

[REDACTED]  
Attorney at Law

**MEMORANDUM**

TO: [REDACTED]

[REDACTED]

FROM: [REDACTED]  
Attorney at Law

RE: [REDACTED]

DATE: [REDACTED]

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Pursuant to your request, here is a capsule synopsis of Colorado law on the question of what happens when a bank customer's (here, [REDACTED] employee (here, our customer's bookkeeper, [REDACTED]) forges the customer's signature on company checks over a protracted period of time (here, approximately four years), and thereby embezzles monies from the customer's account (here, in the approximate amount of \$200,000).

**I  
THE FOUR TYPES OF FORGED ITEMS  
AND THEIR TREATMENT AS BETWEEN PAYOR  
BANKS, DRAWER-CUSTOMERS, AND PRESENTING-  
COLLECTING BANKS**

There are four types of forged and altered items: an item on which the drawer's signature has been forged; an item on which the payee's or a subsequent endorsee's signature has been forged; an item that has been altered from the way it was drawn by the drawer; and an item that has had blanks that were left blank by the drawer filled in by someone else. The subject of forged endorsements is covered exclusively by Article 3 of the *Uniform Commercial Code* as adopted in Colorado (hereafter referred to as the "Code"). <sup>FN1</sup> This section therefore covers situations involving forged drawer signatures and both types of alterations. The liabilities for forged and altered items may be analyzed by addressing two questions: (1) As between a payor bank and its drawer-customer, who should bear the loss? (2) To the extent the drawer-customer is not responsible, as between a payor-bank and its presenting bank or prior collecting banks, who should bear the loss?

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A. **Between Payor Bank and Drawer-Customer.** When a check has been wrongfully altered or where blanks left by the drawer have been filled in, the payor bank has a limited right to charge the drawer's account if the payment is made in good faith. An altered check may be charged only as it was originally drawn. The bank may not charge the drawer's account for any larger amount to which the check may have been increased. FN2 When blanks have been filled in, the bank may charge the drawer's account for the full amount, even if the bank knows that blanks had been left and filled in later. The bank may not do this, however, if it knows that the person filling in the blanks acted wrongfully. FN3

Neither an altered check nor one bearing a forged drawer's signature is properly payable. FN4 If a payor bank pays such a check, it must recredit its drawer-customer's account for the amount of the loss unless the customer is precluded from asserting the alteration or forgery against the payor bank. The customer may be precluded in two ways. First, if the customer's negligence substantially contributed to the alteration (*e.g.*, the check was drawn in a manner that made it unusually easy to increase to a greater amount) or the forgery (*e.g.*, a corporate customer failed to exercise ordinary care in protecting its check stock and check-writing machine from misuse), the customer is precluded from asserting the unauthorized payment against the payor bank unless the customer further establishes that the payor bank failed to exercise ordinary care in paying the check. If both the customer and the bank were negligent, the loss is allocated between them based on the extent to which the failure of each to exercise ordinary care contributed to the loss. FN5 Second, a customer may be precluded from asserting an alteration or forgery against its payor bank if the customer fails to examine his bank statement and promptly report the unauthorized payment. FN6

B. **Between Payor Bank and Presenting/Collecting Bank.** If a payor bank pays a check which was improperly altered and is required to recredit the payment to its customer's account, the payor bank may recover its loss from the presenting bank (or a prior transferor) due to a breach of the presentment warranty that the check had not been altered. FN7 However, the Code gives the warranting presenting (or collecting) bank a complete defense against a claim on the warranty if the payor bank's customer is precluded from recovering the loss from the payor bank--*i.e.*, the payor bank is not required to recredit its customer's account for the unauthorized payment because the customer's negligence contributed to the loss or because the customer failed to report it promptly. FN8

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If a payor bank pays a check which bore the forged signature of its drawer-customer, the payor bank can recover on the presentment warranty only if the presenter (or prior transferor) *knew* that the signature of the purported drawer was unauthorized. FN9 Accordingly, unless the customer is precluded from asserting the forgery against the payor bank as described above, in most cases the loss resulting from payment over a forged drawer's signature will be borne by the payor bank.

FN1 See West's C.R.S.A. §§ 4-3-404; 4-3-405; 4-3-406. Former Code § 4-3-406, which is the predecessor of West's C.R.S.A. § 4-3-406, has been applied in Vectra Bank v. Bank Western, 890 P.2d 259 (Colo.App.1995).

FN2 West's C.R.S.A. § 4-4-401(d)(1).

FN3 West's C.R.S.A. § 4-4-401(d)(2).

FN4 West's C.R.S.A. § 4-4-401(a).

FN5 West's C.R.S.A. § 4-3-406.

FN6 West's C.R.S.A. § 4-4-406(d).

FN7 West's C.R.S.A. § 4-4-208(a)(2).

FN8 West's C.R.S.A. § 4-4-208(c).

FN9 West's C.R.S.A. § 4-4-208(a)(3).

**II**

**THE CUSTOMER'S DUTY TO DISCOVER AND REPORT**

This portion of this Memorandum is particularly germane to the current situation which is involved in our relationship with [REDACTED]

Since a bank may be liable to its customer if it pays a forged check, a check with a forged endorsement, or an altered check, the customer should report promptly the discovery of any forgery or alteration. If a customer receives a statement from his bank, he must exercise

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reasonable promptness in examining it to determine whether any paid item was unauthorized either because it had been altered or because the customer's signature was forged. If the customer should reasonably discover such an unauthorized payment based on the statement provided by the bank, he must promptly notify the bank. FN1 Failure to do so will greatly restrict the customer's rights. He may not assert any claim based on his unauthorized signature or any alteration if the bank suffers a loss resulting from his failure to act. FN2 Even without such loss, if there is another forgery of the customer's signature or alteration by the same wrongdoer after the customer has received and had 30 days to review the statement, he loses all claims as to unauthorized items paid by the bank without notice of the first forgery or alteration. FN3

The customer is not, however, precluded from asserting an improper payment against his bank if he can establish that lack of ordinary care on the part of the bank in paying the item contributed to the loss. If the customer can prove that such a failure contributed to the loss, then the loss is allocated between customer and bank on a comparative negligence basis--*i.e.*, the portion of the loss attributable to the customer's failure to report promptly an unauthorized payment is borne by him, and the bank bears the portion of the loss attributable to its own failure to exercise ordinary care. FN4 Because a bank's failure to examine an item before paying it usually will *not* constitute a lack of ordinary care, FN5 in most cases where a customer's failure to report promptly (either the customer's unauthorized signature or an altered check) results in a loss to the bank or is followed by another forgery or alteration by the same wrongdoer, the loss will fall entirely on the customer.

Without regard to either the customer's or the bank's lack of care, a customer is barred from asserting an improper payment against his bank due to an alteration or forgery of the customer's signature if the customer fails to report it within one year after the statement is made available to him. If a customer is precluded from asserting an unauthorized payment against his payor bank because of such one-year limitation, the payor bank is likewise precluded from pursuing a breach of presentment warranty claim on the same unauthorized payment. FN6 The Code does not require that a customer promptly discover and report any unauthorized payments made by a payor bank due to forged endorsements. Accordingly, a customer would have until the expiration of Article 4 of the Code's general three-year statute of limitations to make a claim against her payor bank for payment of a check bearing a forged endorsement. FN7

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A customer is obligated only to report unauthorized payments if his bank provides statements. FN8 A bank statement may include the original paid items, but it need not. FN9 If original items are not returned to the customer, the statement must describe each item paid by at least its number, amount, and date of payment. FN10

FN1 West's C.R.S.A. § 4-4-406(c).

FN2 West's C.R.S.A. § 4-4-406(d)(1).

FN3 West's C.R.S.A. § 4-4-406(d)(2).

FN4 West's C.R.S.A. § 4-4-406(e).

FN5 West's C.R.S.A. § 4-3-103(a)(7), which is made applicable to Article 4 by West's C.R.S.A. § 4-4-104(c), provides that "ordinary care" does not require a bank to examine an item if failure to do so does not violate the bank's procedures, and those procedures do not vary unreasonably from general banking practices which are not disapproved by Articles 3 or 4.

FN6 West's C.R.S.A. § 4-4-406(f).

FN7 West's C.R.S.A. § 4-4-111. See West's C.R.S.A. § 4-4-406, Official Comment 5. But see Stjernholm v. Life Ins. Co. of N. America, 782 P.2d 810 (Colo.App.1989) (where drawer sued his payor bank for paying checks that bore unauthorized endorsements under theory of conversion, rather than three-year limitation specified in former Code § 4-4-406(4), predecessor to West's C.R.S.A. § 4-4-406(f), six-year limitation applicable to conversion was applied, and rather than holding that limitation period began to run when drawer received his bank statements from the payor bank as contemplated by former Code § 4-4-406(4), court held that limitation period began to run when drawer discovered unauthorized endorsements).

FN8 West's C.R.S.A. § 4-4-406(c).

FN9 West's C.R.S.A. § 4-4-406(a).

FN10 West's C.R.S.A. § 4-4-406(a).

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**III**  
**SOME PRELIMINARY CONCLUSIONS REGARDING THE IMPACT**  
**OF THE ABOVE-DESCRIBED RULES ON THE GRAHAM & SONS SITUATION**

As I understand the facts, the same bookkeeper, Ms. ██████████, engaged in an ongoing pattern of forging the signature of one or more of the authorized signors on the account(s) in question which began some four years ago, and continued up until Mr. ██████████ finally noticed something unusual (a paid invoice to a supplier who had not been used for about three years).

The crucial sentences set forth above upon which I believe the Bank can comfortably rely in this situation include:

“Even without such loss, if there is another forgery of the customer's signature or alteration by the same wrongdoer after the customer has received and had 30 days to review the statement, he loses all claims as to unauthorized items paid by the bank without notice of the first forgery or alteration.”

This will almost undoubtedly turn out to be the case in the ██████████ situation. Moreover, as set forth above:

“Because a bank's failure to examine an item before paying it usually will *not* constitute a lack of ordinary care, FN5 in most cases where a customer's failure to report promptly (either the customer's unauthorized signature or an altered check) results in a loss to the bank or is followed by another forgery or alteration by the same wrongdoer, the loss will fall entirely on the customer.”

There is in any case – whether the bank is in any way at fault or not – a one year statute of limitations on recovery, as also set forth above.

My conclusion, based on the facts made available to me to date, is that this situation will end up falling entirely on the shoulders of ██████████ and that the Bank will not likely face any exposure whatsoever to liability. This does not, of course, mean that the customer will

