

Principles of Cheque Fraud Claims: A Brief Introduction

A great deal of fraudulent activity is carried out through the use of fraudulent or phoney cheques. Many other fraud utilize banking facilities. I learned many years ago that it is very important to keep your eyes open to the possibilities inherent in cheque fraud claims. Depending on how quickly you act, you may be able to prevent the loss from a current, or recover funds from a fraudster or a bank.

In my experience, a lot of people are unfamiliar with basic bills of exchange concepts. Fair enough; these can be counter intuitive at times. However, there are certain basic things that everyone should try to be aware of so that you can make the most of what opportunities come your way.

Please note that this short piece is an introduction only and is designed to provide a brief overview of what to look for when you are confronted with a cheque fraud case. Any omissions (and there will be omissions) are for the sake of brevity and clarity.

Basic Concepts

Some basic concepts are helpful. First, the person or entity on whose account a cheque is drawn is called the “drawer”. The person to whom the cheque is payable is called the payee. The bank on which a cheque is drawn is called the “drawee bank”. The bank (or credit union) into which a cheque is deposited or at which it is negotiated is called the “collecting bank”. An account agreement is an agreement between the customer and his/her own bank. Normally, an account agreement will contain certain “verification” provisions which means that the customer has a certain length of time from the date statements are delivered in order to raise objections about the legitimacy of cheques. The Canadian Payment Association Clearing System is a system by which the collecting banks take cheques which were deposited to them, and “clear” the cheques by returning them to the drawee bank. Once this occurs, and once the time for returning the cheques back through the Clearing has expired, the drawee bank will debit its customer’s account to “pay” for the cheque.

There are several ways that a loss can occur either through a fraudulent cheque or the mis-use of legitimate cheque. First, there is a case of the forged drawer’s signature. Where a drawer’s signature is forged, it has no effect whatsoever and the cheque is essentially a worthless piece of paper. In the banking system, the drawee bank is deemed to know its customer’s signature. Therefore, if a fraudster negotiates a cheque with the forged drawer’s signature, it is the responsibility of the drawee bank to catch this and return the cheque through the clearing essentially within a day of receipt. After that, the time limit under the CPA Rules expires and the only recourse for the customer will be to see if recovery can be had from its own bank. These days, that is unlikely.

Next, we have cheques which are “converted”. A cheque which bears a legitimate signature is a valuable bill of exchange and is worth whatever the face value of the cheque is. If a fraudster takes the cheque, forges the endorsement of the legitimate payee, and then deposits the cheque to his/her own account, then both the fraudster and the collecting bank have “converted” that cheque. A subsequent action by the legitimate payee, or in some circumstances, the drawer as against the collecting bank, will normally be successful. In actions like this, it is no excuse for the collecting bank to say that it exercises due diligence since conversion is what is known as a “straight liability” tort.

A cheque is “materially altered” when a fraudster alters, for example, the payee name, or the amount of a cheque without the authority of the drawer of the cheque.

Finally, we have counterfeit cheques. Counterfeit cheques have become increasingly common, as a result of technological change which makes the counterfeiting process much easier. For our purposes here, we will call a counterfeit cheque one which is created entirely by a fraudster. It may be a duplicate of a real cheque, or simply a complete fabrication. But in any event, it is not the cheque which is taken from a customer’s cheque stock. Normally, the counterfeiter will have obtained some document which contains authorized signatures and these signatures will be scanned and inserted onto the counterfeit cheque. A counterfeit cheque is the same as forgery, as far as the bills of exchange regime is concerned. It is wholly inoperative and it is essentially a worthless piece of paper. As with a cheque bearing a forged drawer signature, a drawee bank has one day to return counterfeit cheque, after the cheque has found its way to the drawee bank through the Clearing.

The CPA Rules provide for longer return times for both converted cheques (cheques bearing forged endorsements) and materially altered cheques. It is for this reason that there is ample opportunity with respect to cases of conversion and materially altered cheques to both prevent the loss from occurring in the first place, or to effect some kind of recovery as against the collecting bank.

In the case of a legitimate cheque bearing a forged endorsement, the drawee bank has 6 years (from the date of receipt) to return the cheque back through the Clearing, thereby putting the loss on the collecting bank. It is also possible for the “true owner” of the cheque or the person or entity “entitled to immediate possession” to sue the collecting bank in conversion in which case such an action must be brought within two years (in Ontario) from the date of discovery. In the case of a materially altered cheque, the drawee bank has 90 days from the date of receipt to return the cheque back through the Clearing to put the loss on the collecting bank. I think that the loss is now clear that the act by a collecting bank in accepting for deposit or materially altered cheque also amounts to a conversion. Therefore, if it is not practical to have the drawee bank return the altered cheque through the Clearing, or if the 90 day period has passed, then the true owner of the cheque can sue the collecting bank for conversion. Once again, the action must be brought within two years of the date of discovery.

What to Do When Confronted with a Cheque Fraud

As can be seen above, there are a variety of different possibility that arise in the case of a cheque fraud. The very first thing to try to figure out is either your cheque was counterfeit or forged on the one hand or converted or altered on the other hand. In order to do this, the first thing you need to do is to get a copy of the cheque, both front and back. You need to get an explanation from the client as to the nature of the loss; was the cheque deposited to the account of the payee? Has there been an alteration. In the event that the cheque is a forgery or a counterfeit, it is necessary to get a copy of the customer’s account agreement with its bank. If there is going to be any claim against the customer’s own bank is imperative that notice of the loss be given to the bank immediately even if the full particulars are not yet known.

Finally, it is always helpful to get the advice of someone who knows what he is doing.