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The City of New York Civil Court Holds That Pre-Authorized Drafts or Telechecks Are Subject to the Uniform Commercial Code in the Same Manner as Any Other Checks - Interbank of New York v. Fleet Bank

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THE CITY OF NEW YORK CIVIL COURT HOLDS THAT PRE-AUTHORIZED DRAFTS OR TELECHECKS ARE SUBJECT TO THE UNIFORM COMMERCIAL CODE IN THE SAME MANNER AS ANY OTHER CHECKS— *INTERBANK OF NEW YORK V. FLEET BANK*

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INTERBANK of New York v. Fleet Bank[1] is a case of first impression that deals with the issue of whether the notation "verbally authorized by your depositor" qualifies as a signature on a check and, if so, whether the item should still be considered a negotiable instrument and treated as an ordinary check as defined by the Uniform Commercial Code ("U.C.C.").[2] In addition, this case determines that if an item with this notation is unauthorized, whether it should be handled in the same manner as an ordinary forged check.[3] The City of New York Civil Court, basing its decision on archaic standards and empty precedence, mistakenly held that a forged pre-authorized draft should be treated the same way an ordinary forged check is treated. Although it is already well settled that a drawee who accepts or pays an ordinary check on which the signature of a drawer is forged is bound on its acceptance and cannot recover back its payment,[4] items with the notation "verbally authorized by your depositor" in place of an indorsement should not be held to this standard. Therefore, the issue raised in this case is whether the notation

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1. 730 N.Y.S2d 208 (N.Y. Civ. Ct. 2001).
2. *Id.* at 208.
3. *Id.* at 209
4. "This rule, first set forth in Price v. Neal (3 Burr. 1354 [1762]), is followed in section 3-418 of the Uniform Commercial Code and inferentially in section 3-417 (Subd. [1], par. [b]) and section 4-207 (subd. [1], par. [b]) of the Uniform Commercial Code." *Id.* (citing Mortimer Agency, Inc. v. Underwriters Trust Co., 341 N.Y.S.2d 75 (N.Y. Civ. Ct. 1973); Banco Mercantil De Sao Paulo S.A. v. Nava, 466 N.Y.S.2d 198 (N.Y. Sup. Ct. 1983)).

"verbally authorized by your depositor" qualifies as a signature and, if so, whether it should be treated as a forged signature on an ordinary item under the U.C.C. when the notation and the draft are unauthorized.[5] With the recent increase in the number of pre-authorized drafts used in lieu of other payment options, this is an issue that necessitates a modern solution and solid precedence.

In today's fast-moving environment, many businesses are finding that they can solve collections and account receivable issues with automatic bank drafting, a process that can accelerate cash flow and ensure on-time monthly payments from vendors and customers.[6] While banks and other credit institutions have offered this service to their loan customers for years, more businesses are now using this method of collection that streamlines and automates payment systems, helping to eliminate invoicing and billing as well as late payments and collection problems.[7] This procedure allows consumers to pay for goods and services by telephone, verbally authorizing businesses to debit their bank account.[8]

These checks are commonly known in the banking industry as "pre-authorized drafts" or "telechecks."[9] They are created when a consumer allows the subject vendor to prepare and issue a pre-authorized check drawn on the consumer's account at the consumer's designated financial institution.[10] The consumer provides the vendor with the necessary account number and bank information.[11] The vendor then issues a check drawn on the consumer's account and the check is deposited into the vendor's respective checking account for collection.[12]

In this case, Bell Telephone ("Bell") issued two drafts on the Interbank of New York ("Interbank") account of its customer, Dimitrios Tasoulis, to pay for telephone services.[13] These drafts contained the typed notation "verbally authorized by your depositor."[14] Bell deposited these drafts in its account at Fleet Bank ("Fleet") and Bell was ultimately paid by Interbank.[15] Tasoulis then advised Interbank that he never authorized Bell to issue the drafts.[16] Tasoulis signed an affidavit of forgery with respect to each draft in which he stated that he had never authorized the

5. *Interbank of New York*, 730 N.Y.S.2d at 209.

6. D. Ann Slayton Shiffler, *Automatic Bank Drafts Gaining Momentum*, 17 BAL. BUS. J. 39 (2000). "Health and fitness clubs were the first businesses to get on the automatic bank draft bandwagon back in the late 1980s, when the industry was seeking ways to increase cash flow, retain members and simplify accounting procedures. Today, apartment complexes, storage companies, dentists and many other business sectors have discovered the benefits of automatic bank drafting, which is one of the fastest growing methods for receiving monthly payments." *Id.*

7. *Id.*

8. *Interbank of New York*, 730 N.Y.S.2d at 208-09.

9. *Id.* at 208.

10. *Id.*

11. *Id.*

12. *Id.* at 209.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

drafts to be issued by Bell.[17]

Interbank filed suit against Fleet in the Civil Court of New York City, New York, to recover on the two drafts for $1,709.04.[18] Interbank alleged that a pre-authorized check cannot be treated as an ordinary check and is not a negotiable instrument since the drafts were not signed by the maker.[19] In response, Fleet moved for an order granting summary judgment in its favor and dismissing Interbank's complaint.[20] The court granted Fleet's motion for summary judgment and dismissed the complaint.[21]

Writing for the court, Judge Edmead first addressed whether the payor[22] bank or the collecting and depository[23] bank is responsible for the loss attributable to forged checks.[24] As previously discussed, it is settled law that a drawee who accepts or pays an instrument on which the signature of a drawer is forged[25] is bound on its acceptance and cannot recover back its payment.[26] Therefore, Interbank would be liable for a forged signature of its customer on an ordinary check. The reasoning Judge Edmead gave for this is because Article 3 of the U.C.C. provides for ensuring the ready negotiability of commercial paper and advancing the important policy of assigning loss based upon the relative responsibility of the parties.[27] These ends are accomplished by establishing commercially sound rules designed to place the risk of loss attributable to forged signatures with the party best able to prevent them.[28] The reason the drawee bank is bound on the acceptance of a forged instrument is because that bank has the maker's signature and is expected to know and compare each signature with the signatures that are on file.[29] Another rationalization is that it is highly desirable to end the transaction on an item when it is paid rather than reopen and upset a series of transactions at a later date when the forgery is discovered.[30]

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17. *Id.*

18. *Id.* at 209 n.1. The original complaint was filed to recover on four drafts in the total sum of $3,361.16 made by Bell and Sprint. However, it was later discovered that Fleet only processed the two Bell drafts and that Mellon Bank processed the two drafts from Sprint. *Id.*

19. *Id.* at 210.

20. *Id.* at 208.

21. *Id.* at 212.

22. Interbank is the payor bank, which means the bank that is the drawee of a check or draft. U.C.C. § 4-105(3) (2000).

23. Fleet is the collecting and depository bank, which means the bank handling the item for collection and the first bank to take an item. U.C.C. § 4-105(2), (5) (2000).

24. Forgeries are unauthorized signatures that are "wholly inoperative as that of the person whose name is signed." U.C.C. § 3-404(1) (2000). An unauthorized signature or indorsement "means one made without actual, implied, or apparent authority and includes a forgery." U.C.C. § 1-201(43) (2000).

25. *See supra* note 24.

26. *See supra* note 4.

27. Getty Petroleum Corp. v. Am. Express Travel Related Servs. Co., 683 N.E.2d 311 (N.Y. 1997).

28. *Id.*

29. U.C.C. § 3-418 cmt.1 (2000).

30. *Id.*

Next, the court struggles with whether these checks, due to a lack of signature, can be considered negotiable instruments[31] and handled as such by the aforementioned section of the U.C.C.[32] "'Signed' includes any symbol executed or adopted by a party with a present intention to authenticate a writing."[33] A signature is made "by any word or mark used in lieu of a written signature."[34] The court concluded that the notation "verbally authorized by your depositor" does constitute a signature.[35] The judges reasoning was that if a drawer or maker intended this notation to authenticate the check and intended that it take the place of a written signature, then the check would be a negotiable instrument.[36]

According to the court, the notation "verbally authorized by your depositor" can constitute a signature under the UCC, and thus, when unauthorized, can constitute a forged signature.[37] Consequently, Judge Edmead deems that the pre-authorized checks in this case should be treated as any other check that contains a forged signature since they are negotiable instruments.[38] The court erroneously came to this conclusion based on a case in which a court held that the unauthorized use of a stamped printed signature constituted a forged signature.[39] This attempted analogy falls short because the stamp used in *William Iselin & Co. v. Fireman's Fund Insurance Co.* was a signature bearing the name of the company that the fraud was committed against.[40]

Finally, the court addressed Interbank's claim that the two pre-authorized checks deposited by Bell in its account at Fleet listed the same account number, but listed different makers (one listed Edward Ness as the maker, and the second listed Valerie Booth as the maker), putting Fleet on notice that there was something wrong with the checks.[41] Judge Edmead rejected this argument since Fleet could only have discovered this if it compared the two checks and, given the volume of the checks going through the system, this would be an impossible task.[42] The court emphasized that commanding this effort from Fleet would defeat the pur-

31. A negotiable instrument is "an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it: (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder; (2) is payable on demand or at a definite time; and (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money." U.C.C. § 3-104(a) (2000). Furthermore, a check means "a draft . . . payable on demand and drawn on a bank." U.C.C. § 3-104(f) (2000).

32. U.C.C. § 3-418 (2000).

33. U.C.C. § 1-201(39) (2000).

34. U.C.C. § 3-401(2) (2000).

35. *Interbank of New York*, 730 N.Y.S.2d at 212.

36. *Id.* at 210.

37. *Id.* at 210-11.

38. *Id.*

39. 501 N.Y.S.2d 846, 848-49 (N.Y. App. Div. 1986).

40. Every bill of lading in dispute bore a printed stamped signature of "Lawson Trucking Co., Inc., J. Lawson, President" and in Mr. Lawson's deposition, he testified that he had never authorized anyone to purchase the stamp or to use it. *Id.* at 847.

41. *Interbank of New York*, 730 N.Y.S.2d at 211.

42. *Id.*

pose of the UCC, "to have a speedy commercially sound method for commercial paper to pass through the banking system."[43] Judge Edmead concludes her analysis that pre-authorized checks should be handled like an ordinary check by stating that parties and entities that deal with this type of draft should "know their rights, responsibilities, and liability as to these items, so that they can take steps to avoid loss."[44]

The court's analysis unfortunately neglects the opportunity to use this case of first impression to deal with an important issue that will no doubt occur more frequently with the increase in technology and the obvious advantages to using pre-authorized drafts during the collection process. The bulk of the reasoning used in this case uses precedence from a time when bartering was preferred over the usage of paper money much less checks. Technology has changed the world in which we live and, in order to be logical and effective, the law must change with it. The sponsor's of the U.C.C. apparently agree. Last year, these sponsors appointed a Drafting Committee to consider and draft possible revisions to U.C.C. Articles 3, 4 and 4A.[45] This Committee met twice during 2000 focusing on a wide range of current payment system and negotiable instrument issues and developments.[46] The reason for this meeting: Advances in technology.[47]

Among other things, the Drafting Committee was concerned with adding sections to the U.C.C. that would address pre-authorized drafts. Implicated at the meeting were issues under: Section 3-103(a)(7) (the standard of "ordinary care"); Section 4-208 (breach of presentment warranty); and a new proposed Section 4-402A that would require re-credit of the customer's account within ten days, pending an investigation to determine whether the draft was authorized.[48] Another revision would also add a new Section 4-208(a)(4), to create a new presentment warranty to the effect that any item without a handwritten signature purporting to be that of the customer is warranted by the depository bank to be authorized.[49] With these changes, the loss for unauthorized telephone drafts would shift from the payor bank and customer to the depository bank, at least where the customer obviously did not sign as the drawer.[50]

These proposals would effectively require the depository bank to confirm that a drawer signature is that of the customer on whose account the draft is drawn; this would occur by imposing a warranty to this effect in favor of the payor bank.[51] This, of course, would partially reverse *Price v.*

43. *Id.*
44. *Id.*; *see also* Alvin C. Harrell, *NCCUSL Articles 3,4, and 4A Drafting Committee Highlights Current Payment System and Negotiable Instrument Issues*, CONSUMER FIN. L. Q. REP. (Fall 2000).
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*

Neal, on grounds the depository bank is in the best position to prevent loss by intercepting unauthorized telephone checks when they are originated, thereby precluding their entry into the banking system.[52] It would not prohibit the use of telephone checks, but would place the risk of loss for improper ones on the depository bank.[53] This is also supported by the argument that the loss should fall on the party who dealt with the wrongdoer (the depositor).[54]

The court's analysis in this case suggests that the laws of the abacus should be applied to the personal computer. Technology has deemed the court's analysis and reasoning obsolete. Judge Edmead is under the impression that drawee banks have the tools necessary to compare indorsements on every check with the signature cards of its customers. Some operation centers process over 1 million items each day. Analyzing each item would be neither sensible nor cost-effective. In fact, the courts reasoning for why the collecting bank should not be responsible for noticing the difference between the payees on the checks is the exact reasoning why the drawee bank should not be responsible for unauthorized, preauthorized drafts. Requiring the payor bank to verify signatures on each item processed daily would certainly defeat the rationale behind Articles 3 and 4 of the U.C.C. This constraint would be neither speedy nor a commercially sound method for items to pass through the banking system.

Unfortunately, as technology increases efficiency, new rules must be created to handle the side effects. As the court and the U.C.C. suggests, the risk of loss caused by fraud involving pre-authorized drafts should still remain in the hands of those best suited to prevent the fraud, but now those hands belong to the depository bank. The law established in *Price v. Neal* was sufficient during the times for which it was established; however, in this case, the precedence that it established blurred the court's vision and destroyed the integrity of the court's decision.

52. *Id.*
53. *Id.*
54. *Id.*