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Appellate Division, Second Department Docket Nos. 2011-03205 and 2011-10990

Court of Appeals
of the
State of New York

CLEMENTE BROS. CONTRACTING CORP.
and JEFFREY A. CLEMENTE,

Plaintiffs-Appellants,

– against –

APRILE HAFNER-MILAZZO a/k/a APRILEANNA MILAZZO,

Defendant,

– and –

CAPITAL ONE, N.A.,

Defendant-Respondent.

AMICUS CURIAE BRIEF OF THE CLEARING HOUSE ASSOCIATION L.L.C.

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 500.1(f) of the Rules of this Court, The Clearing House Association L.L.C. ("The Clearing House") hereby states that it is not a subsidiary of any other entity. The Clearing House is a limited liability company and as such has no shareholders. Rather, each member holds a limited liability company interest in The Clearing House that is equal to each other member's interest. The Clearing House has one affiliate, The Clearing House Payments Company L.L.C.

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

Established in 1853, The Clearing House Association L.L.C. ("The Clearing House") is the United States' oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits.[1] The Clearing House is a non-partisan advocacy organization representing, through regulatory comment letters, *amicus* briefs and white papers, the interests of its member banks on a variety of important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated clearing-house, funds-transfer, and check-image payments made in the United States.[2] The member banks of The Clearing House process millions of checks each year. The Clearing House and its member banks thus have a substantial interest in the issue presented by this Court in its request for *amicus curiae* participation.

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[1] The members of The Clearing House are Banco Santander, S.A.; Bank of America, N.A.; The Bank of New York Mellon; The Bank of Tokyo-Mitsubishi UFJ Ltd.; Branch Banking and Trust Company; Capital One, N.A.; Citibank, N.A.; Comerica Bank; Deutsche Bank Trust Company Americas; Fifth Third Bank; HSBC Bank USA, N.A.; JPMorgan Chase Bank, N.A.; Manufacturers and Traders Trust Company; PNC Bank, N.A.; The Royal Bank of Scotland PLC; State Street Bank and Trust Company; The Toronto-Dominion Bank; UBS AG; U.S. Bank N.A.; and Wells Fargo Bank, N.A.

[2] *See* http://www.theclearinghouse.org.

Courts within and without New York have uniformly held that the UCC permits a bank and its customer to agree to shorten the one-year period in UCC § 4-406(4) within which a customer must review its bank statement and report any forged items. Departing from this long line of precedent would fundamentally impact the business practices of New York banks (including the member banks of The Clearing House) because it would expose them to substantial additional losses from check fraud and would create inconsistent obligations under the laws of the various states in which they operate. Moreover, as discussed below, eliminating the ability of a bank and its customer to freely agree to a shorter time period within which the customer must review its statement and report a forgery to its bank would unintentionally ***increase*** the amount of fraud against banks and their customers alike. This is because there would be no obligation or incentive on the part of customers to exercise diligence in reviewing their account statements for fraud in a timely manner, and frauds would be left unchecked to continue for a substantial period of time.

Because checks are still utilized as a common form of payment, it is essential that there be an effective system for promptly identifying and dealing with instances of check fraud. Banks – and their customers – have a vital interest in the preservation of that system. Eliminating the ability of banks to agree with their customers to shorten the one-year period in UCC § 4-406(4) would impose

undue costs on New York banks and their customers and discourage customers from taking reasonable precautions to protect against fraud.

INTRODUCTION

The Clearing House submits this brief as *amicus curiae* and urges the Court to affirm the Order of the Appellate Division, Second Department that affirmed the dismissal of plaintiffs' claims.

This brief addresses an issue of importance to banks that operate in New York – maintaining the ability of banks and their customers to contractually agree to shorten the one-year time period provided in UCC § 4-406(4) within which a customer must make a claim to its bank for payment of an altered or forged item. The Clearing House's member banks and other financial institutions have long understood that such provisions – which are included in substantially the same form in all banking customer account agreements at all of The Clearing House's member banks – are valid and proper under the UCC and may be used to shorten the one-year period.

On February 8, 2011, the Supreme Court, Commercial Division, dismissed the claims of plaintiffs Clemente Brothers Contracting Corp. ("Clemente Contracting") and Jeffrey A. Clemente. The Supreme Court ruled that plaintiffs' claims against Capital One were precluded because Clemente Contracting had failed to notify Capital One of forged items on its checking account within 14 days

of delivery of its account statement and copies of the forged checks, as required by the rules and regulations of North Fork Bank (Capital One's predecessor) and as required by a corresponding corporate resolution of Clemente Contracting expressly agreeing to this provision. *See Clemente Bros. Contracting Corp. v. Hafner-Milazzo*, No. 21385-10, 2011 WL 675564 (Sup. Ct. Suffolk Cnty. Feb. 8, 2011). Indeed, plaintiffs did not report some of the forgeries to Capital One for more than two years after they occurred. *Id.* On November 14, 2012, the Appellate Division, Second Department unanimously affirmed, finding that Capital One had established its prima facie entitlement to judgment as a matter of law by submitting evidence that the monthly account statements including the forged items were made available to plaintiffs, and that plaintiffs had failed to discover and report any of the alleged forgeries within the agreed 14-day period. *See Clemente Bros. Contracting Corp. v. Hafner-Milazzo*, 100 A.D. 3d 677, 679 (2d Dep't 2012).

This Court granted leave to appeal and invited *amicus curiae* briefing on the question of "whether a bank and its customer may shorten the statutory time period provided for in UCC 4-406 within which the customer must make a claim to its bank for payment of an altered or forged item." *See* Notice to the Bar dated June 5, 2013.

As set forth below, the Appellate Division properly held that a bank and its customer may agree to shorten the statutory time period within which the customer must notify its bank that the bank has paid on a forged check. Section 4-103(1) of the UCC explicitly provides that a bank and its customer may agree to vary the terms of the provisions of Article 4. Consistent with this provision, New York courts and courts nationwide have uniformly upheld agreements between banks and their customers shortening the one-year statutory period in UCC Section 4-406(4), including agreements where the time period is shortened to 14 days.

As discussed below, there are sound policy reasons why this Court should, like appellate courts in other states that have addressed the issue, hold that a bank and its customers may agree to shorten the default time period in Section 4-406(4). The most important reason is the public policy implication of prohibiting New York banks from agreeing with their clients to shorten the default time period. Simply stated, the unintended – but undoubted – consequence of a decision prohibiting parties from agreeing to shorten the time period would be to allow fraud to grow undetected: A customer knows if it intended to authorize a payment to a payee. When a customer examines its statement with "reasonable promptness," fraud is averted. The sooner the customer examines its statement, the more fraud is averted. Indeed, the Official Uniform Comment to Section 4-406

explicitly recognizes the importance of ensuring that a customer examine its bank statement promptly upon receipt:

> One of the most serious consequences of failure of the customer to [exercise reasonable care and promptness to examine its bank statement] is the opportunity presented to the wrongdoer to repeat his misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine his statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop payment of further items.

UCC § 4-406 cmt. 3. Accordingly, we urge this Court to affirm the decision of the Appellate Division.

ARGUMENT

I. THE APPELLATE DIVISION PROPERLY HELD THAT A BANK AND ITS CUSTOMER MAY AGREE TO SHORTEN THE STATUTORY TIME PERIOD WITHIN WHICH THE CUSTOMER MUST NOTIFY ITS BANK THAT THE BANK HAS PAID ON A FORGED CHECK

A. Article 4 Of The UCC Provides Two Distinct Situations Where The Risk Of Loss With Respect To Forged Checks Shifts To A Bank's Customer

As this Court observed 25 years ago, "Articles 3 and 4 of the UCC envision a series of shifting burdens of risk of loss with respect to forged checks. Initially, the law places the risk of forgeries on the bank. A forged signature is 'wholly inoperative as that of the person whose name is signed' (UCC § 3-404(1)), and therefore is not 'properly payable,' and the bank cannot debit the depositor's account (UCC § 4-401(1))." *Putnam Rolling Ladder Co., Inc. v. Mfrs. Hanover Trust Co.*, 74 N.Y.2d 340, 345 (1989); *see Monreal v. Fleet Bank*, 95 N.Y.2d 204,

207 (2000). The bank may avoid this strict liability when its customer does not inspect its statement and canceled checks with reasonable care and promptness.

First, as discussed in *Putnam*, under UCC § 4-406(2) – a section of the UCC that is ***not*** at issue in the present appeal – the burden of loss on forged checks can be shifted to the customer in certain circumstances where the bank establishes that the customer failed to exercise reasonable care to examine its bank statement. As the Court observed, the UCC "imposes certain reciprocal duties on the customer. Failure to comply with those duties shifts the burden of loss from bank to customer. UCC 4-406[(1)] imposes upon a customer the duty to inspect its statement and canceled checks with reasonable care and promptness. [Under UCC § 4-406(2)], [f]ailure to do so results in the preclusion of any claim against the bank for repeated forgeries by the same wrongdoer after the first such forged check and statement reflecting it are made available to the customer." *Putnam*, 74 N.Y.2d at 345. Section 4-406(2) "reflects the fact that the customer is generally in a better position than the bank to prevent repetition of forgery":

> A skillful forgery may not be detected by even a careful bank inspector, but the customer to whom the canceled check and statement are returned should know whether or not it actually intended to authorize payment of its funds to the named payee. Thus, the shifting burden of loss is intended as well to encourage the parties to use reasonable care in situations where, from a systemic point of view, that is the efficient loss-avoidance mechanism.

Id.[3]

Separately, a bank may avoid strict liability for payment on forged checks where – ***regardless of care or lack of care of either the customer or the bank*** – a customer that is provided with a copy of the checks paid on its account does not timely report a forgery to its bank. Section 4-406(4) – which ***is*** at issue in the present appeal – provides that:

> Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration on the face or back of the item . . . is precluded from asserting against the bank such unauthorized signature . . . or such alteration.

UCC § 4-406(4). As Chief Judge Kaye stated in describing Section 4-406(4):

> This provision is derived from the depositor's common-law duty to examine drafts and statements furnished by the bank and report alterations or forgeries within a reasonable time. The same policy underlies UCC 4-406(4): with the depositor in the better position to discover an alteration of the check or forgery of his or her own signature, the absolute time limit places the burden on the depositor to examine the statement and items with reasonable promptness. "***[T]here is little excuse for a customer not detecting an alteration of his own check or a forgery of his own signature***" (UCC 4-406, Comment 5).

Woods v. MONY Legacy Life Ins. Co., 84 N.Y.2d 280, 284 (1994) (internal citations omitted) (emphasis added).

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[3] If a bank invokes Section 4-406(2) (which, again, is not at issue here), Section 4-406(3) "shifts the loss of even repeated forgeries back to the bank when the customer, although in breach of its own duty to inspect its canceled checks and statements, is able to establish that the bank lacked ordinary care in paying the forged checks." *Putnam*, 74 N.Y.2d at 345-46.

Thus, the policy reasons behind Sections 4-406(2) and 4-406(4) are similar: Fraud can be stopped when a customer examines its statement with "reasonable promptness."

B. The UCC Explicitly Permits A Bank And Its Customer To Agree To Vary The Statutory Time Period Within Which The Customer Must Notify Its Bank That The Bank Has Paid On A Forged Check

The UCC is clear that the provisions in Article 4 may be varied by agreement of the parties. Specifically, Section 4-103(1) provides:

> The effect of the provisions of this Article may be varied by agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

UCC § 4-103(1). The Official Uniform Comments to the UCC make plain that "[s]ubsection (1) confers blanket power to vary all provisions of the Article by agreements of the ordinary kind. . . . The agreement may be direct, as between the owner [of the account] and the depositary bank. . . . It may be with respect to a single item; or to all items handled for a particular customer, e.g., a general agreement between the depositary bank and the customer at the time a deposit account is opened." *Id. cmt*. 2.

Section 4-103(1)'s "blanket power to vary all provisions" of Article 4 permits agreements to vary the one-year default notice period in Section 4-406(4).

On its face, Section 4-103(1) permits a bank and its customer to agree to vary the effect of a provision of Article 4 as long as the agreement does not "disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or [] limit the measure of damages for such lack or failure." An agreement to shorten the default notice period "does not absolve [the bank] of its duty to exercise ordinary care or good faith, nor does it limit the measure of damages. Instead, [it] merely varies the effect of [§ 4-406(4)] in that the period of time in which [the customer] must report an unauthorized signature or alteration on an item, without having its claim for losses precluded by the bar in [§ 4-406(4)] is shortened . . ." *Nat'l Title Ins. Corp. Agency v. First Union Nat'l Bank*, 559 S.E.2d 668, 671 (Va. 2002) (upholding agreement reducing one-year period in substantively identical Va. Code § 8.4-406(f) to a period of 60 days); *see Am. Airlines Emps. Fed. Credit Union v. Martin*, 29 S.W.3d 86 (Tex. 2000) (upholding agreement reducing one-year period in substantively identical Tex. Code 4.406(f) to a period of 60 days: "The UCC draws a careful distinction between disclaiming liability, which it does not permit the bank to do, and limiting the time period during which a bank can be charged with liability for paying unauthorized items, which it permits the bank to do.).

Thus, under the plain language of Section 4-103(1), a bank and its customer may agree to shorten the one-year default notice period provided by

Section 4-406(4), and that should be dispositive of the question on which the Court invited *amicus curiae* participation. *See In re World Trade Ctr. Bombing Litig.*, 17 N.Y.3d 428, 442-443 (2011) ("As a matter of statutory construction, a court must 'attempt to effectuate the intent of the Legislature' and 'where the terms of a statute are clear and unambiguous, the court should construe it so as to give effect to the plain meaning of the words used.'") (internal citations omitted).

C. New York Courts And Courts Nationwide Have Uniformly Upheld Agreements Between Banks And Their Customers To Shorten The Statutory Time Period In UCC Section 4-406(4)

New York courts have repeatedly acknowledged the ability of banks and their customers to contractually agree to shorten the period within which the customer must notify its bank that the bank has paid on a forged check, and have specifically acknowledged the ability of the parties to agree to shorten the period to 14 days.

The Second Department held in this case, of course, that the "parties may shorten the one-year notice period [in UCC § 4-406(4)] by agreement" and noted that "[h]ere, the parties, by agreement, shortened the one-year period to 14 days." *Clemente Bros. Contr. Corp. v. Hafner-Milazzo*, 100 A.D.3d 677, 679 (2d Dep't 2012). This holding was in accord with prior Second Department decisions that affirmed the dismissal of claims against a bank for paying on forged checks where a "deposit account agreement . . . required the plaintiff to notify it of

any discrepancy in the bank statement within 15 days after receipt of the statement," *Radon Constr. Corp. v. Colwell*, 248 A.D.2d 366, 366 (2d Dep't 1998), and where an agreement governing the customer's account required the customer to notify the bank of an altered check "within 30 days after his account statement was mailed to him," *Qassemzadeh v. IBM Poughkeepsie Emps. Fed. Credit Union*, 167 A.D.2d 378, 378 (2d Dep't 1990). *Cf. Catalano v. Marine Midland Bank*, 303 A.D.2d 617, 618 (2d Dep't 2003) (plaintiffs waived right to bring action against bank by failing to notify bank of unauthorized withdrawals within 14 days after account statements itemizing transactions were made available to them, as required by deposit account agreement); *J. Sussman, Inc. v. Mfrs. Hanover Trust Co.*, No. 5367/85, 1986 WL 213396 (Sup. Ct. Queens Cnty. Dec. 11, 1986), *aff'd*, 140 A.D.2d 668 (2d Dep't 1988) (affirming dismissal of claims against bank where plaintiff did not notify bank of forged checks within 14-day period agreed between bank and depositor).

The First Department has similarly recognized that, where an agreement provides that a bank is not responsible to its customer for losses on forged checks unless the customer provides written notice of the forgery within a set period of time after receipt of the monthly statement containing the forged check, "the effect of such agreement [is] to abbreviate [the] statutory one-year condition precedent" found in UCC § 4-406(4). *Gluck v. JPMorgan Chase Bank*,

12 A.D.3d 305, 306 (1st Dep't 2004) (affirming dismissal of claims against bank where deposit account agreement required customer to provide notice within 60 days of receipt of statement containing forged item). The First Department has dismissed a customer's claims where a bank's "rules and regulations [] required notification of forgeries within 30 days of the applicable statement's closing date," *Josephs v. Bank of N.Y.*, 302 A.D.2d 318, 318 (1st Dep't 2003); *see Garage Mgmt. Corp. v. Chase Manhattan Bank*, 22 A.D.3d 432, 433 (1st Dep't 2005) (citing *Gluck*), and where a customer's agreement with its bank "provided that statements of account would be considered correct for all purposes unless [the customer] gave the bank written notice, within six months, of any forged endorsement . . .." *Retail Shoe Health Comm'n v. Mfrs. Hanover Trust Co.*, 160 A.D.2d 47, 50 (1st Dep't 1990).

Relying on this uniform appellate precedent, lower state and federal courts in New York have repeatedly held that the "one-year time period in UCC 4-406(4) may be shortened pursuant to the terms and conditions of the bank account." *In re the Estate of Ray*, 24 Misc. 3d 285, 289, 874 N.Y.S.2d 891 (Surr. Ct. Kings Cnty. 2009) (agreed terms and conditions required customer to notify bank of errors within 60 days of mailing or transmission of monthly statement); *see Fundacion Museo de Arte Contemporaneo de Caracas-Sofia Imber v. CBI-TDB Union Bancaire Privee*, 996 F. Supp. 277, 291 (S.D.N.Y 1998) (one-year "default

standard" in Section 4-406(4) was validly shortened to 30 days by agreement); *Wells v. Bank of N.Y.*, 181 Misc. 2d 574, 578, 694 N.Y.S.2d 570, 574 (Sup. Ct. N.Y. Cnty. 1999) (customer "precluded from continuing any action based on alleged forged checks, where it did not report the alleged fraud within 15 days after the monthly statement showing the discrepancy was received by it").

In a decision that is frequently cited with approval by courts addressing this issue in other states, a New York court held that a customer and its bank could validly agree to shorten the one-year default period in Section 4-406(4) to 14 days. *See Parent Teacher Ass'n, Pub. Sch. 72 v. Mfrs. Hanover Trust Co.*, 138 Misc. 2d 289, 295, 524 N.Y.S.2d 336 (Civ. Ct. Bronx Cnty. 1988) (Stallman, *J.*). The court noted that "[c]onditions precedent and shortened periods of limitation similar to those at issue here have been routinely accepted in the banking relationship, usually without extensive analysis. Such provisions are not only compatible with statute and case law; they are in accord with public policy by limiting disputes in a society where millions of bank transactions occur every day." *Id.* at 295 (internal citations omitted).[4]

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[4] Contrary to the plaintiffs' argument, the Third Department and Fourth Department have not held to the contrary. The cases to which plaintiffs cite, *Herzog, Engstrom & Koplovitz v. Union National Bank*, 226 A.D.2d 1004 (3d Dep't 1996) and *Aikens Construction of Rome, Inc. v. Simons*, 284 A.D.2d 946 (4th Dep't 2001), dealt with UCC § 4-406(2), which, as discussed above at Point I(A), is not at issue here. *Herzog* does not mention UCC § 4-406(4), and neither case explicitly addresses whether the one-year default provision in that section can be modified by agreement. We would not assume that the Third and Fourth Departments intended to create a split among the Departments *sub silentio* or to disagree with the decisions of the First and

Courts outside New York have similarly held that the one-year "default standard" in Section 4-406(4) of the UCC may be shortened by agreement between a bank and its customer. Research reveals that appellate courts in 11 states have approved of a bank and its customer agreeing to shorten the time period in Section 4-406(4) (or its analogue in that state's UCC), and we are not aware of any appellate court holding that Section 4-406(4)'s one-year time period may not be shortened. The courts holding that the time period may be shortened include the highest courts of four states, and they approved limits as short as 20 days. *See Stowell v. Cloquet Co-op Credit Union*, 557 N.W.2d 567, 570-72 (Minn. 1997) (upholding 20-day notice provision); *Peters v. Riggs Nat'l Bank, N.A.*, 942 A.2d 1163, 1168 (D.C. 2008) (approving shortening of time period to 60 days); *Nat'l Title Ins. Corp. Agency v. First Union Nat'l Bank*, 559 S.E.2d 668, 672 (Va. 2002) (same); *Am. Airlines Emps. Fed. Credit Union v. Martin*, 29 S.W.3d 86, 98 (Tex. 2000) (same, noting that this was "consistent with the UCC" and that "other jurisdictions have enforced shortened notice periods ranging from fourteen to sixty

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Second Departments when it is not apparent that the issue was even before their courts. Nor is Clemente Contracting helped by this Court's decision in *Regatos v. North Fork Bank*, 5 N.Y.3d 395 (2005). That case addressed whether parties could agree to vary the one-year time period for reporting fraudulent electronic funds transfers set forth in UCC § 4-A-505. *Id.* at 402. *Regatos* concerned a section of Article 4-A, *not* Article 4. Different Articles of the UCC have different provisions governing the ability of parties to vary their obligations, *compare* UCC § 4-A-204(2) *with* UCC § 4-103(1), and UCC § 4-103(1) was not at issue in *Regatos*.

days").[5] We have set out in the margin the decisions of intermediate appellate courts of seven states (and other lower state and federal courts) that have similarly approved of agreements to shorten the "default standard" time period to as few as 14 days.[6]

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[5] Additionally, although its opinion does not explicitly reference the UCC, the Supreme Court of Alabama has held that a claim against a bank for payment on a forged check was precluded where the account agreement provided that the customer must notify the bank of any errors within 10 days after the closing date of the statement. *See McCulley v. SouthTrust Bank of Baldwin Co.*, 575 So.2d 1106, 1107-08 (Ala. 1991).

[6] *See Borowski v. Firstar Bank Milwaukee, N.A.*, 579 N.W.2d 247, 252-53 (Wis. Ct. App. 1998) (upholding 14-day period where policy underlying Article 4 requires "persons to be vigilant in the conduct and safeguarding of their own affairs"); *Groue v. Capital One*, 47 So.3d 1038, 1042-43 (La. Ct. App. 2010) (contractual 30-day time period to notify bank of altered checks barred account holder's action against bank); *Napleton v. Great Lakes Bank, N.A.*, 945 N.E.2d 111, 119 (Ill. App. Ct. 2011) (approving shortening of notice provision to 30 days); *Freese v. Regions Bank, N.A.*, 644 S.E.2d 549, 552 (Ga. Ct. App. 2007) (upholding 30-day notice provision); *FCT Elecs., LP v. Bank of America, N.A.*, No. CV 106002699, 2011 WL 4908850, at *11 (Conn. Super. Ct. Sept. 22, 2011) ("[30-day] shortened statute of limitations contained in the Deposit Agreement is not contrary to public policy and enforcing the shorter reporting requirements is consistent with decisions from other jurisdictions"); *Absolute Drug Detection Servs., Inc. v. Regions Bank*, 116 So.3d 1162, 1166-67 (Ala. Civ. App. 2012) (deposit agreement that shortened Alabama's 180-day period for reporting suspected unauthorized transactions to 30 days acted as "absolute[] bar[] [to] any claims [plaintiff] might otherwise have asserted against [defendant bank] based on those allegedly unauthorized transactions," without regard to the care exercised by bank); *Century Constr. Co., LLC v. BancorpSouth Bank*, 117 So.3d 345, 348-49 (Miss. Ct. App. 2013) (approving shortening of notice provision to 60 days); *W.J. Miranda Constr. Corp. v. First Union Nat'l Bank*, No. 98-29112-CA11, 1999 WL 1567728 (Fla. Cir. Ct. Sept. 24, 1999) (same); *Kansas City Screw Prods. Inc. v. Cent. Bank of Kansas City*, No. 1216-CV04214, 2013 WL 5976026, *1 (Mo. Cir. Ct. June 19, 2013) ("substantial weight" should be given to authority from other jurisdictions, and one-year period in the UCC may be limited to 60 days) (citing *Borowski*, 579 N.W.2d at 252-53); *Chirila v. Bank of America, N.A.*, No. 3:11-cv-0005, 2013 WL 315218, at *5 (D. Nev. Jan. 25, 2013) ("three-year statute of limitations on actions against a bank to recover amounts drawn by forged checks may be varied by agreements such as the [60-day] Agreement in this case because Nevada law expressly provides for such agreements"); *Travelers Cas. and Sur. Co. of America v. Bank of America, N.A.*, No. BC 390020, 2009 WL 3735308 (Cal. Super. Ct. May 22, 2009) (approving shortened notice provision of 60 days); *see also Graves v. Wachovia Bank, Nat'l Ass'n*, 607 F. Supp. 2d 1277, 1280 (M.D. Ala. 2009) (deposit agreement shortened Alabama's 180-day period for reporting forged checks to 40 days); *Bank of America, N.A. v. Putnal Seed & Grain, Inc.*,

D. Assuming Arguendo That There Is Any Restriction On The Ability Of A Bank And Its Customer To Vary The Statutory Time Period In UCC Section 4-406(4), Agreements To Shorten This Period To 14 Days Are Permissible Under The UCC

Most courts (both within and without New York) that have held that a bank and its customer may agree to vary the one-year default period in Section 4-406(4) have not identified any statutory or other limit on how short (or long) the parties may agree to make the time period. Those courts that have identified constraints on the ability of parties to agree to vary the time period have generally said that the shortened time period will be upheld unless it is "***manifestly unreasonable***," citing to the language set forth in UCC §§ 4-103(1) and 1-102(3). *See, e.g.*, *Fundacion Museo de Arte Contemporaneo*, 996 F. Supp. at 291 (one-year "default standard" in Section 4-406(4) could be "varied by agreement so long as the substituted standard is not manifestly unreasonable"); *P.T.A., Pub. Sch. 72*, 138 Misc. 2d at 292 (shortened time frame may not be "unconscionable or manifestly unreasonable, or the product of overreaching") (citing *cmt.* to UCC § 4-103); *Borowski*, 579 N.W.2d at 251 ("[w]e apply the 'manifestly unreasonable' test

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965 So.2d 300, 301 (Fla. Dist. Ct. App. 2007) (deposit agreement that required customer to notify bank of problems or unauthorized transactions within 60 days was valid condition precedent to customer's claim for reimbursement). We note that one lower court said in dicta that an agreement to shorten the statutory period to 60 days was "manifestly unreasonable" because the agreement reduced the statutory time period by too great a percentage, the bank did not obtain a knowing and voluntary waiver from the plaintiff, and the plaintiff did not receive any benefit as a result of the shortening of the provision. *See In re Clear Advantage Title, Inc.*, 438 B.R. 58, 68 n.6 (Bankr. D.N.J. 2010). This decision is inapposite given that, here, Clemente Contracting had issued a corporate resolution expressly recognizing the 14-day provision.

[in Section 4-103(1)] to the agreement between [the bank] and [its customer] to reduce the one-year period to fourteen days"); *Stowell*, 557 N.W.2d at 571-72 (applying "manifestly unreasonable" test); *Freese*, 644 S.E.2d at 552 (same). And one court has framed the question as whether the "agreed-upon time for giving notice is unreasonably short," in which case the agreement would "in effect disclaim[] liability for a lack of ordinary care" and be unenforceable. *Am. Airlines*, 29 S.W.3d at 97.

It is not clear to us that the "manifestly unreasonable" language in Section 4-103(1) should, in fact, apply to an agreement to vary the one-year period in Section 4-406(4) (at least under New York's UCC). As noted above, Section 4-103(1) provides that:

> The effect of the provisions of this Article may be varied by agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

UCC § 4-103(1). The "manifestly unreasonable" language does not appear to modify the first clause of the Section, which gives parties the ability to agree to vary the effect of the provisions of Article 4. Instead, the "manifestly unreasonable" language appears to be a limitation only on an agreement as to the standards by which a bank's responsibility for its own lack of good faith or failure to exercise ordinary care is to be measured (which is not at issue in Section 4-

406(4), as that section explicitly applies "[w]ithout regard to care or lack of care of either the customer or the bank"). Indeed, if the legislature intended to prohibit ***every*** freely reached contractual variation of Article 4 that was "manifestly unreasonable," Section 4-103(1) would presumably have stated so explicitly (*e.g.*, stating "The effect of the provisions of this Article may be varied by agreement, except that no agreement may be manifestly unreasonable, . . .").

This Court has observed in a different context that Section 4-103(1) provides the parties with broad discretion to vary the terms of Article 4 in circumstances where, as here, a bank's duty of care is not implicated. *See David Graubart, Inc. v. Bank Leumi Trust Co.*, 48 N.Y.2d 554, 560 (1979) (holding that "the Code's requirements can be modified by agreement to conform them with commercial usage, in or out of banking circles, so that parties may advantage themselves of the 'wisdom born of accumulated experience'").[7] Other courts have similarly held that Section 4-103(1) provides the parties with broad discretion to agree to amendments of Article 4's provisions that do not implicate a bank's duty of care. *See, e.g., Scott Stainless Steel, Inc. v. NBD Chicago Bank*, 625 N.E.2d 293, 297 (Ill. App. 1st Dist. 1993) ("[t]he clear language of section 4-103(1)

[7] The *Graubart* court did not need to address (or apply) the "manifestly unreasonable" language in Section 4-103(1) because the UCC provision at issue, Section 4-301, did not implicate the bank's duty of care. Instead, because the agreement was to a *procedure* other than that specifically approved by Article 4, the Court noted that the UCC required that the new procedure be "reasonable." *Id.* at 561-62 (citing UCC § 4-103(4)). Section 4-103(4) is not applicable here because the variation to Section 4-406(4) is not a procedure.

authorizes a bank to enter into an agreement with its customers that modifies the provisions of Article 4 of the Code," and "[t]he only limitations placed upon any such agreement is that the bank may not disclaim responsibility for its own lack of good faith or failure to exercise ordinary care"); *Lema v. Bank of America, N.A.*, 826 A.2d 504, 510-11 (Md. 2003).

Assuming *arguendo*, however, that "manifestly unreasonable" or "unreasonably short" is the appropriate standard, courts that have applied those standards have held that strong policy reasons support the conclusion that an agreement to limit the period in Section 4-406(4) to as few as 14 days is not "manifestly unreasonable." *See Borowski*, 579 N.W.2d at 252-53 ("we conclude that the fourteen-day period is not 'manifestly unreasonable' as that term is used in § [4-103(1)]"); *P.T.A., Pub. Sch. 72*, 138 Misc. 2d at 295 (agreement that eliminated liability of the bank unless customer provided notice within 14 days of any errors in the customer's statement was not "manifestly unreasonable");[8] *see also, e.g.*, *Stowell*, 557 N.W.2d at 571-72 (20-day notice provision not manifestly unreasonable); *Fundacion Museo de Arte Contemporaneo*, 996 F. Supp. at 291 (agreement that bank be notified of any irregularities in an account statement

[8] *See also* Barkley Clark & Barbara Clark, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS § 3.01[3][c][ii] (rev. ed. 2013) ("The reduction in notice from one year to fourteen days does not seem out of line, although a bank would be pushing it by attempting to reduce the period further.").

within 30 days of mailing was not manifestly unreasonable even "though both parties knew the Venezuelan mail delivery system was unreliable").

Further evidence that 14 days is not "manifestly unreasonable" is found in the text of Section 4-406 itself. Under Section 4-103(3), "[a]ction or non-action approved by [] Article [4] . . . constitutes the exercise of ordinary care." Under Section 4-406(1), a customer must examine its bank statements and paid items "promptly" and notify its bank "promptly" if it discovers a forged item. Under Section 4-406(2)(b), the customer must give such notice within "a reasonable period not exceeding fourteen calendar days" or the customer is precluded from asserting claims for any subsequent forged item caused by the same wrongdoer. Thus, a requirement that a customer notify its bank of a forged check within 14 days of the date of its bank statement is not manifestly unreasonable – but is reasonable as a matter of law.

II. THERE ARE SOUND POLICY REASONS WHY THIS COURT SHOULD, LIKE OTHER APPELLATE COURTS THAT HAVE ADDRESSED THE ISSUE, HOLD THAT A BANK AND ITS CUSTOMERS MAY AGREE TO SHORTEN THE STATUTORY TIME PERIOD IN UCC SECTION 4-406(4)

In its Notice to the Bar inviting *amicus curiae* participation, the Court stated that "[o]ne of the issues on appeal is whether a bank and its customer may shorten the statutory time period provided for in UCC 4-406 within which the customer must make a claim to its bank for payment of an altered or forged item."

As demonstrated above, both the text of the UCC and the uniform holding of courts nationwide suggest that that question – *i.e.*, whether the time period may be shortened by agreement ***at all*** – should plainly be answered in the affirmative. We submit that if the separate question of whether that statutory time period may be shortened by agreement ***to 14 days*** is to be reached, it, too, should be answered in the affirmative.

First, affirming the Appellate Division's holding that the time period may be so shortened would avoid a significant split in authority over the interpretation of the UCC. This Court has made plain that "[o]ne of the Uniform Commercial Code's basic purposes is to 'make uniform the law among the various jurisdictions.'" *Monreal*, 95 N.Y.2d at 209; *see also Woods*, 84 N.Y.2d at 285 (recognizing that consideration of decisions from other jurisdictions interpreting the UCC to help achieve uniformity furthers "the goal of the UCC – 'to simplify, clarify and modernize the law governing commercial transactions' (UCC 1-102(2)(a))"). As discussed above (Point I(C)), appellate courts across the country have uniformly upheld agreements between banks and their customers to shorten the statutory time period in UCC § 4-406(4), and have upheld agreements to shorten the period to 14 days. A contrary statement by this State's highest court would create a significant split in authority that would undermine a primary goal of the UCC – to make uniform the law among the various jurisdictions. *See* UCC §

1-102(2)(c). It would also create conflicting obligations for the numerous New York banks that also operate without the State.

More important is the public policy implication of prohibiting New York banks from agreeing with their clients to shorten the default time period in Section 4-406(4). As noted above, the unintended but undoubted consequence of a decision denying the parties' ability to shorten the limit would be to encourage fraud and to allow fraud to go (and grow) undetected. The Clearing House's member banks have long recognized that the very significant losses caused by check fraud can be minimized if customers review their statements promptly and alert banks to fraudulent activity on their accounts as soon as they are aware of it. On the other hand, if a customer has the invariable right to be made whole for fraud so long as it provides notice of that fraud to its bank within many months or up to a year, banks would be left without the ability to obligate customers to take reasonable steps to detect check fraud, and there would be no incentive for the customer to exercise any diligence in reviewing its account for fraud in a timely manner. Of course, if fraud is not detected until a year (or even months) after the fact, the potential for identifying the perpetrator – much less recovering the stolen funds – is severely diminished, and the potential for repeated fraud by the same offender grows substantially. Those consequences can be avoided by permitting banks and their customers to continue their decades-long standard practice of

agreeing to a shorter time period within which the customer will review its statement and alert its bank if there are any forged or altered items.

As noted above, The Clearing House's member banks and other banks and their customers routinely agree to limit the statutory time period within which to report check fraud, typically to a period of 30 or 60 days after the receipt of statement on account. If New York were to suddenly change course, after decades of jurisprudence acknowledging the intention of the drafters of the UCC to allow parties to limit the notice period, that would have serious repercussions for banking in New York.

First, as described above, removing the parties' freedom of contract with respect to this issue and rigidly restricting the parties to a one-year reporting period would facilitate a greater amount of fraud, impose greater losses on banks, and would ultimately increase the costs associated with providing checking accounts and raise the cost of banking to customers.

It would also impose a burden on New York banks to discern the authenticity of transactions that would be far more easily monitored by customers. It is of course the customer who can most readily discern the authenticity of a signature purported to be his or her own and recall whether or not a certain funds transfer was authorized. *See* UCC § 4-406 *cmt*. 1 (1990) ("If the customer made a record of the issued checks . . . the customer should usually be able to verify the

paid items shown on the statement of account and discover any unauthorized or altered checks."). Because the customer is in a better position than the financial institution to prevent fraudulent transactions made against its account, it is vital that banks be permitted to enlist their customers' assistance in promptly detecting and preventing fraud. This is best accomplished by permitting a customer to agree to shorten the period within which it will notify its bank of a forged or altered check.

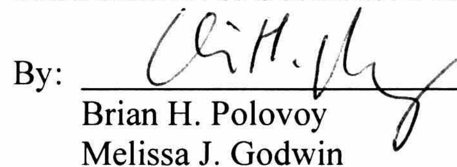
CONCLUSION

The Clearing House respectfully urges the Court to affirm the decision of the Appellate Division.

Dated: February 10, 2014

Respectfully submitted,

SHEARMAN & STERLING LLP

By: 

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