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The Check Is on the Telephone

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The Check Is . . . on the Telephone?

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I. INTRODUCTION

"The check is in the mail" is a well worn phrase that has delayed and hindered debt collection for countless years. Today, the delay is also a consideration in the expanding field of telemarketing. After all, the telephone sale is never quite complete when the customer agrees to mail a check for payment. The illusive check must still arrive. A relatively new procedure now exists to eliminate the mailing—a customer or debtor can issue a check over the phone. This is not an electronic transfer of funds. Rather, customers give banking information from the front of their checks to the seller over the phone and the seller produces a physical check. The process can be very helpful to telemarketers and debt collectors because they can deposit an actual check into their accounts within a matter of hours. This system, however, is

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subject to abuse and fraud when unauthorized or erroneous checks are manufactured.

The Uniform Commercial Code,[1] because it covers negotiable instruments, may apply to unauthorized or disputed checks by phone. But the negotiability of checks by phone is questionable because of the nature of the telephone solicitation process and the resulting instrument. The absence of the drawer's signature or the presence of an authorized signature will affect liability. This article will first describe checking by phone systems and then analyze the liability of the parties in this type of transaction. Finally, implications and conclusions regarding the practice of taking checks over the phone will be presented. The article concludes that if checks by phone become a significant practice, then the present checking account will likely be changed to accommodate banks' increased liability.[2]

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1. The Uniform Commercial Code (U.C.C. or Code) has been adopted in all fifty states. A table of jurisdictions and the effective date of adoption can be found in 2 U.L.A. 1-2 (Supp. 1995). A major revision of Articles 3 and 4 was proposed in 1990. Thirty-six states had adopted the 1990 revision of Articles 3 and 4 as of October 25, 1994. Fred H. Miller & Donald J. Rapson, *The Emerged and Emerging New Uniform Commercial Code—Introduction; Status of UCC Revisions*, Dec. 8, 1994 ALI-ABA Course of Study, *available in* WESTLAW, C965 ALI-ABA 1.

2. Recent telemarketing rules by the Federal Trade Commission (FTC), effective December 31, 1995, are also relevant to this discussion. Under rules developed pursuant to the Telemarketing and Consumer Fraud and Abuse Act (Act), 15 U.S.C. §§ 6101 to 6108 (1994), the FTC requires that specific, verifiable authorization be given to a telemarketer for payment by "check, draft, or other form of negotiable paper drawn on a person's checking, savings, share, or similar account." FTC Telemarketing Sales Rule, 60 Fed. Reg. 43,866 (1995) (to be codified at 16 C.F.R. § 310.3(a)(3)). Verifiable authorization includes: (1) a signed instrument or other express authorization; (2) tape recorded oral authorization in which the customer must also recieve the date, amount, and number of the instrument along with the payor's name and the date of the customer's authorization; or (3) written confirmation sent to the consumer, including the above specific information, before the instrument is submitted for payment. *Id.* Failure to obtain authorization is a deceptive practice subject to the penalties allowed under the Federal Trade Commission Act. 15 U.S.C. § 6102(c) (1994).

The Act gives federal and state officials and individuals the opportunity to pursue fraudulent telemarketing practices, and seeks to deter unauthorized transactions. 15 U.S.C. §§ 6103 to 6105 (1994). However, because the telemarketer has the option of *sending* written confirmation before depositing a check for collection, the problems described in this article will likely continue. The mail system will probably be slower than the check collection system, thus, a consumer will be unable to stop payment before our standard scenario unfolds. If the drawer alleges that the check that has been paid by the drawee is unauthorized, the liability of the parties will remain an issue. The FTC Telemarketing Rule does not ameliorate the dilemma of a customer who is unable to stop the collection of an unauthorized check before it is collected, nor does it affect the potential losses of banks or the bank customer relationship.

II. CHECK BY PHONE SYSTEMS

"No credit card? Over your limit? No problem—you can give us your check over the phone." Utilizing this fast, easy way to buy merchandise, the customer does not have to bother with writing the check and putting it in the mail. The customer even saves the cost of a stamp. Sellers can capitalize on impulse buying and benefit from the immediacy of the sale.[3] Debt collectors need not wait to see if the debtor really did put the payment in the mail. A physical check can be sent to the seller's or creditor's bank for deposit within hours. A growing number of companies, including Western Union, International Banking Technologies, Quick Card Systems, and Fidelity Checks, are selling the service of checking by phone.[4] According to a representative from Telecom Systems, the system is relatively new because the software and database needed to verify bank accounts throughout the United States, Mexico, and Canada were not previously available.[5] In addition, computer hardware has become increasingly affordable and more readily available. While the process previously required a sophisticated computer setup that cost about $250,000, today all of the equipment needed to produce a check can cost as little as ten thousand dollars.[6]

The check by phone system incorporates computers, modems, fax machines, and overnight mail. When telemarketing is involved, the vendor of the check-writing service installs the system on the client's computer allowing the client access, through a modem, to the software necessary to verify that the information collected by the client from the buyer is accurate. The client obtains the bank name, account number, check number, and routing number from the bottom of the buyer's check. The vendor's software allows verification of the checking information while the buyer is on the phone.[7] The verified information is sent over the modem to the vendor, who manufactures the physical check and sends it by overnight mail to the client. The client can then deposit the generated check into its account the very next day.

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3. Lambeth Hochwald, *Tele-Check Payment Still Under Study*, FOLIO, Mar. 1, 1994, at 23. Commercial activity over the Internet expands daily. Payment by sending checking information by electronic means will raise the same issues as are analyzed in this article—whether the signature is valid and whether the check is negotiable.

4. Karen Burka, *Subscribers Pay by Phone—With Checks*, FOLIO, Jan. 1, 1993, at 30.

5. Paul M. Eng, *Ordering by Phone? Now You Can Pay by Check*, BUS. WK., Aug. 31, 1992, at 66.

6. Rick Jurgens, *Check Fraud Grows, but Banks and Printers Battle Back*, CHRISTIAN SCI. MONITOR, Nov. 15, 1993, at 10. The cost estimate is based on Jurgens' list of equipment necessary for in-house check-making.

7. International Banking Technologies asserts that it is the only service that provides verification instantly over the phone. Letter from Shawn Noel, International Banking Technologies (May 19, 1994) (on file with author).

A collection agency can use the system the same way. Furthermore, the vendor of the checking service can itself be the collection agency and forward the checks to the client. In this case, physical generation of checks is accomplished electronically at the client's place of business after the information has been obtained by the vendor/collector.[8]

Wherever it is physically produced, the check's design is important because it may affect the check's negotiability.[9] All of the checks reviewed by this author[10] have contained the following: (1) the words "pay to the order of" or the like; (2) the amount to be paid; (3) the bank's name, sometimes specifically identified as the drawee bank; (4) the date; and (5) identification of the drawer with the statement that either the payment or the signature of the depositor was authorized. Information about the transaction, a company ID, or a number to call with any questions about the draft may also be found. Many checks contain the language that payment is "guaranteed" or "absolutely guaranteed" by the named company or by the payee.[11]

A great deal of variation exists in how, or if, a signature appears on the phoned checks. The following categories summarize the types of signatures:

(1) *A printed signature of the drawer.* The check may state that it is a computer generated signature. The printed signature may be preceded by the word "signed" and followed by the words "by authorized representative." Alternatively, it might be preceded by the words "charge to" or "charge to the account of."
(2) *No signature.* Some drafts have no line or indication that any signature is necessary. The depositor is usually identified by his or her name, and sometimes address, at the top of the instrument. Nothing is present where the signature line is usually found on a standard check.
(3) *"No signature required."* These words are placed where the signature line is normally found on a check.
(4) *The signature of an officer of the vendor.* The check states that the officer, whose signature is found on the check, is an "authorized signatory for" the named drawer.

Furthermore, many checks state that the signature is "authorized" by the depositor and "guaranteed" by the payee. The type of signature, or the lack thereof, not only affects negotiability, but also establishes which parties are

8. *See* Hochwald, *supra* note 3; Burka, *supra* note 4; Eng, *supra* note 5 (describing the systems used by collection agencies).

9. *See infra* note 15 and accompanying text (discussing application of the negotiability requirements to these instruments).

10. The author has reviewed 13 different checks generated by phone.

11. *See infra* notes 66-67 and accompanying text (discussing the significance of the payment guarantee).

liable if problems or defenses to payment arise. An examination of the U.C.C. is necessary in order to predict the result if mistakes are made when checks are given by phone.

III. NEGOTIABILITY OF A CHECK BY PHONE

Article 3 of the U.C.C. provides the framework for analyzing whether a check is a negotiable instrument.[12] Negotiability is significant because certain holders of a negotiable instrument are protected from many defenses available to the drawer of the check.[13] The following analysis refers to the original version of Article 3, and explains where the revised version produces different results.[14]

For an instrument to be negotiable, it must be a written, unconditional promise or order to pay a sum certain in money, signed by the maker or drawer.[15] Checks manufactured as a result of information given over the phone satisfy all of the requirements of a negotiable instrument except for the questionable signature. A written order, using words of negotiability, instructs the unconditional payment of a sum of money to a named payee.[16] Because the manufacturer of the check is at a different location than the drawer, there will obviously never be a personal signature of the drawer on the check by phone. In fact, the drawer may never see the check unless it is returned to her by the bank in a monthly statement.

The lack of a personal signature is not an impediment, in itself; checks containing printed or stamped signatures may all be acceptable under the U.C.C.'s definition of a signature.[17] A document is signed when "any symbol [is] executed or adopted by a party with present intention to authenticate a writing."[18] This broad definition includes "any trade or assumed name," or "any word or mark used in lieu of a written signature."[19] The 1990 revisions to the U.C.C. more specifically provide that a "signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any

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12. A check is defined as a "draft drawn on a bank and payable on demand." U.C.C. § 3-104(2)(b). A draft is an order to pay. *See* U.C.C. §§ 3-104(2)(a), 3-102(1)(b).

13. *See* U.C.C. §§ 3-305, 3-306 (rights of a holder in due course and of one who is not a holder in due course); *see also* discussion *infra* note 61 and accompanying text.

14. A majority of states have adopted the 1990 revisions to Article 3. *See* Miller & Rapson, *supra* note 1.

15. U.C.C. § 3-104(1). Revised section 3-104(a) contains changes not relevant to this discussion. Differences in the scope of coverage under the original and revised versions are discussed *infra* notes 71-76 and accompanying text.

16. *See supra* text accompanying notes 10-11.

17. *See* U.C.C. § 1-201 cmt. 39.

18. U.C.C. § 1-201(39).

19. U.C.C. § 3-401 (2).

name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing."[20] According to U.C.C. definitions, then, the signature must appear on the face of the instrument and must be intended to be the signature of the drawer. The first question for consideration is whether the various types of "signatures" found on phone checks satisfy the signature requirement on a negotiable instrument.

A. No Signature

Checks that state that "no signature is required" are clearly nonnegotiable. The lack of a signature, as well as the additional statement that no signature is needed, leads to the obvious conclusion that there is no intent to effectuate a signature.

Another category of checks has no signature and also no line or place indicating that a signature is anticipated. Even though these checks do not contain a statement about the nonnecessity of a signature, the result should be that they, too, are nonnegotiable. It has been argued, however, that the broad definition of a signature may include a name printed at the top left corner with an address.[21] In *Littky & Mallon v. Michigan National Bank*,[22] a check contained an unauthorized signature on the traditional signature line. The bank that accepted the check argued, nonetheless, that the imprinted name on the top of the check sufficed as a signature. Although recognizing that the definition of a signature is "broadly construed,"[23] the court emphasized that "courts must use common sense and commercial experience in determining whether a mark constitutes a signature."[24] In the court's opinion, "such a conclusion would be unreasonable where there was a written signature at the appropriate place on the check."[25]

Using the same reasoning, it could be argued that the opposite result should be reached when checks by phone do not have a signature or signature line, because in that case there is no evidence of an invalid signature to rebut the argument that the printed name should be considered a signature. However, as the *Littky* court emphasized, experience and expectations must be carefully considered. A preprinted name on a check is commonly considered to be for identification purposes, not as a signature, especially when it is accompanied by an address. Common sense and usage dictate that the

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20. U.C.C. Revised § 3-401(b).

21. *See* U.C.C. § 1-201 cmt. 39 (stating that "in appropriate cases [the signature] may be found in a billhead or letterhead").

22. 287 N.W.2d 359 (Mich. Ct. App. 1979) (per curiam).

23. *Id.* at 360.

24. *Id.* at 361.

25. *Id.*

preprinted name is not intended to be a signature and, thus, that these instruments are nonnegotiable. This result is consistent with court holdings that unsigned money orders and unsigned certified checks are nonnegotiable when they lack a bank's signature, even though they bear the bank's imprinted name or certification mark.[26]

B. Generated Signatures

The third category of checks contains a printed, typed, or computer-generated drawer's name. These names, when preceded by words such as "signed" or "signature," indicate a clear intention for the mark to be a signature. In that case, even if the signature is unauthorized, the check is negotiable.[27] Most checks have a line for the printed, typed, or computer-generated signature, but even without the line, these reproduced signatures will likely be recognized as signatures for the purpose of negotiability.[28] Indeed, these phone-generated checks resemble the commonly accepted and recognized payroll or corporate checks.

Other printed drawer's names, even though in the traditional space for a signature, are problematic when they contain language that the amount should be "charged to" the person or their account. These words contradict the common assumption that this name is a signature; instead, they indicate that the name is affixed to the instrument for the purpose of identifying the account to be charged. If the name is for identification only, then the check is nonnegotiable because of lack of an intent to make the mark a signature.

C. Signature by an Agent

Finally, the check may contain the signature and name of an officer of the seller or collector as an "authorized representative" of the drawer. Because any mark, as long as it is accompanied by the intent to effectuate a signature, will operate as a signature,[29] the name of an authorized agent, signing in a

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26. *See* 2 Bender's U.C.C. Serv. (MB) § 2.06 [1] (1994); *see also* Jacoby Transp. Sys. v. Continental Bank, 419 A.2d 1227 (Pa. Super. Ct. 1980) (holding that a preprinted corporate name in the lower right hand corner of the check, without accompanying signature lines, was sufficient to support a finding of a making of an unauthorized signature). *But see* Pollin v. Mindy Mfg. Co., 236 A.2d 542 (Pa. Super. Ct. 1967) (holding that a blank signature line below a preprinted company name indicated no intent to sign).

27. *See infra* note 29 and accompanying text.

28. *See Jacoby Transp. Sys.*, 419 A.2d at 1231 (stating that the printed name of the company, without a signature line, was sufficient as a signature). *But see Pollin*, 236 A.2d at 545 (Pa. Super. Ct. 1967) (holding that the printed corporate name above two blank signature lines was not a signature).

29. U.C.C. § 3-401(2); U.C.C. Revised § 3-401(b).

representative capacity is a sufficient mark to qualify the check as negotiable.[30] Even if the signature is unauthorized, the signature will act as the signature of the agent and the instrument will remain negotiable.[31] The liability of the drawer will be at issue, however, based on the fact that the agent's signature is allegedly unauthorized.[32]

IV. LIABILITY FOR THE NEGOTIABLE CHECK BY PHONE

The check by phone transaction may be completed according to the expectations of all the parties. The drawer's account will be debited by the drawee bank, the funds will be sent through the collecting banks to the payee bank, and the payee's account will be credited. However, if the drawer challenges the signature and authorization for the check, then this series of transactions must be analyzed to determine the liabilities of the involved parties. Because the banking system is now involved, the analysis will involve Article 4 of the U.C.C. The recent revisions to Article 4 will be noted where applicable.[33]

A. Charging the Customer's Account

The alleged drawer of a negotiable check has a defense to liability if the signature affixed to the check was unauthorized.[34] To utilize this defense, the alleged drawer must plead the invalidity and overcome the U.C.C.'s statutory presumption of the signature's authenticity.[35] A drawer's denial of authorization by phone for a check to be signed is evidence of forgery and overcomes the presumption. The person seeking to collect payment then has the burden of proving that the signature was indeed authorized. Some evidence that the authority was granted must be presented. Some check by phone systems record the conversation between the parties in order to prove authorization. But

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30. U.C.C. § 3-403(1); U.C.C. Revised § 3-402(a).

31. U.C.C. § 3-404(1); U.C.C. Revised § 3-403(a).

32. Although not expressly stated in the Code, it is commonly accepted that a forged or unauthorized signature does not destroy negotiability because of lack of a signature. Instead, liability of the party whose signature is missing is the ultimate issue. *See* 2 Bender's U.C.C. Serv. (MB) § 2.06[1] (1994) ("If a name or other mark appears in the lower right-hand corner of an instrument containing the other requisites of negotiability, the instrument is clearly negotiable, even though the alleged maker or drawer denies that he ever signed it or that he intended to authenticate it by the adopted mark.").

33. A majority of states have adopted the 1990 revisions to Article 4. *See* Miller & Rapson, *supra* note 1.

34. U.C.C. § 3-401(1) ("No person is liable on an instrument unless his signature appears thereon."); U.C.C. Revised § 3-401(a) ("A person is not liable on an instrument" unless she or her agent signed.).

35. U.C.C. § 3-307(1); U.C.C. Revised § 3-308(a).

because recording will normally cost the customer an additional amount, many companies may not record the conversation. When a call is unrecorded, phone operators are unlikely to recall one authorization out of hundreds or thousands of calls. Accordingly, without a recorded conversation, the testimony of the alleged drawer may be more credible than that of the collector or seller to prove that the signature was unauthorized. If the signature is established as unauthorized, then the drawee bank cannot charge the drawer's account because it has not paid according to its customer's order.[36]

Even if the signature is found to be unauthorized, the drawee bank may be able to avoid refunding the drawer's account under three theories. The drawee bank may argue (1) that the negligence of the drawer contributed to the unauthorized signature; (2) that the drawer failed to report the discrepancy promptly; or (3) that the customer ratified the signature.

1. Negligence

Under the original version of Article 3, a bank will escape liability for paying over an unauthorized signature if it can prove (1) that its customer substantially contributed to the making of the unauthorized signature by his or her negligence, and (2) that the bank paid "the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business."[37] This analysis is a two step process: first, the customer's negligence must be established, then the actions of the bank must be shown to be reasonable.

The bank must first show that the customer negligently contributed to the fraud. An example of a customer's negligent contribution to fraud is when a drawer's signature is fraudulently produced by an employee who, without authorization, uses the employer's checks and rubber signature stamp.[38] If the employer's failure to take reasonable precautions to safeguard the checks and stamp substantially contributed to the unauthorized use by the employee, then the employer will bear the loss. The employer will be precluded from arguing that the signature was unauthorized.

An analysis of the check by phone scenario must consider whether giving information about one's check routing and bank account over the phone amounts to negligence. One brochure distributed by a vendor of check by phone systems anticipates concern by the buyer about giving this information

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36. U.C.C. § 4-401(1) (providing that a bank can only charge a drawer's account for items that are "properly payable"); U.C.C. Revised § 4-401(a). Court decisions have established that instruments without authorized signatures are not properly payable. *See, e.g.*, Stepter v. Hibernia Nat'l Bank, 524 So. 2d 210 (La. Ct. App. 1988); Taylor v. Equitable Trust Co., 304 A.2d 838 (Md. 1973); North Carolina Nat'l Bank v. Hammond, 260 S.E.2d 617 (N.C. 1979).

37. U.C.C. § 3-406.

38. U.C.C. § 3-406 cmt. 7; *see also* U.C.C. Revised § 3-406 cmt. 3.

over the phone. Under "Handling Customer Objections," the script calls for the telemarketer to answer such questions by responding: "Your credit card information is as vital as your checking information and of course, we would have your checking information any way if you were to mail in your payment."[39] Credit cards, however, are governed by completely different legal rules and are subject to different regulations. Although it is correct that checking information is regularly available whenever a check is given for payment, information is normally not delivered to an entity that can physically manufacture a check with the encoding necessary to enable it to pass without delay through the banking clearinghouse channels. In reality, though, the telemarketer's arguments may seem reasonable to most consumers who are not aware of the significant legal differences between checks and credit cards or of the potential harm that can occur by giving banking information over the phone. If a customer has dealt with a prior unauthorized signature by phone, that experience might support an argument that the drawer should realize that checking information should not be given over the telephone. Under the negligence standard, the ultimate question is whether the ordinarily prudent person would safeguard checking and banking information. As our society increasingly utilizes electronic, computer, fax, and other technological innovations to do business, the question becomes more difficult to answer.

Even if negligent, the customer may still win if the bank has not acted according to "reasonable commercial standards."[40] The debate surrounding the forged or unauthorized drawer's signature centers around the extent of the bank's duty to recognize the signature of its customer. Decisions conflict regarding what is reasonable for a bank to do in this age of electronic sorting and magnetic ink character recognition where 120,000 checks are processed per hour.[41] Many banks do not inspect checks under a certain dollar amount for irregularities.[42] On the other hand, when the Code was written, these technological advances were not in use, and some modern decisions have relied upon the fact that banks have signature cards with which to compare customers' signatures and with which they can detect forgeries. Thus, despite the prevalence of high speed check processing, some courts find that banks have *not* exercised ordinary care when they have not visually inspected a check for irregularities.[43]

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39. Sales Script of International Banking Technology, Inc. (on file with the author).

40. U.C.C. § 3-406.

41. *See* Florence P. Berkley, Note, *Computerized Check Processing and a Bank's Duty to Use Ordinary Care*, 65 TEX. L. REV. 1173, 1178 n.47 (1987).

42. *See, e.g.*, Medford Irrigation Dist. v. Western Bank, 676 P.2d 329, 331 (Or. Ct. App. 1984) (noting the bank's practice of not reviewing checks for amounts less than $5,000).

43. *See* Hanover Ins. Cos. v. Brotherhood State Bank, 482 F. Supp. 501, 510 (D. Kan. 1979) (finding that the common practice of banks not to examine checks for small amounts did not relieve the bank of liability); Wilder Binding Co. v. Oak Park Trust & Sav. Bank, 527 N.E.2d

The opposite conclusion has been reached by another group of courts. Emphasizing commercial practice, the court in *Perini Corp. v. First National Bank*[44] commented,

> it would be a sham to fasten liability on the defendant banks, which operate in a world of electronic impulses and encoded integers, on the basis of the eyeball to eyeball mercantile confrontations of halcyon days. Minute examination of checks for forgeries is an old banker's tale; two hundred years after *Price v. Neal*, bankers do not purport to be graphologists.[45]

Thus, courts are split as to what actions constitute ordinary care under the original code.

The revised U.C.C. attempts to clarify a bank's duty by adding that "reasonable commercial standards do not require [a bank using automated processing] to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage."[46] In addition, revised Section 3-406 effectively changes the defense of lack of ordinary care from a contributory negligence to a comparative fault defense. If the bank has failed to live up to reasonable commercial standards, the "loss is allocated"[47] between the bank and its customer, both of whom have been negligent.[48]

In summary, the application of negligence standards will be triggered only if giving information about checking accounts over the phone is unreasonable. If negligence standards apply, then the bank may escape or limit liability, depending on which version of the code is applied and whether or not its inspection regimen was commercially reasonable.

354, 359 (Ill. App. Ct. 1988) (finding that the failure to inspect any checks under $1,000 constituted a lack of ordinary care).

44. 553 F.2d 398 (5th Cir. 1977).

45. *Id.* at 420 (referring to the final payment rule of Prive v. Neal, 3 Burr. 1354 (K.B. 1762)); *see also* Rhode Island Hosp. Trust Nat'l Bank v. Zapata Corp., 848 F.2d 291, 294 (1st Cir. 1988) (finding that a bank that followed customary practice, including one percent review of checks between $100 and $1,000, exercised reasonable care).

46. U.C.C. Revised § 3-103(a)(7).

47. U.C.C. Revised § 3-406(b).

48. *See generally* Nan S. Ellis & Steven B. Dow, *Banks and Their Customers Under the Revisions to Uniform Commercial Code Articles 3 and 4: Allocation of Losses Resulting from Forged Drawers' Signatures*, 25 LOY. L.A. L. REV. 57 (1991).

2. Failure to Report

A customer has a duty to examine his or her bank statement and promptly report any unauthorized signature to the bank.[49] Failure to promptly report the invalid signature acts as a defense to the bank's liability[50] unless the customer can prove that the bank did not exercise ordinary care in paying the check.[51] The above discussion of the meaning of ordinary care, and whether the bank needs to examine each check for an authorized signature, also applies in a failure to report situation.[52] The revised code's definition of ordinary care may again change the result by not requiring item by item examination by the bank.[53] Also, unlike the result under the original code, the bank's negligence does not act as a complete bar to recovery under the revised code, and losses are allocated between the parties.[54]

Several additional facts will distinguish this analysis from the straight negligence situation. First, the code specifically provides that the bank will not be liable for subsequent losses caused by the same "wrongdoer" if the customer does not report the unauthorized signature within fourteen calendar days of receiving the bank statement.[55] The revised code extends this time period to thirty days.[56]

The ability to detect unauthorized signatures is hindered because some banks do not return canceled checks. This practice may explain the revised code's extension of the time to report unauthorized signatures, as well as its requirement that a drawee bank provide minimum information on bank statements[57] and its imposition of liability for actual losses if the physical checks are not produced upon request.[58]

49. U.C.C. § 4-406(1).

50. U.C.C. § 4-406(2) (making this defense applicable only if the bank suffers a loss).

51. U.C.C. § 4-406(3).

52. *See supra* notes 40-48 and accompanying text.

53. *See supra* notes 46-48 and accompanying text.

54. U.C.C. Revised § 4-406(e).

55. U.C.C. § 4-406(2)(b).

56. U.C.C. Revised § 4-406(d)(2).

57. U.C.C. Revised § 4-406(a).

58. U.C.C. Revised § 4-406(b). The drawer can sue the drawee bank for losses, and the drawee bank can sue the bank that promised to, but did not, retain the checks. U.C.C. Revised § 4-209(b)-(c). In any case, there is a one year statute of limitations for reporting unauthorized signatures. U.C.C. § 4-406(4); U.C.C. Revised § 4-406(f).

3. Ratification of Unauthorized Signature

The bank will not be liable if the drawer, the customer, has ratified the signature on the check given by phone.[59] Ratification is retroactive, and can be express or implied by conduct, which includes the "retention of benefits received in the transaction with knowledge of the unauthorized signature."[60] Thus, a person ordering and paying by phone cannot keep the product and claim that the signature was unauthorized. Retention of the product will be considered ratification of the unauthorized signature.

B. Collecting and Depositary Banks

If unable to charge its customer's account because of the unauthorized signature, the drawee will examine its rights against other parties in the transaction, such as collecting banks, the depositary bank, and the payee. A check begins to pass through banking channels for collection by first being deposited into a customer's account. The customer's bank (the depositary bank) may forward the check to a collecting bank, which may then present the item for payment to the drawee (payor) bank. The payor bank cannot reverse the process when payment has been made to a holder in due course or one who "in good faith changed his position in reliance on the payment."[61] Collecting and depositary banks will have changed their position in reliance on the item when they finally credit their customer's accounts. Therefore, lack of good faith is the payor bank's only argument to try to reverse the process. Lack of good faith requires the knowledge of the banks involved in the transaction that the particular checks were not properly authorized. In this modern era of fast processing of checks, such knowledge is unlikely.

The payor bank must then determine whether it can recover because of a breach of warranty by the forwarding banks. When a bank presents an item for collection, it makes three implied warranties: (1) it has good title; (2) it has no knowledge of an unauthorized signature; and (3) no material alterations have been made.[62] The warranty of having no knowledge of unauthorized signatures applies here. It will be difficult, if not impossible, to prove that a bank breached a warranty by having knowledge of an unauthorized signature, because it was almost certainly removed from the telephone transaction.

59. U.C.C. § 3-404(2); U.C.C. Revised § 3-403(a).

60. U.C.C. § 3-404(2) cmt. 3; U.C.C. Revised § 3-403(a) cmt. 3.

61. U.C.C. § 3-418 (the final payment rule). A holder in due course is one who takes for value, in good faith and without notice of a claim of defense. U.C.C. § 3-302. Good faith is defined in U.C.C. § 1-201(19).

62. U.C.C. § 4-207(1).

C. Liability of the Payee

The payor bank may attempt to collect payment from the payee for the return of the unauthorized funds. If the payee also manufactured the check and placed the unauthorized signature upon it, then the payor may recover because the payee (1) has not acted in good faith,[63] and (2) has breached the warranty of having no knowledge of an unauthorized signature.[64] If the payee is not the one who manufactured the check, but instead has contracted out to a vendor or collecting agent who produces the unauthorized signature, then the drawee, payor bank may once again be unable to recover. Revised section 3-418 clarifies and specifically provides for the drawee's right to recover payments from a payee when the drawer's signature was unauthorized.[65] The payee who does not also manufacture the check is one step removed from the transaction, and, thus, has probably acted in good faith and without knowledge of an unauthorized signature.

If the drawer's signature is proved to have been unauthorized, it operates as the signature of the person who actually signed, regardless of the name appearing on the instrument. Thus, whoever seeks to collect payment or reimbursement for a check by phone with an unauthorized signature may hold the vendor or manufacturer of the check liable as a drawer. When an established company, such as Western Union, is involved, the drawee bank may have a viable legal avenue to pursue for redress. The economic reality, however, is that a bank will probably not pursue legal avenues for reimbursement for an unauthorized check if the amount of the check is small. In the case of a seller who manufactures the check for the buyer, the drawee bank can proceed against it for an unauthorized check, but the seller may not be willing or able to pay, if indeed it can even be found. Thus, although the producer of the unauthorized check by phone will be legally liable, the drawee bank may still bear the ultimate burden of an unauthorized signature.

A check may state that payment is "guaranteed" by the payee. The words "payment guaranteed," when accompanied by a signature, mean that the guarantor will pay if the drawer is not paid at demand, and furthermore will pay whether or not demand is made.[66] The payee/guarantor undertakes primary liability to a subsequent transferee. However, unless the unauthorized

63. U.C.C. § 3-418; U.C.C. Revised § 3-418(c).

64. U.C.C. § 3-417(1)(b); U.C.C. Revised § 3-417(a)(3).

65. U.C.C. Revised § 3-418(a)(ii) & cmt. 1. The comments indicate that this section specifically sets forth the "unstated remedy" available under mistake and restitution in the original version. *See generally* Bryan D. Hull, *Common Law Negligence and Check Fraud Loss Allocation: Has Common Law Supplemented or Supplanted the U.C.C.?*, 51 OHIO ST. L.J. 605 (1990) (noting that the revisions to Articles 3 and 4 leave questions that still must be solved under common law principles).

66. U.C.C. § 3-416(1).

signature is discovered and the payor bank will not pay, or payment is ordered stopped[67] by the drawee, this promise is of little effect. It will not allow the payor bank to recover a payment that has already been made, because then the guarantee of payment will have been met.

Finally, another method that may be used by the payor bank to hold the payee liable is subrogation. A bank that pays a check in spite of the drawer's unauthorized signature takes the rights of the drawer in the underlying transaction, on which an action against the payee may be based.[68] Thus, if the payee can be found, the payor bank can recover the unauthorized amount if the drawer had a defense to payment.

V. LIABILITY FOR THE NONNEGOTIABLE CHECK

A check will be nonnegotiable if it has no signature. In analyzing a nonnegotiable check, the first question to be considered is whether it is governed by the U.C.C., and if so, to what extent. Article 4 will still apply to nonnegotiable checks by phone because it covers "items" that are collected through banking channels.[69] The drawee bank must still credit the customer's account for checks that are not properly payable.[70]

The language describing the scope of Article 3 differs between the original and revised versions. Originally, the scope of Article 3 was not clearly described, but did not include money, documents of title, or investment securities.[71] Only the comments stated the positive scope of the article: "drafts, checks, certificates of deposit and notes as defined in 3-104(2)."[72] Section 3-104 delineates the requirements of negotiability. The comments to that section note that similar results may be reached by the application of contract law to nonnegotiable instruments.[73] The Official Comment to section 3-805 confuses the issue by providing that nonnegotiable checks are still governed by the law merchant,[74] and it can be inferred that the provisions of the code, except for holder in due course status, may be applied by analogy.[75] In that case, the law merchant, as reflected through the code, would result in the same liabilities as previously discussed.[76]

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67. *See* U.C.C. § 4-403 (stop payment orders).

68. U.C.C. § 4-407.

69. U.C.C. § 4-104(g).

70. *See supra* note 36 and accompanying text. Concerning other duties that continue under Article 4, see *supra* notes 49-58 and accompanying text.

71. U.C.C. § 3-103.

72. U.C.C. § 3-103 cmt. 1.

73. U.C.C. § 3-104 cmt. 2.

74. The English common law governing merchants. Unless specifically displaced by provision of the U.C.C., the law merchant supplements the Code. U.C.C. § 1-103.

75. U.C.C. § 3-805 cmt. Section 3-805 has no parallel in Revised Article 3.

76. For an in depth analysis of the history, efficacy and interplay between common law and

Revised Article 3 states, "[t]his Article applies to negotiable instruments."[77] The comments to the definition section referring to negotiability specifically state that the code may be applied "by analogy" to a nonnegotiable instrument, depending upon the "expectations of the parties and the differences between the writing and an instrument governed by Article 3."[78] Thus, it is possible that the check without a signature may still be governed by the principles of Article 3, by analogy.

Courts have not always chosen to apply the code by analogy, and instead have sometimes applied contract principles to nonnegotiable instruments.[79] Applying contract law instead of Article 3 to the unsigned check would eliminate the final payment provision which protects depositary and collecting banks, resulting in the possible liability of the depositary and collecting banks under the defense of mistake. The common law remedy of restitution would require that these banks return the amounts mistakenly paid, proceeding backwards through the collecting chain. The depositary bank would then be the entity required to proceed against the payee. From the payor bank's viewpoint, it may be in a better position if it holds a nonnegotiable, rather than negotiable, instrument.

VI. ANALYSIS AND IMPLICATIONS

If a check by phone bears an unauthorized drawer's signature, the liability of the parties will depend upon whether the check is negotiable or nonnegotiable. The negotiable check will probably place the loss on the payor/drawee bank, since the item is not properly payable unless the customer has been negligent, has failed to inspect or report the signature within the time period, or has ratified the signature. The collecting and depositary banks will not be liable because of the final payment rule, unless they have breached a warranty by knowing of the unauthorized signature. The drawee may proceed against the payee for recovery of the funds.

U.C.C. remedies, see Steven B. Dow & Nan S. Ellis, *The Payor Bank's Right to Recover Mistaken Payments: Survival of Common Law Restitution Under Proposed Revisions to Uniform Commercial Code Articles 3 and 4*, 65 IND. L.J. 779 (1990).

77. U.C.C. Revised § 3-102(a).

78. U.C.C. Revised § 3-104 cmt. 2.

79. *See, e.g.*, Northern Trust Co. v. E.T. Clancy Export Corp., 612 F. Supp. 712, 715 (N.D. Ill. 1985) (using common law to determine the legal effect of an endorsement on a nonnegotiable instrument); Centerre Bank of Branson v. Campbell, 744 S.W.2d 490, 496 (Mo. Ct. App. 1988) (holding that failure of consideration is a valid defense to a nonnegotiable note); DH Cattle Holdings Co. v. Reinoso, 575 N.Y.S.2d 203, 204 (App. Div. 1991) (finding that interest "to be determined" made a note nonnegotiable but still enforceable as a contract); Taylor v. Roeder, 360 S.E.2d 191, 194-95 (Va. 1987) (finding a variable interest rate note was nonnegotiable and that assignment principles, rather than holder in due course applied).

If a check is missing a signature, then it is nonnegotiable. Consequently, Article 3 and the final payment rule may not apply. The law of contracts will allow the drawee bank restitution from the collecting or depositary bank based on the mistaken payment.

Because banks in both cases of negotiable and nonnegotiable checks by phone will probably bear the loss of an unauthorized signature, they have an incentive to address the issue. The speed with which banks act will likely depend on the extent of check by phone use and the extent to which the accompanying problems discussed in this article emerge.

Check fraud is a growing problem; estimates are that it increases thirty to thirty-five percent per year.[80] In 1993, commercial banks lost $815 million because of fraud, including forgery.[81] Increased security measures, such as harder-to-duplicate checks and computer databases programmed to verify signatures, are being used to battle the losses.[82] Banks will also need to alert their customers to the perils of giving checking account information over the phone in order to combat unauthorized checks.

Neither educating consumers about potential abuse nor manufacturing nonduplicative checks may be sufficient to address the issue of unauthorized checks. Evidence indicates that checks by phone are increasingly accepted.[83] If losses increase proportionately, banks will need to consider alternate methods to reduce their costs. One option would be to allocate the losses, at least in part, to the customer by agreement.[84] While negligence and good faith cannot be disclaimed,[85] the parties could stipulate to a standard and agree that if checking information was given by phone the customer would bear some financial responsibility for unauthorized use of the information. In light of the large number of checks processed by each bank, it does not seem unreasonable to place some of the burden of loss on the customer, who is most able to avoid that loss.

The practical problems with loss allocation agreements, and indeed with risk allocation in the U.C.C., are in the proof and the economics. Whether the information was given over the phone, whether the signature was authorized,

80. Rick Jurgens, *Check Fraud Grows, but Banks and Printers Battle Back*, CHRISTIAN SCI. MONITOR, Nov. 15, 1993, at 10.

81. Josh Chetwynd, *Bankers Survey Finds Check Fraud Is Rising Sharply*, WALL ST. J., Dec. 1, 1994, at A6.

82. Monique P. Yazigi, *A Pen Mightier Than the Password*, N.Y. TIMES, Sept. 8, 1991, at F9.

83. A sales flyer from International Business Technology states that "the largest home shopping club, the largest manufacturer of copying equipment, the largest collection agency, direct response and thousands of other businesses" use check by phone systems. (Flyer on file with author).

84. An agreement between banks and customers is allowed as long as it is not "manifestly unreasonable." U.C.C. § 4-103(a).

85. *Id.*

and whether the bank or customer was negligent are questions of fact that must be submitted to a judge or jury. Often it will not be cost effective to pursue a legal remedy when even the most minimal of legal proceedings could quickly exceed the amount of the disputed check.

The increased legitimate use of checks by phone, accompanied by increased fraudulent use of the same method, could lead banks to spread the risk of their losses by charging fees or higher rates for consumer checking accounts instead of pursuing individual claims. Because it is probably uneconomical to pursue the factual evidence of authorization for each check, increased charges for every checking account would be a method to recoup a bank's losses.

VII. CONCLUSION

Checks by phone are negotiable instruments if they are signed. However, if the drawee bank paid the check over an unauthorized signature, it will have to recredit the account of its customer. The drawee bank will suffer the loss unless: (1) its customer was negligent; (2) the customer failed to promptly report the unauthorized signature; (3) the customer ratified the signature; or (4) the payee can be found and is able to reimburse the bank. Collecting and depositary banks may not be held liable because of the final payment rule.

Checks by phone are nonnegotiable if they do not bear a signature or mark intended as a signature. If a court decides to apply the U.C.C. by analogy, the nonnegotiable check may yield the same results as a negotiable check. However, a nonnegotiable check may be analyzed under contract law. As a result, collecting and depositary banks will be liable for restitution under the doctrine of mistake, because the final payment rule will not apply.

Technological advances have forever changed commercial practices in society. Payroll checks are mass-produced, goods are ordered by computer or over a computer network, and e-mail and fax machines provide quick transmission of documents over long distances. It was inevitable that the check, an instrument in existence for hundreds of years, dependent on paper and a signature, would eventually be influenced by technology. But technology and convenience might have its costs. If check by phone becomes a significant part of the checking environment, then the allocation of risks under the U.C.C. to the drawee or other banks may result in higher costs being passed on to consumers.