

Subcommittee on Payments

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2008 Annual Meeting Sarah Howard Jenkins, Chair

At the 2008 annual meeting, the Subcommittee on Payments jointly sponsored a panel presentation entitled *Modernizing Payments Law: Prepaid Debit, Stored Value and Other Forms of Electronic Money* with the Electronic Payments and Financial Services Subcommittee of the Cyberspace Law Committee. The panel presentation was coordinated by Sarah Jane Hughes and Stephen T. Middlebrook, co-chairs of the Electronic Payments and Financial Services Subcommittee. Panelists expressed concerns on numerous issues including: inconsistent regulation of some payment providers and the absence of guidance and regulation of others; existing conflicts between federal and state regulations; consumer confusion; and the need to address prepaid debit, stored value, and other forms of electronic money in any harmonizing of payments law. As a point of comparison, Thaeer Sabri, Chief Executive of Electronic Money Association (London, UK), addressed the European Union's experience in regulating electronic money from 2000 with the Electronic Money Directive which created a carve out for non-bank issuers of prepaid or stored value products to the EU's current efforts in implementing the Payment Services Directive. The Payment Services Directive, described as a comprehensive set of rules applicable to all payment services whether credit, money transfer, or prepaid, must be implemented by all Member States by November 2009.

Recent Authority UCC Article 3 – Comparative Negligence By Stephen C. Veltri

Comparative negligence provisions appear in a number of the loss allocation rules set forth in articles 3 and 4 of the Uniform Commercial Code. These provisions generally allow a person liable for the loss resulting from check fraud to apportion that loss with others whose negligence "substantially contributed" to the success of the fraudulent scheme. Recently, a closely divided Indiana Supreme Court read one of these comparative negligence provisions quite narrowly.

In *Auto-Owners Insurance Company v. Bank One*, 879 N.E.2d 1086 (Ind. 2008), an insurance adjuster opened an account at Bank One in the name of "Auto-Owners, Kenneth B. Wulf." The adjuster, Wulf, then began to steal checks made payable to his employer, Auto-Owners Insurance Company. He indorsed the checks with a rubber stamp that read "Auto-

Owners Insurance For Deposit Only” and deposited them for collection in the Bank One account. The checks were all paid and, in this fashion, Wulf was able to steal over \$500,000 from his employer.

Generally, section 3-405 of the Code fixes the loss for this kind of employee theft on the employer. The section validates any fraudulent indorsement made by an employee who has been given responsibility to handle his employer’s checks. As a result the checks are properly payable. The banks collecting and paying the check are thus absolved from liability and the employer bears any loss the employer cannot recoup from the embezzler. Section 3-405, however, has a comparative negligence provision that reads “If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.”

Auto-Owners Insurance Company contended these provisions allowed it to shift a portion of the loss resulting from Wulf’s thefts to Bank One. The company established that Bank One never requested any documentation from Wulf showing he had the authority to open and use the account. In a 3-2 decision, however, the Indiana Supreme Court held that only negligence connected with the “taking” and “paying” of a check was relevant under section 3-405, not negligence associated with the opening of the account used to collect the check. The court noted section 3-405 was meant to make employers responsible for monitoring their employees and the court believed that purpose would be frustrated by shifting any portion of a loss occasioned by an employee’s fraudulent indorsement to any bank absent evidence that bank was negligent in “taking” or “paying” a check.

Alternatively, the court held that any negligence by Bank One in opening the account was by itself too remote from the check fraud to be said to have “substantially contributed” to the loss. Relying on precedent cited in the official comments, the court asked whether Bank One’s negligence in opening the account was a “substantial factor” in causing Auto-Owner’s loss. The court held it was not. It noted the account was opened some eight years before the thefts were detected. Consequently, the court felt Auto-One’s failure to supervise its employees was the only substantial factor contributing to the loss; any negligence on the part of the bank was not. Accordingly, the court affirmed a summary judgment in favor of Bank One.

Parties looking to mitigate losses suffered due to check fraud frequently seek to apportion the loss with depository banks under the Code’s comparative negligence provisions. The Indiana Supreme Court’s decision should offer these banks some comfort not only with its parsing of the statute to isolate the acts associated with the opening of an account from check collection, but also with its narrowing of the legal standard for causation.