COMMERCIAL LITIGATION

Slamming the Door on Defenses to Disbursement of Counterfeit Funds

By: Leo K. Barnes Jr.

In February 2011 we reviewed *JP Morgan Chase Bank, N.A. v. Pinzler*, 28 Misc.3d 1214(A) pertaining to an attorney's liability for disbursement of counterfeit funds. In *Pinzler*, the defendant attorney was found liable to the plaintiff bank for disbursing funds to a client that was drawn on a counterfeit check. The court concluded that under UCC § 3-414(1) the attorney, as an indoser, was secondarily liable, even though the attorney had no knowledge that the check was counterfeit. The court, however, left open the issue as to whether the law firm could succeed on its counterclaim, notwithstanding the finding that the attorney was responsible for the dishonored deposit. Specifically, the court agreed to hold summary judgment in abeyance pending the attorney's pursuit of his counterclaim premised upon the bank's alleged negligence in advising that the funds had cleared into his account.

Recently, in a very similar fact pattern, the New York Court of Appeals addressed the exact issue left open in *Pinzler*, and expressly rejected the law firm's claims that the bank was negligent in advising that the counterfeit funds had cleared the account. Specifically, in *Greenberg, Trager & Herbst, LLP v. HSBC Bank*, 2011 N.Y. Slip Op. 07144, 2011 WL 4834474 (2011), summary judgment was granted in favor of two defendant banks, HSBC and Citibank N.A., when the Court of Appeals ruled, inter alia, that it was unreasonable as a matter of law for the law firm to rely upon an oral statement by a bank employee that the funds had cleared.

According to the court's decision, the plaintiff law firm, Greenberg, Trager & Herbst, LLP ("GTH"), received an email from Northlink Industrial Limited ("Northlink"), a company based in Hong Kong, who was looking for assistance in the collection of debts owed by its North American customers. In exchange for representation, GTH required a $10,000 retainer. GTH was then informed by Northlink that it had recently received a check from one of its customers for $197,500. GTH was instructed that it could take its retainer from the check and wire the remaining funds ($187,500) back to Northlink.

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The check was deposited into the firm's trust account at HSBC Bank and on the next business day HSBC processed the check and provisionally credited the law firm's account for the full amount of the check pursuant to applicable laws. That same day, the check was returned to HSBC, the depository bank, due to a routing number error that needed "repairing." A return for reasons other than a dishonor, such as a routing number error, is referred to as an "administrative return" in the banking industry.

GTH was never notified of the "administrative return" and four business days later, one of the partners at GTH called a representative of HSBC and inquired as to whether the check had "cleared." In response, GTH alleged that the representative told it that "the funds were available for disbursement." Relying on the statement, GTH wired the amount of the check less the $10,000 retainer to Northlink.

Thereafter, HSBC received a dishonor notice from Citibank, the payor bank, because the check was suspected to be counterfeit. HSBC then charged back GTH's account for the amount of the check. Immediately following the chargeback, GTH brought suit against both HSBC and Citibank for negligent misrepresentation and equitable estoppel. Both banks moved for summary judgment dismissing the causes of action asserted against them.

In granting summary judgment in favor of HSBC and Citibank, the court first referenced UCC § 4-302(a) which pertains to Citibank's (the payor bank) duty to a non-customer and stated:

> UCC 4–302(a) provides that a payor bank is liable for an item received by the payor bank if it "does not pay or *return the item* or send notice of dishonor until after its midnight deadline" (emphasis added). In this case, it is uncontroverted that Citibank returned the check…within its midnight deadline.

The Court of Appeals then distinguished a line of cases pertaining to a customer's claims against a payor bank "for that payor's bank failure to use ordinary care with regards to forged checks drawn on the customer's account" under UCC § 4-406(3). The court noted that GTH was not a customer of Citibank, the payor bank, and instead was only the customer of HSBC Bank, the depository bank. Thus, the court found that UCC § 4-406(3) was inapplicable.

Next, the court addressed GTH's claim against HSBC for negligent misrepresentation, premised upon the theory that HSBC was an agent for GTH pursuant to UCC 4-201 and, as agent, HSBC owed GTH a fiduciary duty. Although the Court of Appeals acknowledged the agency relationship, it characterized the same much more narrowly, and confirmed that the purpose of UCC 4-201 is not to impose a fiduciary obligation upon HSBC, but to permit the bank the process the check, all the while maintaining risk of loss on the customer. The Court of Appeals ruled that the relationship between HSBC and GTH was not one in which imposes a fiduciary duty on the depositing bank, and held that:

> GTH's claim is based on the alleged oral statement by the HSBC representative that the check had "cleared" — an ambiguous remark that may have been intended to mean only that the amount of the check was available (as indeed it was) in GTH's account. **Reliance on this statement as assurance that final settlement had occurred was, under the circumstances here, unreasonable as a matter of law** [emphasis added].

GTH's final claim was for equitable estoppel. The Court of Appeals sided with the opinion of the Appellate Division and affirmed dismissal of the estoppel claim stating that:

> we agree, that **"[GTH] was in the best position to guard against the risk of a counterfeit check by knowing its 'client'"** and that until there is a final settlement of the check, the risk of loss lies with the depositor.

The Court of Appeals characterization of a law firm's reliance upon a bank's oral advice that a check had cleared as unreasonable as a matter of law, coupled with the court's confirmation that the law firm maintained the best position to avoid by the fraud by "knowing its client," proved to be a very expensive lesson.

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