

**Cutting the Gordian Knot:
eChecks, Mobile Banking Fraud,
Check 21, and Holder In Due Course**



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**eChecks –
Another twist on check fraud**



Frank J. McGee
THE FRAUD BULLETIN
VOLUME 15

The Interconnections of Fraud

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eCHECK FRAUD – IT'S ALREADY HAPPENING

e Checks is a new technology designed to move money quickly and efficiently to the intended recipient by email. The email includes a link to a file that contains a check image payable to the recipient, and an access code to open the file and download and print the check. The check image can be downloaded only once for printing.

The flaw is the recipient's ability to print the eCheck as a high-resolution PDF, which can be reprinted and cashed multiple times. Every check appears genuine. Penetration has already exploited this flaw.

A company in the West with hundreds of small vendors in 40 states switched to eChecks. Over a two-month period the company issued about 8,000 eChecks, and soon had over \$17,000 in check fraud losses!

More than 50 of the eCheck recipients downloaded and saved the check images as high-resolution PDFs. Then, they printed and cashed or deposited those duplicate checks.

Over 300 duplicate eChecks hit the company's bank account.

Checks have used software to detect duplicate checks for decades. The process is based upon check numbers and dollar amounts. In this case, the bank could not identify many of the duplicate eChecks because about 50 percent of the total eChecks issued had a check number that was not readable or captured by the bank's Check Recognition (OCR) software.

As the duplicate eChecks were discovered by the company and presented to the bank, the bank began reimbursing the company. However, as the dollar losses grew, the bank told the company it should have been using Positive Pay, even though the bank had never before mentioned Positive Pay. The bank refused to reimburse the company for additional losses. Positive Pay will work with eChecks, but would be difficult because of the high percentage of unreadable check numbers, each of which would have become a Positive Pay exception item.

One of the company's vendors had its email system hacked. The hacker intercepted the eCheck email, and downloaded and printed the eCheck image. The hacker then cashed the check at a check-cashing store after forging the endorsement. The company has had an affidavit of legal endorsement with its bank and expects to recover the \$2,500 from the bank of last deposit, however, this does not spare them the harassment of dealing with the fraud.

eCheck users should be mindful of their legal liability for duplicate checks under UCC § 3-302, Holder in Due Course. If a check looks "genuine," the drawer can be held liable for the face value of the check, even if the check is counterfeit. (See Page 8, Robert Teller v. Sonoma Valley Bank and Weaver Consulting Co.) Because every eCheck can be printed as a PDF that appears "genuine," eCheck users are strongly encouraged to buy check fraud insurance.

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How eChecks work

How eChecks work

- 1 Create & send**
Log in to your eChecks account or integrate with QuickBooks and other software to send checks in a few clicks.
- 2 Receive, retrieve & print**
Recipient receives a link to their email, retrieve their eCheck from our secure online portal and print the check from any form of office printer.
- 3 Deposit the check**
Recipient cashes the eCheck at a bank branch, through an ATM or using Mobile Deposit Capture on a smartphone.

The Flaw in eChecks

- ✓ The flaw in eChecks is a dishonest recipient's ability to download & print the eCheck as a high-res PDF.
- ✓ A high-res pdf can be reprinted & cashed 1000+ times
- ✓ Each printed eCheck looks identical to the very first printed eCheck; each looks genuine and is genuine.
- ✓ Under the UCC, every eCheck is a negotiable instrument for which the drawer can be held liable under UCC's "holder in due course" (HIDC) – each check appears genuine. **Even if a duplicate eCheck is caught on Pos Pay, the issuer can still be held liable for the face value because of HIDC, which trumps Positive Pay.**

HIDC Court Case

Holder in Due Course

- An innocent party who accepts a check for goods or services
- No evidence of alteration or forgery, or knowledge of fraud by recipient
- Statute of Limitations
 - ✓ 10 years from issue date
 - ✓ Three (3) years from date of return
- A Holder in Due Course can sell his/her rights

Holder in Due Course (HIDC)

- Robert Triffin v. Somerset Valley Bank and Hauser Contracting Company
 - 80 counterfeit checks totaling \$25,000 on authentic-looking check stock
 - **Bank returns them as counterfeit**
 - Triffin bought \$8,800 of returned checks from four check cashing stores; sued Hauser as a **HIDC** for negligence for not controlling his check stock

<http://caselaw.findlaw.com/nj-superior-court-appellate-division/1315264.html>

Holder in Due Course (HIDC)

- Lower court rules in favor of Triffin, saying **the** checks looked "genuine"
- **Hauser appealed; claimed he never had possession of the checks or authorized their issuance.**
- Federal Appellate Court **UPHELD** lower court; ruled the checks looked "**genuine**"
- **Hauser Contracting ordered to pay Triffin \$8,800**
- **Solution:** Use controlled, high security checks

<http://caselaw.findlaw.com/nj-superior-court-appellate-division/1315264.html>

eCheck Fraud Example

An eCheck fraud example

In one case involving eCheck fraud, the company's bank could not read the check number on about 10% of the eChecks presented for payment. The dollar amount of each check appeared as a debit on the bank statement, but without the check number. Reconciliation was impossible without the check number, which appeared on the image.

An eCheck fraud example

Because check images are pulled by the (missing) check number, the customer asked its bank to pull hundreds of check images based upon each item's "trace number."

About 300 of the eCheck images were duplicate checks that looked absolutely identical to other checks.

One check had been printed & deposited 50 times.

100% Satisfaction Guaranteed (but only for 60 days!)



100% Satisfaction Guarantee

"Xxxxxx eChecks are guaranteed to save you time and money. If, within 60 days, you're not completely satisfied with your eChecks experience, Xxxxxx will refund the unused portion of your eChecks order."

There is No Solution

eChecks work in a society where everyone is HONEST

In today's society eChecks carry an immitigable risk that paper checks don't have

Get an Indemnity Agreement that covers losses and costs from duplicate eCheck presentments

Include Attorney and CPA fees

Mobile Banking Fraud – merging the new with the old....



A report on banking fraud released by *American Bankers Association* highlights the impact mobile banking fraud is having on institutions of all sizes, with **100%** of the largest financial institutions reporting RDC fraud & a **400%** growth in losses reported over two years across financial institutions of all sizes.

thepayers.com April 2016

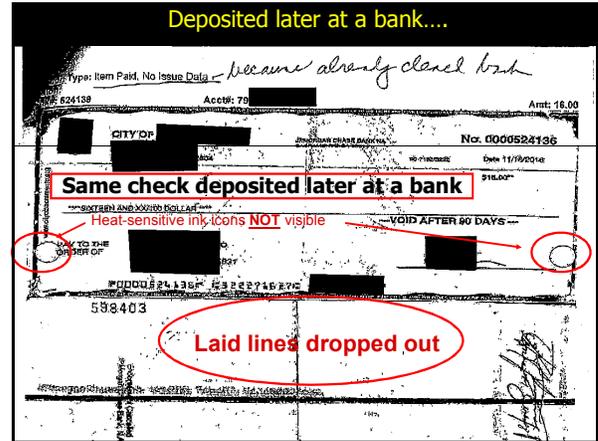
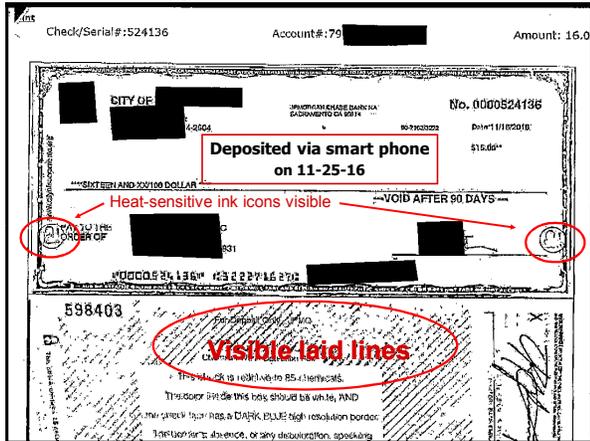
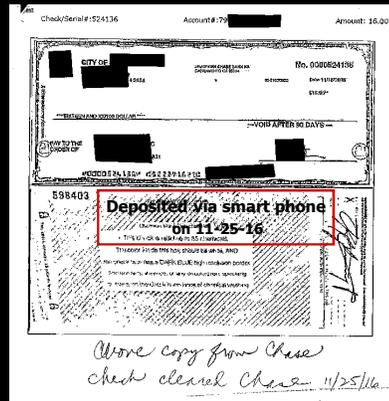
Mobile Banking Fraud:

Double Deposits



Example of Double Deposits

Deposited by smart phone November 25, 2016



- Mobile Banking Deposit Fraud Scenario:** A check is mailed to Dishonest Don
- Don uses a smart phone app to deposit check
 - ✓ Takes pix of front of check
 - ✓ Endorses the back of a different check
 - ✓ Uploads check; is pays at drawer's bank
 - 3 days later, Don cashes the same check at a check cashing store
 - ✓ 2nd check hits the drawer's bank account
(check is presented for payment twice)

Who Takes The Loss?

The answer is found in the Rules governing

Check 21

AND

The Uniform Commercial Code (UCC):

Holder In Due Course

Mobile Banking & Check 21

1. Mobile depositing is another form of Remote Deposit Capture
2. Remote Deposit Capture is part of Check 21
3. Check 21 has specific rules that govern Remote Deposit Capture (including mRDC)
4. The Rules determine who takes the loss

Check 21 Rules

Two Warranties:

- ✓ Image of check is clean; everything is legible; substitute check is properly created
- ✓ Check is presented for payment only one time; **no double presentments.**

The Fed did not envision Remote Deposit Capture desktop scanners or mobile banking smart phone apps in 2004!

§ 229.52 Substitute check warranties

- A bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check)... warrants... that—

§ 229.52 Substitute check warranties

- (2) No depository bank, drawee, drawer, or indorser will receive presentment or return of, or otherwise be charged for, the **substitute check, the original check, or a paper or electronic representation of the substitute check or original check** such that that person will be asked to make a payment based on a check that it already has paid.

§ 229.52 Substitute check warranties

- (b) Warranty recipients. A bank makes the warranties... to the person to which the bank transfers, presents, or returns the substitute check or a paper or electronic representation of such substitute check and to any subsequent recipient, which could include a **collecting or returning bank, the depository bank, the drawer, the drawee, the payee, the depositor, and any indorser.** These parties receive the warranties regardless of whether they received the substitute check or a paper or electronic representation of a substitute check.

§ 229.56 Liability

(c) Jurisdiction. A person may bring an action to enforce a claim... in any United States district court or in any other court of competent jurisdiction. Such claim shall be brought within one year of the date on which the person's cause of action accrues... a cause of action accrues as of the date on which the injured person first learns...of the facts and circumstances giving rise to the cause of action, including the identity of the warranting or indemnifying bank against which the action is brought.

Under the § 229.56 Warranty...

Bank of First Deposit (BOFD) can charge the loss against its customer's account.

Liability for the loss falls on the bank that allowed its customer to use the smart phone app.

Warranty Claims

A Breach of Warranty claim can be filed within one year from the cause of action.

- Cause of action begins to run the date the injured party first learns of the loss.
- Claims must be made within 30 days after the person has reason to know or further losses cannot be claimed.
- Comparative negligence applies.

Email: Breach of Warranty Claim

Greg Lister

From: [REDACTED]@first-
Sent: Wednesday, February 7, 2016 10:54 AM
To: [REDACTED]
Cc: [REDACTED]@first-
Subject: Re: LWTS&V03 Check 21 Breach of Warranty Claim - City of [REDACTED]

Thank you for the update. I will look for the \$96.00 credit and will contact [REDACTED] check service staff to let them know that reimbursement for the \$125.00 check and \$30.00 returned check charge will be forthcoming.

Best Regards,
Greg Lister

On Feb 7, 2016, at 10:42 AM, [REDACTED]@city- wrote:
Hi [REDACTED] and [REDACTED],
According to our back office, a Breach of Warranty claim was submitted to Bank of America on January 12, 2016. The claim was reviewed and [REDACTED] Bank of America's recourse will be to seek reimbursement from their customer [REDACTED], and we have credited \$30 to City as well.

Thank you,
[REDACTED]

Actual Breach of Warranty Claim

Greg Lister

From: [REDACTED]@first-
Sent: Wednesday, February 7, 2016 1:05 PM
To: [REDACTED]
Cc: [REDACTED]@first-
Subject: Returned Check Notice Dated 12/7/15
Attachments: Collection Letter from [REDACTED]

Dear Mr. [REDACTED],

The purpose of this message is to update you on the status of his outstanding payment.

Upon receipt of your letter dated December 7, 2015 (copy attached), the City's banking institution [REDACTED] Bank of America [REDACTED] Check 21 Breach of Warranty Claim against the Bank of First Deposit (Bank of America). Today, I received confirmation [REDACTED] Bank of America has agreed to honor the claim and reimbursement will be for the check amount and returned check charge will be credited to the City's checking account.

Upon receipt of the funds, a check will be issued and mailed to [REDACTED].

Should you have any questions, please don't hesitate to contact me at [REDACTED].

Sincerely,
[REDACTED]
Bank of First Deposit City Treasurer

Check Fraud



Check Fraud

Why talk about Check Fraud?

Check Fraud

Produces more \$ Losses
than all other types of payment fraud!

The FIRST Check Fraud Lawsuit in 1762

Price sued Neal for check fraud

Price v. Neal, England

The FIRST Check Fraud Lawsuit in 1762

Price sued Neal for check fraud
Price v. Neal, England



Plaintiff, Price, argued that:

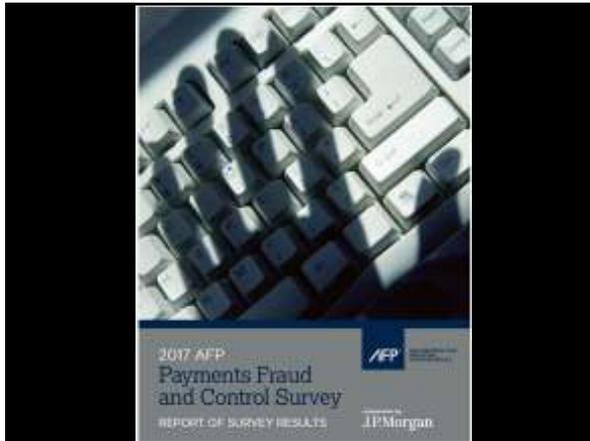
Defendant, Neal, was indebted to him for 80£ for money had and received: and damages were laid to 100£. Plaintiff should recover back the money he paid them by mistake believing "that these were true genuine bills."

Plaintiff "could never recover it against the drawer, because no drawer existed; nor against the forger, because he is hanged."

The jury found a verdict for the Plaintiff; and assessed damages of 80£ and costs 40s. (Bank had NO liability... even in 1762!)

**Check fraud has continued
unabated for 250 years!**

(but with few public hangings)



**Association for Financial Professionals
Payments Fraud Survey**

“**Checks** remain the most-often targeted payment method by those committing fraud attacks.

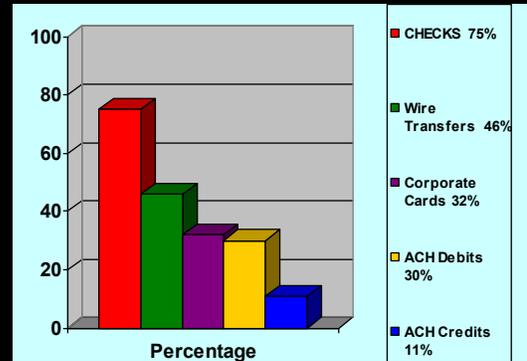
Check fraud also accounts for the **largest dollar amount of financial loss due to fraud.**”

**Association for Financial Professionals
Payments Fraud Survey**

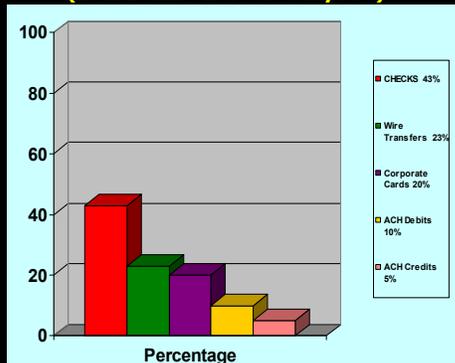
50% of large organizations
(plus millions of smaller organizations)
still issue checks

Check fraud is not going away!

Fraudulent Payment Attempts (by Method)
(Respondents were hit multiple ways-- total > 100%)



Fraud LOSSES (by Method)
(How Dollars were actually lost)



Frank Abagnale

Catch Me If You Can

Technology is making Frank Abagnale's "gift" achievable by mere mortals



Quiz
—
True or False?

QUIZ: True or False?

- 1) Placing a Stop Payment on a check ends your legal responsibility to pay the check.

FALSE

Holder in due course trumps Stop Payments

QUIZ: True or False?

- 2) Positive Pay will catch all check fraud attempts.

FALSE

Pos Pay won't catch Altered Payee Names or counterfeit checks using the same check number

QUIZ: True or False?

- 3) Payee Positive Pay will catch all check fraud attempts including added payee names.

FALSE

Won't catch ADDED Payee Names placed two (2) lines above the original payee name

QUIZ: True or False?

4) If you're using Payee Positive Pay the quality of your check stock doesn't matter.

FALSE

If the counterfeit checks looks "genuine" you can be held liable for the check under Holder in due course (See *Triffin v. Somerset Valley Bank and Hauser Contracting Co.*)

Uniform Commercial Code §3-302

Holder in
Due Course

Web: FraudTips.net

Quiz: Yes or No

Does placing a Stop Payment on a check end your legal obligation to pay the check?

Quiz: Yes or No

Does placing a Stop Payment on a check end your legal obligation to pay the check?

NO

Holder in due course trumps Stop Payments

Holder in Due Course

- Trumps Stop Payments
- Trumps Positive Pay

Trump (n.) To get the better of an adversary or competitor by using a crucial, often hidden resource.

Solution

1. Print a SHORT expiration # of days on the check
"This check expires and is void 20 days from issue date"
2. DO NOT reissue the check until after 20 days
3. "Void After 90 days" is too long!
4. Banks do not care to what is printed.
This verbiage prevents some HIDC claims.

Someone who accepts
an expired instrument (a check)

Has No Legal Standing

as a Holder in Due Course

Holder in Due Course

Federal Appellate Court

Lawsuit

HIDC & Stop Payments

Robert Triffin v. Cigna Insurance

- Two year old check; payment stopped
- No "expiration date" was printed on the check
 - **UCC: Check valid for 10 years or 3 years**
- Print on your checks: "**This check expires and is void 25 days from issue date**"
 - ✓ Don't re-issue check until first check expires

<http://caselaw.findlaw.com/nj-superior-court-appellate-division/1093442.html>

<http://www.jurispro.com/files/documents/doc-1066206627-article-2071.pdf>

HIDC & Controlled Check Stock

- Robert Triffin v. Somerset Valley Bank and Hauser Contracting Company
 - 80 counterfeit checks totaling \$25,000 on authentic-looking ADP check stock
 - Bank returned the checks as counterfeits
 - Triffin buys \$8,800 in returned checks from four check cashing stores, and as a HIDC, sued Hauser for NEGLIGENCE for not controlling his check stock

<http://caselaw.findlaw.com/nj-superior-court-appellate-division/1315264.html>

HIDC & Controlled Check Stock

- Lower court rules in favor of Triffin, saying **the** checks looked “genuine”
- Hauser appealed; claimed he never had possession of the checks or authorized their issuance.
- Federal Appellate Court UPHELD lower court; ruled the checks looked “genuine”
- **Hauser Contracting ordered to pay Triffin \$8,800**
- **Solution:** Use controlled, high security checks

<http://caselaw.findlaw.com/nj-superior-court-appellate-division/1315264.html>

HIDC & Controlled Check Stock

Robert Triffin v. Pomerantz Staffing Services

- 18 counterfeit checks drawn on Pomerantz’ acct cashed at check cashing store. **Every check under \$400**
- Each check had a warning printed on the face: **“THE BACK OF THIS CHECK HAS HEAT SENSITIVE INK. RUB TO CONFIRM AUTHENTICITY”**
- Check cashier cashed the checks without examining the back of the checks

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

HIDC & Controlled Check Stock

Robert Triffin v. Pomerantz Staffing Services...

- Counterfeit checks looked authentic on face, but **DID NOT HAVE** heat-sensitive ink on the back
 - Because cashier did not verify heat-sensitive ink on the back, **it could not** claim Holder in Due Course status

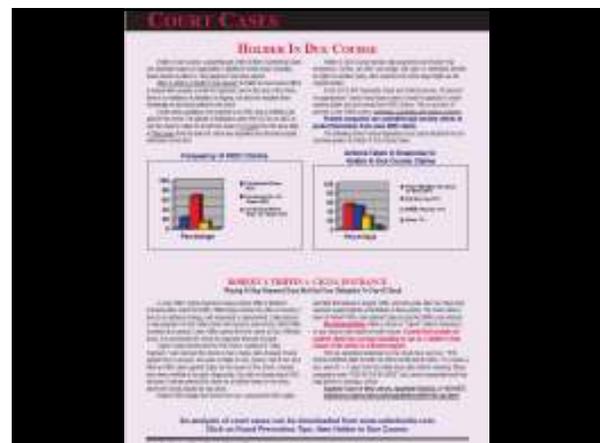
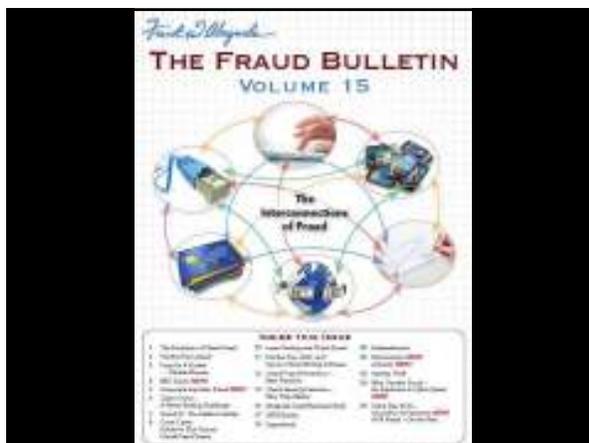
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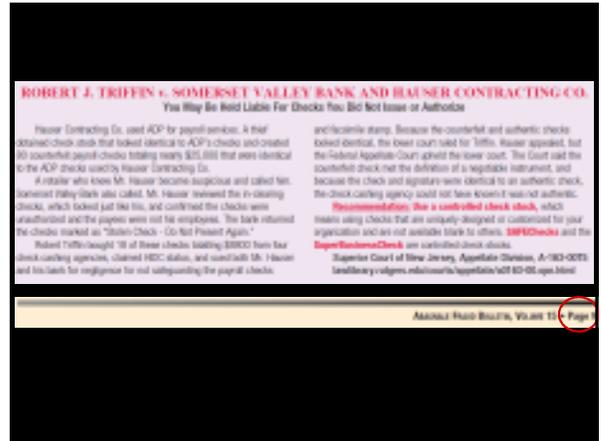
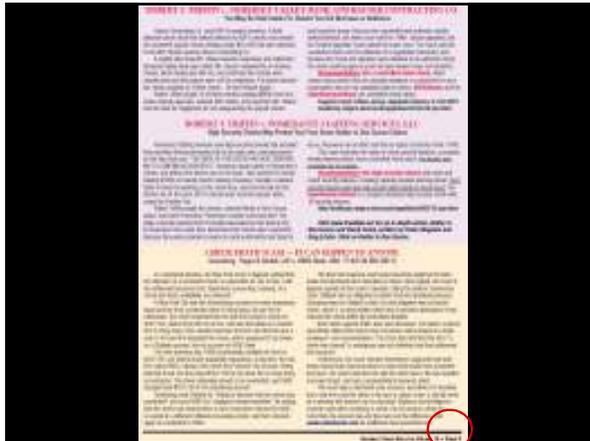
HIDC & Controlled Check Stock

Robert Triffin v. Pomerantz Staffing Services...

- Triffin **LOST** because the security feature was absent, and forged signature was not specifically disavowed
- Pomerantz’ check security features helped save him

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





The Check Fraud Quiz Continues....

QUIZ: True or False?
5) In a Check 21 world, check security features don't matter if you're using Payee Positive Pay.

FALSE
Holder in due course trumps Payee Pos Pay

QUIZ: True or False?
6) Your payables are processed by a third party (your bank) that uses Payee Positive Pay. The quality of the check stock they use doesn't matter to you because if there's loss, they'll take the hit.

Depends...

on what the contract says.
If it is silent, you have liability.

QUIZ: True or False?

7) If you have a great relationship with your bank, you'll never be held liable for a check fraud loss

HA!

Cincinnati Insurance Co. vs. Wachovia Bank

Yesterday's generation



Willie Sutton
Profession: Bank Robber
(1901 - 1980)



"I rob banks because that's where the money is."

Today's generation –
What once was "old" is NEW



“...Gangs traditionally associated with drugs and violent crimes are increasingly committing financial frauds.

Gangs are getting into crimes like check fraud and identity theft because they are more lucrative, harder to detect, and carry lighter prison sentences...”

Wall Street Journal, March 8, 2016

“We think of gang members being knuckleheads, but these guys are using a sophisticated thought process and getting involved in stuff that requires technology and an understanding of the banking system.”

Wall Street Journal, March 8, 2016

When federal agents arrested a group of Outlaw Gangsta Crips last summer in Brooklyn, N.Y., the 38-page indictment included robbery, attempted murder and cocaine distribution. But it also included an atypical charge for a street gang case: bank fraud.

Wall Street Journal, March 8, 2016

“Check fraud has become especially popular...fraudsters are familiar with checks and so are able to commit check fraud with relative ease with the help of sophisticated equipment.”

Wall Street Journal, March 8, 2016

What has changed are the size and scale of the operations. **“The sums of money involved are staggering...**the potential amount of money involved and damage to people’s financial accounts is greatly out of proportion to other gang crimes....”

Wall Street Journal, March 8, 2016

“Prosecutors said the gang members **created and deposited fake checks**, and then quickly withdrew money from the accounts before the banks could identify the checks as fake.

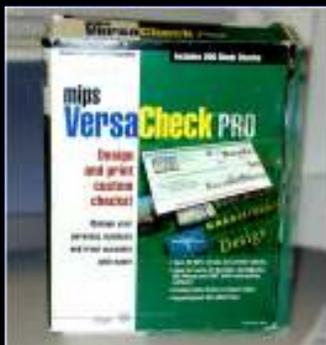
The alleged scheme reaped more than **\$500,000 for the group....**”

Wall Street Journal, March 8, 2016

Twelve members of a group known as the **Van Dyke Money Gang** were accused last summer of bilking banks out of more than **\$1.5 million.**

Manhattan federal prosecutors say the gang, **mostly men in their 20s living in Brooklyn,** **fraudulently obtained money orders** and cashed them at bank accounts along the East Coast.

Wall Street Journal, March 8, 2016



BOSTON'S #1 SELLER



Don't Write Checks!

- Use Commercial Purchase Cards
- Pay electronically (ACH)

But, if you're going to write checks...

Use High Security Checks

Strategies to Prevent Check Fraud

1. High Security Checks
2. Positive Pay
3. Payee Positive Pay
4. ACH Filter or Block

Effective check fraud prevention strategies start with a high security check

Which security features matter most?

1. Using a Controlled check stock

Controlled check stock are checks that are not sold blank unless the check face has been customized for that company, and the account holder, account number, & ship-to address has been verified.

Uncontrolled check stock

Uncontrolled check stock:

Checks that can be purchased entirely blank, or are sold without the buyer, the account number and the ship-to address being verified or authenticated.

The buyers can be fraudsters!

How is
Uncontrolled Check Stock
a problem?

Fraudsters Create Counterfeit Checks

Fraudsters use:

1. Adobe Illustrator
2. Scanner
3. ORIGINAL blank check stock (uncontrolled) to create authentic-looking counterfeit checks, including Cashiers Checks & Official Checks.

Counterfeit Cashier's Checks

CHECK FRAUD SCAM — IT CAN HAPPEN TO ANYONE Greenberg, Trauer & Weisat, LLP v. HSBC Bank, USA 17 RLY 3d 555 (2017)

In a landmark decision, the New York Court of Appeals upheld that the depositor of a cashier's check is responsible for risk of loss "until the settlement becomes final. Statements concerning 'clearing' of a check and funds availability are irrelevant."

A New York City law firm (Greenberg) received an email requesting legal services from a potential client in Hong Kong. As part of the transaction, the client requested that the law firm accept a check for \$197,750, deduct \$10,000 for its fee, and wire the balance to another firm in Hong Kong. (This should have been the first clue that this was a scam.) The law firm deposited the check, which appeared to be drawn on a Citibank account, into its account at HSBC Bank.

The next business day, HSBC provisionally credited the firm for \$197,750, per federal funds availability regulations. A day later, the law firm called HSBC, asking if the check had "cleared" the account. Being told that it had, the firm wired \$187,750 to the other firm in Hong Kong as instructed. The check ultimately proved to be counterfeit, and HSBC charged back \$197,750 to the Greenberg account.

Greenberg sued Citibank for "failing to discover that the check was counterfeit" and sued HSBC for "negligent misrepresentation" for stating that the check had cleared when in fact it had been returned to HSBC, re-routed to a different Citibank processing center, and then returned again as counterfeit to HSBC.

The New York Supreme Court issued summary judgment for both banks and dismissed all of Greenberg's claims. Upon appeal, the Court of Appeals upheld the first court's decision. Citing the Uniform Commercial Code, Citibank had no obligation to detect fraud for Greenberg because Greenberg was not Citibank's client. Its only obligation was to pay the check, return it, or send written notice that it had been dishonored. It had returned the check within the prescribed deadline.

Both claims against HSBC were also dismissed. The bank's contract specifically stated that clients may not pursue claims based on a bank employee's oral representations. The Court also held that the term "a check has cleared" is ambiguous and not definitive that final settlement had occurred.

Furthermore, the Court rejected Greenberg's argument that both banks should have had procedures in place that would have prevented the fraud. The Court ruled that the law firm itself was in the best position to prevent fraud, and had a responsibility to know its client.

This scam was a text-book-case scenario, and while it is shocking that a law firm could be taken in by such a classic scam, it should serve as a warning that anyone can be deceived. Vigilance and intelligence must be used when accepting a check. Do not accept a check for more than the amount due and then wire out the difference. Visit www.safechecks.com for additional fraud prevention tips.

Business Press Buzzards, Volume 105 • Page 1

Counterfeit Cashier's Checks

A New York City law firm (Greenberg) received an email requesting legal services from a potential client in Hong Kong. As part of the transaction, the client requested that the law firm accept a check for \$197,750, deduct \$10,000 for its fee, and wire the balance to another firm in Hong Kong. (This should have been the first clue that this was a scam.) The law firm deposited the check, which appeared to be drawn on a Citibank account, into its account at HSBC Bank.

Counterfeit Cashier's Checks

The next business day, HSBC provisionally credited the firm for \$197,750, per federal funds availability regulations. A day later, the law firm called HSBC, asking if the check had "cleared" the account. Being told that it had, the firm wired \$187,750 to the other firm in Hong Kong as instructed. The check ultimately proved to be counterfeit, and HSBC charged back \$197,750 to the Greenberg account.

Counterfeit Cashier's Checks

The New York Supreme Court issued summary judgment for both banks and dismissed all of Greenberg's claims. Upon appeal, the Court of Appeals upheld the first court's decision. Citing the Uniform Commercial Code, Citibank had no obligation to detect fraud for Greenberg because Greenberg was not Citibank's client. Its only obligation was to pay the check, return it, or send written notice that it had been dishonored. It had returned the check within the prescribed deadline.

Counterfeit Cashier's Checks

Both claims against HSBC were also dismissed. The bank's contract specifically stated that clients may not pursue claims based on a bank employee's oral representations. The Court also held that the term "a check has cleared" is ambiguous and not definitive that final settlement had occurred.

Counterfeit Cashier's Checks

Furthermore, the Court rejected Greenberg's argument that both banks should have had procedures in place that would have prevented the fraud. The Court ruled that the law firm itself was in the best position to prevent fraud, and had a responsibility to know its client.

This scam was a text-book-case scenario, and while it is shocking that a law firm could be taken in by such a classic scam, it should serve as a warning that anyone can be deceived. Vigilance and intelligence must be used when accepting a check. Do not accept a check for more than the amount due and then wire out the difference. Visit

Who Sells Blank, Uncontrolled Checks?

- Virtually ALL business accounting & check writing software vendors
-

Who Sells Blank, Uncontrolled Checks?

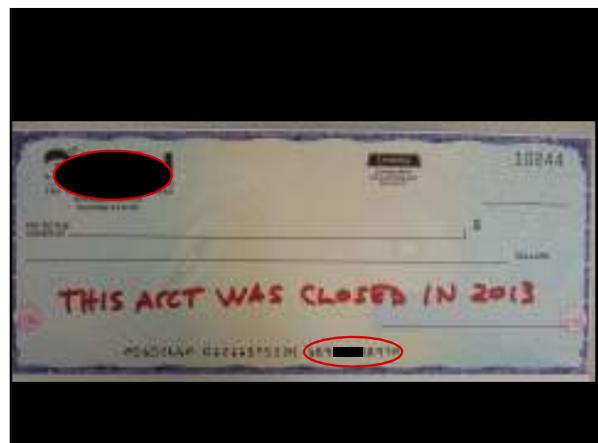
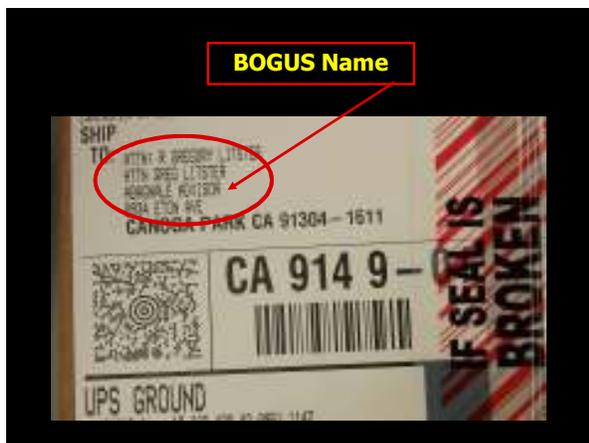
- Virtually ALL business accounting & check writing software vendors
- Virtually ALL check printers:
 1. Large, national check printers
 2. Small print brokers buying from wholesalers

I bought high-security checks from
XXXXX (Major National Check Printer)...

I bought high-security checks from
XXXXX...

...using a bogus name and

...a closed account number!



Uncontrolled Checks



Uncontrolled Checks

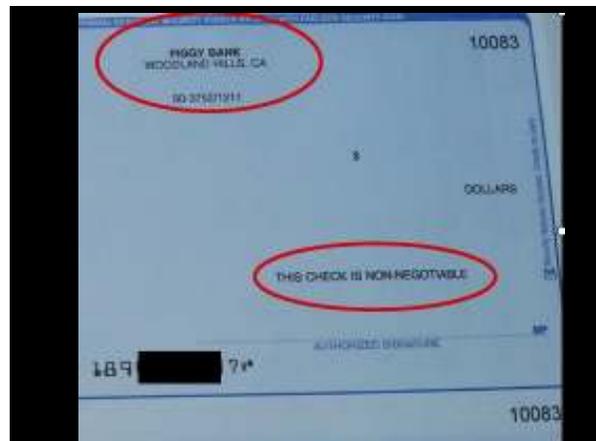
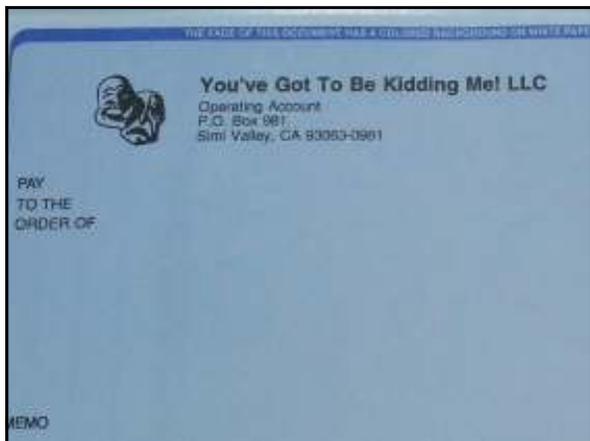
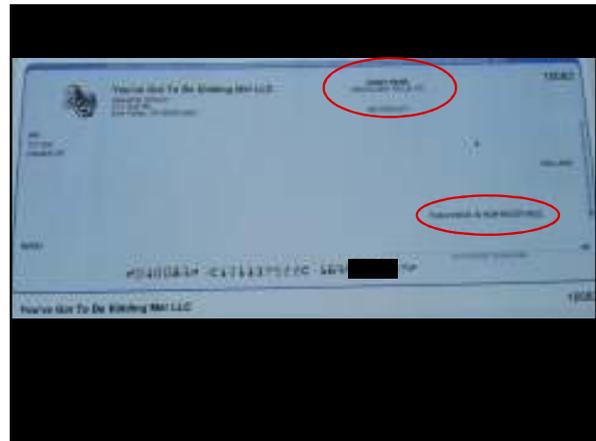
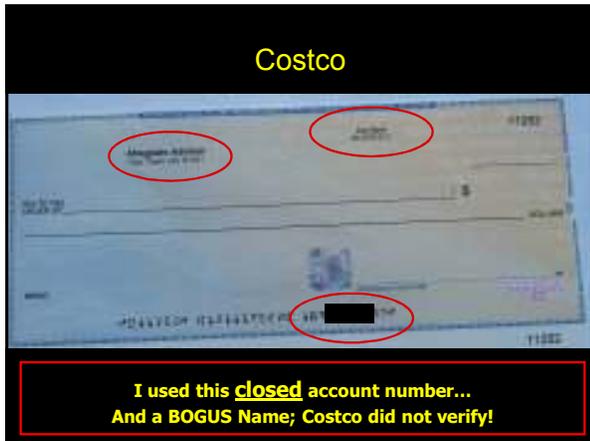
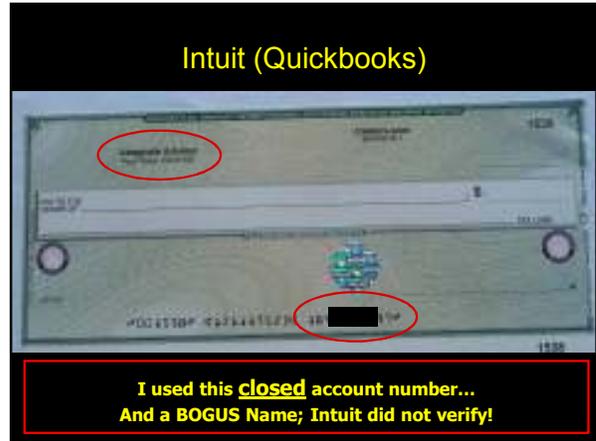
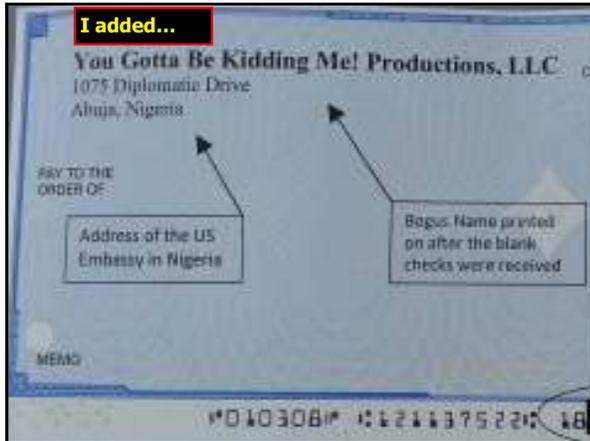


Check Printer did not verify Bogus Name / Closed Account # / Address



Fraudsters **ADD** a Name & Logo





Consider sales policies of your check vendor

Reconsider vendors that sell their checks entirely blank. SAFEChecks does not sell checks entirely blank unless the face of the check has been uniquely designed and customized for that customer or end user.

Consider sales policies of your check vendor

Reconsider vendors that sell their checks entirely blank. SAFEChecks does not sell checks entirely blank unless the face of the check has been uniquely designed and customized for that customer or end user.

For companies that use entirely blank checks, we can print the company's website along the edge, or a customized logo on the face.

SAFEChecks SECURE ORDERING PROCEDURES

To prevent unauthorized persons from ordering checks on your account, all new check orders are verified with your bank. We confirm that the name, address and account number on the order form match the information on file with the bank. Check orders are shipped to the address on file with the bank. Reorders with a change of address are re-confirmed with the bank.

SAFEChecks pays its employees **\$100** if they catch an unauthorized person trying to buy checks using someone else's account number.

Every new check order is verified with the bank

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SAFEChecks has never had a check replicated or used in a scam in over 20 years.

Additional Security Features

1. Controlled check stock.
 - Dual-tone True watermark
 - Thermochromatic ink
 - Correctly worded warning banners
 - Toner anchorage
 - Copy void pantograph
 - Chemical sensitivity
 - Chemical wash detection box
 - Inventory control numbers

Positive Pay

Payee Positive Pay

Realogy Controls

1. Changes in Escrow Instructions – In Person
2. Payee Positive Pay
3. ACH Debit blocks
4. Post No Check – All non-check disbursement account
5. All new bank accounts opened by Realogy Treasury
6. Any changes to bank account must go through Realogy Treasury

Positive Pay

Positive Pay is an automated check-matching service offered by many banks. Each day checks are issued a file of those checks is sent to the bank.

How Positive Pay Works



A Company
Issues Checks

How Positive Pay Works

② XYZ Company transmits
check issue data to the bank

①
XYZ Company
Issues Checks

How Positive Pay Works



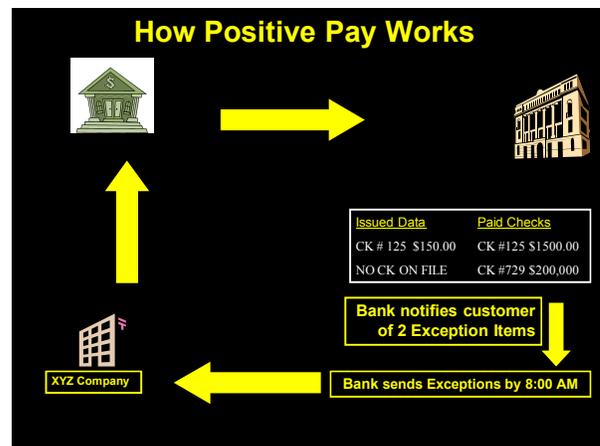
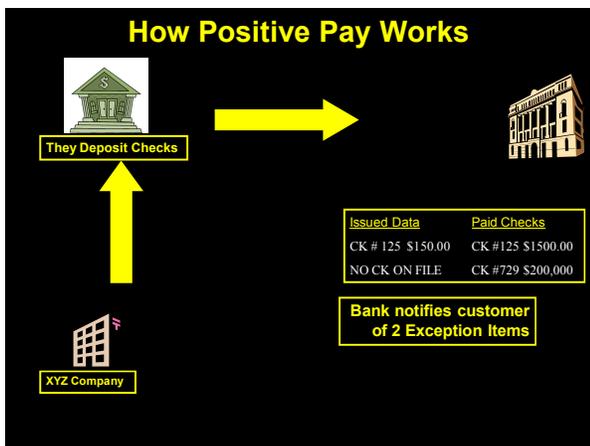
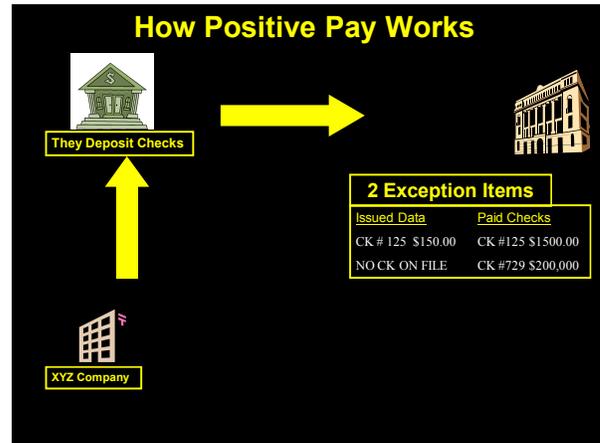
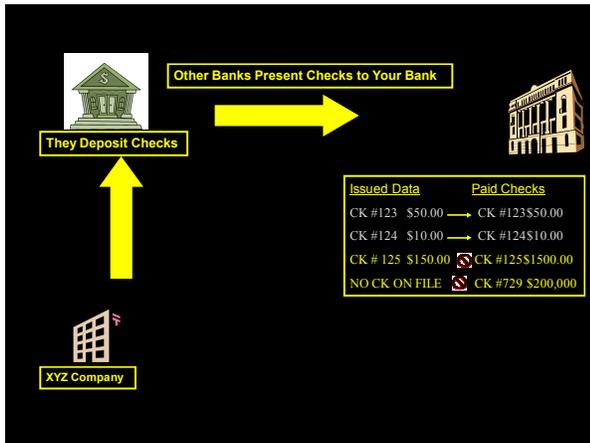
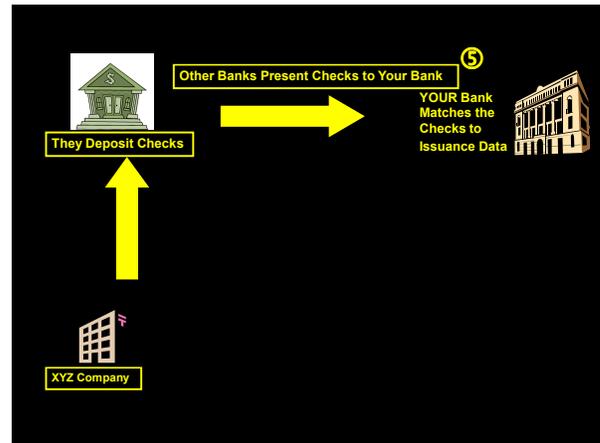
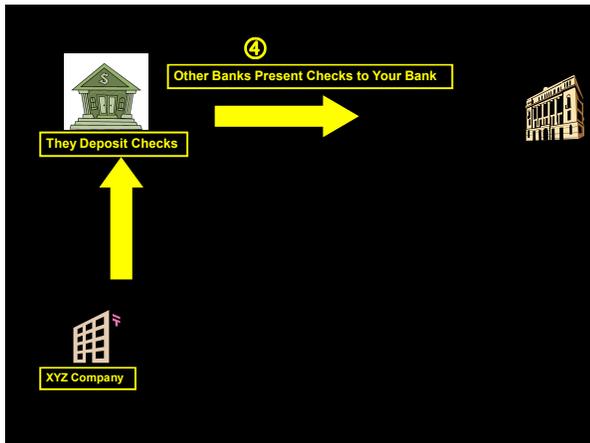
They Deposit Checks

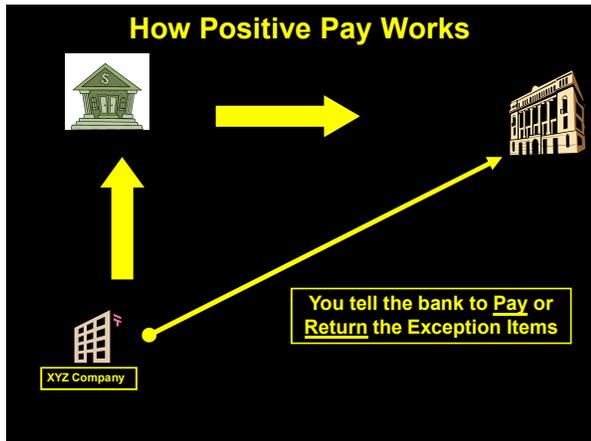
Employees

Vendors

Releases the checks to:

XYZ Company





Positive Pay does not protect against:

1. Counterfeit Checks using the identical check number and dollar amount
2. Altered Payee Names
3. Added Payee Names

Payee Positive Pay

Payee Positive Pay
Will Catch Altered Payee Names

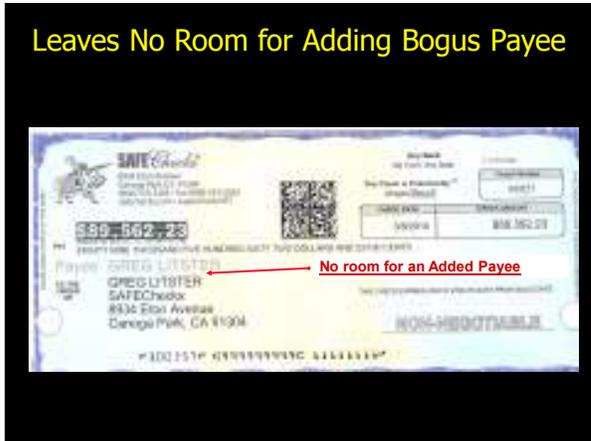
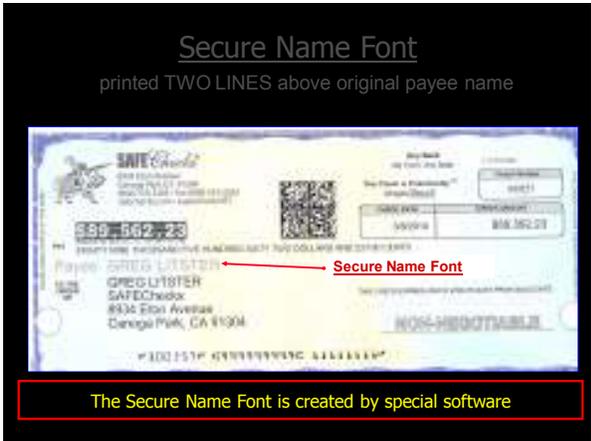
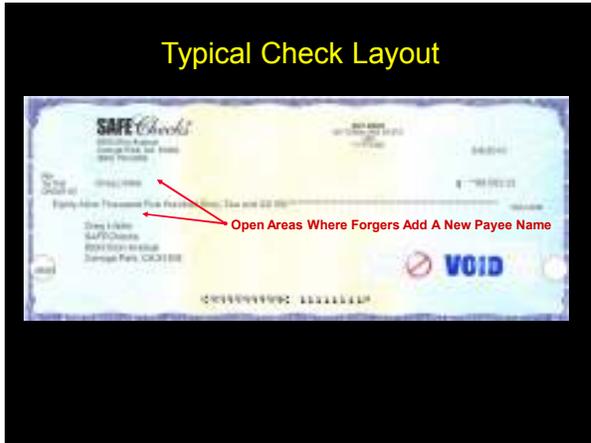
Payee Positive Pay
Will Not Catch Added Payee Names

Printed two (2) lines above the original payee name

Banks have NO solution for checks printed with a bogus name two (2) lines above the original payee name

The "Solution" is a
Secure Name Font

**Secure Name Font
&
Barcode Positive Pay**



Secure Name & Number Fonts are created by special software

The software interfaces between your computer and laser printer. When printing checks, select the special software's virtual printer. The check data passes thru the software and is reformatted, and the checks print on your laser printer.

Secure NUMBER Font blocks out the area where a bogus Payee Name could be added



Add **WARNINGS** to the Check



THIS CHECK CLEARS THROUGH POSITIVE PAY PAYEE NAME ON FILE AT THE BANK

Encrypted barcode



The Encrypted Barcode is created by the special software. Helps deter fraudsters and embezzlers

Encrypted Barcode contains:

1. Drawer
2. Payee Name
3. Dollar Amount
4. Issue Date
5. Check Number
6. Account Number
7. Routing/Transit Number
8. Date and Time Check was printed
9. Laser Printer used
10. The employee that printed the check (deters embezzlement)

The Secure Name Font, Barcode, and a Positive Pay file for the bank is created by the special software

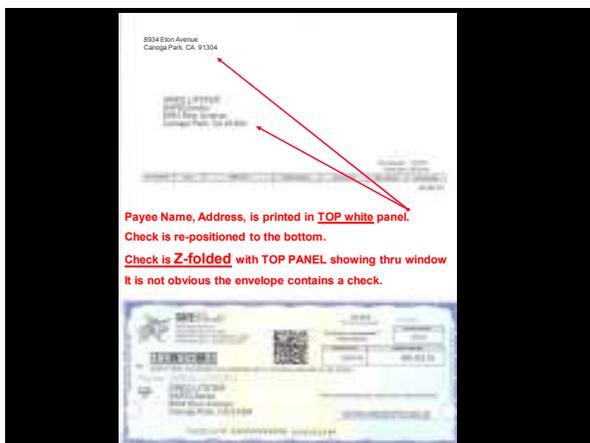
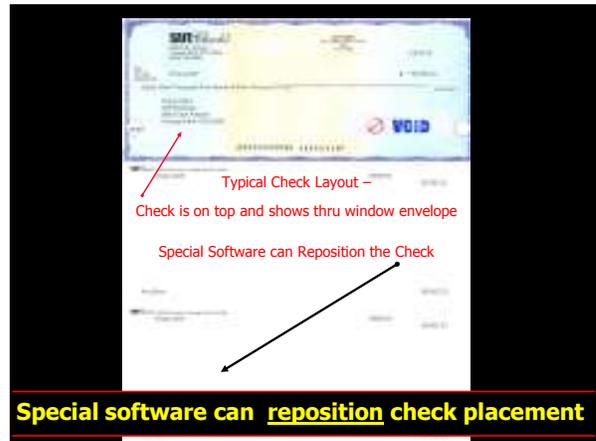
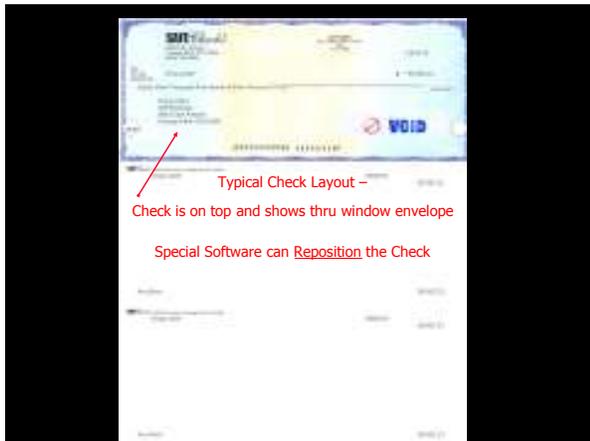
NO technical skills are required to create a Positive Pay file

The Secure Name Font, Barcode, and a Positive Pay file for the bank is created by the special software

- ✓ Eliminates the need for technical skills to create a Payee Positive Pay file
- ✓ NO Retyping Vendor Names into ALL CAPS
- ✓ Converts Payee Name into ALL CAPS as checks are printed.

The special software:

1. Converts font size to 14 point automatically
2. Accumulates & configures the check data to send Positive Pay files to the bank
3. Adds Barcode & Secure Name Font
4. Reposition where the check actually prints



Legal Reasons to use Positive Pay

CINCINNATI INSURANCE COMPANY v. WACHOVIA BANK
Wachovia Bank Wins Lawsuit Over Customer That Refused Positive Pay

Schultz Foods Company issued a check for \$153,856 to Amerada Hess Corporation. Thieves stole the check out of the mail, changed the name of the payee, and convinced the new bogus payee (an unwitting accomplice) to endorse the check and deposit it into his bank. His bank presented the check for payment to Schultz Foods' bank, Wachovia Bank, and Wachovia charged \$153,856 against Schultz Foods' account. Before Schultz Foods discovered the fraud, the funds had been wired out, and the money disappeared.

When the fraud was discovered, Schultz Foods reported the altered check to Wachovia and demanded to account for it credited. Wachovia refused, citing that Schultz Foods had been alerted the chance to implement "Positive Pay" after three previous check fraud incidents, but had declined. Instead, Schultz Foods had purchased a check fraud insurance policy from Cincinnati Insurance Co. Positive Pay, however, would have prevented this loss.

Schultz Foods made a \$153,856 claim under its policy with Cincinnati, who paid the claim and filed suit against Wachovia to recover its loss. Cincinnati contended that the altered check was not "properly payable" and Wachovia was liable for the loss. However, the Wachovia deposit agreement signed by Schultz Foods contained a list of precautions that a customer should take to protect their account. The

Agreement included a conditional release of Wachovia's liability: "You agree that if you fail to implement ... products or services that are designed to deter check fraud, ... you will be precluded from asserting any claims against Wachovia for paying any unauthorized, altered, counterfeit or other fraudulent item ..."

Wachovia had not required Schultz Foods to absorb any losses from the prior incidents, even though Schultz Foods never implemented Positive Pay. Cincinnati argued that Schultz Foods "had an expectation that Wachovia would reimburse Schultz Foods' account" for unauthorized charges if Schultz Foods took precautions such as closing its account. However, that expectation was contrary to Wachovia's deposit agreement, which contained an anti-walker provision, allowing it to waive enforcement of the terms of the Agreement.

Even though Wachovia voluntarily shielded Schultz Foods from past check fraud losses, its deposit agreement protected it from liability. The Court agreed with Wachovia's argument that the deposit agreement between Wachovia and Schultz Foods required Schultz Foods either to implement Positive Pay or to assume responsibility for any fraud losses caused by its failure to implement Positive Pay.

For the complete court case and commentary, visit www.wachovia.com/articles.

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Court Order

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

CINCINNATI INSURANCE COMPANY, as Successor of Todd's Seas, Inc., d/b/a Schultz Foods Company, Plaintiff, Case No. 08-CV-2134 (PIS/DJ)

v. WACHOVIA BANK, NATIONAL ASSOCIATION, Defendant.

Cincinnati Insurance v. Wachovia Bank
 Wachovia Bank Wins Lawsuit Over Customer That Refused Positive Pay
 The Legal Rationale to Implement Positive Pay and High Security Checks

Frank W. Abagnale
 Abagnale & Associates
 (800) 237-7442

Greg Litter
 SAFDChecks
 (800) 755-1268
greg@safdcchecks.com

In what may well become a precedent-setting case, Wachovia Bank won a lawsuit against a customer's insurance company after the customer failed to implement Positive Pay and later suffered a \$153,856.46 check fraud loss. The bank had repeatedly recommended that the customer use Positive Pay, but the customer declined.

Background:

In late 2005, Todd's Snax, Inc., (the Schultz Foods Company ["Schultz Foods"]), issued a check in the amount of \$153,856.46 to Ametada Hoes Corporation (now on Wachovia Bank). Thieves stole the check out of the mail, changed the name of the payee to "Kenneth Payton," and induced Payton (an unwitting accomplice) to endorse the check and deposit it into his account at TCF Bank. Payton was a minister who had been beguiled by the fraudsters into believing he was helping with an urgent humanitarian need in Singapore, demonstrating that no good deed goes unpunished.

Clark's Bank Deposits and Payments Monthly
 Volume 19, No. 8
Commercial Customer Who Rejects Positive-Pay Bears Risk of Resulting Check Fraud Loss (Posted September 2010)

Commercial Customer Who Rejects Positive-Pay Bears Risk of Resulting Check Fraud Loss (Posted September 2010)

In a recent decision from Minnesota, a company that had been offered a positive-pay product by its bank but rejected the offer was liable when the bank later paid a big check that had an altered payee that would have been caught by a positive-pay fraud filter. The bank was the loser because language contained in its deposit agreement.

The Minnesota case. In *Cincinnati Ins. Co. v. Wachovia Bank, N.A.*, 2010 WL 2773478 (D. Minn. 7/14/10), Schultz Foods maintained a commercial checking account with Wachovia Bank (now Wells Fargo). Over the course of that relationship, Schultz Foods was the victim of check fraud four times. On the first three occasions, Schultz Foods closed the compromised account and opened a new account, and Wachovia absorbed the loss. In 2007, Schultz Foods issued a check in the amount of \$153,856.46 to Ametada Hoes Corporation. The check was stolen before it reached the intended payee. In a classic "mugging" scheme, the thieves removed the name of the intended payee and substituted the name of Kenneth Payton, who was an unwitting accomplice of the thieves. Payton endorsed the check and deposited it into his account at TCF Bank. The altered check was then presented to Wachovia and paid.

usBanker
 Noted & Noteworthy
 US Banker | November 2010

By Editorial Staff

A Pennsylvania judge's ruling in a recent check-fraud case could wrap up ongoing talks about businesses that copying anti-fraud protection services from their banks.

The case was *Shultz Foods Co. vs. Wachovia Corp.*, which stemmed from Wachovia's decision in 2009 not to issue a nearly \$154,000 (aka Shultz) issued (aka to check fraud). After Wachovia covered its losses on three previous occasions, Shultz accused Wachovia would have its bank after a fourth loss. But Wachovia balked, triggering the lawsuit.

In August, a federal court sided with Wachovia and threw out the case, largely due to a specially crafted deposit agreement from Wachovia that required Shultz to pay for certain anti-fraud services in order to be covered for losses.

U.S. District Judge Patrick Schiltz ruled that Wachovia had "reasonable" claims for the disposition because of three prior fraud incidents. But Schiltz had refused the fee-based "positive pay" service, which could have alerted Wachovia to the stolen check by cross-matching it for possible alterations against a list of lost issued checks.

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The case even attracted the attention of Frank Abagnale, the famed '60s fraudster turned security consultant. Based upon the lawsuit, banks will almost certainly be reviewing and re-writing their deposit agreements to include the kinds of provisions Wachovia Bank included. Abagnale wrote in a shared memo with SAFDChecks CEO Greg Litter.

Loose Ends...

Stop Payments

Multiple Payee Names on Checks

ACH Filters and Blocks

Quiz: Yes or No?

Does placing a Stop Payment on a check end your legal obligation to pay the check?

NO

Holder in due course trumps Stop Payments

Solution

1. Print a SHORT expiration # of days on the check
"This check expires and is void 20 days from issue date"
2. DO NOT reissue the check until after 20 days
3. "Void After 90 days" is too long!
4. Banks do not care or pay attention to what is printed. This prevents some HIDC claims.

Multiple Payee Names & Endorsements

If Multiple Payee Names on a check do not include the word "and" after the names —

the Payee is "ambiguous" and legally means

"OR"

A forward slash [virgule, vær-gyül "/"] = OR

ACH Filters and Blocks

Prevent unauthorized ACH debits from paying against your bank account

An unauthorized ACH debit MUST be returned within 24 hours after it posts or it

CANNOT BE RETURNED!

ACH Filters and Blocks are available through your Bank



Greg Litster, President
SAFEChecks
(800) 755-2265
(818) 383-5996 cell
greg@safechecks.com

