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Paper Tigers? Cashier's Checks, Nonpayment, and the Holder in Due Course Debate

By Thomas O. Ashby and Eli A. Rosenberg*

This article describes competing views of cashier's checks as equivalents of cash or, more properly, similar to ordinary negotiable instruments but with significant statutory glosses.

A "paper tiger" is more teeth than bite. The term denotes something that seems very strong and dangerous but is really weak and unimpressive. Cashier's checks are subject to at least two debates about dishonor important for American banking law. This article is intended to vanquish some paper tigers among the debaters' contentions and to highlight other contentions that rightly help shape decisions of banks, bank customers, and judges.

This article describes competing views of cashier's checks as equivalents of cash or, more properly, similar to ordinary negotiable instruments but with significant statutory glosses. Because the ordinary instrument concept makes holder in due course status important, this article discusses circumstances affecting when a presenter of a cashier's check is a holder in due course. Banks or bank customers considering these circumstances will be better analysts of whether a holder's contentions in favor of honoring a cashier's check are paper tigers or not.

RECENT HISTORY ABOUT CASHIER'S CHECKS AND NONPAYMENT

A "cashier's check" is a draft drawn by a bank on itself, the bank.[1] As such, cashier's checks have been governed largely by Uniform Commercial Code

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Legal ethics suggest that, among other duties, an attorney should be prepared to zealously advocate the position of the attorney's client. The authors believe they and other advocates appropriately could advocate different positions on some of this article's topics from time to time, depending on the client being represented.

[1] Revised U.C.C. § 3-104(g).

("U.C.C.") Article 3 and Federal Reserve Regulation CC. The law of nonpayment of cashier's checks is largely the law of Article 3 and its interpretation by courts and scholars.[2]

Legal authorities frequently use terms with trade usage in discussing cashier's checks. One is "issue," which means "the first delivery of an instrument by the maker or drawer . . . for the purpose of giving rights on the instrument to any person."[3] For a cashier's check, the "issuer" or "issuing bank" is the bank that draws and delivers it.[4]

Article 3 was revised by the National Council of Commissioners of Uniform State Laws ("NCCUSL") in 1990.[5] The respective versions of Article 3 are referred to as "Revised Article 3" and "pre-Revision Article 3." Before the revision, lawyers and judges sharply disagreed about whether cashier's checks were more like cash or more like a promissory note or other ordinary negotiable instrument payable at sight ("ordinary instrument view"). The pre-Revision legal authorities are significant for analyzing the current debate.

Pre-Revision, the basic legal theory for the view that cashier's checks were equivalent to cash seized on the fact that the bank that is the payor of the cashier's check also signs the cashier's check. Because the signature was seen as a promise to pay, this was considered by some courts and scholars as the equivalent of accepting the cashier's check for payment at the time it was issued (written and delivered by the issuing bank).[6]

However, banks drawing and delivering cashier's checks often thought they did so subject to normal rights of any check drawer. Those rights included the right to refuse to pay the check, such as by stopping payment or its equivalent, in certain circumstances.[7] This led to what many considered to be a disconnect between issuing bank conduct and expectations of the public.

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[2] Some legal authorities contend that a cashier's check may not be "dishonored" but acknowledge circumstances exist when a cashier's check-issuing bank, called an issuer (*see* U.C.C. § 3-412), may decline to pay the cashier's check. Although, colloquially, declining to pay is sometimes referred to as "dishonoring" the cashier's check, purer language describes such an event simply as nonpayment or refusing to pay. *See* U.C.C. § 3-411(b) (referring to "dishonor" of a teller's check but to refusal to pay a cashier's check).

[3] U.C.C. § 3-105.

[4] *See generally* U.C.C. § 3-412.

[5] Citations to the U.C.C. in this article are to the Revised Article unless marked with a "PR," such as "PR U.C.C. § 3-302."

[6] *Da Silva v. Sanders*, 600 F. Supp. 1008, 1012 (D.D.C. 1984).

[7] *See generally,* PR U.C.C. Secs. 3-507 and 3-601(2); *Khan v. Alliance Bank*, 79 Va. Cir. 634 (Va. Cir. Ct. 2009) (issuer was entitled to and did "stop payment"); Brian J. Davis, *The Future of Cashier's Checks Under Revised Article 3 of the Uniform Commercial Code*, *27 Wake Forest L. Rev.*

Proponents of the cash equivalence view contended that the public assumed cashier's checks were cash equivalents, and that commerce is enhanced if cashier's checks are treated as cash equivalents. Such treatment was advocated as enhancing speed in payment systems and increasing confidence in banks in general and the checking system in particular.[8]

Proponents of the ordinary instrument view of cashier's checks observed that if a bank really intended to issue a check that it accepted immediately for payment, or if a payee insisted on such a check, the proper mechanism was a certified check, not a cashier's check. The ordinary instrument view saw no theoretical underpinning for depriving a check drawer of rights to stop or decline payment in appropriate circumstances, just because the check drawer was the payor bank.

Meanwhile, holder in due course ("HDC") law was also fragmented. Pre-Revision Article 3 defined a holder in due as one who took a check "for value; and in good faith; and without notice that is overdue or has been dishonored or of any defense against or claim to it on the part of any person."[9] Pre-Revision, some jurisdictions placed significant objective glosses on the notice or good faith requirements for HDC status. Others required only that the holder lack subjective knowledge of the pertinent defense or claim involving the check.

Revised Article 3 sought to improve both the law of cashier's checks and the sometimes related HDC law.

REVISED ARTICLE 3

Revised Article 3 ostensibly adopts the ordinary instrument view of cashier's checks.[10] Although comment 1 to Section 3-412 also states that no substantive change from existing law is intended, this apparently is because NCCUSL thought existing law properly understood was basically an ordinary instrument

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613, 626–28 (1992) (contending that technically "stop payment" analysis does not apply to cashier's checks but a similar right to refuse to pay exists, and advocating the ordinary instrument theory under Revised Article 3).

[8] *Da Silva v. Sanders*, 600 F. Supp. 1008, 1013 (D.D.C. 1984). Douglas J. Landy, *Failure of Consideration Is Not a Defense to a Bank's Refusal to Pay a Cashier's Check*: Revised—§ 3-411(c), 15 Banking L.J. 92, 95–96, 115 (1998).

[9] PR U.C.C. Sec. 3-302 (subdivision letters omitted).

[10] *See generally*, U.C.C. Sec. 3-412 and comment 1 (treating cashier's check as the same as a note and commenting that certain statutes refer to a cashier's check as a "draft," but the issuer's liability is "stated by Section 3-412 as being the same as that of the maker of a note rather than that of the drawer of a draft").

or demand note analysis.[11] Revised Article 3 contains at least three features, however, useful to those who contend for greater certainty in cashier's checks being paid rapidly.

Revised Article 3-411 added express ability of a holder to recover consequential damages if a cashier's check issuer "wrongfully refuses" to pay.[12] This can even include attorneys' fees, if the pertinent state's laws allow for it and the facts show lack of "reasonable grounds" to believe that refusal was appropriate.[13]

Moreover, the prefatory note to Revised Article 3 uplifts the importance of increasing treatment of cashier's checks to be more equivalent to cash as one purpose of Revised Section 3-411 "and related provisions."

Also, Revised Article 3 makes it possible to argue that a cashier's check issuer to avoid statutory damages must not only have a reasonable belief in a defense to payment of the check, the issuer must also have a reasonable belief that its defense is valid against the person entitled to present the check. This typically is the holder.

As for HDC law, Revised Article 3 brings important clarity to an often debated HDC question, does one evaluate a holder's notice of a claim or defense on a subjective basis independent of industry standards or reasonableness concepts, or, instead, by requiring adherence to objectively reasonable conduct? Revised Article 3 answers the question by defining good faith.

Good faith now is defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[14] This is not as difficult a requirement to meet as a reasonably prudent holder standard. But it does inject an element of reasonableness. To act in good faith, a holder is not required to act reasonably per se, but a holder is required to observe standards of "fair dealing" that are reasonable.[15] On balance, this changed definition favors cashier's check issuers. It now retains the subjective test of pre-Revision case law ("honesty in fact") but adds a second requirement, "the observance of reasonable commercial standards of fair dealing."

A discussion of the legal authorities pertinent to revised Article 3 helps banks and their customers plan for and handle cashier's checks.

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[11] *See generally*, Brian J. Davis, *The Future of Cashier's Checks Under Revised Article 3 of the Uniform Commercial Code*, 27 Wake Forest L. Rev. 613, 632 (1992).

[12] U.C.C. Sec. 3-411(b).

[13] U.C.C. Sec. 3-411(c) and comment 2.

[14] U.C.C. Section 3-103 (4).

[15] U.C.C. 3-103(4).

LEGAL AUTHORITIES UNDER REVISED ARTICLE 3: WHICH TIGERS IN THE DEBATE ARE PAPER?

Cash-Equivalent View Versus Ordinary Instrument View

A cashier's check is a check drawn on the account the drawer bank itself.[16] Legal authorities long were divided on whether a cashier's check functioned basically as equivalent to cash or instead as equivalent to an ordinary negotiable instrument drawn by and on a bank.

Advocates seeking payment of a cashier's check tend to describe the cash-equivalent view as positing that once a cashier's check is issued it must be paid and that a cashier's check cannot be dishonored by the issuing bank (i.e., the drawee bank, which is also the drawer). But the actual Pre-Revision legal authorities upholding the cash-equivalent view contain nuances and further fragmentation of perspectives.[17]

Advocates of the cash-equivalent view continue, under Revised Article 3, to press two primary justifications.

First, cash-equivalence exponents invoke the concept of "acceptance" of a draft. Whether a note, check or other type of draft, both Pre-Revision Article 3 and Revised Article 3 stated that acceptance was a drawee's signed engagement or agreement to honor or pay the draft as presented.[18] The signature "must be written on the draft and may consist of the drawee's signature alone."[19] A cashier's check, of course, contains the signature of the drawer, which happens to also be the drawee. Thus, cash-equivalence advocates stated that, under the

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[16] U.C.C. § 3-104(g).

[17] *See, e.g.*, *Da Silva v. Sanders*, 600 F. Supp. 1008, 1013 & n. 13 (D.D.C. 1984) (court lauds the cash-equivalent view, but states in a footnote that in situations where a payee plaintiff sued an issuer after fraudulently inducing issuance of or giving failed consideration for the cashier's check, perhaps the issuer should be allowed to invoke defenses against the payee); and *Warren Fin., Inc. v. Barnett Bank of Jacksonville, N.A.*, 552 So. 2d 194, 201 (Fla. 1989) (promoting the cash-equivalent view but stating that an issuer may assert its own "real" defenses, and perhaps its own "personal defenses"). The cash-equivalent view was described Pre-Revision as the majority view. *Flatiron Linen v. First Amer. State Bank*, 23 P.3d 1209 (Colo. 2001); *see also 4 Hawkland U.C.C.* Series 3-104:16 (2019) (describing cash-equivalent view as the majority view but criticizing it because of, among other things, the accepting bank's ability to revoke acceptance and the tendency of judges who purport to adopt the cash-equivalent view to allow issuers to raise failure of consideration and fraud as defenses if the holder is not an HDC).

[18] PR U.C.C. § 3-410(1); U.C.C. § 3-409(a).

[19] U.C.C. § 3-409(a); *see also* PR U.C.C. § 3-410(1).

literal statutory language, the drawee had accepted the cashier's check when it signed the cashier's check as drawer upon issuance and further discussion was pointless.[20]

Second, cash-equivalence exponents contend that usage of cashier's checks in commerce and the public's perception of cashier's checks supports treating them as equivalent to cash. "People accept a cashier's check as a substitute for cash because the bank stands behind it rather than an individual."[21]

Advocates of the ordinary instrument view provide several rebuttals. What follows are just a few of them.

As for acceptance at time of issuance, exponents of the ordinary instrument view observe that Revised U.C.C. Section 3-411 was newly added. It provides, in part:

> (a) In this section, "obligated bank" means the acceptor of a certified check or the issuer of a cashier's check or teller's check bought from the issuer.
>
> (b) If the obligated bank wrongfully (i) refuses to pay a cashier's check or certified check, (ii) stops payment of a teller's check, or (iii) refuses to pay a dishonored teller's check, the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages.

NCCUSL could have easily either omitted cashier's checks from this new statute if NCCUSL agreed with the "accepted at issuance" analysis or have expressed that analysis in Section 3-411's statutory text or comments. Instead, NCCUSL described what happens when a bank that refuses to pay a cashier's check acts "wrongfully."[22] This implies there will be times when the refusal to pay is not wrongful.[23]

Subsection (c) of Section 3-411 also helps tame the tiger of a cashier's check as pure cash equivalent. If a bank could never raise its own defenses to payment

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[20] *Flatiron Linen v. First Amer. State Bank*, 23 P.3d 1209 (Colo. 2001); *see also In re Lee*, 108 F.3d 239 (9th Cir. 1997) at n.2. (Cashier's check is accepted upon issuance).

[21] *Stringfellow, infra*, 878 S.W.2d at 944; *see also* Douglas J. Landy, *Failure of Consideration Is Not a Defense to a Bank's Refusal to Pay a Cashier's Check*: *Revised U.C.C. § 3-411(c)*, 115 Banking L.J. 92, 102 (1998).

[22] U.C.C. § 3-411(b).

[23] *E.g., Transcon. Holding Ltd v. First Banks, Inc.*, 299 S.W.3d 629, 653 (Mo. Ct. App. 2010).

of a cashier's check, then a bank could never have "reasonable grounds to believe" that such a defense was available.[24]

Moreover, ordinary instrument view advocates contend that legal authorities never properly analyzed the "acceptance" statute. Pre-Revision as well as revised comments to the acceptance statute contain this discussion of a drawee's signing operative as acceptance:

> Customarily the signature [[showing acceptance]] is written vertically across the face of the instrument, but since the drawee has no reason to sign for any other purpose a signature in any other place, even on the back of the instrument, is sufficient.

But a drawee of a cashier's check has a vital "reason to sign for any other purpose" than acceptance. Because the cashier's check drawee bank is also the drawer, of course the bank will sign the cashier's check upon issuance. Its reason for signing is as drawer and not as drawee.

NCCUSL also changed the "acceptance" section's language about the time an acceptance becomes effective. No longer is an acceptance effective or operative "when completed by delivery or notification."[25] Rather, it is now effective "when notification pursuant to instructions is given or the accepted draft is delivered for *the purpose of giving rights on the acceptance* to any person."[26]

As for the public's perception of cashier's checks, ordinary instrument view advocates contend that such is immaterial in the face of new Section 3-412.[27] They also contend that the public does not or at least should not view cashier's checks as cash equivalents.

For instance, unlike greenbacks or coins, it is clear that cashier's checks eventually must be delivered to a bank to be paid. This almost certainly involves

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[24] *Transcon. Holding Ltd v. First Banks, Inc.*, 299 S.W.3d 629, 653 (Mo. Ct. App. 2010) at 654. While Subsection 3-411(c) clearly indicates some defenses are sometimes available to payment of a cashier's check, this subsection is not necessarily authority for so-called "personal" defenses. Those advocating against the existence of personal defenses can contend Section 3-411(c) only refers to "real" defenses. *See infra* at footnotes 51–54.

[25] PR U.C.C. § 3-410(1).

[26] U.C.C. § 3-409(a) (emphasis supplied).

[27] *E.g.*, *Farmers & Merchants State Bank*, 841 F.2d at 1440–42 (whether treated as an accepted draft or a promissory note, a cashier's check should not be treated differently from any other instrument subject to the Uniform Commercial Code, notwithstanding any "public perception of cashier's checks as the equivalent of cash"); quoted with approval by *In re Lee*, 179 B.R. 149, 160 (Bankr. App. 9th Cir. 1995), *aff'd*, 108 F.3d 239 (9th Cir. 1997).

the holder of the cashier's check at the time of deposit or encashment dealing with a bank at which the holder has a deposit account. Call this "the holder's bank" for discussion.

The holder's deposit account agreement with the holder's bank almost certainly will contain language about how soon funds available from deposit of cash and of cashier's checks, respectively, are available to the depositor-holder. The deposit account agreement very likely will allow cash deposits to be immediately available for withdrawal, clearing against debits on the account, or other use by the holder. In contrast, the agreement very likely will require the passage of time, at least one banking day, for a cashier's check proceeds deposited into the account to be available for withdrawal or other use. Although the holder's bank may voluntarily choose to make funds immediately available, the deposit account agreement quite likely will allow the holder's bank the right to withhold funds deposited from a cashier's check but not from cash.

Will the ordinary instrument view deprive the public and the commercial system of a crucial source of rapidly available funds? Such is unlikely. Consider alternatives such as certified checks, bank wire transfers, money orders, and prepaid cards. Some disadvantages exist for some of these sources, such as the difficulty with certified checks being properly read by magnetic ink character recognition bank fund flow equipment.[28] But, all told, any "essential utility" argument for the cash-equivalent view continues to decrease over the years.[29]

The ordinary instrument view of cashier's checks thus is not a situation of the law of the jungle, where a strong party imposes its will without mercy on a weak one. The ordinary instrument view of cashier's checks still draws support from contractual principles, the marketplace power of deposit customers to select banks that may voluntarily choose to give immediate availability to a specific cashier's check, and the presence of alternatives like certified checks and wire transfers that, for small fees, allow more certain immediate availability of funds with less chance of dishonor or credit reversal.

Proponents of the ordinary instrument view also uplift the fact that, although for certain purposes a cashier's check is treated as a draft, and it can be presented into bank clearing channels accordingly,[30] for analyzing the issuing bank's

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[28] Douglas J. Landy, *Failure of Consideration Is Not a Defense to a Bank's Refusal to Pay a Cashier's Check*: *Revised U.C.C. § 3-411(c)*, 115 Banking L.J. 92, 99 (1998).

[29] Brian J. Davis, "*The Future of Cashier's Checks Under Revised Article 3 of the Uniform Commercial Code,*" 27 Wake Forest L. Rev. 613 (1992) (noting increased availability of credit cards and electronic wire transfers).

[30] *See* U.C.C. Sections 3-103(a) and 3-104(f).

liability, U.C.C. Section 3-412 specifies the cashier's check issuer is treated as the maker of a note. Ordinary instrument view advocates observe that the NCCUSL Prefatory Note to Revised Article 3, while seeking to improve "the acceptability of bank obligations like cashier's checks as cash equivalents" does so not by prohibiting dishonor or deeming dishonor impossible but rather by "providing disincentives to *wrongful* dishonor."[31] This "balance" between the interests of "the banking community, the users, and the Federal regulators" also allowed Revised Article 3 to provide expedited "availability of funds to customers and reduce risks to banks."[32]

Many of the court decisions choosing the cash-equivalent or ordinary instrument views do not expressly analyze how the specific changes in Revised Article 3 weigh on the debate. Decisions that, at least at first blush, contain language ostensibly supporting a cash equivalence view include *Flatiron Linen, Inc. v. First Am. State Bank*,[33] *Stringfellow v. First Am. Nat'l Bank*,[34] (rejecting the ordinary instrument view expressed in *John Deere Co. v. Boelus State Bank*[35]; *Rezapolvi v. First National Bank of Maryland*[36]; and *TPO, Inc. v. FDIC*),[37] *Da Silva v. Sanders*,[38] (also refraining from adoption of aspects of *Rezapolvi* and *TPO*); and *Weldon v. Tr. Co. Bank, N.A.*[39]

Decisions that recognize a cashier's check issuer may sometimes stop payment or otherwise refuse to pay without incurring liability include *EA Mgt. v. JP Morgan Chase Bank, N.A.*,[40] *Hart v. N. Fork Bank*[41] (finding a bank may stop payment on its cashier's check if "there is evidence of fraud"); *Johnson v. First Midwest Bank*[42] ("a bank may be justified in stopping payment on a cashier's or teller's check in cases of error or fraud"); *Nat'l City Bank v. Citizens*

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[31] 2 Uniform Laws Annotated 12 (West Publishing Co. 2004).

[32] *Id. at p. 11.*

[33] *Flatiron Linen, Inc. v. First Am. State Bank*, 23 P.3d 1209, 1212–13 (Colo. 2001)(en banc).

[34] *Stringfellow v. First Am. Nat'l Bank*, 878 S.W.2d 940, 943 n.3, 944 (Tenn. 1995).

[35] *John Deere Co. v. Boelus State Bank*, 448 N.W. 2d 163 (Neb. 1989).

[36] *Rezapolvi v. First National Bank of Maryland*, 459 A.2d 183 (Md. 1983).

[37] *TPO, Inc. v. FDIC*, 487 F.2d 131 (3rd Cir. 1973).

[38] *Da Silva v. Sanders*, 600 F. Supp. 1008, 1011 (D.D.C. 1984).

[39] *Weldon v. Tr. Co. Bank, N.A.,* 499 S.E.2d 393, 396 (Ga. Ct. App. 1998).

[40] *EA Mgt. v. JP Morgan Chase Bank, N.A.,* 655 F.3d 573, 576 (6th Cir. 2011).

[41] *Hart v. N. Fork Bank*, 37 A.D.3d 414–15 (N.Y. App. Div. 2007).

[42] *Johnson v. First Midwest Bank*, No. 04-83665 (Bankr. C.D. Ill. Dec. 20, 2005).

Nat'l Bank of Sw. Ohio[43] (finding a bank may stop payment on a cashier's check "when fraud is involved in the procurement of the cashier's check or if there is failure of consideration"); and *Associated Carriages, Inc. v. Int'l Bank of Commerce*[44] (same). Some of these decisions involve disputes that arose under Pre-Revision Article 3.

Of the decisions that expressly discuss Article 3's revisions, *Transcontinental* is instructive. The *Transcontinental* court recognized that before the U.C.C.'s revision in the early 1990s courts "divided sharply" over the issue of whether a bank may dishonor or refuse to pay its cashier's checks.[45]

Some legal authorities, commended by *Transcontinental*, upheld the ordinary instrument view, even before Revised Article 3. As the *Transcontinental* court explained, the U.C.C. revisions cemented this negotiable instrument view as correct, such that an issuer may properly assert its own defenses against liability.[46] The *Transcontinental* court grounded its holding in the language of Mo. Stat. § 400.3–412 (analogue to U.C.C. Section 3-412) and related case law. Citing a noted scholar, the *Transcontinental* court also observed that "[i]f the drafters of the revised U.C.C. had intended to codify a 'pure cash-equivalence' theory, under which the issuing bank has no right to stop payment under any circumstances, it would have said so clearly."[47]

Although a debate between proponents of cash-equivalence and ordinary instrument views remains,[48] it is hoped that authorities such as *Transcontinental* will eventually dominate, thus implementing NCCUSL's compromise of adopting the ordinary instrument view but adding potential for significant damages in Section 3-411 in some circumstances in which a cashier's check issuer wrongfully refuses payment.

How Does Holder Type Help Determine Whether an Issuer Is Liable for a Cashier's Check?

As least absent the most extreme and thus unconvincing cash equivalence views, some defenses to cashier' liability are available to a cashier's check issuer

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[43] *Nat'l City Bank v. Citizens Nat'l Bank of Sw. Ohio*, No. 20323 (Ohio Ct. App., Nov. 12, 2004).

[44] *Associated Carriages, Inc. v. Int'l Bank of Commerce*, 37 S.W.3d 69, 72–75 (Tex. App. 2000).

[45] *Id.* at 646.

[46] *Id.* at 656.

[47] *Id.* at 656 (quoting 1 Barkley Clark & Barbara Clark, The Law of Bank Deposits, Collections and Credit Cards, § 3.06[3][ii]).

[48] *4 Hawkland U.C.C. Series* § 3-104:16 (2019), *MidAmerica Bank, FSB v. Charter One Bank, FSB,* 905 N.E.2d 839, 846 (Ill. 2009).

regardless of the type of holder of that check. These are often called "real" defenses.[49] Section 3-305(a)(1) lists them:

> a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings.[50]

Additionally, if the drawee of a cashier's check (or any check) has a claim in recoupment that "arose from the transaction that gave rise to the" cashier's check and if the holder is the one against whom the claim arose, the drawee, here, the cashier's check issuer, has a defense.[51]

A holder in due course ("HDC") of the cashier's check typically cuts off most of the other common defenses of a cashier's check issuer,[52] which are sometimes called "personal" defenses. Of course, most cashier's checks are paid routinely. For a cashier's check to end up in court, often there are allegations of fraud in the inducement, failure or lack of consideration, or some other "personal" defense. Thus, cashier's check litigation often involves the threshold issue of whether the holder is an HDC.

The type of personal defenses typically foreclosed by HDC status include:

- Lack of consideration;
- Failure of consideration;
- Duress;
- Undue influence;
- Misrepresentation that does not render the transaction void;
- Breach of warranty;
- Unauthorized completion of an incomplete instrument; and
- Prior payment.

As noted above, however, the absence of these personal defenses does not mean that a HDC is free from all defenses an obligated bank (issuer) may raise.

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[49] U.C.C. 3-305 (a) and comment 1.

[50] U.C.C. § 3-305.

[51] *See generally*, U.C.C. Sec. 3-305(a)(3) and (b).

[52] U.C.C. Section 3-305(b).

Under the U.C.C., in a non-consumer transaction, a HDC still takes an item subject to certain "real" or "universal" defenses that may be raised, including unauthorized signature (forgery), bankruptcy, infancy, fraudulent alteration, duress, mental incapacity, or illegality that renders the obligation void, fraud in the execution, and discharge of which the holder has notice when he takes the instrument.[53]

The differences between the "personal" and "real" defenses noted above are generally clear. But one facet that requires further examination is fraud, specifically, fraud in the "factum" vs. fraud in the inducement. Fraud in the "factum" is a "real" defense that is available against a HDC. It occurs in the rare event where a signer of a check or note is essentially tricked into signing a check or note that he or she did not realize actually was a check or note or did not understand the nature or content of the check or note. An example is a maker who is tricked into signing a note in the belief that it is merely a receipt or some other document.[54] In the context of the U.C.C., this defense is based on the "excusable" ignorance of the signer. This means that, if "fraud in the factum" is raised as a "real" defense against an HDC, an examination must be made into not only whether the signer was ignorant with respect to the nature of the document signed, but also whether the signer then had no reasonable opportunity to obtain such knowledge.

Fraud in the "factum" is distinguished from fraud in the inducement, which is a personal defense, not available against an HDC. An interesting example of this fact directly applicable to cashier's checks can be found in the commentary accompanying the U.C.C. Consider an example of a buyer of goods who fraudulently induces his or her bank to issue a cashier's check to the order of the seller of those goods. The check is delivered by the bank to seller, who has no notice of the fraud. The seller may very well be a holder in due course and can take the check free of bank's defense of fraud in the inducement.[55]

HDC Elements Discussed

For obligations and rights relating to checks, including cashier's checks, who is an HDC is first of all statutorily defined. The HDC definition at Section 3-302(a) deserves full quotation:

> Subject to subsection (c) and Section 3-106(d), "holder in due course" means the holder of an instrument if:

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[53] U.C.C. §§ 3-401, 3-305, 3-407, 3-601.

[54] U.C.C. Comment 1 to Article 3-305.

[55] U.C.C. Commentary to Article 3-305.

> (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and
>
> (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).[56]

Notice and Good Faith

To be an HDC, a holder must lack several types of notice. With cashier's checks, some of these types are litigated much more frequently than others. The primary notice-related evidentiary and conceptual contests in cashier's check disputes have involved notice of what is loosely called "dishonor" or stoppage of payment, or of claims to the instrument such as rescission of negotiation, or of an unauthorized signature, or of a defense or of a claim in recoupment under U.C.C. § 3-305(a). Recall that Section 3-305(a) includes both "real" and "personal" defenses. Thus, if a holder has "notice" of a Section 3-305(a) "personal" defense of fraud in the inducement, the holder should not be deemed an HDC.[57]

To qualify for HDC status, a holder also must have taken the cashier's check "in good faith."[58] When practitioners, scholars or judges analyze HDC status, facts related to good faith and to notice often blend together. But analysts of good faith should start with its statutory definition to help correctly classify a holder. This is especially true because Revised Article 3 significantly changed the good faith definition.

Good faith under the Uniform version of Article 3 now means "honesty in fact and the observance of reasonable commercial standards of fair dealing." The location of this definition varies depending on whether a state has enacted the 2001 Revision of Article 1. Even if a state has enacted such revision, analysts should be aware of both alternative locations, which will help evaluate scholarly and judicial comments made before the 2001 Revision became widespread. NCCUSL in the 2001 Revision eliminated the specific good faith definition

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[56] U.C.C. § 3-302(a).

[57] *See generally* U.C.C. § 3-305(a)(2).

[58] U.C.C. § 3-302(a)(2)(ii).

from Article 3 and placed the same language into Article 1 at Section 1-201(20). Before the 2001 Article 1 revision but after the 1989 Article 3 revision, good faith for Article 3 transactions is defined at U.C.C. § 3-103(4).

New York, however, as of the writing of this article still adhered to the Pre-Revision definition of good faith, i.e., "honesty in fact in the transaction or conduct concerned."[59] New York thus omits good faith from the terms defined in Section 3-102. Lawyers analyzing New York cashier's checks thus find them, compared with cashier's checks governed by another state's laws, to have sharper claws and less able to be tamed by assertions that the check holder lacks good faith. This article considers, except where otherwise noted, case law that has developed in states enacting the uniform "good faith" definition rather than the New York non-uniform one.

When faced with challenges about notice or good faith, a cashier's check holder asserting HDC status sometimes starts with the nature of the instrument. The holder contends that a cashier's check is even less likely than other checks to have been "dishonored" by the time the holder took possession or to contain an unauthorized signature or an alteration, or to be subject to any defense or claim in recoupment. In the context of a cashier's check taken for payment of an obligation, it has been said:

> The fact that payment is made by a cashier's check is strong evidence that the recipient of the check took it in good faith and without notice of the fraud perpetrated by the debtor in obtaining the cashier's check.[60]

Although there is some merit to this starting point for analysis, it is notable that cashier's checks are often presented by a depository bank rather than a party who received the cashier's check in payment of an obligation such as a trade debt or installment payment contract and, in any event, the quoted treatise only cited one judicial opinion for its statement.

That opinion, *Wohlrabe v. Pownell*,[61] is extensive and significantly favorable for those claiming HDC status. The *Wohlrabe* court indicates having notice requires more than a failure to inquire about an unknown fact, and that some "danger signals" or a "shining red light" must be present for the holder to infer that the check is subject to a claim or defense.[62]

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[59] N.Y. U.C.C. § 1-201(20).

[60] *5A Anderson U.C.C.* § 3-302:32 (3d. ed. 2019).

[61] *Wohlrabe v. Pownell*, 307 N.W.2d 478, 484 (Minn. 1981).

[62] 307 N.W.2d at 484–85. *See also Citizens Fidelity Bank & Trust Co. v. Southwest Bank & Trust Co.,* 472 N.W.2d 198, 202 (Neb. 1991) (facts "calculated to merely arouse or excite

Wohlrabe concerned a doctor who lent funds to his accountant and former office manager, reportedly a fraudster named Pownell, who used the funds to buy a cashier's check. Pownell then gave the cashier's check to an attorney for a trust, which trust had been defrauded by Pownell. By the time the attorney, on behalf of the trust, received the cashier's check, the attorney thought Pownell had defrauded the trust and had told Pownell that if the trust was not repaid immediately he would conclude Pownell was guilty of embezzlement. When the doctor sued he lost, in large part because the court concluded the trust's notice of fraud against it did not equate to notice that the cashier's check had been procured by fraud such that the trust was subject to a defense or recoupment claim.[63]

It is crucial to note, however, that *Wohlrabe* was decided under Pre-Revision Article 3. While the Revision may not affect the Minnesota Supreme Court's view of HDC notice,[64] the related concept of HDC good faith has changed and no longer fits the court's description of a purely subjective test of "white heart, empty head."[65] Whether the *Wohlrabe* court would now reach the same result as its 1981 ruling is unknown.

Notice issues sometimes involve a mismatch between the person supplying the funds for a check and the person using the check. Courts have expressed a willingness to find HDC status for checks despite arguments that notice of a defense or recoupment existed due to a mismatch between the funder of the check and the obligation that the check is used to pay.

The most common instance of this is where holder presents a check drawn on an entity's bank account that was made payable to the holder and used to pay a debt owed by an entity's employee to the holder. The drawer sometimes defends, unsuccessfully, based on forgery or unauthorized use of the check by the employee.[66] In the cashier's check context, this would be analogous to an entity remitter whose fraudulent employee then uses the cashier's check to pay her or his individual debt owed to a third party.

For cashier's checks, notice issues sometimes involve whether failure or insufficiency of consideration or fraud in the inducement allows the issuer to

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suspicion" differ from those which equate with "knowledge, or a reason to know").

[63] 307 N.W.2d at 484–85.

[64] *Apex IT v. Chase Manhattan Bank USA, N.A.*, No. Civ. 04-2684RHKAJB (D. Minn. Mar. 11, 2005) (citing *Wohlrabe* with approval on notice issues).

[65] *Wohlrabe, supra*, 307 N.W.2d at 483.

[66] *See generally, Apex IT v. Chase Manhattan Bank USA, N.A.*, No. Civ. 04-2684RHKAJB (D. Minn. Mar. 11, 2005) and cases collected therein.

properly refuse to pay. For example, a cashier's can be issued to a checking account customer of the issuer based on uncleared deposit items (deposited checks) recently deposited into the customer's account. If the deposited items are later dishonored, at a minimum the cashier's check is subject to a defense of failure or insufficiency of consideration and it may also be subject to a defense of fraud in the inducement. Because these defenses are likely to be personal rather than real defenses, notice and other HDC elements matter.

Two examples where the holder failed to establish HDC status due to notice issues (and also good faith issues) and lost the litigation are *API Supply Co. v. Premier Bank*[67] and the non-cashier's check case of *Squire Industries, Inc. v. Cunningham.*[68]

If the cashier's check holder is an organization, such as a depository bank, U.C.C. § 1-202(f) can be important. Among other instruction, Section 1-202(f) provides that although an organization has certain due diligence duties in connection with information it receives, this does not require an organization's employee or similar individual to communicate information, unless communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.[69]

As for good faith, two court decisions showing some of the judicial approaches are *Maine Family Federal Credit Union v. Sun Life Assur. Co. of Canada*[70] and *Wells Fargo Bank v. Ferruggio Ins.*[71]

Maine Family is one of the first opinions to discuss in detail the revised good faith definition, which now requires an HDC to meet both a subjective and an objective test.[72]

A factfinder now must determine:

> As to the "reasonable commercial standards of fair dealing" prong:
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> The factfinder must . . . determine first, whether the conduct of the

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[67] *API Supply Co. v. Premier Bank*, 593 So.2d 660 (La. Ct. App. 1991) (rehearing denied 1992).

[68] *Squire Industries, Inc. v. Cunningham*, CV085023714S (Conn. Super. Sept. 27, 2013).

[69] U.C.C. Section 1-202(f).

[70] *Maine Family Federal Credit Union v. Sun Life Assur. Co. of Canada*, 727 A.2d 335 (1999).

[71] *Wells Fargo Bank v. Ferruggio Ins.*, 358 F.Supp. 3d 887 (D. Ariz. 2019).

[72] *Maine Family Federal Credit Union v. Sun Life Assur. Co. of Canada*, 727 A.2d 335, 340 (Maine 1999); Negotiable notes: Holder in due course rule—Requirements for holder in due course—Holder—Holder in due course—Good faith, 2 L. Distressed Real Est. § 24:77 (2019) (citing *Maine Family* with approval). This is a significant change, *Maine Family*, *supra*, at 342.

> holder comported with industry or 'commercial' standards applicable to the transaction and, second, whether those standards were reasonable standards intended to result in fair dealing. Each of those determinations must be made in the context of the transaction at hand.[73]

In addition,

> The objective component of good faith requires the holder to comport with "industry or commercial standards applicable to the transaction" which are reasonable. *Maine Family Federal Credit Union v. Sun Life Assurance Co., supra,* at 727 A.2d 343. There has been no evidence presented regarding the industry or commercial standards applicable to the check cashing business in which Squire was engaged.[74]

Maine Family involved a case where a depository institution, receiving $120,000 in checks, was held to be subjectable to a jury as to whether it was an HDC. At trial, the issuing bank prevailed on the HDC topic. *Maine Family* affirmed on appeal. Three facts seemed especially important: The checks were significantly above the depository institution's self-set threshold for imposing a discretionary hold on deposit items; the checks were drawn on an out-of-state bank; and the depository institution's president admitted that some other banks placed out-of-state deposits on hold before crediting the deposits.[75]

However, some legal authorities criticize *Maine Family* for requiring too much objective good faith.[76] *Maine Family* and its criticism illustrate how fact specific good faith analysis can now become.

Wells Fargo involved a $100,000 check drawn by an insurance office used to open a business checking account for the defendant at the plaintiff bank. The

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[73] *Any Kind, supra* at 165 (quoting *Maine Family Fed. Credit Union v. Sun Life Assurance Co. of Canada,* 727 A.2d 335, 343 (1999). *See also, In re Nelson* (Bankr. D. Ore. Sept. 28, 2007) (denying summary judgment for movant alleging HDC status).

[74] *Squire Industries, Inc. v. Cunningham*, CV085023714S (Conn. Super. Sept. 27, 2013) (denying HDC status after trial due to the purported HDC's proof failure on industry standards).

[75] 727 A.2d at 344.

[76] *Wells Fargo Bank NA v. Ferruggio Insurance Services of LA, Inc.,* 358 F.Supp.3d 887, 893 (D. Ariz. 2019); *Choice Escrow & Land Title, LLC v. BancorpSouth Bank*, 754 F.3d 611, 623 n.6 (8th Cir. 2014); *Travelers Cas. & Sur. Co. of Am. v. Wells Fargo Bank N.A.*, 374 F.3d 521, 527 (7th Cir. 2004); *and compare John Deere, supra*, 448 N.W.2d at 167. It is clear that good faith does not require due care or ordinary care, a holder can be negligent and still achieve HDC good faith. *Maine Family Federal Credit Union v. Sun Life Assur. Co. of Canada*, 727 A.2d 335, 343 (Maine 1999) at 343; *Wells Fargo Bank NA v. Ferruggio Insurance Services of LA, Inc.*, *supra*, 358 F Supp.3d at 893–94.

defendant and the insurance office agreed to stop payment on the check, despite the fact the plaintiff bank had paid significant funds out of the checking account in reliance on the $100,000 check. The bank prevailed on summary judgment. The objective part of good faith equated to the fairness of the bank's conduct. Facts the court considered important were the discretionary nature of the bank's policy for how fast to allow withdrawals from deposited check proceeds; the ordinary and complete nature of the physical check; and the bank's affidavit that it had no notice of the check's dishonor or any defense or claim in recoupment.[77]

One commentator has asked whether another aspect of fairness is the extent to which a holder treated those involved with the pertinent cashier's check less fairly than the holder treats others similarly situated.[78] But such should not be sufficient.

For instance, a holder may be routinely unfair if it typically seeks out counterparty representatives who are known to be foolish and inexperienced or encourages suspected fraudsters who have a history of criminal or regulatory fines to make no disclosures and to obtain cashier's checks before major financial problems surface.

If the cashier's check holder is a financial institution, it will often be because a checking account customer has deposited or cashed the cashier's check at that financial institution.

Relevant considerations of that holder's good faith, in addition to the factors already discussed, might include the "Know Your Customer" analysis undertaken when it opened the checking account; its policies on verifying the authenticity and fund support of large deposit items; its knowledge of any depositor financial defaults, crimes or frauds; and its knowledge of any stop payments, garnishments or other unusual activity likely to reduce funds that probably were used to pay for the cashier's check.

On the other hand, even if hasty and repeatedly negligent conduct by a financial institution holder occurred, at least some courts will still find the holder to have acted in good faith if the holder did not engage in unfair "advantage taking."[79]

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[77] *Wells Fargo Bank NA v. Ferruggio Insurance Services of LA Inc., supra*, 358 F.Supp.3d at 894–95.

[78] *1 White Summers & Hillman, Uniform Commercial Code* § 1:10 (6th ed. 2013) (raising the question of whether this is part of the objective standard).

[79] *State Bank of The Lakes v. Kansas Bankers Sur. Co.,* 328 F.3d 906, 909 (7th Cir. 2003)

Value

Another important element in HDC analysis is whether an item is taken for "value."[80] Under the U.C.C., taking for "value" is stated in terms of performed consideration (meaning consideration sufficient to support a simple contract), security interests, payment of antecedent debt, security for an antecedent claim, the giving of negotiable paper, and the making of an irrevocable commitment.[81] In practice, to determine whether the "value" element of HDC status has been met, courts look to whether or not a purported HDC has given value or changed its position in reliance on payment or a promise.[82] In the context of a cashier's check, courts have looked to see if the bank taking the cashier's check did so for value or changed its position in reliance on the cashier's check to determine whether the bank qualified as a HDC.[83]

One common point of contention that arises in HDC cases with respect to "value" including in cases involving cashier's checks, is whether or not a bank's provisional crediting is sufficient to show that a bank has taken a check for "value" to qualify it as a HDC.

The law is well established that a bank's provisional credit, without more, does not constitute taking for value for purposes of obtaining holder in due course status.[84] The genesis of this rule actually predates the U.C.C. and is based on the understanding that a bank's mere entry of a credit on its books does not mean the bank has parted with value, particularly under circumstances

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(stating this standard while finding good faith despite holder's repeated acceptance of unsigned documents).

[80] *See generally*, U.C.C. §§ 3-302, 3-303.

[81] *5A Anderson U.C.C. § 303-303:12 (3d. ed.).*

[82] *See, e.g., Pelaez v. Regal V World Wide Holdings*, (No. 95 Civ. 3410 (KTD) (S.D.N.Y. June 18, 1996); *Crossland Savings, FSB v. Foxwood & Southern Co.*, 609 N.Y.S.2d 282, 284 (2d Dept. 1994) (finding that a holder could not assert HDC status where it did not give value or change its position in reliance on payment).

[83] *See Mid-Continent Nat. Bank v. Bank of Independence* 523 S.W.2d 569 (Mo. Ct. App. 1975) (negotiating bank was not a holder in due course of a fraudulently procured Cashier's check where it did not take the cashier's check for value and did not change position in reliance on check).

[84] *See, e.g., Lynnwood Sand & Gravel v. Bank of Everett,* 630 P.2d 489, 491 (Wash. Ct. App. 1981); *Marine Midland Bank-New York v. Graybar Electric Co.,* 363 N.E.2d 1139 (N.Y. 1977); *St. Paul Fire & Marine Ins. Co. v. State Bank*, 412 N.E.2d 103 (Ind. Ct. App. 1980); *Universal C.I.T. Credit Corp. v. Guaranty Bank & Trust Co.,* 161 F.Supp. 790 (D. Mass. 1958); Official Comment 3, RCWA 62A.3-303; *see generally* J. White & R. Summers, Uniform Commercial Code § 14-5 (2d ed. 1980).

where "no pre-existing debt has been extinguished in consideration for the item . . . for which credit was given."[85]

However, one must be careful in relying on the general rule cited above where granting of the provisional credit does not allow the accountholder to draw on the provisional funds. For example, in the case of *Lynnwood Sand & Gravel*, while the court noted the general rule that a provisional credit without more does not constitute taking for value, in holding that the provisional crediting in that case did constitute taking for value, the court reasoned that a bank gives value when it provisionally credits an account and allows the accountholder to make withdrawals against the uncollected checks for which the provisional credit was given.[86]

In other words, a provisional credit given by a bank in scenarios such as an overdraft where the bank actually parts with value by giving the accountholder a right to withdraw the provisional credit may suffice to constitute value for purposes of obtaining HDC status.

This point is bolstered by commenters, who have noted that cases where a credit is given that has not been withdrawn by the accountholder require careful analysis to determine the appropriate outcome:

> One must read 4-210(a)(2) with great care to determine the outcome in a case in which the credit has not been withdrawn. . . . On close reading, one finds that the giving of a credit is itself the giving of value only when the credit is "available for withdrawal as of right." Whether a customer has the "right" to withdraw a credit will be determined by agreement with the bank or, in the absence of such an agreement, by 4-215 and Regulation CC.[87]

Miscellaneous Defenses Other Than Denial of HDC Status

Although the main defenses to liability for the face amount of the cashier's check are likely to involve HDC status, issuers who believe it is unfair for them to be liable for a cashier's check should also consider other defenses. Defenses that are valid even against an HDC can be useful for legitimate leverage in negotiations and for opposing some summary judgment motions.

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[85] *Marine Midland*, 630 P.2d at 711 (citing *Sixth Nat. Bank of City of New York v. Lorillard Brick Works Co.*, 29 *Jones & S. 29* (N.Y. Sup. Ct. 1892).

[86] *Lynnwood*, 630 P.2d, at 491.

[87] *White & Summers, Uniform Commercial Code*, § 18:7, 246 (6th Ed. Nov. 2018) (discussing the giving of value in holder in due course cases).

Two Innocents Doctrine

One defense that may apply even against an HDC involves what is sometimes called the "two innocents" doctrine. This doctrine offers a rule for decision about loss bearing. If both (or all) parties to cashier's check litigation are innocent of intentional wrongdoing, which of the parties should bear the loss?

The doctrinal answer places the loss on the parties whose conduct made it possible for the intentional wrongdoer to perpetrate the wrong.[88]

The *May* case involved a suit against, among other defendants a surety on a promissory note. The plaintiff bank had neglected to procure and/or file some "chattel mortgages" apparently required by the loan documentation. The court held that the bank had a duty to procure and file the mortgages and, had the bank done so, the surety could have subrogated to the mortgagee rights and benefited after paying off the bank. As concerns the bank and the surety, the bank was better positioned to have procured the mortgages. Because the bank did not do so, the surety escaped liability.[89]

Legal authorities have not found express mention of the "two innocents" doctrine in Article 3. Although *May* involved a payee seeking to enforce a note, it predated even Pre-Revision Article 3. Analysis of whether the "two innocents" doctrine survived enactment of Article 3 begins with Uniform Commercial Code § 1-103(b). Section 1-103(b) provides "unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions."

A similar section has long existed in the U.C.C. The recent tone of NCCUSL, as reflected in official comment 2 adopted in all or substantially all states, is that practitioners and courts should be more willing than they had

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[88] *E.g., Nebraska State Bank of Valparaiso v. May*, 220 N.W. 276, 276 (Neb. 1928); *see, e.g., Jordan v. Butler*, 182 Neb. 626, 637, 156 N.W.2d 778, 785 (1968) ("[I]t is a rule of longstanding that where one of two innocent persons must suffer by the acts of a third, the one whose conduct, act, or omission enables such third parties to occasion the loss must sustain it if the other person acted in good faith without knowledge of the facts and altered his position to his detriment").

[89] *Nebraska State Bank of Valparaiso v. May*, *supra,* 220 N.W. at 277.

been to find displacement of common law principles by pertinent U.C.C. sections.[90]

Section 3-105 is the main, but not the only, Article 3 section listing defenses and recoupment claims to which a holder generally or an HDC particularly is subject. Section 3-105(a) begins by stating that, "Except otherwise provided in this section, the right to enforce the obligation of a party to pay an instruments is subject to the following." Section 3-105(a) does not state that the enforcement right is subject "only" to the listed defenses.

Similarly, in describing which of the subsection 3-105(a) defenses apply to an HDC, Section 3-105(b) does not use exclusive language, i.e., does not provide that the HDC is subject "only" to the specified defenses. Thus, a powerful argument can be made that the literal language of Article 3 does not displace the "two innocents" doctrine.

However, the holder has a potential rebuttal by invoking the policies of Article 3. Among them are to promote simplicity and uniformity in the law governing commercial transactions.[91] Because of its vagueness, the "two innocents" doctrine is contrary to those Article 3 policies. Still, courts have understandably been reluctant to jettison the doctrine, and many doctrines are allowed to supplement the U.C.C. despite lack of uniformity among the various states. One of the best discussions is from the en banc Colorado Supreme Court:

> Application of Colorado's U.C.C. can result in loss to an innocent party in favor of a holder in due course. . . . However, an important policy objective of the statute is to protect the party least able to protect himself or herself. . . . [W]here one of two innocent parties must suffer because of the wrongdoing of a third person, the loss must fall on the party who has by his conduct created the circumstances which enabled the third party to perpetuate the wrong.[92]

The conclusion is that the "two innocents" doctrine continues to exist as a possible defense against HDCs.

Notice, however, notice the "two innocents" doctrine also can work in favor of a holder. In *Georg*, the court invoked the doctrine to favor a holder of a

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[90] *See generally*, U.C.C. § 1-103 comment 2. Does Revised Article 3 "displace" the "two innocents" doctrine?

[91] U.C.C. § 1-103(a).

[92] *Georg v. Metro Fixtures Contractors, Inc.,* 178 P.3d 1209, 1216 (Colo. 2008) (en banc) (internal citations and quotes omitted); *see Bank of Colorado v. Berwick*, 09-CV-02552-CMA-CBS (D. Colo. Mar. 29, 2011).

cashier's check over a party whose agent had defrauded it.[93] When trying to tame the tiger of a cashier's check, an issuer should think carefully before invoking the "two innocents" doctrine.

Failure to Mitigate Damages

Another defense that may be raised, even if the cashier's check holder is an HDC, is failure to mitigate damages. This defense may be somewhat limited even if successfully proven, however, because it might not pertain to liability for the face amount of the cashier's check.[94] However, if applicable it clearly can reduce or eliminate the "expenses" or "consequential damages" that otherwise might be awarded under Section 3-411(b).

In *South Central Bank of Daviess Cnty. v. Lynville Nat. Bank*, the Court of Appeals of Indiana considered—but denied for factual reasons—the issuing bank's argument that the holder in due course of the cashier's check failed to mitigate damages.[95] Other courts have acknowledged that the payee bank (or "accepting bank") has the "general duty of one injured by a wrongful act or omission, to use 'use reasonable care to avoid loss or to minimize the damages resulting.'"[96] The court in *Third National* applied this concept even though "such duty is not expressly imposed by the U.C.C."[97]

Moreover, a duty to mitigate damages under the U.C.C. is also implicit in the code's treatment of general principles of law. Specifically, the U.C.C. provides that, "[u]nless displaced by the particular provisions of the Uniform Commercial Code, the principles of law and equity, including . . . validating or invalidating cause[s] supplement its provisions."[98] Generally, the duty to mitigate is a limitation on consequential damages.[99] Because U.C.C. § 3-

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[93] *See also Apex IT v. Chase Manhattan Bank USA, N.A.*, 56 U.C.C. Rep. Serv. 2d 849 (D. Minn. Mar. 11, 2005) (a non-cashier's check opinion denying payee's motion because at least some discovery was appropriate on whether payee was an HDC, but noting that the "two innocents" doctrine was likely to favor the payee-holder); *Da Silva v. Sanders*, 600 F. Supp. 1008, 1012 (D.D.C. 1984).

[94] *See generally*, U.C.C. Section 3-412.

[95] 901 N.E.2d 576 (2009).

[96] *Third Nat. Bank & Trust Co. v. Diamond Savings & Loan Co.*, 43 Ohio App.3d 140, 143 (1987) (quoting Ohio Jurisprudence 3d (1981) 27, Damages, § 16).

[97] *Third Nat. Bank & Trust Co.*, 43 Ohio App.3d at 143.

[98] U.C.C § 1-103 (amended 2001).

[99] *Bank of N.Y. v. Amoco Oil Co.*, 35 F.3d 643, 659 (1994).

411(b) (amended 2002) specifically provides for consequential damages, the duty to mitigate damages is a natural supplement to the U.C.C. in this area.[100]

Although legal authorities support the defense of failure to mitigate damages, to the extent such defense is allowed it should be as an affirmative defense. Courts should take care not to allow speculative or exaggerated concerns over damages to vitiate too frequently the promptness of relief available to an HDC. Courts should avoid potentially chilling the willingness of depository banks to employ depositor-friendly policies.

U.C.C. Section 3-411

Section 3-411 also deserves analysis for its basic impact on cashier's check handling. U.C.C. Section 3-411 is important with respect to obligations between banks relating to cashier's checks because it subjects an obligated bank (meaning the cashier's check issuer) to liability for expenses and consequential damages if the bank "wrongfully" refuses to pay a cashier's check, unless the refusal to pay occurs because:

(1) The obligated bank suspends payments;

(2) The obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument;

(3) The obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument; or

(4) Payment is prohibited by law.[101]

Under Section 3-411 then, an obligated bank may escape liability for expense or consequential damages under two scenarios: (1) if its refusal to pay is not wrongful, or (2) if its refusal otherwise fits within a category set forth in subsection (c) by, for example, having some reasonable grounds to believe that it has a defense available against the person entitled to enforce the cashier's check.

Associated Carriages, Inc. v. International Bank of Commerce,[102] provides a helpful illustration of this point. *Associated Carriages* involved a bank's refusal to

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[100] *Contrast Bank of N.Y.*, 35 F.3d at 659–60 (refusing to consider the duty to mitigate damages with regard to documents of title because Article 7 of the U.C.C. does not specifically provide for consequential damages).

[101] *See generally*, U.C.C. § 3-411(b), (c).

[102] *Associated Carriages, Inc. v. International Bank of Commerce*, 37 S.W.3d 69 (Tex. Ct. App. 2000).

cash a cashier's check made payable to a corporation. The corporation sued the bank, citing U.C.C. Section 4-11 arguing that the bank had wrongfully refused to pay the cashier's check.[103] In its defense, the bank argued that its refusal to cash the cashier's check was not wrongful where it had a reasonable doubt regarding whether the person demanding the cashier's check be cashed was actually entitled to enforce payment.[104] The court ruled in favor of the bank. The court found that the bank's policy of refusing to cash cashier's checks made payable to corporations to protect both customers and corporate payees sufficiently supported a finding that bank did not wrongfully refuse to cash its cashier's check.[105]

Section 3-411 also plays an important role in the "cash equivalent" debate described above. Specifically, while acknowledging that a cashier's check is used as the equivalent of cash under certain circumstances, the drafters of U.C.C. Article 3 were concerned that imposing an absolute obligation on issuing banks to pay on cashier's checks in every circumstance would result in the promotion of fraud.[106]

For this reason, the drafters of revised Article 3 intended U.C.C. § 3-411 to strike a balance between the need to encourage an obligated bank to pay on a cashier's check where the obligation to pay is clear, while simultaneously giving the obligated bank the ability to raise defenses it has reasonable grounds to believe are available against a person seeking to enforce the instrument.[107] As one court put it, the revisions made to Article 3 in 1992 plainly contemplate, through U.C.C. § 3-411, an issuing bank's right to refuse to pay a cashier's check based upon its own defenses.[108]

As noted above, applying a rule that always requires payment of cashier's checks and prohibits a bank from refusing to pay its cashier's check based upon its own defenses undermines the very purpose behind U.C.C. § 3-411.

For one thing, such an interpretation renders superfluous the word "wrongfully" in subsection (b) of U.C.C § 3-411, when, by contrast, inclusion of the word "wrongfully" logically implies that there are occasions when a refusal to pay a cashier's check is not wrongful.

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[103] *Id. at* 72.

[104] *Id. at* 73–74.

[105] *Id.* at 73.

[106] *5 Hawkland U.C.C. Series* § 3-411:2 (Dec. 2018).

[107] *Id.*; U.C.C. § 3-411.

[108] *Transcon. Holding Ltd v. First Banks, Inc.*, 299 S.W.3d 629, 653 (Mo. Ct. App. 2010).

Moreover, the provision in subsection (c) that a bank is not liable for expenses or consequential damages if it "asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument" recognizes that, under appropriate circumstances, a bank may refuse to pay a cashier's check based on the bank's own defenses. If a bank could never raise its own defenses to payment of a cashier's check, then a bank could never have "reasonable grounds to believe" that such a defense was available.[109]

According to the U.C.C. commentary, a bank's wrongful refusal to pay a cashier's check may make it liable for the attorneys' fees of recipient bank. Specifically, the U.C.C. commentary to Section 3-411 notes that, in cases where an obligated bank wrongfully refuses to pay, it is liable to pay for expenses and loss of interest resulting from that refusal. While there is no express provision for attorneys' fees, the commentary goes on to note that such fees are not necessarily excluded and could well be granted "because they fit within the language 'expenses * * * resulting from the nonpayment.'"[110]

Legal authorities awarding or declining to award attorneys' fees under Section 3-411 are few. Therefore, although it does not provide extensive analysis of Section 3-411, the *State Bank & Trust v. First State Bank of Texas* litigation is significant. Factually complex and involving cashier's checks issued respectively by both banks, the key for Section 3-411 analysis was the cashier's check issued by the defendant, First State Bank of Texas ("FSBT"). The plaintiff contended for attorneys' fees under Section 3-411(b). The trial court rejected the contention. The trial court concluded that even though FSBT ultimately lost and had to pay its cashier's check, FSBT had a "reasonable, though ultimately "unsupportable," ground to believe it had a claim or defense against the plaintiff.[111] The trial court basically limited it factual comments to noting that FSBT's borrower rather than FSBT had provided the funds for the cashier's check.

The trial court also noted that even if the plaintiff had prevailed, the plaintiff would only have been allowed fees from the date it amended its complaint to include the Section 3-411(b) claim.

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[109] *Id. at* 654.

[110] *See* U.C.C. Comment 2 to Section 3-411.

[111] *State Bank & Trust v. First State Bank of Texas*, 39 U.C.C. Rep. Serv.2d 191 (N.D. Okla. 1999).

The U.S. Court of Appeals for the Tenth Circuit affirmed the trial court on the Section 3-411(b) ruling.[112] Although the Tenth Circuit's ruling delves into other interesting cashier's check issues, it sheds no further light on Section 3-411(b) standards.

Are lawyers, payees and bankers in the jungle of rejected cashier's checks left completely in the dark? Not if U.C.C. Section 3-416 illuminates.

Section 3-416 imposes transfer warranties on certain person who transfer instruments for consideration. This section does not directly apply to issuers of cashier's checks.[113] But case law about attorneys' fee recovery under Section 3-416 illuminates to an extent Section 3-411(b). This is because Section 3-416 includes a Comment with language identical to the pertinent part of Comment 2 to Section 3-411.[114]

Section 3-416 legal authorities tend to require another state statute or contract language to expressly include attorneys' fees recovery for the plaintiff, rather than merely interpreting the U.C.C. comment to include attorneys' fees. Examples are *TD Banknorth, N.A. v. Key Bank, N.A.*,[115] and *Grasso v. Crow*.[116]

The successful plaintiff in *South Central Bank of Daviess County v. Lynneville National Bank*[117] shines further light anecdotally. Having prevailed on appeal to get paid the face amount of the cashier's check it held in due course, the plaintiff negotiated after remand on the issue of expenses and consequential damages. According to one of the plaintiff's lawyers, the plaintiff settled the attorneys' fees part of its claim for half the attorneys' fees.[118]

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[112] *State Bank & Trust v. First State Bank of Texas*, 242 F.3d 390, 43 U.C.C. Rep. Serv.2d 1206 (10th Circ. 2000). The appeals court rejected as "frivolous" the plaintiff's assertion that because FSBT ultimately lost the issue, FSBT must lose under Section 3-411(b). *Id*. The Tenth Circuit partially reversed on certain attorneys' fees details under a non-U.C.C. Oklahoma statute not pertinent to Section 3-411 analysis.

[113] *See* U.C.C. 3-203(a) (transfer is delivery by a person other than an instrument's issuer).

[114] Compare U.C.C. 3-416 Comment 6 to U.C.C.3-411 Comment 2.

[115] *TD Banknorth, N.A. v. Key Bank, N.A.,* 463 F. Supp. 2d 87, 88 (D. Me. 2006).

[116] *Grasso v. Crow,* 67 Cal. Rptr. 2d 367, 368 (Cal. App. 2d Dist. 1997).

[117] *South Central Bank of Daviess County v. Lynneville National Bank*, 901 N.E.2d 576 (Ind. Ct. App. 2009).

[118] Author's notes, Sept. 7, 2020, call with John T. McGarvey, who was plaintiff co-counsel in a *South Central Bank of Daviess County v. Lynneville National Bank*, 901 N.E.2d 576 (Ind. Ct. App. 2009) and is a member of the Permanent Editorial Board of the U.C.C.

CONCLUSION

Cashier's checks are best analyzed as ordinary negotiable instruments subject to a special damages statute that favors to some extent the cashier's check holder. Issuers and remitters, however, should heed the risk that a court will be influenced by pre-Revision legal authorities and also public policy considerations to be especially eager to force payment of cashier's checks, such as by finding a plaintiff to be an HDC.

Payees, their obligors, depository banks and others who desire a more cash equivalent transaction should consider other payment types. Depository banks and issuers do well to consider concepts analyzed above when writing bank policies and when deciding how immediately to make funds from cashier's checks available.

Although a powerful type of payment, cashier's checks sometimes are paper tigers without a bite due to lack of HDC status. For all concerned, in the jungle of cashier's check law, forewarned is forearmed.