Employee Theft: Liability

Article By:

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If your employee steals customers' checks received for payment, what do you do? Fire her. Call the police. Then call your insurer. You should have employee fidelity coverage. After that, call your lawyer. Someone may have to pay you back other than the fired employee and your insurer.

That someone is the bank that cashed the checks for the employee that stole the customers' payments. Recently, Giordano, Halleran & Ciesla, P.C. was able to recover over $300,000 from the depository bank when an employee stole customer payments from her employer, fraudulently endorsed the employer's name, and deposited them into her personal bank account. Another $100,000 was recovered from the CGL insurer based upon the rider insuring against employee theft.

The case involved a bookkeeper who stole checks given to the employer. The checks were made out to the employer's company. The employer had given the employee control over the negotiable instruments to record receipt of the same in the company's computer based accounts receivable ledger. Statutorily, per the UCC, N.J.S.A. 12A:3-405, the employer had entrusted the employee with the negotiable instruments. The employee, or "faithless agent", stole the checks, applied the employer company's endorsement, endorsed her name below, and deposited them into her own checking account via an ATM. The bank never checked the endorsements, and made the funds available for withdrawal the next day. The employee withdrew the funds the next day, and repeated this thousands of times over three years.

Generally, if a bank pays a negotiable instrument over a fraudulent endorsement it has strict liability. See UCC, N.J.S.A. 12A:3-420. But, if an employer entrusts an employee with the negotiable instrument, and the employee fraudulently applies the employer's endorsement so as to negotiate the check to herself, then the endorsement is effective, and is not fraudulent. See UCC, N.J.S.A. 12A:3-405. This is typically true because the employer had not safeguarded the negotiable instrument, and had entrusted it to a faithless agent, i.e., the employee. In such a case the bank no longer has strict liability. The question of the bank's liability for accepting and paying over the faithless agent's endorsement then devolves to one of comparative negligence rather than the strict liability.

In such a circumstance, the UCC, N.J.S.A. 12A:3-405, allows an employer to pursue recovery from the depository bank based upon a comparative negligence theory. The employer can still recover if the bank failed to "exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss." The point is, even though the bank has statutory strict liability for accepting and paying on a fraudulently endorsed check, the bank has a statutory defense. There is a shifting of the burden away from the bank if the stolen and fraudulently endorsed negotiable instrument was entrusted to a faithless agent employee. However, simply because the bank does not have strict liability, you should not give up. The UCC allows for a presentation of a claim against the bank based upon the comparative negligence between the employer and the bank, i.e., the employer’s negligence in entrusting the negotiable instrument to the faithless employee, and not having sufficient controls to determine it is missing, versus the bank’s negligence in accepting the fraudulent endorsement.

Once a claim is filed the prospect of the bank having to have its own employees and policy makers sit through a trial whereby the bank’s operating procedure and negligence is at issue is extremely helpful in obtaining a settlement. Larger banks pay out enormous sums of money over fraudulent endorsements each year. Some accept over $20 million in ATM deposits per day. Some do not check the endorsements of these deposits, and routinely allow access to funds in less than 24 hours. Banks do not want to air in a public forum like a trial the issue that the endorsements on hundreds of millions, even billions of checks deposited at ATMs, are not checked. The advent of smart phone check depositing is just as problematic. With the right fact pattern, or more properly the right presentation of the fact pattern, the bank should settle for some percentage of the lost sums based upon their comparative negligence, even though the statute does not hold them strictly liable for the loss.

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