

THE NIGERIAN CHECK SCAM: AN OLDIE REVISITED

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The authors explain that the growing problem of counterfeit checks has increased the need for attention to two issues: (i) what basic preventive measures can banks and individuals take to avoid falling victim to the fraud, and, (ii) assuming the passing of the counterfeit check was successful, who is generally liable for the fraud?

Recent years have seen the proliferation of different variations of what is often called the “Nigerian Check Scam.” This scam typically unfolds when someone, usually located outside of the country, fabricates a counterfeit check and asks a bank customer inside the country to accept the counterfeit check, deposit the check into his or her bank account, and quickly wire funds outside of the country in exchange for a portion of the funds. Another variation of the scam unfolds when a fraudster offers to buy an item that an individual seller inside the country has listed for sale on the Web. Instead of sending a check for the listed price, the fraudster sends a check for a substantially larger amount (providing some plausible reason a larger amount was mistakenly sent in the first place) and asks the seller to wire back the difference.

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Individuals who fall victim to the scam usually deposit the check into their bank accounts and request the depository bank to wire the funds to a specified account overseas. By the time the depository bank receives notice that the check is counterfeit, it may be too late: the depository bank has already irrevocably wired the funds out of the country. Under such circumstances, the individual customer may be liable to his or her bank. Banks, on the other hand, who fall victim to the scam may also be liable (or ultimately bear the loss) depending on how quickly the counterfeit check was discovered and what steps were taken by the bank to prevent the loss.

The growing problem of counterfeit checks has increased the need for attention to two issues. First, what basic preventive measures can banks and individuals take to avoid falling victim to the fraud? Second, assuming the passing of the counterfeit check was successful, who is generally liable for the fraud? This article discusses each of these issues.

THE GROWTH OF COUNTERFEIT CHECKS

The growth of counterfeit checks¹ is due in large part to the ever-increasing sophistication of technology that enables a fraudster to create checks that are facially indistinguishable from genuine checks.² Indeed, technology purchased at the local electronics store has allowed fraudsters to image or duplicate checks on the cheap with little effort. Such technology includes high-end copiers, scanners, printers or other electronic imaging or copying equipment.

According to the American Bankers Association, attempted check fraud more than doubled between 2003 and 2006, reaching an estimated \$12.2 billion in 2006.³ Significantly, counterfeit checks became the fastest growing cause of actual dollars lost, increasing from 15 percent (or \$104 million) in 2003 to 28 percent (or \$271 million) in 2006.⁴ Further, 44 percent of community banks' 2006 check fraud losses were attributable to organized customer scams, with counterfeit checks having the highest median loss per case at \$2,758.⁵

Despite the growth of counterfeit checks and the scams that rely on them, there are basic measures that banks and individuals can take to avoid losses associated with counterfeit checks.

PROTECTING AGAINST COUNTERFEIT CHECKS

Generally, there are two banks that are candidates to bear the loss resulting from the depositing of a counterfeit check: the drawee (or payor bank)⁶ and the depositary bank.⁷ Each of these banks has contact or dealings with the counterfeit check as the check makes its way through the banking system. Each bank can thus take certain basic steps to decrease the risk of losses associated with such counterfeit checks.

The Depositary Bank

As the first bank to often observe and take possession of a counterfeit check, there are several simple measures the depositary bank can take to protect both itself and its unwary banking customer.

First, if the check is over a certain amount or appears to be an unusually high dollar amount for a specific banking customer, the bank should telephone the drawee or payor bank to verify that the bank in fact exists, the account on which the check is drawn actually exists, and that the account contains enough funds to cover the check amount.⁸ If the drawee bank informs the depositary bank that the account does not exist or that it contains insufficient funds to cover the check, the depositary bank may refuse to accept the deposit from its customer.

Second, the depositary bank can opt to handle an unusually large check (with regard to a specific banking customer) as a direct or special collection item. Instead of sending the check through the Federal Reserve System, the bank can send it directly to the drawee bank and wait until it receives the funds from the drawee bank before making them available to the customer. The direct collection route may enable the depositary bank to receive the funds before the deadline by which the bank makes the funds available to its customer.⁹

Third, with regard to individuals who are not customers of a bank and attempt to cash a check, the depositary bank may wish to use what is known as the thumbprint signature program.¹⁰ Pursuant to this program, when a non-customer attempts to cash a large check, the bank can require the non-customer to place an imprint of his or her thumb on the check.¹¹ The sim-

ple requesting of a fingerprint of a non-customer is likely to cause a would-be scammer to think twice before attempting to pass a counterfeit check, especially given that the thumbprint signature program aides law enforcement in apprehending any number of criminals.¹²

Fourth, given the turnover rate for bank tellers, the depository bank should make a concerted effort to the continued training and education of its tellers with respect to how to spot counterfeit checks.¹³ Tellers are on the front lines with regard to combating counterfeit checks and thus tellers should be educated on how to spot a counterfeit check. Such training may include basics as explaining what the symbols and numbers on the MICR line represent and how each symbol or number on the MICR line corresponds to other information on the check, as well as explaining that the bank address printed on the check should correspond to the appropriate Federal Reserve District.¹⁴

The Drawee Bank

While the drawee or payor bank (i.e., the bank on which the counterfeit check is purportedly drawn) may not have actual contact with the customer that attempts to cash a counterfeit check, the payor bank can undertake certain technological safeguards so as to minimize the ability of a fraudster to successfully counterfeit a check. For example, a payor bank should use a reputable check printing company that uses the latest security features with regard to printing checks, including using, for example:

- Watermarks: subtle designs on the front and back of the check that can be seen when held up to the light. These designs generally cannot be copied by copiers or scanners;
- High Resolution Microprinting: very small printing that appears as a solid line to the naked eye, but when magnified the line becomes a series of words;
- Copy void pantographs: the word “VOID” or “COPY” becomes visible when a copy is made;
 - Warning bands: language on the check that alerts bank employees how to inspect the check before accepting it;

- Three-dimensional reflective holostripe: a metallic stripe containing a hologram, similar to those on credit cards, which are difficult to reproduce because they are produced by a laser-based etching process;
- Reactive safety paper: when a counterfeiter attempts a chemical alternation of the check, the check “bleeds” resulting in the check becoming discolored;
- Security inks: reactive inks that discolor when certain chemicals are used for alternation of the check; and
- Thermo-chronic inks: ink that is sensitive to touch and when activated, alters color or vanishes.¹⁵

These technological safeguards, in addition to other anti-fraud tools deployed (*e.g.*, a positive pay system or variations thereof), can minimize a drawee bank’s exposure to counterfeit checks and the associated losses thereto.

The Banking Customer

As with the majority of checking scams, an unsuspecting victim is needed to successfully pull off the fraud. With regard to the typical Nigerian Check Scam, the victim is usually an individual who, for some reason or another, is in direct contact or communication with the fraudster. As a result of such communications, the individual receives a counterfeit check and then deposits it.

To help avoid falling victim to a check scam, individuals can utilize a variety of common sense measures including: (1) being cautious and suspicious of anyone who represents or insists that funds be wire transferred out of the country, (2) request that a cashier’s check be drawn on a bank branch in the local area so as to verify with the bank that the check is valid, (3) when using the internet to sell or buy goods, use an escrow service or online payment system as opposed to direct payment by check, (4) generally never accept payment for an amount over the selling price of an item or the agreed-upon price for a service, and (5) understand the difference between when a check clears as opposed to when funds are available for withdrawal.¹⁶

These common sense approaches can help limit a fraudster’s ability to

pass a counterfeit check to banking customers and thereby into the banking system.

LIABILITY FOR COUNTERFEIT CHECKS

Once a counterfeit check enters the banking system and has been successfully deposited (at least for a time period during which the depository bank irrevocably wire transfers funds out of the country), the question becomes who is liable and who will or should ultimately bear the loss. Often times it is the depository bank who bears the initial loss.¹⁷ This is because the customer often has insufficient funds to cover the loss, and the drawee bank may not be obligated to pay the amount on the check if it timely dishonors the check.¹⁸ The depository bank may thus be stuck with the loss and seek to recoup its loss from either the customer or drawee bank.

Articles 3 and 4 of the Uniform Commercial Code (“UCC”) govern negotiable instruments and determine who may ultimately be liable for the losses associated with a counterfeit check.

Transferring the Loss to the Customer

If the customer signed an account agreement with the bank that allocates liability for counterfeit or returned checks to the customer (as is often the case), the depository bank has a strong argument that the customer is ultimately responsible for repaying the bank. The bank may thus assert a claim against the customer for damages relating to the counterfeit check.

Furthermore, the UCC’s general scheme is that the loss should fall on the party in the best position to avoid the fraud.¹⁹ A depository bank can thus attempt to shift the entire loss to the customer by arguing that customers are in the best position to avoid the fraud because they have direct contact with the fraudster and are best able to determine whether the check is likely genuine or counterfeit based on the interaction with the fraudster.

Alternatively, the depository bank may attempt to shift part of the loss to the customer by seeking an allocation of liability based on comparative negligence under UCC § 3-406.²⁰ UCC § 3-406 provides:

- (a) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.
- (b) Under subsection (a), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.
- (c) Under subsection (a), the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under subsection (b), the burden of proving failure to exercise ordinary care is on the person precluded.

Under this section of the code, the bank may argue that the customer contributed to the loss by failing to exercise “ordinary care” in accepting and depositing the counterfeit check in the first place.²¹ Thus, if the customer failed to promptly notify his or her bank of certain circumstances relating to the counterfeit check or somehow contributes to the passing of the counterfeit check, the customer may be liable for at least part of the loss.²²

On the other hand, UCC § 3-406 may also provide a defense for customers as to the bank. The customer may claim that it was the bank who failed to exercise “ordinary care” in evaluating the authenticity of the check, or by following appropriate procedures, and is therefore precluded from asserting a claim against the customer, who accepted the check from the scammer in “good faith.” This defense may be unsuccessful, however, if the counterfeit check was created with technology that renders the check virtually indistinguishable from a genuine check, because a reasonable bank teller would not be able to detect that the check is a counterfeit.

If the above argument prevails, liability for the loss will be allocated between the bank and its customer according to each party’s relative contribution to the loss. This is somewhat similar to comparative fault in a per-

sonal injury case. Of course, attempting to shift part or all of the loss to the customer will only be effective, however, if the customer is solvent.²³ In cases where the loss is substantial, the customer is likely insolvent or may file for bankruptcy and the debt to the bank may be discharged. In this situation, the assignment of liability to the customer will have no practical effect on the bank's loss. If this is the case, or more generally, the depository bank may in some cases attempt to transfer the loss to the drawee bank.

Transferring the Loss to the Drawee Bank

The depository bank may attempt to transfer liability to the drawee or payor bank by asserting that the drawee bank failed to timely return the counterfeit check or send notice of dishonor as required.²⁴

Under the UCC, if a drawee bank settles for a check before midnight of the banking day on which it received the check, it may generally revoke its settlement and avoid making final payment by returning the check or sending notice of dishonor before its "midnight deadline."²⁵ The midnight deadline is midnight on the next banking day after the banking day on which the drawee bank receives a check.²⁶

Generally, if the drawee bank fails to settle for the check before midnight of the day of receipt, or fails to return the check or send notice of dishonor before its midnight deadline, it is liable for the amount of the check.²⁷ And while the midnight deadline may sound formalistic, the rule satisfies the need for finality and certainty in banking transactions and facilitates the negotiation of millions of checks each day, as well as allowing the recipients of checks that are dishonored to enforce their rights against the drawer without delay.²⁸

Accordingly, if the drawee bank fails to return or dishonor the counterfeit check by the midnight deadline, the depository bank may generally transfer liability to the payor or drawee bank. If, however, the drawee bank does timely return or dishonor the check, then the depository bank may be liable for the loss.

CONCLUSION

Check scams continue to increase as new technologies allow fraudsters to counterfeit checks with ease, using better and more authentic-looking

checks. Given the increase in the amount of fraud on the Internet and elsewhere, including unsuspecting banking customers who may take possession and attempt to pass or deposit a counterfeit check, both banks and banking customers need to be more attentive to the probability of such checks.

By utilizing simple and cost-effective approaches, banks and customers can reduce liability or losses resulting from counterfeit checks. Given the sheer number of counterfeit checks that are passed through the banking system each year, however, banks and banking customers may likely continue to fall victim to counterfeit checks and the scams associated with them. Should this occur, the UCC determines which party will ultimately bear the loss associated with the passing of a counterfeit check.

NOTES

¹ Because the UCC does not per se distinguish between forged and counterfeit checks, counterfeit checks are treated as forged checks under the UCC. *Cf. Cumis Insurance Society v. Girard Bank*, 522 F. Supp. 414, 417, fn. 3 (Dist. Pa. 1981).

² See CHECK FRAUD: A GUIDE TO AVOIDING LOSSES, Prepared by Check Fraud Working Group with representatives from the Office of the Comptroller of the Currency, February 1999; see also *Wachovia Bank, N.A. v. Foster Bank*, 457 F.3d. 619, 623 (7th Cir. 2006) (recognizing the “modern copying technology” with regard to check counterfeiting).

³ See 2007 News Release by American Bankers Association, available at <http://www.aba.com/Press+Room/112707Deposit+FraudSurvey.htm>.

⁴ See *id.*

⁵ See *id.*

⁶ The drawee or payor bank is usually the bank that is required to pay out money when a check is presented. See UCC § 3-103(4).

⁷ The depository bank is the bank where a customer who is in possession of a counterfeit check generally deposits the counterfeit check into his or her account.

⁸ See *Wachovia*, 457 F.3d. at 623, *supra* (suggesting in dicta that the depository bank should have taken steps to prevent an altered check from being deposited when the check was for \$133,000 and the particular customer had not previously deposited large checks).

⁹ *Cf.* 12 C.F.R. § 229.10 (2008).

¹⁰ See CHECK FRAUD: A GUIDE TO AVOIDING LOSSES, *supra* note 3; see also Illinois Banking Association website available at http://www.ilbanker.com/vendors_

thumbprint.asp (providing that the thumbprint signature program was developed in Texas and is a successful tool in decreasing check fraud and indicating that 38 states have adopted the program).

¹¹ See *id.*

¹² See *id.* (providing that the thumbprint signature program dramatically speeds up the investigative process with respect to check fraud and has been used as evidence in theft and burglary trials).

¹³ See CHECK FRAUD: A GUIDE TO AVOIDING LOSSES, *supra* note 2 (providing examples of how and what to educate tellers on common warning signs of counterfeit checks, including providing education on the MICR line and what it represents).

¹⁴ See *id.* (providing that the MICR or “Magnetic Ink Character Recognition” are numbers printed in magnetic ink on a check that can be read by machines. Also, the numbers are encoded with the name and address of the payor bank, account number, and check number).

¹⁵ See *id.* (providing check security features that help deter check fraud).

¹⁶ See Comptroller of the Currency, Administrator of National Banks, Consumer Advisors CA 2007-1, January 16, 2007, available at <http://www.occ.treas.gov/ftp/ADVISORY/2007-1.html>.

¹⁷ See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: PRACTITIONER TREATISE SERIES VOLUME 2, at 207 (4th ed. 1995). If, however, the drawee or payor bank pays on a counterfeit check, the payor bank may ultimately be liable for the loss. See UCC § 4-401(a).

¹⁸ See UCC § 3-408 (1999); see also WHITE & SUMMER at 70. When the drawee bank realizes that the account does not exist or that the account holder has insufficient funds to cover the amount of the check, the drawee bank can dishonor the check by timely returning the check or sending timely notice of dishonor or non-payment under the UCC. See UCC § 3-502(b)(1).

¹⁹ See *Wachovia*, 457 F.3d. at 622 (citing *Holtz v. J.J.B. Hilliard W.L. Lyons, Inc.*, 185 F.3d 732, 743 (7th Cir. 1999)).

²⁰ See WHITE & SUMMERS at 239.

²¹ See UCC § 3-103(a)(9) stating that “ordinary care” means the observance of reasonable commercial standards.

²² If the bank customer waits longer than one year from the date his or her statement is received to report an altered or counterfeit item, the customer may be liable regardless of the care or precautions (or lack thereof) taken by the customer. See UCC § 4-406.

²³ WHITE & SUMMERS at 209-10 (suggesting that the loss associated with a fraudulent check will rest on the “first solvent party in the stream” after the drawer of the counterfeit check).

²⁴ UCC § 4-301(a) provides “If a payor bank settles for demand item other than a documentary draft presented otherwise than or immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it (1) returns the item...or (2) sends written notice of dishonor or nonpayment if the item is unavailable for return.”

²⁵ *See id.*

²⁶ *See id.* UCC § 4-104(a)(10).

²⁷ *See id.* UCC § 4-302(a)(1). The drawee bank may have additional time, however, due to a clearinghouse rule or other agreement. *See* WHITE & SUMMERS at 304.

²⁸ *See, e.g., First Nat'l Bank in Harvey v. Colonial Bank*, 898 F. Supp. 1220 (N.D. Ill. 1995) (“[T]he special role of the payor bank in the check collection system justifies the imposition of liability regardless of negligence. The midnight-deadline requires the payor bank ‘the bank in the best position to know whether there are funds available to cover the check’ to decide whether to pay or return the check...”); *American Title Ins. Co. v. Burke & Herbert Bank & Trust Co.*, 813 F. Supp. 423, 428 (E.D. Va. 1993) (“Without these strict time limits, the dependent chain of credit created by presentment of a check would threaten the efficient operation of the banking industry.”); *Citizens Fidelity Bank & Trust Co. v. Southwest Bank & Trust Co.*, 472 N.W. 2d 198, 203 (Neb. 1991) (“Courts have consistently expressed that the primary reason for automatic or strict liability under § 4-302 is a need for finality and certainty in business transactions; accordingly, if a payor bank fails to fulfill its statutory duty to return or dishonor an item in a timely manner, the payor bank is subject to sanction for its tardiness under the Uniform Commercial Code.”); *Merrill Lynch v. Pierce, Fenner and Smith, Inc. v. Devon Bank*, 832 F.2d 1005, 1007 (7th Cir. 1987) (“Billions of dollars in transactions must be processed by every midnight-deadline and everyone has an interest in having this time defined with precision.”).