been used in a check fraud scam.



About the authors

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

Greg Litster is president of SAFEChecks, and a former 18-year banker. He is an associate of Frank Abagnale, and is editor of Mr. Abagnale's publication. can be downloaded at safechecks.com/bulletin.htm. SAFEChecks sells high security checks, MICR laser check printing software, and Positive Pay file formatting software.

Mr. Litster lectures on check fraud and embezzlement across the United States, and provides expert witness services in check fraud cases. He can be contacted at GLITSTER@aol.com and greg@safechecks.com, or by phone at (800) 949-2265.

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