community BANKER

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Welcome to the July/ August issue of the COMMUNITY BANKERS' ADVISOR.

The ADVISOR is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

YOU ARE ASKING . . .

Q: Please give a brief rundown of the midnight deadline rule when it comes to forged checks. What if we don't have a customer's affidavit of forgery but are pretty sure that it's not the customer's signature?

A: A check with an unauthorized signature is a check with a signature made without actual, implied, or apparent authority; "unauthorized signature" includes a forgery. N.D.C.C. § 41-01-09(2)(oo) (U.C.C. § 1-201). It's the responsibility of the paying bank to recognize its customer's – the drawer's – signature. If the paying bank wants to return a check because it believes it's a forgery, it should return the check before midnight of the banking day following the banking day of presentment. N.D.C.C. § 41-04-29 (U.C.C. § 4-301) & N.D.C.C. § 41-04-30 (U.C.C. § 4-302).

If you aren't able to get your customer's affidavit in time to return the item for "forgery" but are reasonably confident the item is not legitimate, you should return it within the midnight deadline time limit using "signature not on file" or "nonconforming signature" or some other valid and logical reason. That said, you should make *every* effort to contact the drawer to ask about the check. The important thing is to meet the midnight deadline for returning the forged check. You should also be as honest with the depositary bank as you can. No bank could reasonably accept a check marked with one of these reasons for redeposit.

Though you asked for a "brief" rundown, the midnight deadline is not a brief subject. Payor banks must decide whether to pay or dishonor checks by the midnight deadline. N.D.C.C. § 41-04-29 (U.C.C. § 4-301). The definition given for this magical time frame is familiar to us: the "'Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later." N.D.C.C. § 41-04-04(1)(j) (U.C.C. § 4-104).

Another relevant definition is "banking day", which is defined as "the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions." N.D.C.C. § 41-04-04(1)(c) (U.C.C. § 4-104). Under this definition, the part of a business day when a bank is open only for limited functions such as to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is *not* part of a banking day. If a bank keeps an item too long, it may not be able to return it – the dreaded "late return." N.D.C.C. § 41-04-30(1)(a) (U.C.C. § 4-302).

A bank may protest late returns, and should check all returned items to ensure the items were returned in a timely manner. Late returns of $100 or more can be returned through the Federal Reserve's clearing system by filing a "Claim of Late Return"; these claims must be made within two months of the item charge date. Those claims under $100 or past the two-months deadline will have to be handled on a bank-to-bank basis. If a drawee bank disputes the claim of late return, it should submit a Late Return Disclaimer to the Federal Reserve that charged it with the Claim of Late Return.

Generally, the midnight deadline applies to any check being returned for a reason that the bank would have recognized if it had inspected each check. This is a non-exhaustive list, but typically, reasons for return are 1) forged drawer's signature; 2) counterfeit items; 3) signature unlike the signature on file; 4) the drawer's signature is missing; 5) an unauthorized signature; 6) missing endorsement; 7) not endorsed as drawn; 8) an apparent alteration; 9) the check is post-dated; 10) the check is stale; 11) payment was stopped on the check; 12) non-sufficient funds; 13) the account was closed; 14) an invalid account number; 15) the drawer is incompetent or deceased; or 16) the funds are subject to hold.

As with nearly everything in this world, there are exceptions – the Return Exceptions. The midnight deadline does not apply to 'breach of warranty claims" such as a forged endorsement or fraudulent alteration. N.D.C.C. § 41-04-30(2) (U.C.C. § 4-302) and N.D.C.C. § 41-04-20 (U.C.C. § 4-208).

THE BUSINESS OF BANKING QUIZLET

1.0 You are holding a cashier's check issued by your bank. Which party is both the drawer and the drawee?

a. A merchant using a cashier's check to buy inventory.
b. The bank.
c. A merchant selling inventory and getting paid by a cashier's check.
d. A customer bailing his nephew out of jail with a cashier's check.

The correct answer is b. A "cashier's check" is a draft – an order to pay a fixed sum of money - and the bank is both the drawer and the drawee. N.D.C.C. § 41-03-04(7) (U.C.C. § 3-104).

2.0 The Electronic Fund Transfer Act states that your customer will only be liable for $50 if someone steals his debit card, as long as:

a. He reported the theft within 21 days of discovery.
b. He reported the theft within 7 days of discovery.
c. He reported the theft within 2 days of discovery.

The correct answer is c. If your customer notifies the financial institution within two business days after learning of loss or theft of the access device, his liability is limited to $50. 12 C.F.R. §205.6(b)(1). If he doesn't report the loss within 2 business days of discovering it, his liability will increase.

3.0 A stale check is one that:

a. Contains a payment date at least six months in the future.
b. Was previously dishonored by a bank.
c. Was not presented for payment within sixty days of its date.
d. Was not presented for payment within six months of its date.

The correct answer is d. A stale check is presented more than 6 months after its date, and the bank isn't obligated to honor it. N.D.C.C. § 41-04-35 (U.C.C. § 4-404).

4.0 There is a conflict between the provisions of Article 3 (Negotiable Instruments), found in N.D.C.Ch.41-03 and Article 4 (Bank Deposits and Collections), found in N.D.C.Ch.41-04. Which Article of the Uniform Commercial Code controls?

a. Negotiable Instruments law in Article 3 governs the conflict.
b. Bank Deposits and Collections in Article 4 governs the conflict.
c. Neither. They can never ever be in conflict.

The correct answer is b. According to N.D.C.C. § 41-04-02(1) (U.C.C. § 4-102), if a conflict arises between Article 3 and Article 4, Article 4 controls.

5.0 Lena loses several checks from her checkbook - # 441, # 442, and # 443. She came into the bank and executed a written stop-payment order. She ordered the bank not to pay these items, and described the item with "reasonable certainty" and in a time and manner that afforded the bank a reasonable opportunity to act on it. Four months after the date of the stop payment order, your bank paid check # 443 in the amount of $960.00, which caused Lena's account to be overdrawn. The liable party is:

a. Lena is liable for the $960 *and* the overdraft fee because the stop payment order expired after three months.
b. Lena and the bank are equally liable because she lost the checks in the first place.
c. The bank is liable because it paid even though there was a valid stop payment order.

The correct answer is c. A stop payment order is effective for six months. The amount of loss may include damages for the wrongful dishonor of subsequent checks - those that bounced after the $960 was erroneously taken from her account. N.D.C.C. § 41-04-34(2) & (3) (U.C.C. § 4-403).

6.0 Which of the following is not a negotiable instrument?

a. A certificate of deposit.
b. A check.
c. A draft.
d. A revocable promise to pay.

The correct answer is d. A negotiable instrument is an unconditional promise or order to pay a fixed amount of money, with or without interest, if it is payable to bearer or to order at the time it is issued or first comes into possession of a holder; is payable on demand or at a definite time; and 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. N.D.C.C. § 41-03-04(1) (U.C.C. § 3-104). A revocable promise to pay can't be negotiated - and who'd want it?

7.0 A customer or collecting bank that transfers an item and receives a settlement or other consideration makes certain warranties to the transferee and to any subsequent collecting bank. Which of the following is *not* a transfer warranty?

a. The transferor/warrantor is not entitled to enforce the instrument.
b. The item has not been altered.
c. All signatures on the item are authentic and authorized.
d. The instrument is not subject to a defense or claim of any party that can be asserted against the transferor/warrantor.

The correct answer is a. The customer or collecting bank must warrant that it is entitled to enforce the item. The substance of this section is that customers or collecting banks that transfer items, whether by endorsement or not, undertake to pay the item if it is dishonored. N.D.C.C. § 41-04-19(1) (U.C.C. § 4-207).

8.0 A financing statement is valid for _____ years. A continuation statement of the original financing statement must be done within _____ months prior to the expiration of the five-year period in order to remain perfected.

a. 5; 3
b. 10; 3
c. 5; 6
d. 5; 12

The correct answer is c. A financing statement is effective for a period of **5** years after the date of filing. A filed financing statement lapses at the expiration of the five-year period unless a continuation statement is filed; a continuation statement may be filed only within **6** months before the expiration of the five-year period. N.D.C.C. § 41-09-86 (U.C.C. § 9-515).
