Duck, You Sucker!

Avoiding the Nigerian Check Scam

By Larry B. Childs and Brant J. Biddle

On a typical Monday morning, Atticus Darrow, Esq. receives an atypical email that sends his pulse racing. A businessman from Nigeria has run into some trouble collecting a debt from an American corporation, and he needs Mr. Darrow's help. Mr. Darrow is thrilled – he's always longed to break into the international debt collection scene, and now he has his chance!

The requested assistance sounds simple enough. The businessman needs Mr. Darrow to draft a letter to the debtor, demanding payment of the debt. If the debtor makes good, Mr. Darrow will assist in transferring the debt funds to the businessman's bank account.

Barely a week after mailing the demand letter, Mr. Darrow receives a response from the debtor in the form of a cashier's check for the full debt amount of $500,000 drawn on a Canadian bank. Mr. Darrow deposits the check into his firm's client trust account in a local Alabama bank. A few days pass as Mr. Darrow waits for the check to clear. Maybe Mr. Darrow is careful enough even to ask his bank whether he is free to use the funds. The bank representatives answer that the funds are available, and, indeed, Mr. Darrow can see that the funds appear in his firm's account. Satisfied, Mr. Darrow deducts his reasonable fee and wires the remainder to the businessman's bank in Nigeria.

Time passes as Mr. Darrow turns to other matters. Soon enough, however, he receives a message from his firm's bank that sends his pulse racing all over again: the cashier's check was counterfeit, and the bank has charged back the firm's account for the $500,000 proceeds and charged an overdraft fee to boot. The firm immediately moves to reverse the transfers, but the funds are long gone. With no other options, Mr. Darrow's firm turns to litigation – it will sue its bank for failing to prevent the fraud and for incorrectly assuring Mr. Darrow that the funds were available. Mr. Darrow's firm has two key chances for success – *slim* and *none*. Because, as Mr. Darrow's firm will soon learn, the depositor of a counterfeit check almost always bears the risk of loss.

Foreign Check Scams Targeting Law Firms

Some have called it a "Nigerian check scam."[1] The scammer poses as a foreign business and contacts a law firm to request legal assistance. Whatever the assistance may entail, the scam itself will involve the firm's receipt of a check that is drawn on a foreign bank but is, in fact, counterfeit. After the oblivious firm deposits the check into a trust account at its bank, the scammer requests that the firm transfer the proceeds to a separate account.

The crux on which the scammer relies is that there will be sufficient delay between the time that the law firm deposits the check and the time that it will take for the check to bounce.[2] Within that window, the scammer can exhaust the funds before anyone is the wiser.

Far too often, this scam succeeds, and the funds become irrevocably lost. Under such circumstances, the law firm will have little choice but to bear the loss for the reasons described below.

The law firm's knowledge or ignorance is irrelevant: if the check is counterfeit or otherwise unauthorized, the law firm has breached the transfer warranties.

The Depositor's Burden of Risk for a Counterfeit Check

In a typical check scenario, a bank customer deposits a check at its own bank, which the Uniform Commercial Code ("UCC") calls the "depositary bank."[3] If the depositary bank is not the bank ultimately responsible for honoring the check – i.e., the "payor bank"[4] – then the depositary bank will act as a "collecting bank,"[5] either presenting the check to the payor bank for final settlement or transferring the check to an "intermediary bank"[6] for an intermediary settlement. This process will continue until the payor bank finally determines whether to pay the check, return the check, or give notice of "dishonor" or nonpayment of the check.[7] In the meantime, pursuant to the Expedited Funds Availability Act,[8] the depositary bank must make funds from the deposited check available to the depositor soon after the deposit. This quick availability of deposited funds, when coupled with the potential delay in the check's final settlement with the payor bank, could easily lead a depositor to assume (wrongly) that the check has already cleared.

But suppose that a bank customer – perhaps a law firm – deposits a check drawn on a foreign bank and then spends or transfers the funds in the mistaken belief that the check has cleared. What loss might the law firm risk if the check is later revealed to be counterfeit?

Quite a bit, actually.

First, in depositing a check at its bank and thereby receiving a settlement for the proceeds, a law firm makes certain "transfer warranties."[9] For example, the firm warrants that "all signatures on the item are authentic and authorized" and that "the item has not been altered."[10] The law firm's knowledge or ignorance is irrelevant: if the check is counterfeit or otherwise unauthorized, the law firm has breached the transfer warranties.

A law firm cannot disclaim transfer warranties,[11] and a breach could render the firm liable for the value of the deposited check.[12] Moreover, the transfer warranties run not only to the firm's bank, but also to any intermediary banks to which the check is later transferred before its final settlement with the payor bank. If the payor bank dishonors the check because it is counterfeit, the firm faces liability to its bank or any subsequent transferees for breach of warranty.

Second, a law firm's bank can likely saddle the firm with the loss for a dishonored check without ever resorting to litigation. The UCC makes clear that an initial

settlement of a check after deposit is *provisional*; the depositary bank only temporarily credits the law firm's account for the value of the check while the depositary bank seeks its own settlement either from the payor bank or an intermediary bank.[13] If the firm's bank cannot – for any number of reasons including dishonor of the check – collect its own settlement, the bank can simply "charge back the amount of any credit" it previously gave to the law firm upon deposit of the check.[14] In short, if a law firm deposits a foreign check at its bank, the firm runs a risk that the payor bank will later dishonor the check, leading the firm's bank to charge back the check's value from the firm's account.

Through these mechanisms, the UCC allocates the risk of loss for a dishonored check to the depositor.[15] In effect, a law firm that deposits a foreign check is offering up a hand grenade without a pin. Only the payor bank holds the pin. Down the line the grenade goes, moving from the depositor to its own bank to intermediary banks, until finally it reaches the payor bank. If the payor bank honors the check, it plants the pin, and every prior transferee can breathe easier. But if the payor bank dishonors the check, someone else will have to bear the loss. Someone else will be left holding the grenade. Almost without fail, the grenade will begin moving back up the line until it finds its way back into the hands of the law firm.

And then…KABOOM!

The Limited Recourse Available to Law Firms that Deposit Counterfeit Checks

As the dust clears, the law firm may seek to redirect the losses to its bank. Often, that plan comes too little, too late.

To reiterate, the UCC allocates the loss of a counterfeit check to the depositor. To that end, the UCC enumerates only a handful of duties owed by the depositor's bank to

the depositor.[16] Nevertheless, many a hapless depositor has attempted to establish that its bank owed some duty to prevent the fraud and that the bank's failure to save the depositor from its own mistake constitutes negligence or a breach of contract. A depositor might raise such a defense if sued for breach of transfer warranties.[17] Or a depositor may assert this theory as a claim in litigation to recover what its bank charged back against its account. In either case, courts have proven reluctant to recognize that a depositor's bank owes a depositor any duty to detect fraud.

For example, in *Sarrouf Law LLP v. First Republic Bank*,[18] a lawyer with the plaintiff firm received an email from someone purporting to be the chief executive officer of a Dutch company called Big Machinery. The CEO requested that the lawyer assist in drafting an agreement to sell a piece of heavy equipment to a purchaser in Massachusetts. He later advised that the purchaser's broker would deliver to the lawyer a check for the initial purchase deposit. Soon enough, the lawyer received two checks from the broker, one to cover a $3,000 retainer fee and the other for $337,044 to cover the initial deposit. The lawyer arranged to deposit the check into his firm's IOLTA account with First Republic Bank. Upon deposit, bank representatives informed the firm's bookkeeper that the check funds would be available immediately. Two days later, the CEO requested that the firm transfer the funds to two separate foreign banks by 11 a.m. that same day. Although the lawyer's retainer check had just been returned as nonpayable, the lawyer nevertheless arranged for his firm to transfer the funds. Later that day, the payor bank returned the check as counterfeit. First Republic Bank then charged back the firm's IOLTA account, resulting in the IOLTA account being overdrawn by nearly $260,000. By then, the firm could no longer recall the transferred funds from the foreign banks.

The firm sued First Republic Bank for negligence and breach of California's UCC, seeking to recover some $311,550 that it had deposited into its IOLTA account to restore its previous balance. However, the trial court granted First Republic Bank's motion for summary judgment, and the Massachusetts Court of Appeals affirmed. In rejecting the negligence claim, the court of appeals explained that the firm had failed to establish that the bank owed any duty to "discover that the deposit check was counterfeit" or to "refrain from making a true statement . . . that the check proceeds were immediately available" or to "refuse to execute [plaintiff's] valid and duly authorized wire transfer instructions."[19] Turning to the firm's UCC claim, the court of appeals explained that the firm had not established any failure of the bank to perform in good faith. Nor had the firm challenged the bank's exercise of ordinary care as to any duties enumerated in the UCC. Rather, the firm sought to establish the bank's "obligation to detect the counterfeit nature of a check drawn on another bank, deposited by [the firm]," a duty not present in either the UCC or the parties' agreements.[20] Because the firm, not First Republic Bank, was in the best position to detect fraud by its client, the court of appeals affirmed dismissal of the claims.

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More recently, in *Cadence Bank, N.A. v. Elizondo*,[21] a lawyer received a cashier's check for $496,850 from a scammer who posed as both creditor and debtor in a purported debt-collection action. At the scammer's insistence, the lawyer deposited the check into his IOLTA account with Cadence Bank and then quickly wired $398,980 to a third party in Japan. In the process, the lawyer signed an International Outgoing Wire Transfer Request ("IOWTR") provided by Cadence. When the payor bank dishonored the cashier's check, Cadence sued the lawyer to collect the overdrawn funds. The lawyer filed several counterclaims, including a claim for breach of contract. He argued that Cadence's damages stemmed from Cadence's own breach of the IOWTR, which directed Cadence

employees to verify that the lawyer's "collected balance" held sufficient funds before approving a transfer. This argument swayed a state district court, which granted summary judgment for the lawyer on his breach of contract claim. The Texas Supreme Court, however, concluded that the IOWTR served primarily "to facilitate Cadence's internal processing of the wire transfer" and did not impose any contractual obligations sufficient to overwrite Cadence's rights to charge back the overdrawn fees under the UCC and the lawyer's deposit agreement.[22]

In *Perlberger Law Associates, P.C. v. Wells Fargo Bank, N.A.*,[23] a law firm agreed in June 2020 to represent an individual purporting to be the president of a Florida tool company in collecting a $199,550 debt. The law firm contacted the supposed debtor and subsequently received a signed Citibank cashier's check in the amount of the debt owed. The law firm's president then deposited the check into the firm's trust account at Wells Fargo. Upon determining that the funds were "available," the firm's president returned to Wells Fargo with a copy of wire instructions that the law firm had received from the client.[24] After the firm's president confirmed the wire instructions with Wells Fargo, the transfer proceeded per the client's instructions. Unfortunately for the law firm, the client's instructions, in fact, directed the funds to a bank in Nigeria. Within days, Citibank returned the check unpaid to Wells Fargo. Wells Fargo, in turn, notified the law firm that the cashier's check was forged, and it charged the firm's operating account in the amount of $199,500, resulting in an overdraft.

The law firm promptly brought suit against Wells Fargo in federal district court for its failure to detect the fraudulent check. The firm asserted numerous statutory and common law duties, including a novel claim that the firm qualified as a third-party beneficiary of Wells Fargo's transfer warranties under the Pennsylvania Commercial Code. Early in the case, the district court granted Wells Fargo's motion to dismiss in part, finding that Wells Fargo owed no fiduciary duty to the firm and that all claims under the Pennsylvania Commercial Code were inapposite.[25] The court left the proverbial door open only as to the firm's claims for breach of contract, allowing the parties to proceed to discovery to determine whether Wells Fargo owed any implied contractual duty to discover the fraud.[26] However, the district court later closed off that claim as well, granting summary judgment for Wells Fargo on the grounds that the parties' relationship was "governed by the terms of express contracts which Wells Fargo did not breach" and that there was "not legal or factual basis on which [the firm] can prevail under a theory of implied contract."[27]

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But what if a law firm's bank does more than merely perform its duties in accepting the deposited check? Often, whether in response to a customer's question or on their own volition, bank representatives may comment that check funds are available without clarifying that the available funds are provisional. As a result, law firms have also asserted varying theories of misrepresentation or estoppel, arguing that they relied on those comments in choosing to disperse the funds. All the same, courts have proven reluctant to allow recovery.

For example, in *Greenberg, Trager & Herbst, LLP v. HSBC Bank USA*,[28] a partner at the plaintiff law firm fell victim to a check scam that began with an email from a Hong Kong company called Northlink Industrial Limited ("Northlink"). Northlink representatives requested help in collecting debts owed by

some of the company's North American customers. Once the plaintiff firm agreed, Northlink informed the firm that one of Northlink's debtors would provide the firm with a check for $197,750. Northlink instructed the firm to wire the funds – minus the firm's $10,000 retainer – to Northlink's account with Citibank in Hong Kong. Six days after depositing the check into its attorney trust account with HSBC Bank USA ("HSBC"), the firm contacted HSBC to ask whether the check had "cleared," to which HSBC representatives responded "that the funds were available."[29] Satisfied, the firm wired $187,750 to Northlink's Hong Kong account. However, the check was counterfeit, and HSBC charged back the firm's account for the full $197,750. Unable to cancel the wire transfer to the Hong Kong account, the firm sued HSBC, asserting theories of negligent misrepresentation and estoppel based on HSBC's statements that the funds were available.

And if the law firm deposits the check, under no circumstances should the firm act quickly to transfer or otherwise exhaust the funds.

The appellate division of the New York Supreme Court determined that the firm did not have a claim against HSBC absent a fiduciary relationship, which the court explained "does not exist between a bank and its customer."[30] Even if the principles of estoppel governed the allocation of loss, the appellate division concluded that the law firm was "in the best position to guard against the risk of a counterfeit check by knowing its 'client.'"[31] The New York Court of Appeals affirmed, concluding that the firm's reliance on an ambiguous oral statement that the check had "cleared" was "unreasonable as a matter of law."[32] It further explained that "[t]he UCC is clear that, until there is final settlement of the check, the risk of loss lies with the depositor," and it concluded that, because no final settlement of the check occurred under the UCC, "the risk remained with [the firm] and HSBC retained the right to charge back plaintiff's account."[33]

Similarly, in *Law Offices of Oliver Zhou v. Citibank N.A.*,[34] a lawyer received a call from a woman in Japan who requested help in a post-divorce matter concerning her ex-husband. The lawyer agreed and received a cashier's check from the client for $297,500 to cover the cost of an emergency surgery for the couple's child. The lawyer deposited the check into his firm's trust account at Citibank, deducting $10,000 as a retainer fee. The next day, the lawyer asked a Citibank clerk whether the check "was valid and equivalent to cash," to which the clerk responded that the money was available and that "the fund was good."[35] At the direction of the client, the lawyer then requested a wire transfer of $287,450 from the trust account to an account in Japan. However, the payor bank returned the check as a fake, and Citibank subsequently charged back the firm's account for the full value of the check. By then, the lawyer could not reverse the wire transfer.

The lawyer's firm sued Citibank in federal court, arguing that it should bear the firm's loss. The firm asserted, among other theories, that Citibank had negligently failed to detect the fraudulent nature of the check until it was too late. However, the district court dismissed the firm's negligence claim, explaining that Citibank's alleged "failure to identity the check as fraudulent . . . would not constitute a breach of ordinary care as a matter of law."[36] The court further dismissed the firm's claim that Citibank employees had misrepresented the status of the check when they indicated that the funds were available. Relying on the *Greenberg* case, the court concluded that the lawyer's reliance upon such an ambiguous statement was "unreasonable as a matter of law."[37]

Time and again, courts have rebuked depositors who attempted to make an end run around the UCC's allocation of risk for counterfeit checks. As a result, the time for a law firm to take action to protect itself from counterfeit checks comes well before litigation arises.

The Need for Utmost Caution When Handling Foreign Checks

So, what of Mr. Darrow and his law firm? As evident from this article, there may be no means for the firm to recover what it has already lost. Perhaps all Mr. Darrow's firm can do – as any good law firm should – is learn from past mistakes and take greater care in the future.

A law firm that receives a check drawn on a foreign bank should proceed with utmost caution. Does the check come from a known and trustworthy source? If not, the law firm should hesitate before depositing it. Even if the check appears to come from a known and trustworthy source, the law firm should verify with the source that the check is good. And if the law firm deposits the check, under no circumstances should the firm act quickly to transfer or otherwise exhaust the funds. If possible, the law firm should reach out to the payor bank directly for clear confirmation of a final settlement. Ultimately, a final settlement on the check will take time, and patience, even in the face of an impatient client, could make all the difference in protecting a law firm from the risk of loss. ▲

Endnotes

1. *See, e.g.*, *Simmons, Morris & Carroll, LLC v. Capital One, N.A.*, 49,005, p. 1 (La. App. 2 Cir. 06/27/14), 144 So. 3d 1207, 1209.
2. The use of a foreign check only aggravates that gap in time. Because the check is drawn on a foreign bank, it must be sent out for collection, and U.S. return item deadlines and policies do not apply. *See Foreign Check User Guide*, The Federal Reserve, *https://www.frbservices.org/resources/financial-services/check/foreign-check-processing/foreign-check-user-guide.html* (last visited Feb. 17, 2023). For example, the Federal Reserve warns "[s]ome foreign institutions take longer than twenty [20] business days to pass credit." *Id.*
3. *See* Ala. Code § 7-4-105(2) (1975).
4. *See id.* § 7-4-105(3).
5. *See id.* § 7-4-105(5).
6. *See id.* § 7-4-105(4).
7. *See id.* §§ 7-4-301; 7-4-302.
8. *See* 12 U.S.C. § 4001 *et seq.*
9. *See* Ala. Code § 7-4-207(a) (1975).
10. *See id.*
11. *See id.* § 7-4-207(d).
12. *See id.* § 7-4-207(b), (c).
13. *See id.* § 7-4-201(a).
14. *See id.* § 7-4-214(a).
15. The U.C.C.'s allocation of risk to the depositor will often find additional support in the deposit agreement between a bank and its customer. Such agreements typically include deposit warranties and a provisional crediting mechanism consistent with those found in the U.C.C.
16. For example, the depositor's bank "must exercise ordinary care" in carrying out certain specified duties – e.g., presenting a check for settlement or giving notice of dishonor or nonpayment to the depositor – and provides that timely performance of such duties constitutes ordinary care. *See* Ala. Code § 7-4-202(a), (b) (1975). Additionally, the depositor's bank also has a duty to perform any of its obligations in good faith. *See id.* § 7-1-304.
17. Unfortunately, negligence by the depositor's bank may not provide a strong defense. *See Lucas v. BankAtlantic*, 944 So. 2d 1031, 1035 (Fla. Dist. Ct. App. 2006) (noting in dicta that "the bank's negligence is no defense" to a claim for breach of transfer warranties).
18. 148 N.E. 3d 1243 (Mass. App. Ct. 2020).
19. *Id.* at 1248.
20. *Id.* at 1253 (footnotes omitted).
21. 642 S.W. 3d 530 (Tex. 2022).
22. *Id.* at 534–35.
23. Case No. 2:21-cv-02287, 2022 WL 2819136 (E.D. Pa. July 19, 2022).
24. *Id.* at *4.
25. *Perlberger Law Assocs., P.C. v. Wells Fargo Bk., N.A.*, 552 F. Supp. 3d 490, 494–97 (E.D. Pa. 2021).
26. *Id.* at 498.
27. *Perlberger*, 2022 WL 2819136, at *1.
28. 958 N.E. 2d 77 (N.Y. 2011).
29. *Id.* at 80.
30. *Greenberg, Trager & Herbst, LLP v. HSBC Bk. USA*, 73 A.D. 3d 571, 572 (N.Y. App. Div. 2010).
31. *Id.*
32. *Greenberg, Trager & Herbst*, 958 N.E. 2d at 85.
33. *Id.* at 86–87.
34. 15 Civ. 5266 (ER), 2016 WL 2889060 (S.D.N.Y. May 17, 2016); *see also* Martha Neil, *Law firm loses bid to hold banks accountable for its $287K loss in cashier's check fraud*, ABA Journal, May 23, 2016, (providing additional information regarding case facts), *https://www.abajournal.com/news/article/law_firm_loses_bid_to_hold_banks_accountable_for_its_287k_loss_in_cashiers* (last visited Feb. 17, 2023).
35. *Oliver Zhou*, 2016 WL 2889060, at *1.
36. *Id.* at *5.
37. *Id.* at *6.

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