

# SCHENCK, PRICE, SMITH & KING, LLP

## ATTORNEYS AT LAW

PARAMUS OFFICE  
COUNTRY CLUB PLAZA  
SUITE 100  
WEST 115 CENTURY ROAD  
PARAMUS, NJ 07652  
TELEPHONE: (201) 262-1600

NEW YORK OFFICE  
305 BROADWAY, SUITE 900  
NEW YORK, NY 10007  
(212) 822-1456

10 Washington Street  
P.O. Box 905  
Morristown, NJ 07963-0905

Telephone:(973) 539-1000  
Telecopier:(973) 540-7300  
www.spsk.com

THOMAS L. HOFSTETTER  
ADMITTED IN NJ AND PA

DIRECT LINE: (973) 540-7308  
EMAIL: TLH@SPSK.COM

### **DON'T BE SCAMMED: THINK TWICE BEFORE YOU ACCEPT A CASHIER'S CHECK...IT MAY BE FRAUDULENT**

*By Thomas L. Hofstetter and Jane Paftinos*

For anyone who is approached by a stranger concerning a transaction that involves a cashier's check, it is time to proceed with caution. It seems that we must all be on the lookout for a new type of scam that is rocking innocent consumers as well as banks. A growing number of people as well as companies have been scammed by unknowingly accepting fraudulent checks. There have been several scenarios involving fraudulent cashier's checks.

A sample of factual scenarios involving fraudulent checks is as follows:

1. A consumer is selling goods on the marketplace such as on the internet or by posting an ad in the classified section of a newspaper. The prospective "buyer" is interested in buying the good(s) and sends the consumer a cashier's check for more than the purchase price. The buyer then asks the consumer to wire the excess to a third party who is normally located out of the country.
2. Another scenario involves someone selling goods on the marketplace such as the internet. The buyer contacts the consumer and expresses interest in purchasing the goods. The buyer sends the consumer a cashier's check and the consumer ships the goods to the buyer. After the consumer ships out the goods, it is discovered that the check is fraudulent.
3. Any avid shopper could be enticed by being invited to do a little mystery shopping. Under this scenario, the consumer receives a letter that states that he has been the lucky person selected to act as a mystery shopper. The letter includes a cashier's check which must be deposited into the consumer's account. Once the check is deposited, the consumer is instructed to use some of the funds to purchase merchandise from designated merchants while the balance of the funds is to be wired to a third party by means of a designated wire service company.

4. What could be better than an unexpected windfall? A consumer receives a letter which sets forth that he has the right to receive a substantial sum of money which could be by means of winning a foreign lottery or even being the beneficiary of someone's estate. The letter further states that the consumer must pay a processing fee or tax before he can receive the money. The good news is that a check is enclosed to cover the fee or tax. The letter asks the consumer to deposit the check in his account and then instructs the consumer to send a wire to a third party who is usually located in a foreign country.

In each instance, the consumer believes the cashier's check to be authentic and therefore, the check is deposited into the consumer's account. After all, why would a consumer question a check that appears to be a cashier's check. Once the depository bank makes the funds available to the consumer, the consumer does as he is instructed to do based upon the type of scenario. After some time passes, the check is returned "unpaid" by the paying bank to the depository bank because it is then discovered the check is fraudulent. Ultimately, the depository bank reverses the credit to the consumer's account. The consumer then loses the goods sold, the funds wired, or sometimes both.

These schemes appear to be legitimate and for this reason, it becomes difficult to detect the scam that it taking place with the fraudulent cashier's check. Various devices are employed by these scam artists to delay or make the detection of the fraud difficult to uncover. For example, the fraudulent check may be drawn on a bank which is located in a different check processing region from the region in which the depositor is located. Also, the scam artist often times uses and alters a genuine check to make the transaction look as legitimate as possible. Sometimes, the check may list the name of one bank but contain the routing number for another bank. As you can see, there are a number of devices used by these perpetrators to successfully scam their victims. The depositor's bank may not be able to determine that the check is fraudulent when it is deposited. Often times, it can take several weeks before the fraud is uncovered only after the check is returned unpaid by the paying bank. Once the check is returned to the depository bank, the bank then reverses the deposit to the consumer's account and the amount of the check is collected from the consumer. Needless to say, this type of scam not only affects the consumer but banks as well.

The first legal issue that is raised by this scam is funds availability. Funds availability is governed by the Expedited Funds Availability Act, 12 USC 4001 et seq., as well as Regulation CC promulgated by the Board of Governors of the Federal Reserve System, 12 CFR 229. Typically, a bank must make funds deposited by government and cashier's checks available within one business day after deposit, if certain requirements are met. Local cashier's checks are defined as checks payable by, at, or through a bank located in the same check processing region as the location where the check was deposited. Local cashier's checks are made available within two business days after deposit. The bank must make non-local cashier's checks (a check payable outside the check processing region from the location where the check was deposited) available within five business days.

Regulation CC sets forth several exceptions that allow banks to delay making funds available within the above timeframes. If a customer deposits more than \$5,000.00 in any one day, the bank may place a hold on the amount over \$5,000.00. Another example by which a bank may delay making funds available is in which deposits to an account are repeatedly overdrawn. An account may be considered

overdrawn and funds may be delayed if (1) on 6 or more banking days during the previous six months, the account had a negative balance, or would have had a negative balance had checks and charges been paid; or (2) on 2 or more banking days during the previous 6 months, the account balance was negative in the amount of \$5,000.00 or more, or would have been had checks and charges been paid. Another instance in which the bank may also delay making the funds available is if it has reasonable cause to believe that the check is uncollectible from the paying bank. Under this exception, there is reasonable cause if facts exist that would cause a reasonable person to have a well grounded belief that the check is uncollectible. However, the bank may not base its reasonable cause determination on the fact that a check is of a particular class or has been deposited by a particular class of persons. For these reasons, a bank may not place a hold on all cashier's checks. New customers of a bank are also subject to a delay in having funds available to them by a bank. For deposits of accounts of new customers (defined as having an account opened for less than 30 day), next day availability applies only to cash, electronic payments, and the first \$5,000.00 of any other next-day items; the remaining amount from next day items must be available by the 9<sup>th</sup> business day. It is at the bank's discretion to choose any availability schedule for deposits of local, non-local, and on-us checks into the accounts of these new customers.

If the circumstances support imposing a delay, the bank may delay availability only for a reasonable period of time. Regulation CC provides a safe harbor for determining "a reasonable period of time." The bank may withhold funds for a total of 7 business days for local cashier's checks and for a total of 11 business days for non-local cashier's checks. Should the bank hold a check for a period of time longer than the applicable safe harbor, the bank must justify that the longer period is reasonable.

A second legal issue is reversing the deposit credit. The Uniform Commercial Code (UCC) governs the ability of a bank to charge back items returned to it, including fraudulent cashier's checks. Under the UCC, depository banks may charge back to their customer the amount of the check that is later returned by a paying bank after discovering it is a fraudulent check. Furthermore, a bank has the right to provide in its deposit agreement the right to charge back any item regardless of when the item is returned to it. Also, if a paying bank pays a fraudulent cashier's check in error, the UCC generally allows the bank to recover the amount paid.

It is extremely important to know that there is a distinction between the availability of funds and whether or not the funds have cleared. As pointed out above, a bank has certain guidelines to follow in providing the availability of funds to a consumer. A bank may also delay the availability of funds in its discretion. However, a check has not cleared until it has been paid by the paying bank. If a paying bank discovers a cashier's check to be fraudulent, under the UCC, it has a right to return the check to the depository bank. From there, the consumer's account will be reversed for the amount of the check. Just because the funds are "available," it doesn't necessarily mean that the funds have cleared.

Depository banks are encountered with a number of risks as a result of customer deposits of fraudulent checks. Obviously, the average consumer is not familiar with the UCC. For this reason, the customer will argue that the bank should not have credited the account before the check cleared or should have someone followed different procedures in order to detect the fraud. On the other hand, the customer may claim that he was led to believe that the check had cleared by statements made by a bank employee such as the funds were available. Finally, the customer may believe that the bank should not

have reversed the credit after making the funds available. This customer dissatisfaction would raise reputation concerns for the bank as well as potential litigation between them.

Depository banks may also face credit risks in this type of situation. Reversing the deposit could result in the depositor's account to become overdrawn, and thereby create what is in effect, a loan to the depositor. Under this scenario, the consumer may be unable or unwilling to repay the draft.

Paying banks also face risks related to fraudulent cashier's checks. Paying banks may fail to uncover the fraudulent cashier's check and pay the check erroneously. Even if they later identify the check as fraudulent, they may find themselves liable for the amount of the check if they do not return the check in a timely manner.

It is of utmost importance that both consumers and banks act with caution and take necessary steps to avoid being duped by these scam artists.

The following are tips to be followed by a consumer to avoid being a victim in a fraudulent check scam:

1. When selling goods or services on the internet, consider other options for payment such as online payment systems (i.e. Paypal) or an escrow service;
2. If you choose to accept a cashier's check for payment, do not accept a check for more than the purchase price if you are expected to pay the excess to a third party.
3. Try to know the people that you do business with. If it is possible, verify information about the buyer from an independent third party or a source such as the internet. Be cautious about accepting a cashier's check from people that you do not know since it may be difficult to pursue a legal action if the transaction goes wrong.
4. If you do accept a cashier's check, it is important to know the difference between funds being available and the check actually clearing. A bank may be required by law to make funds available even if the check has not cleared. However, it may take several weeks before you know whether or not the check has cleared.
5. If you are given a cashier's check and the bank on which the check is written is in your area, it is helpful to stop by that bank and have them advise you whether or not the check is one they issued and is genuine.

Banks should also take action to avoid risks to the bank and its customers by implementing the following procedures:

1. Depository banks should consider training or take other steps to ensure that its personnel are aware of the increasing number of fraudulent cashier's checks. At a very minimum, bank employees who handle deposits should be aware of the bank's procedures for identifying and handling suspicious cashier's checks.

2. Depository banks should review their deposit agreements to ensure that the agreements appropriately address returned items which thereby mitigates the risks related to fraudulent cashier's checks.
3. Depository banks should explain the status of deposits to its customers clearly and accurately so that any confusion or misunderstanding can be avoided.
4. Depository banks should consider methods of working with deposit customers that become victims of fraudulent cashier's checks. It is important for the bank to provide the customer with assistance associated with any legal claims that are being pursued. Furthermore, it may be wise for all of the parties involved if the if an overdraft of a victim is converted into a loan that the customer can repay over time, instead of demanding that the overdraft be repaid immediately.

If you have been a victim of a fraudulent check scam, please contact this office to see what we can do for you.