TYPES OF CHECKS

- **Check:** A draft drawn by a depositor (the *drawer*) ordering a bank or other financial institution (the *drawee*) to pay a sum certain of money on demand to, or to the order of, a third person (the *payee*). The drawer is liable for ensuring that sufficient funds are in his or her account to cover the check.

- **Cashier’s Check:** A check drawn by the bank on itself, rather than on a drawer’s account, which constitutes the bank’s (i) promise to pay the payee on presentment and (ii) assumption of liability if the bank fails to pay.

- **Traveler’s Check:** A check, often used as a substitute for cash, that is (i) drawn on or payable through a bank and (ii) payable on demand by the holder. A traveler’s check does not require the holder to present it to the drawee bank for payment. A traveler’s check is signed twice.

- **Certified Check:** A check that has been accepted by the drawee bank prior to presentment (indeed, often at the time it is issued). By certifying the check, the bank assumes all liability for failure to pay the check on presentment.
BANK’S DUTY TO HONOR CHECKS - PART I

- **Overdraft**: A check written on a checking account in which there are insufficient funds to cover the check.

  A bank faced with an overdraft has two options: (1) **dishonor** the item (i.e., “bounce” the check), or (2) pay the item and charge the customer’s account, collecting the difference from the next deposit or from the customer’s savings or other account.

- **Postdated Check**: A check dated for payment at some future date.

  A bank may charge a postdated check against a customer’s account upon presentment, unless the customer notifies the bank, in a **timely** manner, that the check is not to be paid until the stated date.

- **Stale Checks**: An uncertified check, that is presented for payment more than six months after its date.

  As a general rule, a bank is **not** obligated to pay a stale check upon presentment, although it may do so.

BANK’S DUTY TO HONOR CHECKS - PART II
Stop-Payment Order: An order by the drawer to his or her bank not to pay or certify a certain check.

The order, if made in a timely and reasonable manner, must be obeyed.

Verbal orders are valid for 14 calendar days; written orders are effective for six months and can be renewed.

Death or Incompetence of Drawer -- A customer’s death or incompetence does not affect the bank’s authority to honor a check drawn on the customer’s account until the bank (i) knows of the death or incompetence, and (ii) has had a reasonable period of time to act on the information.

If the bank does not know of the customer’s death or incompetence at the time a check is issued or presented, the bank may pay the item.

Even when a bank knows of the customer’s death or incompetence, it may still pay or certify checks drawn on or before the day of death for ten days following the date of death, unless a valid stop payment order has been issued.
FRAUD: FORGED DRAWER’S SIGNATURE

- **Forged Drawer’s Signature** -- As a general rule, when a bank pays a check on which the drawer’s signature is forged, the bank is liable and must credit the drawer’s account.

- **Exception: Customer Negligence** -- When a customer’s negligence substantially contributes to the forgery, the bank will generally not be obligated to credit the customer’s account.

  - Every customer has a duty to examine bank statements (as well as cancelled checks or photocopies of checks, if included with the statement) promptly and with reasonable care, and to report any alterations or forged signatures promptly. If a customer fails in this duty, he or she is liable for any improperly paid checks.

  - However, if the customer can prove that the bank was also negligent -- that is, the bank failed to exercise ordinary care in paying the check(s) -- then the customer and the bank will share the liability.
FRAUD: FORGED INDORSEMENTS & ALTERED CHECKS

- **Forged Indorsement** -- As a general rule, when a bank pays a check bearing a forged indorsement, the bank is liable and must credit the drawer’s account.

  If a customer fails to report a forged indorsement within three years after the check has been made available to the customer for inspection, the bank will no longer be liable to the customer.

- **Altered Check** -- A bank has a duty to examine each check before making final payment. If the bank fails to detect an alteration, it is liable to its customer for the difference between the intended amount to be paid and the amount actually paid.

  **Exception: Failure to Report** -- A customer is obligated to exercise the same care with respect to alterations as forged drawer’s signatures.

  **Exception: “Blank Check”** -- Moreover, a bank is rarely liable for paying a check that the customer signed but left blank: (i) the name of the payee and/or (ii) the amount to be paid.
Suppose that Bob, who lives in Houston, wants to pay for an item he sees at Sheila’s Antiques, in Minneapolis, by writing a check on his account at Houston National Bank. Assuming that Sheila’s will accept out-of-town checks, here is a sketch of how the check payment and collection process works:

1. Bob gives Sheila’s a check drawn on Houston National Bank (“HNB”), the drawee bank.

2. Sheila’s deposits the check in its account at First Minnesota Mutual (“FMM”), the depositary bank.

3. FMM sends the check to HNB for payment, at which point FMM has also become the collecting bank, because it is handling the collection of Bob’s check.

4. Quite often, one or more other intermediary banks (including but not limited to Federal Reserve banks) will “handle” Bob’s check between FMM and HNB.

5. Bob’s check is finally presented by FMM or the last intermediary bank for payment by HNB, which has now become the payor bank.
ELECTRONIC FUND TRANSFERS

- **Electronic Funds Transfer (EFT):** A transfer of funds by means of an electronic terminal, telephone, computer, or similar media. There are several types of EFT systems in widespread use, notably:

  - **Automated Teller Machines (‘‘ATMs’’)** may be used by a bank’s customers to make deposits, withdraw funds from checking and savings accounts, transfer funds between accounts, make loan and credit line payments, and take cash advances against credit cards.

  - **Point-of-Sale Systems**, including *debit cards*, allow consumers to transfer funds from their bank account(s) to merchants to pay for purchases.

  - **Direct Deposits and Withdrawals** may be made at the instruction of the bank’s customers, as a means of making regular, periodic deposits (e.g., paychecks) and/or payments (e.g., mortgage payments) more easy for the customer.

  - **Bank-by-Telephone Systems** enable a bank’s customers to check account balances, deposits, the payment status of checks, transfer funds between accounts, and direct payment of certain types of obligations.
DRAWBACKS OF EFT

- Despite the tremendous convenience of EFT systems, there are a number of significant drawbacks, notably:

  1. It is more difficult to issue stop payment orders;

  2. Fewer records are available to document a transaction;

  3. The possibilities of tampering are increased; and

  4. “Float time” -- the time between when a purchase or payment is made and when the bank deducts the amount of the purchase or payment from its customer’s account is greatly reduced.

- Unauthorized Transfer: According to the Electronic Funds Transfer Act of 1978, an unauthorized transfer:

  (1) is initiated by some person other than the bank’s customer who has no authority to initiate the transfer,

  (2) from which the customer receives no benefit, and

  (3) for which the customer did not give the unauthorized user means of access to the customer’s account.