GALLET DREYER & BERKEY, LLP

ATTORNEYS AT LAW

# Attorney Escrow Accounts, IOLA and Ethics. What Every New Lawyer Needs to Know.

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# a/k/a . . . How to avoid finding yourself in a place you never want to be

# Source of law

Appellate Division Rules – They admitted you; they make the rules that allow you to stay. The rules are in your materials.

22 NYCRR Part 1200 Rule 1.15 of the Rules of Professional Conduct for Attorneys; and
22 NYCRR Part 1300 Rule 1300.1 – Dishonored Check Reporting.

# Multistate practice

Which state's rules should apply?

1. The literal rules
2. The ethical principles
3. Client agreement

# Two important questions before we start talking about the rules

Raise your left hand if you have read the Appellate Division Rules.

Raise your right hand if you are admitted to practice law in New York, or about to be.

**What happens if you raised you right hand but not your left hand?**

# Ethics Lesson #1

**Anyone want to hazard a guess?**

False swearing to the Appellate Division is unethical.

# What Is an Attorney Escrow Account?

An account that holds OPM (Other People's Money) – No commingling with your own funds.

If OPM is held incident to the practice of law **OR** if someone involved might think you are acting as an attorney.

Must deposit those funds into an account at a bank IN NEW YORK.

# Opening an Escrow Account

1. **Account in name of provider of legal service (law firm, sole proprietor).**
2. **Subtitle the account – THREE SUBTITLE CHOICES! – Attorney Special Account, Attorney Trust Account, *or* Attorney Escrow Account.**
3. **You can have a common account with multiple clients BUT if it is interest bearing – use separate subaccounts. CLIENT GETS INTEREST! Get SS#.**
4. **Who can sign the signature card/checks? Attorneys ONLY!**
5. **Signature stamps? *(Wow! There's an ethics opinion that allows it but not a good idea.)***
6. **Be prepared for the third degree from your bank.**
7. **You MUST keep detailed records and copies of documents.**

# Two Types of Escrow Accounts
# IOLA vs. Other
## IOLA = Interest on Lawyer Accounts

# IOLA vs. Other (Regular) Escrow Acocunts

IOLA often incorrectly described as non-interest bearing. The ONLY REAL DIFFERENCE is who gets the interest on the account.

**Not IOLA** – The parties can agree who gets the interest.

**IOLA** – The IOLA Fund for New York gets the interest on the account. If parties are not getting interest, THEN must be IOLA

## All other rules are the same

# What the IOLA Fund Is Not

1. It is not a regulator of escrow accounts.
2. It does not make ethics rules.
3. It does not answer ethics questions.
4. It has nothing to do with non-IOLA accounts.
5. It has nothing to do with bounced check reporting.
6. It does not provide money to the Lawyer's Fund for Client Protection.
7. It does not discipline attorneys.

# To IOLA or Not to IOLA

## Attorney's good faith judgment

Fiduciary duty to maximize benefits to client of holding funds.

How long will the deposit exist?

How much interest will be earned? Guideline: <$150 of interest expected, or even more if less than the cost of establishing and maintaining the account.

**IOLA is optional. Interest-bearing account is always a permitted alternative, BUT if no interest, then must be an IOLA.**

# FDIC Insurance

1. $250,000 FDIC insurance – IOLA versus Non-IOLA is the same.
2. Insurance is per beneficial ownership interest.
3. Separate from your own accounts at the bank.
4. You must maintain records of separate ownership interests and amounts, but you must do that anyway as an attorney, so no extra burden.

# NY GBL 778-a

**Special rules IF a down payment is to be held in escrow for the purchase of a home.**

1. Segregate and safeguard the down payment.
2. Not commingle with the escrow agent's funds.
3. Contract must identify the escrow agent and the bank where funds are deposited.
4. May comingle with other escrowed funds
5. Need not be interest-bearing.

- Condos and Coops
  - General Business Law (GBL) §352-e(2-b)
    - "all . . . down-payments . . . by purchasers of residential units shall be held in a special escrow account pending delivery of the [coop or condo], unless insurance of such funds in a form satisfactory to the attorney general has been obtained prior thereto.
  - GBL §352-h
    - Funds must be held in trust and shall not become the property of the sponsor/seller.
  - 13 NYCRR §18.3, §20.3, §21.3, §22.3, §23.3, §24.3, §25.3
    - General requirements for format and content of condo and coop offering plans.

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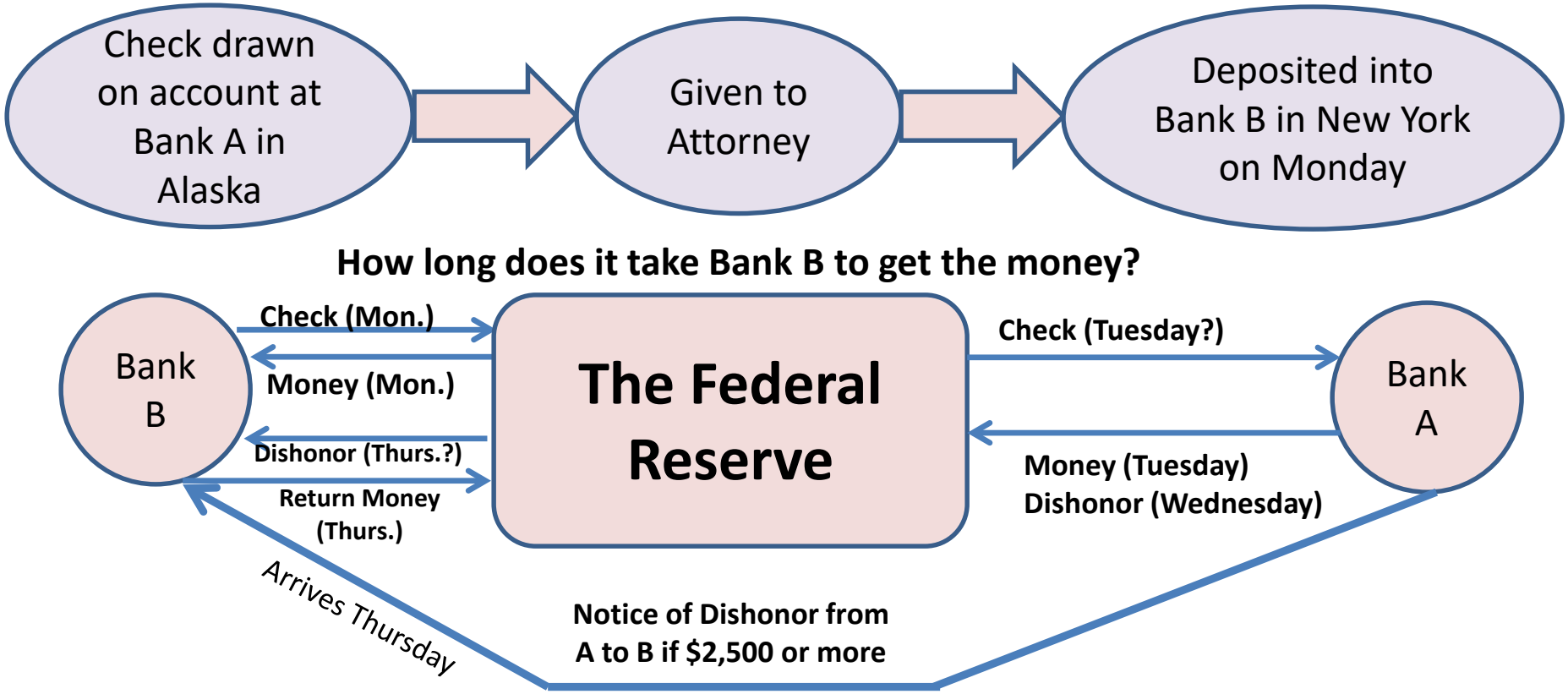
# Time to Disburse: UCC, Fed. Reg. CC and Releasing Funds

1. **Uncollected versus available for withdrawal. Available for withdrawal does not mean bank can't charge back a deposited check that bounces.** Greenberg, Trager & Herbst, LLP v HSBC Bank USA. 17 NY 3d 565 (2011). In your materials.
2. **NO checks against undeposited or uncollected funds.**
3. **Wire transfers into your account – be careful.**
4. **No cash withdrawals! No checks payable to cash! No ATM withdrawals!**

# The Biggest Secret in Banking . . .



# The Bounced Check Rule

1. Only open escrow account with a bank that agrees to the bounced check rule.
2. Bank must report ANY situation in which a check bounces on an attorney escrow account because of insufficient funds to the Lawyer's Fund.
3. Bank has 10 days to withdraw report ONLY for bank mistake. Bank mistake, NOT your mistake. The attorney covered the overdraft IS NOT a bank mistake.
4. If not withdrawn, report is forwarded to disciplinary committee

# Proposed Amendments

1. Banks must provide notice of any overdraft on an escrow account.
2. Prohibit overdraft protection on attorney escrow accounts.
    i. No commingling should already prohibit this.
3. Make it impossible to use ATM card to make withdrawals.
    i. Already a rules violation. They want technology to prohibit cards from being used for withdrawals.
4. Appellate Divisions may restrain attorney escrow accounts of lawyers who are determined to be a public threat.
    i. The devil is in the details. What if client is entitled to funds and needs them, let's say, to consummate a transaction.

# Scams Targeting Attorneys

1. Attorney given more money than needed for the transaction.
2. Attorney collects money for "client."
3. Attorney asked to reissue an escrow account check – AFTER they give you back the original. Oops! The depositor electronically deposited it.

# Protective Steps

1. WAIT after a check is deposited – If you are worried, call drawee bank. Was the check paid?
2. NEVER disburse funds on the day you deposit the funds if deposited by check.
3. If you have to flip money fast, get a wire transfer.
4. Be suspicious. Do you KNOW and TRUST the source of the money?

# If you are not sure?

1. NYSBA Committee on Professional Ethics
2. City Bar Ethics Hotline
3. Err on the side of caution
4. My rule: Never send money "outside" the transaction.

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# Ethics and Banking

## Protecting Your Client's Money And Your Law License

**I.** Introduction.

**(A)** The Appellate Division rules on attorney escrow accounts.

**(i)** The rules are in these materials. Reading the rules is required! – You must certify that you have read the rules when you file your biennial registration statement.

**(ii)** The escrow rules apply whenever an attorney is "in possession of funds belonging to another person incident to the lawyer's practice of law." Do not read "incident to the practice of law" narrowly.

**(B)** Opening an escrow account

**(i)** Who can sign the signature card – Attorneys only.

**(a)** BUT note ethics opinion regarding use of signature stamps by paralegal – it's only a NYSBA opinion, so be cautious about reliance on the opinion.

**(ii)** Be careful how you title the account – follow the rules. Your choices are ONLY "Attorney Special Account," "Attorney Trust Account" or "Attorney Escrow Account."

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**(ii)** Be alert - If it's too good to be true, it is. If you have any suspicions at all, call the bank on which check is draw, find out if it was paid, and wait 2 full days after they say the check was paid.

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# Rules of Professional Conduct

# 22 N.Y.C.R.R. Part 1200

[As amended, effective April 1, 2009]

**RULE 1.15:**

**Preserving Identity of Funds and Property of Others; Fiduciary Responsibility; Commingling and Misappropriation of Client Funds or Property; Maintenance of Bank Accounts; Record Keeping; Examination of Records**

**(a) Prohibition Against Commingling and Misappropriation of Client Funds or Property.**
A lawyer in possession of any funds or other property belonging to another person, where such possession is incident to his or her practice of law, is a fiduciary, and must not misappropriate such funds or property or commingle such funds or property with his or her own.

**(b) Separate Accounts.**

(1) A lawyer who is in possession of funds belonging to another person incident to the lawyer's practice of law shall maintain such funds in a banking institution within New York State that agrees to provide dishonored check reports in accordance with the provisions of 22 N.Y.C.R.R. Part 1300. "Banking institution" means a state or national bank, trust company, savings bank, savings and loan association or credit union. Such funds shall be maintained, in the lawyer's own name, or in the name of a firm of lawyers of which the lawyer is a member, or in the name of the lawyer or firm of lawyers by whom the lawyer is employed, in a special account or accounts, separate from any business or personal accounts of the lawyer or lawyer's firm, and separate from any accounts that the lawyer may maintain as executor, guardian, trustee or receiver, or in any other fiduciary capacity; into such special account or accounts all funds held in escrow or otherwise entrusted to the lawyer or firm shall be deposited; provided, however, that such funds may be maintained in a banking institution located outside New York State if such banking institution complies with 22 N.Y.C.R.R. Part 1300 and the lawyer has obtained the prior written approval of the person to whom such funds belong specifying the name and address of the office or branch of the banking institution where such funds are to be maintained.

(2) A lawyer or the lawyer's firm shall identify the special bank account or accounts required by Rule 1.15(b)(1) as an "Attorney Special Account," "Attorney Trust Account," or "Attorney Escrow Account," and shall obtain checks and deposit slips that bear such title. Such title may be accompanied by such other descriptive language as the lawyer may deem appropriate, provided that such additional language distinguishes such special account or accounts from other bank accounts that are maintained by the lawyer or the lawyer's firm.

(3) Funds reasonably sufficient to maintain the account or to pay account charges may be deposited therein.

(4) Funds belonging in part to a client or third person and in part currently or potentially to the lawyer or law firm shall be kept in such special account or accounts, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client or third person, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

**(c) Notification of Receipt of Property; Safekeeping; Rendering Accounts; Payment or Delivery of Property.**
A lawyer shall:

(1) promptly notify a client or third person of the receipt of funds, securities, or other properties in which the client or third person has an interest;

(2) identify and label securities and properties of a client or third person promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable;

(3) maintain complete records of all funds, securities, and other properties of a client or third person coming into the possession of the lawyer and render appropriate accounts to the client or third person regarding them; and

(4) promptly pay or deliver to the client or third person as requested by the client or third person the funds, securities, or other properties in the possession of the lawyer that the client or third person is entitled to receive.

**(d) Required Bookkeeping Records.**

(1) A lawyer shall maintain for seven years after the events that they record:

(i) the records of all deposits in and withdrawals from the accounts specified in Rule 1.15(b) and of any other bank account that concerns or affects the lawyer's practice of law; these records shall specifically identify the date, source and description of each item deposited, as well as the date, payee and purpose of each withdrawal or disbursement;

(ii) a record for special accounts, showing the source of all funds deposited in such accounts, the names of all persons for whom the funds are or were held, the amount of such funds, the description and amounts, and the names of all persons to whom such funds were disbursed;

(iii) copies of all retainer and compensation agreements with clients;

(iv) copies of all statements to clients or other persons showing the disbursement of funds to them or on their behalf;

(v) copies of all bills rendered to clients;

(vi) copies of all records showing payments to lawyers, investigators or other persons, not in the lawyer's regular employ, for services rendered or performed;

(vii) copies of all retainer and closing statements filed with the Office of Court Administration; and

(viii) all checkbooks and check stubs, bank statements, prenumbered canceled checks and duplicate deposit slips.

(2) Lawyers shall make accurate entries of all financial transactions in their records of receipts and disbursements, in their special accounts, in their ledger books or similar records, and in any other books of account kept by them in the regular course of their practice, which entries shall be made at or near the time of the act, condition or event recorded.

(3) For purposes of Rule 1.15(d), a lawyer may satisfy the requirements of maintaining "copies" by maintaining any of the following items: original records, photocopies, microfilm, optical imaging, and any other medium that preserves an image of the document that cannot be altered without detection.

**(e) Authorized Signatories.**

All special account withdrawals shall be made only to a named payee and not to cash. Such withdrawals shall be made by check or, with the prior written approval of the party entitled to the proceeds, by bank transfer. Only a lawyer admitted to practice law in New York State shall be an authorized signatory of a special account.

**(f) Missing Clients.**

Whenever any sum of money is payable to a client and the lawyer is unable to locate the client, the lawyer shall apply to the court in which the action was brought if in the unified court system, or, if no action was commenced in the unified court system, to the Supreme Court in the county in which the lawyer maintains an office for the practice of law, for an order directing payment to the lawyer of any fees and disbursements that are owed by the client and the balance, if any, to the Lawyers' Fund for Client Protection for safeguarding and disbursement to persons who are entitled thereto.

**(g) Designation of Successor Signatories.**

(1) Upon the death of a lawyer who was the sole signatory on an attorney trust, escrow or special account, an application may be made to the Supreme Court for an order designating a successor signatory for such trust, escrow or special account, who shall be a member of the bar in good standing and admitted to the practice of law in New York State.

(2) An application to designate a successor signatory shall be made to the Supreme Court in the judicial district in which the deceased lawyer maintained an office for the practice of law. The application may be made by the legal representative of the deceased lawyer's estate; a lawyer who was affiliated with the deceased lawyer in the practice of law; any person who has a beneficial interest in such trust, escrow or

special account; an officer of a city or county bar association; or counsel for an attorney disciplinary committee. No lawyer may charge a legal fee for assisting with an application to designate a successor signatory pursuant to this Rule.

(3) The Supreme Court may designate a successor signatory and may direct the safeguarding of funds from such trust, escrow or special account, and the disbursement of such funds to persons who are entitled thereto, and may order that funds in such account be deposited with the Lawyers' Fund for Client Protection for safeguarding and disbursement to persons who are entitled thereto.

**(h) Dissolution of a Firm.**
Upon the dissolution of any firm of lawyers, the former partners or members shall make appropriate arrangements for the maintenance, by one of them or by a successor firm, of the records specified in Rule 1.15(d).

**(i) Availability of Bookkeeping Records: Records Subject to Production in Disciplinary Investigations and Proceedings.**
The financial records required by this Rule shall be located, or made available, at the principal New York State office of the lawyers subject hereto, and any such records shall be produced in response to a notice or subpoena duces tecum issued in connection with a complaint before or any investigation by the appropriate grievance or departmental disciplinary committee, or shall be produced at the direction of the appropriate Appellate Division before any person designated by it. All books and records produced pursuant to this Rule shall be kept confidential, except for the purpose of the particular proceeding, and their contents shall not be disclosed by anyone in violation of the attorney client privilege.

**(j) Disciplinary Action.**
A lawyer who does not maintain and keep the accounts and records as specified and required by this Rule, or who does not produce any such records pursuant to this Rule, shall be deemed in violation of these Rules and shall be subject to disciplinary proceedings.

# Dishonored Check Reporting Rule

Banks in New York State which offer fiduciary accounts to attorneys are required to report all instances of bounced checks on attorney trust, special and escrow accounts.

The reports are forwarded to the **New York Lawyers' Fund for Client Protection**, which serves as a statewide clearing house for these reports.

Banks have 10 days to withdraw reports that have been issued in error. If not withdrawn, the reports are sent to the appropriate Attorney Grievance Committee for investigation.

A bounced-check report generally triggers an audit of the attorney's trust, special or escrow account.

The Appellate Divisions' uniform court rule is reported at 22 NYCRR Part 1300.1.

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## NY Codes, Rules, and Regulations, Part 1300

Dishonored Check Reporting Rules for Attorney Special, Trust and Escrow Accounts

**22 NYCRR 1300.1 Dishonored check reports.**

**A.** Special bank accounts required by rule 1.15 of the Rules of Professional Conduct (22 NYCRR 1200.46) shall be maintained only in banking institutions which have agreed to provide dishonored check reports in accordance with the provisions of this section.

**B.** An agreement to provide dishonored check reports shall be filed with the Lawyers' Fund for Client Protection, which shall maintain a central registry of all banking institutions which have been approved in accordance with this section, and the current status of each such agreement. The agreement shall apply to all branches of each banking institution that provides special bank accounts for attorneys engaged in the practice of law in this State, and shall not be cancelled by a banking institution except on 30 days' prior written notice to the Lawyers' Fund for Client Protection.

**C.** A dishonored check report by a banking institution shall be required whenever a properly payable instrument is presented against an attorney special, trust or escrow account which contains insufficient available funds, and the banking institution dishonors the instrument for that reason. A properly payable instrument means an instrument which, if presented in the normal course of business, is in a form requiring payment under the laws of the State of New York.

**D.** A dishonored check report shall be substantially in the form of the notice of dishonor which the banking institution customarily forwards to its customer, and may include a photocopy or a computer-generated duplicate of such notice.

**E.** Dishonored check reports shall be mailed to the Lawyers' Fund for Client Protection, 119 Washington Avenue, Albany, NY 12210, within five banking days after the date of presentment against insufficient available funds.

**F.** The Lawyers' Fund for Client Protection shall hold each dishonored check report for 10 business days to enable the banking institution to withdraw a report provided by inadvertence or mistake; except that the curing of an insufficiency of available funds by a lawyer or law firm by the deposit of additional funds shall not constitute reason for withdrawing a dishonored check report.

**G.** After holding the dishonored check report for 10 business days, the Lawyers' Fund for Client Protection shall forward it to the attorney disciplinary committee for the judicial department or district having jurisdiction over the account holder, as indicated by the law office or other address on the report, for such inquiry and action that attorney disciplinary committee deems appropriate.

**H.** Every lawyer admitted to the Bar of the State of New York shall be deemed to have consented to the dishonored check reporting requirements of this section. Lawyers and law firms shall promptly notify their banking institutions of existing or new attorney special, trust, or escrow accounts for the purpose of facilitating the implementation and administration of the provisions of this section.

*text is current through December.24,.2013*

| Greenberg, Trager & Herbst, LLP v HSBC Bank USA |
| --- |
| 2011 NY Slip Op 07144 [17 NY3d 565] |
| October 13, 2011 |
| Ciparick, J. |
| Court of Appeals |
| Published by New York State Law Reporting Bureau pursuant to Judiciary Law § 431. |
| As corrected through Wednesday, December 14, 2011 |

[*1]

**Greenberg, Trager & Herbst, LLP, Appellant,**
**v**
**HSBC Bank USA et al., Respondents. (And a Third-Party Action.)**

Argued September 7, 2011; decided October 13, 2011

*Greenberg, Trager & Herbst, LLP v HSBC Bank USA*, 73 AD3d 571, affirmed.

{**17 NY3d at 571} OPINION OF THE COURT

Ciparick, J.

In this dispute between a law firm and two banks, the issues presented are (1) the scope of the duty a payor bank owes to a noncustomer depositor of a counterfeit check and (2) the scope of the duty a depositary bank owes its customer when it acts as a collecting bank during the check collection process. We conclude that neither the depositary/collecting bank nor [*2] the payor bank violated any duty owed to the depositor and that summary judgment dismissing the complaint was properly granted.

I.

Plaintiff Greenberg, Trager & Herbst, LLP (GTH) is a law firm primarily involved in construction litigation law. In September 2007, a partner at GTH received an e-mail from a representative of Northlink Industrial Limited (Northlink), a Hong Kong company. The e-mail stated that Northlink was looking for legal representation to, among other things, assist it in the collection of debts owed by its North American customers. A series of e-mails

followed discussing the nature of Northlink's desired representation. At some point, GTH indicated a willingness to represent Northlink and requested a $10,000 retainer. The law firm was informed that a Northlink customer had sent a payment to GTH and that GTH could take its retainer from those funds. A Citibank check for $197,750 was received by GTH and GTH was instructed, via e-mail, to remit the funds to Northlink while retaining $10,000 as a retainer. The e-mail also provided wiring instructions to Citibank in Hong Kong. On Friday, September 21, 2007, GTH deposited the check into its attorney trust account at HSBC.

The next business day, Monday, September 24th, the HSBC account reconciliation department processed the check and pursuant to the federal funds availability law provisionally credited GTH's account for $197,750. HSBC, like most commercial banks, presents its checks through the Federal Reserve Bank. HSBC determines which Federal Reserve Bank should receive{**17 NY3d at 572} the check for presentment to the appropriate payor bank by utilizing the American Bankers Association routing number located on the bottom of the check. The routing number is part of the microencoding number (MICR) on the bottom of every check. The routing number on the bottom of this check read 026009645. According to HSBC, this routing number indicated that the check should be sent to the Federal Reserve Bank of Philadelphia (FRBP) for presentment to the appropriate payor bank. Accordingly, HSBC sent the check to FRBP for processing. FRBP presented an image replacement document (IRD)[FN1] of the check to Citibank's Item Processing North Department in Englewood Cliffs, New Jersey (Item Processing North) that same day.

According to Citibank, Item Processing North processes only checks with the following three routing numbers: 021000089, 021272655 and 221172610. If a check contains a routing number other than one of these three routing numbers, the check cannot be processed by Item Processing North because it only has access to account information associated with the three routing numbers. Because the routing number was not recognized by Item Processing North, the [*3]automated sorting system directed the IRD to the reject pocket. This happens when there is an issue with the MICR on the check.[FN2] An Image Processing North clerk examined the IRD and determined that the routing number was not a number that belonged to Image Processing North. Image Processing North sent the IRD back to FRBP, with the notation "sent wrong." The FRBP sent the IRD back to HSBC.

HSBC received the IRD with the notation "sent wrong" the next day, September 25,

2007.[FN3] According to HSBC, when {**17 NY3d at 573}a check is returned for reasons other than dishonor, such as a damaged or illegible routing number, it is known in the industry as an "administrative return." HSBC also noted that when a payor bank dishonors a check, HSBC typically receives an Electronic Advanced Return Notification System (EARNS) notification. HSBC did not receive such a notice on September 24 or 25. Because the check was marked "sent wrong," HSBC assumed that there was a problem with the routing number that required repairing. HSBC then repaired the routing number by utilizing the partial routing number located on the top right hand corner of the check. HSBC, using the repaired routing number, determined that the check actually belonged to Citibank, Las Vegas. HSBC placed the repaired routing number on the bottom of the check. On September 26, 2007, HSBC sent the check to the Federal Reserve Bank, San Francisco (FRBS). HSBC never informed GTH of the "administrative return" of the check.

On September 27, 2007, a GTH partner called a representative of HSBC inquiring as to whether the check had "cleared" and if the funds were available for disbursement.[*4] According to GTH, a five-year banking relationship existed between them.[FN4] GTH was informed that the funds were available. Later that day, GTH wired $187,750 from its account to Hong Kong pursuant to the wiring instructions it received from Northlink. GTH claims that, but for the assurance that the check had "cleared," it would not have forwarded the funds. On September 28, 2007, HSBC confirmed to GTH that the wire transfer had been consummated.

On October 2, 2007, HSBC received an EARNS notice from Citibank that the check was being dishonored as "RTM [return to maker] Suspect Counterfeit." An HSBC Branch Manager later contacted GTH, informing them that the check had been dishonored and returned as counterfeit. HSBC then revoked its provisional settlement and charged back GTH's account.{**17 NY3d at 574}

On October 17, 2007, GTH commenced this action against HSBC and Citibank sounding in conversion and conspiracy;[FN5] negligence and negligent misrepresentation by HSBC for failure to inform GTH that the check had been returned and dishonored on September 25, and for informing GTH over the phone that the funds had "cleared" and were available for disbursement; and negligence by Citibank for failing to detect that the check was counterfeit when it was originally presented to Image Processing North on September 24. Both Citibank and HSBC moved for summary judgment dismissing the complaint.

Supreme Court ruled from the bench that HSBC had no duty under the Uniform Commercial Code (UCC) to inform GTH that the check had been returned "sent wrong" on September 25th, but rather that the dishonor actually took place when HSBC discovered the check was "Suspect Counterfeit." The court granted both HSBC and Citibank's motions and dismissed the complaint in its entirety.

The Appellate Division affirmed, holding that because the check had not been dishonored pursuant to UCC 4-212,[FN6] HSBC had no duty to inform GTH of the administrative return of the check. The court further held that, even if an HSBC employee misrepresented that the check had cleared, GTH's reliance on such a misrepresentation does not give rise to an action [*5]for negligent misrepresentation barring a fiduciary relationship, which, it said, does not exist between a bank and its customer. The court additionally found that if the principle of estoppel governs the case, GTH was in the best position to guard against the risk of a counterfeit check by knowing its client. The court finally stated that the personnel at Citibank were not in a position to discern whether the check was counterfeit and had no duty to inform HSBC at that time (*see Greenberg, Trager & Herbst, LLP v HSBC Bank USA*, 73 AD3d 571, 572 [1st Dept 2010]). We granted GTH leave to appeal (15 NY3d 707 [2010]) and now affirm.{**17 NY3d at 575}

II.

The manner in which checks are processed by banks is governed by the Uniform Commercial Code. The UCC defines a "Depositary Bank" as "the first bank to which an item is transferred for collection" (UCC 4-105 [a]). A "Collecting Bank" is defined as "any bank handling the item for collection except the payor bank" (UCC 4-105 [d]). A "Payor Bank" is defined as "a bank by which an item is payable as drawn or accepted" (UCC 4-105 [b]). An "Intermediary Bank" is defined as "any bank to which an item is transferred in course of collection except the depositary or payor bank" (UCC 4-105 [c]).

In a typical check presentation scenario, a bank customer deposits a check at its bank, the depositary bank. After deposit by the customer, the depositary bank either presents the check to the payor bank, or as is more commonplace, the depositary bank sends the check to a clearing house, which acts as an intermediary bank. Once the depositary bank sends the check to the intermediary bank, the depositary bank becomes a collecting bank. The intermediary bank then presents the check to the payor bank (at which time the intermediary bank is also a collecting bank). When the check is received by the payor bank, it either pays

the check, returns the check or dishonors the check.

The UCC prescribes the duties the various banks owe to a depositor. A collecting bank must use ordinary care in presenting a check or sending a check for presentment, sending notice of dishonor or nonpayment or returning a check, and settling the check when the collecting bank receives final settlement from the payor bank (*see* UCC 4-202 [1]). A collecting bank has until midnight of the next banking day (its "midnight deadline" [UCC 4-104 (h)]) to take the above actions when receiving a check, notice of dishonor or final settlement of the check (*see* UCC 4-202 [2]). In other words, whenever a collecting bank receives a check from a depositor or notice or settlement from the payor bank it must act on it by midnight the next banking day.

A payor bank must, by its "midnight deadline" (UCC 4-104 [h]), pay the item (*see* UCC 4-302), return the item or send written notice of dishonor or nonpayment (*see* UCC 4-301). Final settlement of a check occurs when the payor bank has paid the item or fails to return the check, or sends written notice of dishonor or nonpayment of the check by its midnight deadline (*see* UCC 4-301 [1]; 4-302 [a]).{**17 NY3d at 576}

Pursuant to the Expedited Funds Availability Act (12 USC § 4001 *et seq.*), banks are required to make funds from a deposited check available for the depositor's withdrawal within certain short time periods (*see* 12 USC § 4002 [b] [1]). The purpose of the "[a]ct is to provide faster availability of deposited funds" (*Haas v Commerce Bank*, 497 F Supp 2d 563, 565 [SD NY 2007]). This availability is provisional and the collecting bank has the right to charge back the amount if the check is dishonored or the bank fails to receive a settlement for the check (*see* UCC 4-212).

In this case, GTH deposited the check into its account at HSBC on Friday, September 21, 2007. The next business day, Monday, September 24, 2007, HSBC, within its midnight deadline, sent the check to FRBP for presentation, as well as provisionally making the funds available to GTH. FRBP presented the check to Citibank on that same day. Citibank returned the check as "sent wrong," within its midnight deadline, on September 25, 2007. On September 26, 2007, within its midnight deadline, HSBC repaired the routing number of the check and sent it to the FRBS, which ultimately dishonored it as counterfeit on October 2, 2007.

III.

GTH claims that Citibank was negligent in breaching its obligation to implement effective procedures for detecting counterfeit checks in that it failed to detect that the item was fraudulent when Citibank processed the check at Item Processing North. GTH notes the uncontroverted fact that on September 24, 2007, the day Citibank returned the check in question to the FRBP, Citibank returned at least six other checks, each in the identical amount of $197,750, which should have put Citibank on notice that something was amiss. Additionally, Citibank admits that the personnel who reviewed checks after being sent to the reject packet were not trained to determine if they were counterfeit. In short, it is clear that Citibank did nothing to determine if the check was counterfeit prior to returning it to FRBP.

To establish a cause of action sounding in negligence, a plaintiff must establish the existence of a duty on defendant's part to plaintiff, breach of the duty and damages (*see Akins v Glens Falls City School Dist.*, 53 NY2d 325, 333 [1981]). Plaintiff alleges that Citibank owed it a duty to have procedures in place to detect counterfeit checks. For this proposition plaintiff cites{**17 NY3d at 577} *Putnam Rolling Ladder Co. v Manufacturers Hanover Trust Co.* (74 NY2d 340 [1989]) and *Monreal v Fleet Bank* (95 NY2d 204 [2000]).

The duty of a payor bank (in this case Citibank) to a noncustomer depositor of a check is derived solely from UCC 4-301 and 4-302. UCC 4-301 provides in pertinent part:

> "(1) Where an authorized settlement for a demand item . . . received by a payor bank . . . has been made before midnight of the banking day of receipt the payor bank may revoke the settlement and recover any payment if before it has made final payment . . . and before its midnight deadline it

[*7]

> "(a) returns the item; or
>
> "(b) sends written notice of dishonor or nonpayment if the item is held for protest or is otherwise unavailable for return."

UCC 4-302 (a) provides that a payor bank is liable for an item received by the payor bank if it "does not pay or *return the item* or send notice of dishonor until after its midnight deadline" (emphasis added). In this case, it is uncontroverted that Citibank returned the check to FRBP within its midnight deadline.

GTH's reliance on *Putnam* and *Monreal* is unavailing. Those cases dealt with claims by

a customer of a payor bank for that payor bank's failure to exercise ordinary care with regards to forged checks drawn on the customer's account and examined the duties owed by a payor bank to its customers (*see Putnam*, 74 NY2d at 343-346; *Monreal*, 95 NY2d at 206-207). These duties are codified in article 4, part 4 of the UCC. Specifically, the duty of a payor bank to exercise ordinary care in paying a customer's item is found in UCC 4-406 (3). **[FN7]**

In this case, GTH is not a customer of Citibank and the duties codified in UCC 4-406 (3) are not applicable here. Moreover, there was never any payment made by Citibank on the check. In short, the only duty Citibank owed GTH was to pay the{**17 NY3d at 578} check, return the check or send notice of dishonor of the check by midnight of the next banking day after receiving the check. It is uncontroverted that Citibank returned the check within its midnight deadline. Because GTH cannot establish any duty owing from Citibank that was breached, GTH's claims against Citibank were properly dismissed.

IV.

As against HSBC, GTH alleges two causes of action. First, it alleges negligent [*8] misrepresentation as a result of HSBC informing GTH that the check had "cleared"**[FN8]** and the funds were available for transfer and second, it alleges negligence for failing to inform GTH and charge back the check on September 26th, when it was originally returned on September 25th by Citibank via FRBP.

As for the claim of negligent misrepresentation, "liability for negligent misrepresentation has been imposed only on those persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that reliance on the negligent misrepresentation is justified" (*Kimmell v Schaefer*, 89 NY2d 257, 263 [1996]). "[T]he relationship between a bank and its depositor is one of debtor and creditor" (*Brigham v McCabe*, 20 NY2d 525, 530 [1967]; *see also Solicitor for Affairs of His Majesty's Treasury v Bankers Trust Co.*, 304 NY 282, 291 [1952]) and "an arm's length borrower-lender relationship . . . does not support a cause of action for negligent misrepresentation" (*Dobroshi v Bank of Am., N.A.*, 65 AD3d 882, 884 [1st Dept 2009]; *see also Aaron Ferer & Sons Ltd. v Chase Manhattan Bank, N.A.*, 731 F2d 112, 123 [2d Cir 1984]; *Korea First Bank of N.Y. v Noah Enters., Ltd.*, 12 AD3d 321, 323 [1st Dept 2004], *lv denied* 4 NY3d 710 [2005]; *River Glen Assoc. v Merrill Lynch Credit Corp.*, 295 AD2d 274, 275 [1st Dept 2002]; *FAB Indus. v BNY Fin. Corp.*, 252 AD2d 367, 367 [1st Dept 1998]).

This is true even if there is a long-standing relationship between the customer and a particular bank employee (*see Manufacturers Hanover Trust Co. v Yanakas*, 7 F3d 310, 318 [2d Cir 1993]; *Bennice v Lakeshore Sav. & Loan Assn.*, 254 AD2d 731, 732 [4th Dept 1998]) or "if the parties are familiar or friendly" (*Call v Ellenville Natl. Bank*, 5 AD3d 521, 523 [2004]).{**17 NY3d at 579}

GTH argues that, pursuant to UCC 4-201, HSBC was an agent of GTH during the period that HSBC was acting as a collecting bank for plaintiff. UCC 4-201 (1) provides, in pertinent part, that "prior to the time that a settlement given by a collecting bank for an item is or becomes final . . . the bank is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional." GTH thus claims that pursuant to this agency relationship, HSBC owed a fiduciary duty to GTH. HSBC claims that it owed no fiduciary duty, and also relies on a waiver contained in the contract between GTH and HSBC. That contract contained the following provision:

> "**BALANCE INFORMATION**
>
> "Balances may change frequently throughout a business day. You hereby [*9] waive any claim against the Bank based on representations made by the Bank, either orally or in writing to you, or your authorized person, or to any other party, regarding balance information."

Although an agent owes a duty to its principal to disclose all material facts that come to its knowledge regarding the scope of the agency (*see Kirschner v KPMG LLP*, 15 NY3d 446, 480 [2010]), the purpose of UCC 4-201 is not to impose a fiduciary duty on a collecting bank. We have interpreted the statute such that the use of the term "agent" means that the item and any inherent risk in that item remains with the depositor and not the collecting bank (*see Hanna v First Natl. Bank of Rochester*, 87 NY2d 107, 119 [1995] ["(a) collecting bank acts as the agent of its customer, and until such time as the collecting bank receives final payment, the risk of loss continues in the customer, the owner of the item"]; *Long Is. Natl. Bank v Zawada*, 34 AD2d 1016, 1017 [2d Dept 1970] ["(Section 4-201) operates to keep the risk of loss upon the owner of the item rather than the bank and gives to the depositary bank a right to reimbursement superior to the owner's rights to the proceeds and superior to the rights of the owner's creditors"]).

To resolve this case, we do not need to decide whether the relationship between GTH and HSBC would preclude all possible claims for negligent misrepresentation, but it is clear

that the claim GTH asserts here cannot succeed, even accepting as true, as we must at this stage of the litigation, GTH's version of the conversation with the representative at HSBC. GTH's claim{**17 NY3d at 580} is based on the alleged oral statement by the HSBC representative that the check had "cleared"—an ambiguous remark that may have been intended to mean only that the amount of the check was available (as indeed it was) in GTH's account. Reliance on this statement as assurance that final settlement had occurred was, under the circumstances here, unreasonable as a matter of law.

GTH's claim of negligence against HSBC alleges that HSBC owed a duty to GTH to inform it and charge its account back pursuant to UCC 4-212 (1) when the check was first returned marked "sent wrong" to HSBC on September 25th. GTH argues that the return of the check was a dishonor of the check, thereby triggering HSBC's duty to inform GTH and charge back its account by the midnight deadline (i.e., September 26th, the day before GTH wired the funds). UCC 4-212 (1) provides:

> "If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund [*10]from its customer whether or not it is able to return the items if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. These rights to revoke, charge-back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final."

However, the duty a collecting bank owes to a depositor is that of ordinary care in handling the item (*see* UCC 4-202). The UCC does not define "ordinary care," but it should be read as to have its normal tort meaning (*see Putnam*, 74 NY2d at 346). Other courts have determined that while "ordinary care [should] be [understood to have] its normal tort meaning, the realities of the modern banking system cannot be ignored in evaluating a bank's negligence" (*United States Fid. & Guar. Co. v Federal Reserve Bank of N.Y.*, 590 F Supp 486, 499 [SD NY 1984] [internal quotation marks omitted]). HSBC argues that when the check was returned "sent wrong," it was, what is known in the banking industry, an "administrative return." An "administrative return" occurs when the routing number on{**17 NY3d at 581} the check is damaged or unreadable. When such a return occurs, the bank will do more research, repair the routing number and resubmit the check, which is what happened

here. According to HSBC, this type of return is not a dishonor of the check. The check was, in HSBC's view, still being processed.

GTH argues that the UCC does not provide for an "administrative return" of a check and, therefore, the return of the check was a dishonor of the check. HSBC responds that it acted with "ordinary care" because treating a check returned in this manner as an "administrative return," repairing the routing number and re-presenting the check is the custom and practice of the banking industry (*see Trimarco v Klein*, 56 NY2d 98, 105-106 [1982]). HSBC proffered the affidavit of its Assistant Vice-President and First Shift Manager in the Exceptions Processing Department of HSBC as evidence that "administrative returns" occur periodically in the banking industry and are dealt with by repairing the routing number and re-presenting the check. The record demonstrates that HSBC acted with ordinary care (*see Putnam*, 74 NY2d at 347 ["by showing that it acted in accordance with general banking rules or practices, a bank can ensure that its conduct at least prima facie meets an ordinary care standard"]). GTH, by contrast, offered no evidence in support of its claim that the bank acted unreasonably (*see id.* at 346 ["a customer could prove a bank lacked ordinary care by presenting any type of proof that the bank failed to act reasonably"]). GTH relies on HSBC's internal document that noted that the check was returned for insufficient funds as evidence the check was dishonored on September 25th. However, the courts below properly accepted HSBC's explanation that the document stating the check was returned for insufficient funds was a clerical error. In sum, because GTH offered no proof that HSBC failed in its duty to exercise ordinary care in the handling of the check, and no [*11]issues of fact remain, the claim for negligence against HSBC likewise fails.

V.

Finally, GTH argues that it should prevail against both defendants under the theory of equitable estoppel. This argument is unavailing. Under the doctrine of equitable estoppel, when innocent parties suffer from the acts of a third person, the party that enabled the third person must bear the loss (*see Bunge Corp. v Manufacturers Hanover Trust Co.*, 31 NY2d 223, 228 [1972]). Here, neither Citibank nor HSBC breached any duty owed to GTH.{**17 NY3d at 582}

GTH argues that the banks were in the best position to determine that the check was counterfeit. However, the Appellate Division held, and we agree, that "[GTH] was in the best position to guard against the risk of a counterfeit check by knowing its 'client' " (*Greenberg*,

73 AD3d at 572). Additionally,

> "the UCC has the objective of promoting certainty and predictability in commercial transactions. By prospectively establishing rules of liability that are generally based not on actual fault but on allocating responsibility to the party best able to prevent the loss by the exercise of care, the UCC not only guides commercial behavior but also increases certainty in the marketplace and efficiency in dispute resolution" (*Putnam*, 74 NY2d at 349).

The UCC is clear that, until there is final settlement of the check, the risk of loss lies with the depositor (*see Hanna*, 87 NY2d at 119). Final settlement of a check occurs when the payor bank has:

> "(a) paid the item in cash; or
>
> "(b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or
>
> "(c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or
>
> "(d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement" (UCC 4-213 [1]).

[*12]It is uncontroverted that since none of the above actions occurred in this case prior to October of 2007, the risk remained with GTH and HSBC retained the right to charge back plaintiff's account pursuant to UCC 4-212. Since GTH cannot establish that defendants breached any duty owed, the courts below have correctly determined that no triable issues of fact exist and properly awarded summary judgment in favor of the defendant banks.

Accordingly, the order of the Appellate Division should be affirmed, with costs.{**17 NY3d at 583}

Pigott, J. (dissenting in part). I believe that HSBC is not entitled to summary judgment on GTH's negligent misrepresentation claim.

Under New York's Uniform Commercial Code, "[i]f a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is

or becomes final," the bank may revoke the settlement and charge back the amount of any credit given for the item to the customer's account (UCC 4-212 [1]). "The right to charge-back is not affected by . . . failure by any bank to exercise *ordinary care* with respect to the [check] *but any bank so failing remains liable*" (*id.* at 4-212 [4] [b] [emphasis supplied]). Thus, a bank has a duty to exercise ordinary care when dealing with its customers (*Aikens Constr. of Rome v Simons*, 284 AD2d 946, 947 [4th Dept 2001]). The term "ordinary care" is used with its normal tort meaning and not in any special sense relating to bank collections. A customer may prove a bank "lacked ordinary care by presenting any type of proof that the bank failed to act reasonably" (*Putnam Rolling Ladder Co. v Manufacturers Hanover Trust Co.*, 74 NY2d 340, 346 [1989]). Further, section 4-103 (1) states that "[t]he 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."

In this case, GTH alleges that on September 27, 2007, David A. Trager, a partner at GTH, telephoned his contact at HSBC, Frances Scott, to inquire about the status of the Citibank check. Trager and Scott had a five-year banking relationship, whereby Trager would [*13]call Scott to confirm that checks deposited into GTH's trust account had cleared and were available for disbursement. Scott informed Trager that the Citibank check had "cleared" and that the funds were available to be wired to another account. Relying in good faith on that statement, Trager asked Scott to wire proceeds of the check, which she did.

HSBC makes much of the fact that the word "cleared" is not found in the UCC and the majority finds it to be ambiguous. However, UCC 1-205 entitled "course of dealing and usage of trade," defines "usage of trade" as encompassing "any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question" (UCC{**17 NY3d at 584} 1-205 [2]). The term "cleared" is used liberally in the banking business. Indeed, the Federal Trade Commission in a bulletin addressed to consumers states that "[i]t's best not to rely on money from *any* type of check . . . unless you know and trust the person you're dealing with or, better yet—*until the bank confirms that the check has cleared*" (Federal Trade Commission, *FTC Facts for Consumers, Giving the Bounce to Counterfeit Check Scams*, Jan. 2007, available at http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre40.pdf, cached at http://www.nycourts.gov/reporter/webdocs/cre40.pdf [emphasis added]). Therefore, I disagree with the majority's position that relying on this statement was unreasonable as a

matter of law (*see* majority op at 580).[FN*] I suspect many business professionals would have done the same thing as Trager.

Viewing the facts in the light most favorable to GTH, which we are required to do on this motion for summary judgment, GTH raises questions of fact as to whether HSBC failed to exercise ordinary care when Scott misrepresented the status of the check to Trager (*see JP Morgan Chase Bank, N.A. v Pinzler*, 28 Misc 3d 1214[A], 2010 NY Slip Op 51324[U] [Sup Ct, NY County 2010]; *JP Morgan Chase Bank, N.A. v Cohen*, 26 Misc 3d 1215[A], 2009 NY Slip Op 52725[U] [Sup Ct, Albany County 2009]).

Counterfeit check scams are pervasive. That Citibank could not recognize one of its own checks as counterfeit is testament to the seriousness of this problem within the banking industry. It is no answer that Citibank and HSBC seemed to stumble along over a period of 10 days resulting in one of their customers being bilked out of $187,750. This problem has long been known to the banks and a mere recitation of their normal practices does not, in my view, establish the appropriate standard of care in this day and age and certainly not their entitlement to summary judgment.

Equally unavailing is HSBC's claim that the negligent misrepresentation claim [*14] must fail because GTH waived all claims {**17 NY3d at 585}concerning GTH's balance information. Even if GTH waived such claims, this is not a debate about who said what to whom about an account balance. Rather, the issue is whether HSBC told GTH that the check had cleared and whether GTH could have relied on HSBC's representations to that effect.

Chief Judge Lippman and Judges Graffeo, Read, Smith and Jones concur with Judge Ciparick; Judge Pigott dissents in part in a separate opinion.

Order affirmed, with costs.

**Footnotes**

**Footnote 1:** An image replacement document is a digital representation of the check and maintains the status of a legal check in lieu of the original check.

**Footnote 2:** According to Citibank, approximately 2% of scanned checks are redirected to the reject pocket each day. The checks are then manually reviewed to determine why they were rejected.

**Footnote 3:** GTH notes that an internal HSBC document states that the check was returned for "Insuff Funds." HSBC explained that this internal document is a printout from HSBC's returned imaging system, which contains a true and accurate copy of the check. The image of the check itself has the notation, from Citibank, "sent wrong." HSBC further explained that when a check image is placed into HSBC's returned image system, descriptive information is associated with it. The default setting for the descriptive information is "insufficient funds." According to HSBC, an operator did not adjust the default setting and, therefore, the descriptive information read "insufficient funds." However, Citibank did not indicate that the check had been returned for insufficient funds, and there is no indication on the image of the check itself that it was returned for insufficient funds. Moreover, there is no evidence that HSBC treated the check as one that had been returned for insufficient funds.

**Footnote 4:** The contents of this conversation are disputed, with HSBC having a different recollection of the conversation. For purposes of this summary judgment motion we must accept the version as proffered by GTH.

**Footnote 5:** GTH does not address its claims for conversion or conspiracy on this appeal and these claims appear to have been abandoned.

**Footnote 6:** UCC 4-212 (1) states that a collecting bank retains its right to charge back to a customer's account any provisional credit it has given if, upon an item's dishonor, the bank "returns the item or sends notification of the facts" by the midnight deadline. The midnight deadline "is midnight on [a bank's] next banking day following the banking day on which it receives the relevant item" (*see* UCC 4-104 [1] [h]).

**Footnote 7:** UCC 4-406 (1) requires that a customer examine its bank statement to determine if there are any unauthorized signatures or alterations on any item and notify its bank promptly. UCC 4-406 (2) states that if the bank establishes that the customer failed to comply with subsection (1) with respect to an item, the customer is precluded from asserting against the bank its unauthorized signature or any alteration of the item. UCC 4-406 (3) provides: "The preclusion under subsection (2) does not apply if the customer establishes lack of *ordinary care* on the part of the bank in paying the item[ ]" (emphasis added).

**Footnote 8:** We note that GTH, in its own words, asked HSBC if the check had "cleared." "The term 'cleared' is not employed in the UCC and, as commonly used, is not the equivalent of 'final settlement' " (*Call v Ellenville Natl. Bank*, 5 AD3d 521, 524 [2d Dept 2004]).

**Footnote *:** If the term "cleared" means anything in common banking usage, it is that final settlement has occurred (*see* Black's Law Dictionary [9th ed 2009], clear [defining the term as it relates to a bank as "to pay (a check or draft) out of funds held on behalf of the maker "; defining the term as it relates to "a check or draft" as "to be paid by the drawee bank out of funds held on behalf of the maker "]).

**UNITED STATES COURT OF APPEALS**
**FOR THE SECOND CIRCUIT**

August Term 2010

Submitted: January 12, 2011 Decided: February 3, 2011

Docket No. 10-2155-cv

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FISCHER & MANDELL LLP,

*Plaintiff-Appellant,*

v.

CITIBANK, N.A.,

*Defendant-Appellee.*

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Before: POOLER, WESLEY, and CHIN, *Circuit Judges*.

Appeal from a judgment of the United States District Court for the Southern District of New York (Sullivan, *J.*) dismissing plaintiff-appellant's claims against defendant-appellee bank for breach of contract and negligence. Plaintiff-appellant contended that the bank was responsible for the loss of funds when the bank executed wire transfers against insufficient funds. The district court rejected the claims and granted summary judgment to the bank.

AFFIRMED.

BARRY R. FISCHER, The Barry Fischer Law Firm LLC, New York, NY, *for Plaintiff-Appellant*.

BARRY J. GLICKMAN, Zeichner Ellman & Krause LLP, New York, NY, *for Defendant-Appellee*.

CHIN, *Circuit Judge*:

In January 2009, *pro se* plaintiff-appellant Fischer & Mandell LLP ("F&M"), a law firm, deposited a check for $225,351 into its account at defendant-appellee Citibank, N.A. ("Citibank"). The funds were made "available" before the check cleared, and F&M wired most of the funds elsewhere. The check, however, turned out to be counterfeit and was dishonored. Citibank debited the account the amount of the check plus a $10 returned check fee.

F&M brought this action below for breach of contract and negligence, contending that it relied on Citibank's advice that the funds were "available" and that Citibank was responsible for the losses. In a thorough and carefully considered decision, the district court (Sullivan, *J.*) granted summary judgment to Citibank dismissing the claims. We affirm.

## *STATEMENT OF THE CASE*

### A. *Facts*

In January 2009, F&M[1] received from a new client what appeared to be an official Wachovia Bank check for $225,351 (the "Check"). The Check was made payable to F&M, and F&M was advised that it represented partial payment of a debt owed by another entity to the client. On Thursday, January 15, 2009, F&M deposited the Check into its attorney trust account at Citibank.

The client requested a wire transfer of a portion of the funds. On Monday, January 19, 2009, a bank holiday, F&M accessed its trust account through the Citibank website. The website showed that funds in excess of the amount of the Check were "available." As instructed by its client, F&M then requested a wire transfer of $182,780 to an account in South Korea. Citibank executed the transfer the next day.

The client thereafter requested a second wire transfer. On Wednesday, January 21, 2009, F&M again accessed its trust account online and saw an "available" balance of $61,232. F&M then requested transfer of $27,895 to an account in Canada. Because Citibank did not have a direct relationship with the

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[1] F&M is now known as the Barry Fischer Law Firm LLC.

Canadian bank, it sent a payment order to an intermediary bank, Bank of America, N.A. ("BoA"), at 9:37 a.m. the same day.[2]

That afternoon, the Federal Reserve Bank returned the Check as dishonored and unpaid. A Citibank representative telephoned F&M to advise that the Check was counterfeit and had been dishonored. Citibank charged back to the trust account the amount of the Check and a $10 returned check fee, resulting in an overdraft. Citibank then debited an amount necessary to satisfy the overdraft from a money market account F&M maintained at Citibank.

The same afternoon, at approximately 3:30 p.m., F&M asked Citibank to cancel and recall the two wire transfers. Citibank did not, however, seek to cancel the wire transfers until shortly after 6 a.m. the next morning. On January 27 and 28, 2009, Citibank learned that the transfers could not be cancelled because the funds had already been withdrawn.

F&M's accounts at Citibank were covered by a series of written agreements (the "Agreements"), the most relevant of which

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[2] Intermediary banks are a common feature of international electronic funds transfers, the operations of which we explained recently in *Shipping Corp. of India Ltd. v. Jaldhi Overseas PTE Ltd.*, 585 F.3d 58, 60 n.1 (2d Cir. 2009).

were the CitiBusiness Client Manual (the "Manual"), the Citibank Marketplace Addendum (the "Addendum"), and the CitiBusiness User Agreement (the "User Agreement," and collectively the "Agreements").

**B. *Prior Proceedings***

F&M commenced two lawsuits based on Citibank's actions with respect to the Check.

On February 2, 2009, F&M brought an action in the Southern District of New York asserting claims under the Electronic Fund Transfer Act and the Expedited Funds Availability Act and state law. The district court (Sullivan, *J.*) granted summary judgment to Citibank dismissing the federal claims and declining to exercise supplemental jurisdiction over the state law claims. *See Fischer & Mandell, LLP v. Citibank, N.A.*, No. 09 Civ. 1160 (RJS), 2009 WL 1767621 (S.D.N.Y. June 22, 2009). F&M did not appeal the judgment.

On July 14, 2009, F&M commenced this action in the Supreme Court of the State of New York on the state law claims. The complaint asserted two causes of action: breach of contract and negligence. The claims were brought under the common law of New York; the complaint did not cite the Uniform Commercial Code

(the "U.C.C."). Citibank removed the case to the Southern District of New York based on diversity jurisdiction.[3]

Citibank moved for summary judgment, and the district court (Sullivan, *J.*) granted the motion in May 2010. *See Fischer & Mandell, LLP v. Citibank, N.A.*, No. 09 Civ. 6916 (RJS), 2010 WL 2484205 (S.D.N.Y. May 27, 2010). The district court rejected Citibank's assertion that the breach of contract claim was preempted by Articles 4 and 4-A of the U.C.C. because, as the district court observed, both of those articles allow certain of their provisions to be varied by agreement between the parties. The learned district court considered the Agreements, concluded that they were clear and unambiguous, and held as a matter of law that Citibank did not breach its contractual obligations to F&M. *Id.* at **4-6.

As for the negligence claim, the district court held that the claim was preempted by Article 4-A of the U.C.C. *Id.* at **7-8. The district court applied Article 4-A, concluded that

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[3] Citibank is a citizen of Nevada and F&M is a citizen of New York for diversity purposes. Apparently, the parties were unaware of their diverse citizenship in the first action, as there is no reason why they could not have invoked diversity jurisdiction over the state law claims then.

Citibank acted in conformity with Article 4-A, and held that the negligence claim failed as a matter of law. *Id.* at *9.

Final judgment granting Citibank's motion for summary judgment was entered on May 28, 2010, and this appeal followed.

## *DISCUSSION*

### A. *Standard of Review*

We review an award of summary judgment de novo, drawing all reasonable inferences in favor of the non-moving party. *J. Walter Thompson, U.S.A., Inc. v. First BankAmericano*, 518 F.3d 128, 136-37 (2d Cir. 2008).

### B. *The Merits*

We discuss the two causes of action -- breach of contract and negligence -- in turn.

#### 1. *Breach of Contract*

##### a. *U.C.C. Preemption*

A threshold issue is whether Articles 4 and 4-A preempt F&M's breach of contract claim, brought under the common law of New York. If so, the question remains to what extent. The district court held that the breach of contract claim was not preempted in this case because both Articles permit parties in a banking relationship to vary their rights by agreement, to a certain extent, and the relevant contractual provisions here were

not inconsistent with the rights created by the U.C.C. We agree.[4]

Article 4-A "governs the procedures, rights, and liabilities arising out of commercial electronic funds transfers." *Grain Traders, Inc. v. Citibank, N.A.*, 160 F.3d 97, 100 (2d Cir. 1998); *accord Ma v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 597 F.3d 84, 87-88 (2d Cir. 2010). In *Grain Traders*, we held that common law claims arising from electronic funds transfers are precluded "when such claims would impose liability inconsistent with the rights and liabilities expressly created by Article 4-A." 160 F.3d at 103 (citations omitted). We noted, however, that Article 4-A permits some of its provisions to be varied by agreement. *Id.* For example, § 4-A-212 permits a receiving bank to vary its duties to the sender of wire transfers. *See* N.Y. U.C.C. § 4-A-212 ("A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts . . . and the bank owes no duty to any party to the funds transfer except as provided in [Article 4-A] or *by express agreement*." (emphasis added)). Accordingly, a common law breach

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[4] Although Citibank no longer argues, as it did below, that the breach of contract claim is preempted, F&M continues to suggest that the Agreements are inconsistent with the U.C.C. We address preemption to resolve this dispute.

of contract claim is not preempted by Article 4-A to the extent the provisions are not inconsistent with Article 4-A or they fall within one of the areas where a variance is permitted. *See Centre-Point Merch. Bank Ltd. v. Am. Express Bank Ltd.*, 913 F. Supp. 202, 206 (S.D.N.Y. 1996) ("[R]esorting to principles of law or equity outside of Article 4-A is acceptable, so long as it does not create rights, duties and liabilities 'inconsistent with those stated in [Article 4-A].'" (quoting N.Y. U.C.C. § 4-A-102 cmt.)); *Sheerbonnet, Ltd. v. Am. Express Bank, Ltd.*, 951 F. Supp. 403, 414 (S.D.N.Y. 1995) (denying motion to dismiss common law tort and equity claims where they did "not conflict with any of Article 4-A's provisions"); *see also Ma v. Merrill Lynch*, 597 F.3d at 89 (observing that "[n]ot all common law claims are per se inconsistent with [the Article 4-A] regime").

Article 4 governs bank deposits and collections. Neither the New York Court of Appeals nor our Court has directly considered whether or to what extent Article 4 preempts common law actions. The New York Court of Appeals has observed, however, that the New York U.C.C. "has the objective of promoting certainty and predictability in commercial transactions." *Putnam Rolling Ladder Co. v. Mfrs. Hanover Trust Co.*, 74 N.Y.2d 340, 349 (1989) (noting as well that "the UCC not only guides commercial

behavior but also increases certainty in the marketplace and efficiency in dispute resolution"). Article 4 itself recognizes that "[t]he tremendous number of checks handled by banks and the country-wide nature of the collection process require uniformity in the law of bank collections." N.Y. U.C.C. § 4-101 cmt. We therefore hold -- as we did with Article 4A -- that Article 4 precludes common law claims that would impose liability inconsistent with the rights and liabilities expressly created by Article 4.[5]

Our holding gives effect to the terms of § 4-103(1), which provide that "the provisions of [Article 4] 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

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[5] Under New York law, we are permitted to certify to the New York Court of Appeals "determinative questions of New York law [that] are involved in a case pending before [us] for which no controlling precedent of the Court of Appeals exists." N.Y. Comp. Codes R. & Regs. tit. 22, § 500.27(a); *see also* 2d Cir. R. 27.2(a) ("If state law permits, the court may certify a question of state law to that state's highest court."). We resort to certification "sparingly," however, *Highland Capital Mgmt. LP v. Schneider*, 460 F.3d 308, 316 (2d Cir. 2006), and recognize that certification is "not proper where the question does not present a complex issue, there is no split of authority and sufficient precedents exist for us to make a determination," *Tinelli v. Redl*, 199 F.3d 603, 606 n.5 (2d Cir. 1999) (quotation marks and brackets omitted). In the present case, we see no need to certify the Article 4 preemption question as the question before us falls well within the *Tinelli* guidelines.

exercise ordinary care." *Id.* § 4-103(1). This section would be rendered meaningless if common law claims could impose liability inconsistent with the rights and liabilities expressly created by Article 4. *See Sunshine v. Bankers Trust Co.*, 32 N.Y.2d 404, 410 (1974) (finding a purported agreement to extend a bank's time to charge back a depositor's account invalid because the bank "[was] attempting to disclaim its own responsibility for ordinary care" in violation of N.Y. U.C.C. § 4-103).

Here, as discussed below, however, the Agreements did not create rights or obligations inconsistent with those created by Articles 4 and 4-A. Accordingly, we hold that the district court correctly held that the common law breach of contract claim was not preempted and that it correctly looked to the Agreements to decide the rights and liabilities of the parties.

**b. *Analysis of the Claim***

Under New York law, a breach of contract claim requires proof of (1) an agreement, (2) adequate performance by the plaintiff, (3) breach by the defendant, and (4) damages. *First Investors Corp. v. Liberty Mut. Ins. Co.*, 152 F.3d 162, 168 (2d Cir. 1998); *Harsco Corp. v. Segui*, 91 F.3d 337, 348 (2d Cir. 1996). Summary judgment is appropriate if the terms of the

contract are unambiguous. *Topps Co. v. Cadbury Stani S.A.I.C.*, 526 F.3d 63, 68 (2d Cir. 2008).

The parties dispute only the third element, and the principal point of contention is the meaning of the term "available." The thrust of F&M's argument is that when Citibank's website "gratuitously" declared the funds to be "available" before they had been collected, it implicitly represented that the Check had cleared, thereby misleading F&M into believing that funds were "available for withdrawal as a matter of right" for both wire transfers. Citibank argues that "available" meant only that the account balance could be withdrawn from the account and not that the balance represented collected funds.

The district court correctly rejected F&M's interpretation and accepted Citibank's. The Agreements clearly show that while Citibank gave its customers the ability to make use of check proceeds provisionally, that is, before checks cleared, that right was subject to a charge back if a check was returned.[6] We hold, in the circumstances here, that "available"

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[6] F&M agreed to be bound "by all of the rules, regulations, charges and fees in the Citibank Client Manual and Schedule of Fees and Charges and any other account agreements it receives and any modification(s) or amendment(s) of the same."

meant only that account balances were "available" for use on a provisional basis, subject to a charge back if a check was returned, and not that the account balance represented collected funds.

The key provision is contained in the Addendum, which provides clear guidance as to the processing of checks:

> **When Does a Check Clear?:** This process begins when you deposit a check to your account and is not completed until the bank on which the check is drawn either honors or returns it to Citibank unpaid. Checks may be returned because of insufficient funds, missing signatures, stop payment orders, etc.
>
> The schedules in this addendum show when the majority of your check deposits will be made available to you. The schedules are based on the amount of time generally required for checks to clear and on federal and state regulations.
>
> Please note that a check you deposit may be returned unpaid after we have made the funds <u>available</u> to you. If this happens, the amount of the returned check will be deducted from your account balance.

(Emphasis added). The last-quoted paragraph plainly provides that funds will be made "available" on a provisional basis, subject to a charge back if a check is returned.

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Under the Manual, Citibank was entitled to set-off an overdraft against other accounts of the customer, including, for example, a money market account.

The unsurprising notion that customers are responsible for returned checks is reinforced by the Manual, which unambiguously provides:

> **Returned Checks:** If you deposit a check that is returned to us unpaid, we will deduct the amount of the returned check from your account balance and return the check to you. There will also be a service charge.

F&M makes two principal arguments to support its assertion that "available" is synonymous with "collected." First, it points to certain clauses in the Agreements that purportedly provide that only collected funds can constitute available funds. Second, it argues that the district court erroneously ignored controlling provisions of the U.C.C. Both arguments fail.

First, F&M makes much of a provision in the Manual, in a section listing exceptions to Citibank's "Standard Funds Availability Policy," that reserves to Citibank the right to "require that any check you present for deposit be sent out for collection." When this exception is invoked, Citibank will accept a check only on a "collection basis," that is, the funds are not made available until after payment is received from the bank on which the check is drawn. But this exception to Citibank's general policy of making funds provisionally available

was *not* invoked here, and thus it is not relevant. F&M also relies on other references in the Citibank documents to "sufficient" funds and "available" funds, but these references likewise do not stand for the proposition that Citibank's advice that funds were "sufficient" or "available" meant that they had been "collected" or "finally settled."[7]

Second, F&M's argument that the district court erroneously ignored provisions of the U.C.C. also fails, for the controlling agreements do not create rights and liabilities inconsistent with those under the U.C.C. F&M notes, for example, that § 4-213(4) provides that:

> credit given by a bank for an item in an account with its customer becomes available for withdrawal *as of right* (a) in any case where the bank has received a provisional settlement for the item, -- when such settlement becomes final and the bank has had a reasonable time to learn that the settlement is final.

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[7] For example, the User Agreement instructs customers to give online instructions to make transfers or payments "only when a sufficient balance is, or will be, available in that account at the time of withdrawal." It also explains that "Citibank will not act on your CitiBusiness Online withdrawal instructions if sufficient funds are not available." Again, however, "sufficient" does not mean "collected." As Citibank permitted its customers to make use of funds on a provisional basis, as long as there was a "sufficient" balance of "available" funds, a customer could make use of them, subject to a charge back for returned checks.

N.Y. U.C.C. § 4-213(4) (emphasis added). F&M argues that because § 4-213(4) provides that funds are "available for withdrawal as of right" only when a "settlement becomes final," Citibank erred when it advised F&M that the funds were "available" before settlement of the Check became final. The obvious flaw with this argument is that Citibank did not advise F&M that the funds were "available for withdrawal *as of right*." Rather, Citibank advised only that the funds were "available," without representing that the Check had cleared or that the funds had been collected or that settlement had become final. "Available" is different from "available as of right."

In fact, the U.C.C. expressly recognizes that a bank may permit a customer to use funds provisionally, subject to a charge back in the event of dishonor, as § 4-212(1) provides:

> If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor . . . to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund from its customer.

N.Y. U.C.C. § 4-212(1).[8] By permitting its customers access to

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[8] *See also, e.g., Call v. Ellenville Nat'l Bank*, 5 A.D.3d 521, 524 (2d Dep't 2004) ("Accordingly, when final settlement was

funds on a provisional basis, subject to the right of a charge-back and refund, Citibank was merely following a practice that is common in the banking industry.[9]

Accordingly, we affirm the district court's dismissal of F&M's breach of contract claim.

**2. *Negligence***

**a. *U.C.C. Preemption***

The district court correctly held that Article 4-A preempted any common law claims inconsistent with its provisions. As we held in *Grain Traders*, there is "no claim for negligence unless [the] conduct complained of was not in conformity with

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not made on the check by the payor bank due to discovery of the counterfeit, the defendant bank was entitled to revoke the provisional settlement made on the check and charge back [the depositor's] account or obtain a refund from [the depositor] for the funds drawn on the check."); *Chase v. Morgan Guarantee Trust Co.*, 590 F. Supp. 1137, 1138 (S.D.N.Y. 1984) ("[I]f the collecting bank has credited a customer's account for an item and even allowed the customer to make a provisional withdrawal, but fails to receive a final settlement for that item, it may charge back the customer's account.").

[9] "Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether the item will be finally paid. . . . [I]n those cases where the item being collected is not finally paid . . . , provision is made for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund." N.Y. U.C.C. § 4-212 cmt. 1.

Article 4-A." 160 F.3d at 103; *see* N.Y. U.C.C. § 4-A-102 cmt. (Article 4-A is designed to be the "exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article").

**b. *Analysis of the Claim***

In its second claim, F&M argued that Citibank failed to exercise reasonable care because it waited some fifteen hours to try to cancel the two wire transactions after it was asked to do so. F&M contends that it asked Citibank at approximately 3:30 p.m. on January 21 to recall the two wire transactions, and that Citibank made no effort to do so until 6:11 a.m. the next day, January 22. F&M contends that, at a minimum, genuine issues of material fact existed as to whether Citibank acted reasonably by not trying sooner. The district court rejected the argument. We agree.

Under Article 4-A, a "payment order" is an instruction by a "sender" to a "receiving bank" to pay (or to cause another bank to pay) a sum of money (under certain conditions not relevant here). N.Y. U.C.C. § 4-A-103(1)(a). "[A] communication by the sender canceling or amending a payment order is effective . . . if notice of the communication is received at a time and in

a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order." *Id.* § 4-A-211(2). The "receiving bank . . . accepts a payment order when it executes the order." *Id.* § 4-A-209(1). "A payment order is 'executed' by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank." *Id.* § 4-A-301(1).

Here, F&M was the "sender" because it was "the person giving the instruction to the receiving bank," *id.* § 4-A-103(1)(e), that is, the instruction to recall, and Citibank was the "receiving bank" because it was "the bank to which the sender's instruction [was] addressed," *id.* § 4-A-103(d). F&M's instruction to recall the wire transfers, however, came too late, as the documentary evidence shows that Citibank had already executed both payment requests. Citibank executed the payment order for the first wire transfer at 7:51 a.m. on January 20 and for the second wire transfer at 9:37 a.m. on January 21, both well before F&M made its request to cancel at 3:30 p.m. on January 21. Hence, F&M's cancellation order was not effective, as it did not give Citibank "a reasonable opportunity to act on the communication before [it] accept[ed] [*i.e.*, executed] the payment order." *Id.* § 4-A-211(2); *see Aleo Int'l, Ltd. v.*

*Citibank, N.A.*, 160 Misc. 2d 950, 952 (Sup. Ct. N.Y. Cnty. 1994) (order to cancel wire transfer was ineffective where it was given five hours after receiving bank had already accepted payment order).

F&M argues that the district court misapplied Article 4-A because Citibank was not the "receiving bank" but the "sending bank." This argument fails. While it may be that Citibank *sent* F&M's cancellation orders by forwarding the requests to the Korean bank and BoA, it was not the "sender" within the meaning of § 4-A-211(2). In the circumstances here, the sender is the person who "want[s] to withdraw . . . the [payment] order because [he] has had a change of mind about the transaction or because the payment order was erroneously issued or for any other reason." N.Y. U.C.C. § 4-A-211 cmt. 1. F&M was the party that "had a change of mind about the transaction," and it addressed its instruction to Citibank, making Citibank the "receiving bank." *Id.* § 4-A-103(d).

F&M also argues that issues of fact existed as to whether the cancellation orders would have been effective if Citibank had acted more quickly, and challenges the documents showing that the payment orders were executed before the recall request was made. F&M does so, however, in a wholly conclusory

manner, and it is unable to point to any concrete evidence to contradict Citibank's documents showing that it executed the payment orders before the request to cancel was made. *FDIC v. Great Am. Ins. Co.*, 607 F.3d 288, 292 (2d Cir. 2010) (party opposing summary judgment cannot rely on "conclusory allegations or unsubstantiated speculation").

F&M cites documents showing that Citibank did not act on the recall request until 6:11 a.m. on January 22, but even assuming fifteen hours was too long, that delay was not the cause of F&M's injury. F&M also points to its monthly account statement, which showed that the second transfer was not debited to the account until January 22; the fact that the account was not debited until January 22, however, does not undermine the documentary evidence showing that the second payment order was executed the day before. Again, as the district court properly found, the critical question in terms of timing is when Citibank executed the wire transfer requests, as set forth in § 4-A-209(1).

We have considered F&M's remaining arguments and conclude that they lack merit.

## *CONCLUSION*

The judgment of the district court is AFFIRMED, with costs.

| Matter of Tedeschi |
| --- |
| 2014 NY Slip Op 06206 [123 AD3d 17] |
| September 17, 2014 |
| Per Curiam. |
| Appellate Division, Second Department |
| Published by New York State Law Reporting Bureau pursuant to Judiciary Law § 431. |
| As corrected through Wednesday, December 17, 2014 |

[*1]

**In the Matter of Thomas Peter Tedeschi, an Attorney, Respondent. Grievance Committee for the Tenth Judicial District, Petitioner.**

Second Department, September 17, 2014

APPEARANCES OF COUNSEL

*Robert A. Green*, Hauppauge (*Michael Fuchs* of counsel), for petitioner.

*Martin Molinari Coward & Comrie LLP*, Freeport (*Nicole J. Coward* of counsel), for respondent.

{**123 AD3d at 18} OPINION OF THE COURT

Per Curiam.

The Grievance Committee for the Tenth Judicial District served the respondent with a verified petition dated October 16, 2012, which contained one charge of professional misconduct, and subsequently served him with a verified amended petition dated July 1, 2013, which included additional factual allegations with respect to charge one. After a hearing conducted on September 4, 2013, the Special Referee issued a report in which he sustained charge one, as amended. The Grievance Committee now moves to confirm the Special Referee's report, and to impose such discipline as this Court deems appropriate. The respondent cross-moves to disaffirm the report in part.

Charge one, as amended, alleges that the respondent misappropriated funds belonging to other persons or entities, in violation of Rules of Professional Conduct (22 NYCRR 1200.0) rule 1.15 (a), as follows:

The Cohn Trust Sale The respondent represented the Claire Cohn Personal Residence Trust in connection with the sale of certain real property in East Williston to Lance Antony (hereinafter the Cohn Trust sale). On or about August 25, 2011, the respondent received a down payment in connection with the Cohn Trust sale in the amount of $30,000, which he was to hold in escrow until the closing or earlier termination of the contract. At the time, the respondent did not maintain a special account for his law practice. He deposited the down payment into an account he maintained as the executor of his father's estate (hereinafter the estate account). Approximately one week later, the respondent [*2]withdrew the down payment funds from the estate account and deposited them into an account he maintained in his name at Astoria Federal Savings Bank.

On or about November 4, 2011, the respondent opened an IOLA account at Chase Bank (hereinafter the IOLA account){**123 AD3d at 19} and deposited $28,000 therein, representing the Cohn Trust sale down payment. The respondent withheld $2,000 from the transfer for his legal fee in connection with that sale. At the time the respondent retained his fee, the closing had not yet occurred, and he had not obtained the purchaser's permission to remove his fee from the escrowed funds.

The Taylor Avenue Sale

In or about November 2011, the respondent represented Gold Star Equities, Inc. (hereinafter Gold Star), in connection with the sale of certain real property in the Bronx to Global Realty Group, Inc. (hereinafter the Taylor Avenue sale). Pursuant to the contract of sale, the respondent received a down payment in the amount of $50,000, which he was to hold in escrow until the closing or earlier termination of the contract. On November 14, 2011, the respondent deposited that down payment into his IOLA account, and, on that same day, before those funds were available for disbursement, issued a check to Gold Star, drawn on his IOLA account, in the amount of $2,000. The check to Gold Star cleared the respondent's IOLA account on the same day it was{**123 AD3d at 20} issued. It cleared, in

part, against the funds being held in connection with the Cohn Trust sale, an unrelated matter. On November 25, 2011, the respondent made an additional disbursement of the Taylor Avenue sale down payment to Gold Star in the amount of $28,000. At the time the respondent made the aforementioned disbursements, the closing for the Taylor Avenue sale had not yet occurred, and the respondent had not obtained the purchaser's permission to make disbursements from the escrowed funds.

The Colden Avenue Sale

In or about November 2011, the respondent represented Lenart Realty Corp. (hereinafter Lenart) in connection with the sale of certain real property in the Bronx to Global Realty Group, Inc. (hereinafter the Colden Avenue sale). Pursuant to the contract of sale, the respondent received a down payment in the amount of $50,000, which he was to hold in escrow until the closing or earlier termination of the contract. On November 14, 2011, the respondent deposited that down payment into his IOLA account and, on that same day, before those funds were available for disbursement, issued a check to Lenart drawn on his IOLA account, in the amount of $6,000. The check to Lenart cleared the respondent's IOLA account on the same day it was issued. It cleared, in part, against funds being held in connection with the Cohn Trust sale, an unrelated matter. At the time the respondent made the disbursement to Lenart, the closing for the Colden Avenue sale had not yet occurred, and the respondent had not obtained the purchaser's permission to make a disbursement from the escrowed funds.

In view of the respondent's admissions and the evidence adduced, we conclude that the Special Referee properly sustained charge one, as amended. Accordingly, the Grievance Committee's motion to confirm the Special Referee's report, and impose discipline, is granted. The respondent's cross motion to disaffirm the report in part is denied.

In determining an appropriate measure of discipline to impose, this Court has considered the mitigating evidence propounded, including the respondent's

expression of sincere remorse, his unblemished record, his full cooperation with the Grievance Committee in its investigation, and the absence of pecuniary loss to any party.

Notwithstanding the mitigating evidence, the respondent's release of escrowed funds prior to the closing in each of the aforementioned transactions, without the consent of both parties to the transactions, demonstrates his failure to honor his obligations as a fiduciary, in violation of Rules of Professional Conduct (22 NYCRR 1200.0) rule 1.15 (a). Although the respondent may not have fully understood his fiduciary obligations, he is "held to the knowledge of the rules governing attorney [special] accounts" (*Matter of Koston Hui Feng*, 78 AD3d 123, 127 [2010]). Furthermore, despite his claims to the contrary, we find that the respondent received a "direct benefit" from his conduct, inasmuch as his fee with respect to the Cohn Trust sale was paid in advance of the closing. Moreover, inasmuch as the respondent's wife, Denise Tedeschi, and his sister-in-law, Marilyn Davis, are principals of both Gold Star and Lenart, the sellers in the Taylor Avenue and Colden Avenue sales, respectively, the respondent's partial release of escrowed funds in connection with those sales inured to the benefit of members of his family.

Under the totality of the circumstances, the respondent is suspended from the practice of law for a period of one year.

[*3]

Eng, P.J., Mastro, Rivera, Skelos and Cohen, JJ., concur.

Ordered that the petitioner's motion to confirm the Special Referee's report, and impose discipline, is granted; and it is further, {**123 AD3d at 21}

Ordered that the respondent's cross motion to disaffirm the Special Referee's report in part is denied; and it is further,

Ordered that the respondent, Thomas Peter Tedeschi, is suspended from the practice of law for a period of one year, commencing October 17, 2014 and

continuing until further order of this Court. The respondent shall not apply for reinstatement earlier than April 17, 2015. In such application, the respondent shall furnish satisfactory proof that during said period he (1) refrained from practicing or attempting to practice law, (2) fully complied with this order and with the terms and provisions of the written rules governing the conduct of disbarred, suspended, and resigned attorneys (22 NYCRR 691.10), (3) complied with the applicable continuing legal education requirements (22 NYCRR 691.11 [c] [3]), and (4) otherwise properly conducted himself; and it is further,

Ordered that pursuant to Judiciary Law § 90, during the period of suspension, and until the further order of this Court, the respondent, Thomas Peter Tedeschi, shall desist and refrain from (1) practicing law in any form, either as principal or as agent, clerk, or employee of another, (2) appearing as an attorney or counselor-at-law before any court, judge, justice, board, commission, or other public authority, (3) giving to another an opinion as to the law or its application or any advice in relation thereto, and (4) holding himself out in any way as an attorney and counselor-at-law; and it is further,

Ordered that if the respondent, Thomas Peter Tedeschi, has been issued a secure pass by the Office of Court Administration, it shall be returned forthwith to the issuing agency and the respondent shall certify to the same in his affidavit of compliance pursuant to 22 NYCRR 691.10 (f).

# Cashier's Check Scam Targets Attorneys


**By Julie Andersen Hill***

Scammers have been swindling unsuspecting victims using various advance fee frauds for more than a century. In early versions of the fraud, victims received letters purporting to be from a wealthy individual wrongly imprisoned in Spain. The letters requested financial assistance to access money in bank accounts and promised the recipients large rewards for their help.[1] By the 1990s, variants of the scam spread through e-mail and often requested that the recipient assist a Nigerian in his attempt to access money trapped in a foreign bank account.[2] Regardless of the exact form of the fraud, the target loses money and the scammer disappears.

**By understanding this fraud you can avoid becoming the next victim.**

A modern version of advance fee fraud uses counterfeit cashier's checks. "This scam typically unfolds when someone, usually located outside of the country, fabricates a counterfeit check and asks a bank customer inside the country to accept the counterfeit check, deposit the check into his or her bank account, and quickly wire funds outside of the country in exchange for a portion of the funds."[3] The stories scammers use to perpetrate this type of fraud are diverse. Some scammers claim they are selling goods or providing lottery winnings. Others are requesting help from mystery shoppers.[4]

Attorneys are the latest target of cashier's check advance fee fraud.[5] In this version of the fraud, attorneys receive e-mails from purported clients asking for legal help collecting debts. Although attorneys are usually sophisticated enough to avoid fraud, this type of fraud is troublesome because scammers ask attorneys to collect debts — a task that attorneys perform often without incident. Unsurprisingly, attorneys from California to Georgia have been ensnared in cashier's check scams. Losses in such cases often amount to several hundred thousand dollars.[6]

If your e-mail address is listed in a bar directory or available on a webpage, chances are you will receive scam e-mails. In the last three months I have received eight scam e-mails. Electronic filters have probably prevented other similar messages from reaching my inbox. This article discusses how the attorney version of the fraud operates. It also discusses the legal implications for attorneys ensnared in the fraud. By understanding this fraud you can avoid becoming the next victim.

***The Fraud***

The fraud begins with an e-mail requesting legal assistance in collecting a debt. The sender of the letter typically purports to be residing in a foreign country. The following e-mail is typical of those starting the scam:

> After a careful review, we decided to contact you to represent our company in North America. Walex Electronic Ltd. with its head office in Hong Kong [sic] We got your contact detail from our online search for attorney [sic]
>
> The management of Walex Electronic Ltd. requires your legal representation for our North American delinquent Customers. We are of the opinion that a reputable attorney is required to represent us in North America in order for us to recover monies due to our organization by overseas customers, and as well [sic] follow up with these accounts. In order to achieve these objectives a good and reputable law firm like yours will be required to handle this service.
>
> We understand that a proper Attorney Client agreement must be entered into by both parties. This will be done immediately [sic] we receive your letter of acceptance. Attorney, you can advise us what is required to draw a proper letter of engagement that will be review [sic] by our board. We are most inclined to commence talks with you as soon as possible. We shall bring you into a detailed picture of what your responsibility is, when we receive your response.[7]

This particular e-mail provided a link to a legitimate-looking web page for a Chinese company. Sometimes the names of legitimate attorneys are provided as references for the fraudulent client.[8] Other variants of the scam request an attorney's help collecting divorce settlement funds for a client living abroad. For example:

> My name is Jennifer Wong. I am contacting your law firm with regards to a divorce settlement with my ex husband [sic] Richard Wong who reside [sic] in you [sic] jurisdiction. [W]e had an out of court agreement for him to pay me the amount of $550,450.00 dollars[. A]t this time [I] have only received the amount of 44,000.00 dollars. I am seeking the help of your law firm to collect the balance from him. [H]e has agreed to pay me the money. [sic] but have [sic] been inconsistent with the date. I believe that with the help of your law firm he will be willing to pay in order to avoid litigation.[9]

As with e-mails from legitimate prospective clients, some of the scam e-mails appear more professional than others. Some are addressed simply to "counsel," while others address the attorney by name.

If the attorney responds to the e-mail, the scammer will often take steps that seem consistent with a legitimate attorney-client relationship. The scammer may sign a retainer agreement, provide business documents, or even discuss the case with the attorney by telephone.[10] In some instances the scammer provides contact information for an alleged debtor. After the attorney sends a demand letter, the attorney receives word that the debtor has agreed to pay. In other instances, the scammer simply notifies the attorney that the debtor is willing to pay all or part of the debt.[11] In both instances the attorney receives a cashier's check for the amount of the debt and deposits the check in his attorney trust account. The attorney then forwards the amount due to the client, usually via wire transfer. Unfortunately, the cashier's check eventually bounces and the supposed client mysteriously disappears.

***Unraveling the Payments***

For attorneys caught in the fraud, their first thought may be to attempt to pass the loss back to the banks that handled either the cashier's check or the wire transfer. However, relief through payment system laws is typically only available if the attorney discovers the fraud quickly and acts immediately. In many instances the attorney will be left bearing the entire loss.

***Cashier's Checks***

When people accept personal or business checks as payment, they are typically very careful. They know that if the drawer has insufficient funds in its account, the check might bounce. Similarly, if the drawer stops payment on the check, it will bounce. Cashier's checks are different. To get a cashier's check, a bank customer provides the bank with funds sufficient to cover the check up front. The bank then writes a check drawn on the bank's (rather than the customer's) account.[12] Unlike a personal check, a cashier's check will not bounce unless the bank is insolvent or the check is counterfeit. Because there is little risk of a bank becoming insolvent, many conclude that cashier's checks are "as good as cash."[13] Unfortunately, with the advent of computers and high quality printers, it is now easy for scammers to produce convincing counterfeit cashier's checks. A counterfeit cashier's check is not as good as cash.

**With the advent of computers and high quality printers, it is now easy for scammers to produce convincing counterfeit cashier's checks.**

Because cashier's checks were historically considered safe, federal law requires that banks provide customers access to funds deposited by cashier's checks quickly. Suppose you receive a cashier's check made payable to you on behalf of one of your clients. You take that cashier's check to your bank and deposit it in your attorney trust account. Under Regulation CC, if the amount of the cashier's check is $5,000 or less, the bank must allow you to withdraw the funds from that deposit no later than "the business day after the banking day on which" you deposited the funds.[14] If the amount of the cashier's check is greater than $5,000, the bank can hold the funds in excess of $5,000 for "a reasonable period of time" — typically an additional five business days.[15] Even if a bank is allowed by law to hold the funds, it can choose to make the funds immediately available for withdrawal.

Seeing the available funds in the account, many attorneys are tempted to immediately forward the client its portion of the money. Indeed the Rules of Professional Conduct encourage attorneys to quickly forward money by providing that "a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive[.]"[16] It is important to remember that, even though you have access to funds from a deposited cashier's check, the issuing bank may not yet have paid the cashier's check.[17] Counterfeit cashier's checks can take weeks to work their way through the collection process before being dishonored. If a deposited cashier's

check turns out to be counterfeit, the Uniform Commercial Code ("UCC") allows the bank to charge back the amount of the item to your attorney trust account.[18] If there are insufficient funds in the account to cover the charge back, the bank is entitled to seek a refund.[19] Alternatively, the bank can seek payment from you for breach of the "transfer warranty" because by depositing the item, you warranted that, among other things, "all signatures on the item are authentic and authorized."[20] In short, if you have already withdrawn the money from the account and sent it to your supposed client, you will nevertheless be responsible for repayment.

The obvious lesson here is that an attorney should not transfer money from the trust account until he or she is sure the cashier's check has been paid by the bank that issued the check. Unfortunately, determining when the cashier's check has been paid is not always straightforward. Consider the cautionary tale presented in *Amthor v. Commerce Bank*.[21] Mr. and Mrs. Amthor deposited a cashier's check in their checking account. According to their version of the facts, the bank teller repeatedly told them that the cashier's check had "cleared." Based on the teller's representations, the Amthors withdrew most of the deposit and sent the money to an individual in a foreign country. When the bank learned that the cashier's check bounced, it charged back the amount of the check to the Amthors' account. The Amthors sued seeking to recover the amount of the charge-back. A New York court held that the bank was entitled to charge back the item under the UCC notwithstanding any representations by the teller. It explained that "[u]ntil final settlement is made, *i.e.*, until the check is finally paid by the payor bank, the risk of non-collection remained with the customer and any settlement made on the check paid by the bank is provisional only."[22] According to the court, "the customer could not shift the risk of loss to the bank by relying upon statements of the teller that the check had 'cleared' nor could they rely upon the fact that they were permitted to withdraw funds from their account."[23]

**It is, therefore, possible that if a bank wrongly advises a depositor that a counterfeit cashier's check has been paid, the depositor would have a claim under the Deceptive Trade Practices Act.**

Although the UCC will likely be unhelpful, an attorney misled about the status of a deposited cashier's check may have a remedy outside of the UCC. In the 2006 case *Valley Bank of Ronan v. Hughes* the Montana Supreme Court held there could be common law remedies for those misled by a bank teller.[24] Mr. Hughes received two official checks[25] and deposited them in his bank account. After receiving assurances from bank employees that the checks were good, Mr. Hughes wired the bulk of the money to an account in Amman, Jordan. When the bank discovered the official checks were counterfeit, the bank charged back the items to Mr. Hughes' account. To cover the overdraft, Mr. Hughes signed a promissory note agreeing to pay the outstanding balance. When Mr. Hughes could not make the payments on the note, the bank sued to foreclose on property pledged as collateral. Mr. Hughes counterclaimed arguing that the bank had negligently represented that the official checks were good. The bank argued that Mr. Hughes' claim should be dismissed because the UCC was the sole source of law governing the transaction. The Montana Supreme Court held that Mr. Hughes was entitled to bring a negligence claim based on the bank's representations. It reasoned that "[b]ecause such communications are not addressed with specificity by the UCC, common law and equitable principles supplement the UCC and govern the legal rights and responsibilities that apply to [the bank's] representations[.]"[26] The court noted that the negligence claim could potentially allow Mr. Hughes to "obtain a judgment to compensate him for the charge-back debt."[27]

In some states, attorneys misled by the depositary bank might also find relief in consumer protection statutes. For example, in Texas, the Deceptive Trade Practices Act protects consumers from "false, misleading, and deceptive business practices."[28] Although the Act protects only "consumers" of "goods and services,"[29] courts have held that a depositor is a "consumer" of "banking services."[30] It is, therefore, possible that if a bank wrongly advises a depositor that a counterfeit cashier's check has been paid, the depositor would have a claim under the Deceptive Trade Practices Act.

Because there are no published Texas cases similar to *Amthor* or *Bank of Ronan*, the legal landscape in Texas is unclear.[31] Depending of the facts of the particular case, attorneys caught in cashier's check scams may have rights under the UCC, common law, or consumer protection statutes. Regardless of how these issues are ultimately resolved, attorneys are better off avoiding such situations. Attorneys should be careful when forwarding funds from cashier's checks. Attorneys should not rely on the depositary bank's oral representations that the cashier's checks are good or have "cleared."[32]

***Wire Transfers***

Defrauded attorneys unable to collect from the banks involved in processing the counterfeit cashier's check might attempt to recover the wire transfer. Unfortunately, the chances of recovering a wire transfer are slim.

Scammers typically request funds via wire transfer, because wires operate quickly and give the sender little opportunity to stop payment. Under Article 4A of the UCC, once the attorney's bank has sent the wire, it is not generally obligated to attempt to recall the wire.[33] However, many banks will attempt to cancel a wire at the request of the customer. The attorney's bank will typically be entitled to cancel the wire transfer only if the attorney's bank requests cancellation before the scammer's bank accepts the wire.[34] The scammer's bank accepts the wire when it pays the scammer or when it notifies the scammer that the bank has received the funds on his behalf.[35] Acceptance by the scammer's bank can occur in a matter of minutes.[36]

In at least one instance an attorney's bank discovered cashier's check fraud and managed to cancel the wire in time. In that instance, the fraud was discovered while the scammer's bank was closed. "The [attorney's] bankers stayed late at work so they could contact the [scammer's] bank in Hong Kong when it opened in the morning and they were able to stop the money from being deposited into the scammer's account."[37] Other instances are not so fortunate. Valley Bank of Ronan tried to cancel the Hughes' wire transfer ten minutes after it was sent and was unsuccessful.[38] If an attorney does not discover the fraud for several days, it will usually be too late to cancel the payment order and the attorney will be liable for the amount of the wire.

***Trust Accounts***

Scammed attorneys who are unable to recoup losses from banks might avoid or delay replacing funds depleted from the trust account. If there were funds from other clients in the

trust account, this course of action violates attorney ethical rules.

Some states, like California and New York, use a strict liability approach. Under this approach an attorney is guilty of ethical misconduct any time the bank balance of the client trust account falls below the amount the attorney holds in trust.[39] Suppose you have $100,000 in your trust account for legitimate clients. You deposit a counterfeit cashier's check for $50,000 and wire $50,000 to the scammer. The bank discovers that the cashier's check is fraudulent and charges back the $50,000 leaving you with a balance of $50,000. In states following the strict liability approach, you would be guilty of professional misconduct at the time of the charge-back because the amount you hold for legitimate clients ($100,000) exceeds the balance of the account ($50,000).

Texas has not adopted the strict liability approach to attorney trust accounts.[40] However, even in Texas, an attorney is guilty of professional misconduct if his or her actions result in harm to legitimate clients. Under the Texas approach an attorney commits ethical misconduct by failing to "promptly" forward money in the trust account to legitimate clients entitled to receive it.[41] There is no exception in the rule that allows an attorney to delay payments owed to legitimate clients when the attorney is the victim of fraud. Banks know that attorneys have ethical duties regarding trust accounts and sometimes report overdrafts in trust accounts to the State Bar.[42]

To avoid bar discipline and malpractice suits, attorneys who are victims of the attorney cashier's check scams should ensure that even after the fraud, their trust accounts have a sufficient balance to cover all money owed to legitimate clients. In some cases, this may be no small undertaking. A Houston lawyer had to mortgage his home in order to replace more than $100,000 depleted from his trust account due to a cashier's check scam.[43] Again, it would have been better to have avoided the scam in the first place.

***Best Practices***

What can you do to spot fraud? How can you avoid becoming the next victim?[44]

- Take steps to verify the identity of any new client. Consult reputable directories for contact information, rather than relying on information provided by the potential client. Be aware that scammers sometimes impersonate real companies.
- Inspect any cashier's check for signs of fraud or alteration.
- Verify the validity of a cashier's check by contacting the bank issuing the check. Visit the bank in person or obtain the telephone number of the bank from a reputable source — not the check itself. Have the bank verify the check number, the payee, the amount of the check, the date of the check, and the authorizing signature.
- Deposit suspicious items into a trust account separate from other attorney trust funds.
- Do not forward money from your trust account until you are sure that the cashier's check has been paid by the issuing bank. It may be best to wait for two to three weeks and obtain a written statement from your bank that the check has been paid. Update your retainer agreement to specifically allow you to hold funds from cashier's checks for this period of time.
- Immediately report suspected fraud to your bank, local authorities, and the FBI.

Above all attorneys should remember: If it seems too good to be true, it probably is.

* Assistant Professor of Law, University of Houston Law Center. I am grateful to Tim Zinnecker, Jim Hawkins, and Michael Hill for helpful comments on this article.

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1 *See 'Spanish Prisoner' Turns Up in Paris*, N.Y. Times, May 10, 1914.

2 *See* Lily Zhang, Note, *The Can-Spam Act: An Insufficient Response to the Growing Spam Problem*, 20 Berkeley Tech. L.J. 301, 308 n.46 (2005).

3 George Brandon & Matthew J. Ohre, *The Nigerian Check Scam: An Oldie Revisited*, 126 Banking L.J. 223 (2009).

4 *See* Gene A. Marsh, *Counterfeit Cashier's Check Scams — Bank Liability. "The Check Is Good." Or Is It?*, 40 No. 4 UCC L. J. Art. 1 (2008); Kathy H. Chang, Comment, *Online Counterfeit Check Scams: Should There Be Increased Liability for Banks?*, 23 Geo. J. Legal Ethics 505 (2010).

5 *See* Office of the Comptroller of the Currency, Alert 2008-37, Fictitious Official Checks of First Century Bank, N.A., Bluefield, WV, Aug. 21, 2008 (alerting banks to counterfeit checks issued to attorneys who were retained to collect debts for a "client"); Clark H.C. Lacy, Comment, *The Witch's Brew: Nigerian Schemes, Counterfeit Cashier's Checks, and Your Trust Account*, 61 S.C. L. Rev. 753 (2010); Phil Pattee, *There's a New Scam Out There, and It's Targeting Our Lawyers*, Nev. Law., Sept. 2008, at 31.

6 *See* Brenda Sapino Jeffreys, *Too Good to Be True? Consumer Counsel Warn Lawyers to Be Wary of Client E-Mail Scams*, Tex. Law., Jan. 26, 2009, at 1; R. Robin McDonald, *Lawyer Falls Prey to Pricey Internet Scam*, Fulton Co. Daily Rep., Aug. 26, 2008, at 1.

7 E-mail received by Julie Andersen Hill on July 28, 2010.

8 Diane Curtis, *E-mail Scams Continue to Successfully Target Lawyers*, Cal. Bar J., July 2009, *available at* http://archive.calbar.ca.gov/Archive.aspx?articleId=95676&categoryId=95674&month=7&year=2009; Diane Curtis, *Embarrassed Lawyers Fall Victim to Internet Scams*, Cal. Bar J., July 2008, *available at* http://archive.calbar.ca.gov/Archive.aspx?month=7&year=2008 [hereinafter Curtis, *Embarrassed Lawyers*].

9 E-mail received by Julie Andersen Hill on Sept. 30, 2010.

10 *See* Jeffreys, *supra* note 6, at 1; McDonald, *supra* note 6, at 1.

11 *Beware the Chinese E-mail Scam,* 97 Ill. B.J. 390 (2009).

12 In other words, a cashier's check is "a draft with respect to which the drawer and the drawee are the same bank or branches of the same bank." Tex. Bus. & Com. Code § 3.104(g) (Vernon 2007). *See also* 12 C.F.R. § 229.2(i) (2009).

13 *See, e.g.*, California Golf, L.L.C. v. Cooper, 78 Cal. Rptr. 3d 153, 169 (Cal. Ct. App. 2008).

14 12 C.F.R. § 229.10(c)(1)(v).

15 *See id.* §§ 229.12(b)(4), 229.13(b), (h). "A longer extension may be reasonable, but the bank has the burden of so establishing." *Id.* § 229.13(h)(4).

16 Tex. Disciplinary Rules of Prof'l Conduct R. 1.14(b) (1989); Model Rules of Prof'l Conduct R. 1.15(d) (2010).

17 The Uniform Commercial Code refers to this stage as "provisional settlement." Tex. Bus. & Com. Code § 4.201(a) (Vernon 2007).

18 *Id.* § 4.214(a). If the bank fails to act within a "reasonable time after it learns the facts," the bank will be liable for damages caused by the delay. *Id.* Such delays are probably rare and difficult to establish. *See* McDonald, *supra* note 6, at 1 (discussing an attorney's difficulties in gathering facts about the check collection process).

19 Tex Bus. & Com. Code § 4.214(a).

20 *Id.* § 4.207(a). If the attorney depositor indorses the cashier's

check, the bank may also seek payment from the attorney based on indorser liability. *Id*. § 3.415.

21 Amthor v. Commerce Bank, 15 Misc.3d 1130(A), 2007 WL 1299235, (N.Y. Dist. Ct. 2007) (unreported).

22 *Id*. (citations omitted)

23 *Id*. The UCC does offer some protection if non-payment of the cashier's check results from the bank's negligence or bad faith. *See* Tex. Bus. & Com. Code §§ 4.214 cmts. 5-6, 4-103(e). However, in the case of a fraudulent cashier's check the non-payment will typically result from the fraudulent nature of the check rather than the depositary bank's negligence.

24 Valley Bank of Ronan v. Hughes, 147 F.3d 185 (Mont. 2006).

25 The term "official check" is not defined in either the UCC or Regulation CC. Nevertheless, banks sometimes use the term "official check" when referring to both cashier's checks and teller's checks. *See* Guaranty Fed. Sav. Bank v. Horseshoe Operating Co. 793 S.W.2d 652 (Tex. 1990).

26 *Valley Bank of Ronan*, 147 F.3d at 191. *See also* Tex. Bus. & Com. Code § 1.103.

27 *Valley Bank of Ronan*, 147 F.3d at 192.

28 Tex. Bus. & Com. Code Ann. § 17.44(a).

29 *Id*. § 17.45.

30 Bank One, Texas, N.A. v. Taylor, 970 F.2d 16, 28 n.12 (5th Cir. 1992). *See also* La Sara Grain Co. v. First Nat'l Bank of Mercedes, 673 S.W.2d 558, 564 (Tex. 1984). *See generally*, Richard M. Alderman, The Lawyer's Guide To The Texas Deceptive Trade Practices Act, § 2.033[B] (2010).

31 It is possible that the issue will be resolved soon. A Texas attorney caught in a cashier's check scam is currently seeking damages from his bank based on a negligence theory similar to the one employed in *Bank of Ronan*. Buckley, White, Castaneda & Howell, LLP v. Citibank, NA, Cause No. 2008-66714 (Dist. Ct., Harris County, TX, 61st Judicial Dist.) (Plaintiff's First Amended Petition) (Dec. 24, 2008).

32 It is unclear what a teller means when he or she states that an item has "cleared." *Compare* Call v. Elenville Nat. Bank, 5 A.D.3d 521, 524 (N.Y. App. Civ. 2004) (stating that the "term 'cleared' is not employed in the UCC and, as commonly used, is not the equivalent of 'final settlement'") *with Valley Bank of Ronan*, 147 F.3d at 193 n.6 (stating that "[i]f the term 'cleared' means anything in common banking usage, it is that final settlement has occurred.").

33 *See* Tex. Bus. & Com. Code Ann. § 4A.211(b).

34 *See id*. A sender may be permitted to cancel a wire after the receiving bank's acceptance if the receiving bank agrees or if a "funds-transfer system rule allows cancellation." *Id.* at § 4A.211(c). However, in many circumstances the receiving bank will be reluctant to agree to the cancellation and the system rules will be unhelpful.

35 *Id*. § 4A.209(b)(1). The wire is also accepted when the scammer's bank received payment from the attorney's bank, or at the beginning of the next business day after the order was received if the scammer's bank has access to funds sufficient to cover the order. *Id*. § 4A.209(b)(2), (3).

36 The amount of time it takes for the wire to be accepted depends on a variety of factors including the method used to send the wire.

37 Curtis, *Embarrassed Lawyers*, *supra* note 8. The attorney reported that "the 29 hours from the time he learned the cashier's check was fraudulent to the time he'd learned [the bank had] gotten the money back was 'the darkest day of my life.'" *Id*.

38 Valley Bank of Ronan v. Hughes, 147 P.3d 185, 188 (Mont. 2006).

39 Giovanazzi v. State Bar of California, 619 P.2d 1005, 1009 (Cal. 1980); Iversen v. New York State Bar Ass'n, 51 A.D.2d 244, 381 N.Y.S.2d 711, 713 (1976).

40 Texas State Bar v. Gailey, 889 S.W.2d 519, 520-21 (Tex. App. 1994).

41 Tex. Disciplinary Rules of Prof'l Conduct R. 1.14(b) (1989); Model Rules of Prof'l Conduct R. 1.15(d) (2010).

42 A Georgia securities lawyer's attorney trust account was depleted after he was caught in a cashier's check scam. His bank not only sued him to recover the money, it reported him to the State Bar of Georgia. Robert J. Ambrogi, *The Great Lawyer E-mail Scam*, LAW.com, Sept. 12, 2008, *available at* http://legalblogwatch.typepad.com/legal_blog_watch/2008/09/the-great-lawye.html.

43 *See* Jeffreys, *supra* note 6.

44 For suggestions about fraudulent cashier's checks in general see Comptroller of the Currency, Consumer Advisory 2007-1, Avoiding Cashier's Check Fraud, Jan. 16, 2007.

# New York State Bar Association

## Committee on Professional Ethics

Opinion 737 (2/1/01)

Topic: Escrow accounts

Digest: A lawyer may not issue a check from an attorney escrow account drawn against a bank or certified check that has not been deposited or has not cleared.

Code: DR 9-102

**QUESTION**

In payment of a client's obligations to a third party, may a lawyer issue an attorney escrow check against undeposited or uncleared client funds delivered to the lawyer in the form of a bank or certified check?

**OPINION**

Disciplinary Rule (DR) 9-102 establishes the framework for how lawyers must handle clients' funds. For example, DR 9-102(A) provides that a lawyer is a fiduciary with respect to the client whose funds are maintained in the lawyer's escrow account and prohibits the lawyer from commingling such funds with the lawyer's own. DR 9-102(B)(1) requires a lawyer to maintain an escrow account for client funds "separate from any business or personal accounts of the lawyer or the lawyer's firm, and separate from any accounts which the lawyer may maintain as executor, guardian, trustee or receiver, or in any other fiduciary capacity." DR 9-102(C)(4) requires a lawyer to promptly pay to the client from escrow those funds which the client is entitled to receive. DR 9-102(D) requires certain bookkeeping records be maintained for escrow accounts which, pursuant to subdivision (1) thereof, "specifically identify the date, source and description of each item deposited, as well as the date, payee and purpose of each withdrawal or disbursement."

Implicit in this framework is that a lawyer will not draw on funds belonging to Client A for the benefit of Client B. Yet this is literally what occurs where a lawyer maintains funds belonging to multiple clients in a single unsegregated

escrow account and issues a check in payment of the obligation of one client before certified checks or bank checks delivered to the attorney's possession for the benefit of that client in amounts sufficient to cover that obligation are deposited into the lawyer's escrow account and cleared. The issue before this Committee is whether there are practical considerations which, with appropriate safeguards, may permit a relaxation of the ethical proscription against a lawyer, in effect, granting Client B a temporary loan out of funds belonging to Client A.

The issue arises most often in the context of residential real estate closings. In many parts of the State, the seller's attorney or a real estate broker typically holds funds from the buyer in an escrow account. The amount, which in some transactions may be as much as ten percent of the purchase price, represents the buyer's down payment delivered upon execution of a residential purchase contract. This down payment — cleared by the time of closing — may be sufficient for the seller's closing obligations if there is adequate pre-closing planning and communication between the attorneys for the seller, the attorneys for the purchaser and the attorneys for the purchaser's lending institution concerning the correct closing figures and the manner of the purchaser's payment of the balance due. Sometimes, however, open taxes, open judgments or other liens will first appear in a continuation title search run immediately prior to or at the closing in amounts that exceed the funds already cleared and in escrow. As these encumbrances constitute a cloud on title that must be cleared at the closing in order for the seller to convey good title, the purchaser's title agent must be given adequate funds from or on behalf of the seller to cure the problem or to omit them from the title commitment. For this purpose, only a bank check, a certified check or an attorney's check will typically be accepted.

In these circumstances — where the earnest money or down payment deposited and cleared in escrow is insufficient to satisfy the seller's closing obligations and where bank or certified checks in the proper amounts are not available at the closing — it might seem that a practical solution to avoid the delay, inconvenience and expense of an adjournment would be for the seller's attorney to accept for deposit in his or her escrow account the bank or certified checks tendered by the purchaser or the purchaser's lender for the balance of the purchase price, checks usually made payable to the seller, which the seller then endorses over to the seller's attorney for deposit in the escrow account. The seller's attorney would then issue checks drawn on the escrow account payable in the amounts required to satisfy the seller's closing obligations, including the open taxes, judgments or other liens that encumber the good title that the seller is contractually obligated to convey, and remits the balance of the proceeds to his or her client. Apparently, the title companies and others will accept the escrow check of the seller's attorney, notwithstanding actual knowledge that the bank checks and certified checks delivered to the seller's attorney at the closing have not yet been deposited into the attorney's escrow account and, perforce, have not yet cleared. The seller's attorney is often willing to issue such escrow checks because there are sufficient funds, already cleared

on deposit in the attorney's escrow account, to cover the checks issued at the closing. To the extent the total amount of the escrow checks issued at closing thus exceeds the buyer's down payment or earnest money, the funds on deposit in the attorney's escrow account that are used to cover the excess are indisputably funds belonging to other clients.

There are a number of arguments that can be advanced in favor of interpreting DR 9-102 to allow a lawyer to issue escrow checks on behalf of Client B that are covered by cleared funds in the same escrow account deposited on behalf of Client A where the lawyer is in physical possession of bank or certified checks appropriately endorsed for deposit into the lawyer's escrow account on behalf of Client B that, if and when cleared, would be sufficient to cover those escrow checks. Some of these arguments have been favorably considered by the authorities in other states. Thus, Florida and Illinois have adopted specific rules permitting lawyers to disburse uncleared funds. *See* Rule 1.15 of the Illinois Rules of Professional Conduct; Rule 5-1.1(g) of the Rules Regulating the Florida Bar. In addition, New Jersey, North Carolina, and Virginia have approved of the practice, *see* N.J. Eth. Op. 454 (1980), N.C. Eth. Op. RPC 191 (1997), and Va. Eth. Op. 183 (1996), while South Carolina has not. *See In re Hensel*, 2000 WL 640239 (S.C. Sup. Ct. May 15, 2000), S.C. Adv. Op. 78-20 (1978). On balance, however, we find none of the arguments sufficiently persuasive to subvert the obvious intended core purpose of DR 9-102 — to maintain the integrity of a client's funds for the benefit of that client only, until payment of those funds to, for or on behalf of that client and no other client, is due.

First, it can be argued that an attorney comes into "possession" of funds on behalf of Client B within the meaning of DR 9-102(A) when he or she receives the bank checks or certified checks properly endorsed for deposit into his escrow account on behalf of Client B at the closing. Because the risk that a certified check or bank check will not clear is considered to be negligible, it can be argued that the receipt should be analogized to the receipt of cash. However, even cash can be lost or stolen between the time of the closing and the time of the bank deposit, and until the cash is deposited and credited to the escrow account, the cash does not generate available funds. A bank or cashier's check may also be subject to a stop payment order if the check was procured by fraud. *See, e.g., U.S. Printnet, Inc. v. Chemung Canal Trust Co.,* 270 A.D.2d 544, 703 N.Y.S.2d 821, 823 (3rd Dept. 2000), and cases cited therein. In addition, the checks themselves may turn out to be forgeries. *See, e.g.*, *U.S. v. Van Shutters*, 163 F.3d 331 (6th Cir. 1998) (counterfeit bank checks were used to purchase automobiles) and *U.S. v. Werber*, 787 F. Supp. 353 (S.D.N.Y. 1992) (same). Finally, there has been at least one recent case where a fully licensed mortgage broker was unable to meet its obligations, defaulting on its own checks. *See* "New York State Banking Department Suspends Mortgage Banker's License," Press Release issued July 5, 2000 by NYS Banking Department, available at www.banking.state.ny.us.pr (visited 12/5/00).

Second, it is doubtless correct that bank checks and certified checks are ordinarily accepted as a proper tender of payment in business transactions and it is therefore argued to be unreasonable to hold an attorney to a higher standard in the administration of his escrow account. The commercial reasonableness of the practice, however, does not fairly address the situation where one client's funds are being used to cover the checks issued on behalf of another client. If a commercial party chooses to accept the minimal risk of loss associated with the acceptance of a bank check or certified check, that same party will bear any loss that actually comes to pass. However, if Client A's funds are used to cover the checks written by an attorney for the benefit of Client B, and the bank or certified check deposited after the checks are issued to cover Client B's obligations is for whatever reason unpaid, it is Client A, a stranger to the transaction, not Client B, a party to the transaction, who will suffer the loss.

Third, it may indeed be true that in most cases it is incidental closing expenses that will be paid if the subject practice is allowed and that, therefore, any loss, already a remote possibility, will likely be in a nominal amount. In the same vein, it is argued that prohibiting the practice will engender delay and inconvenience and may adversely affect the economy. Whether or not these are accurate statements of the risk and the peril seems, however, beside the point. If a client's funds may not be invaded for the benefit of another, the principle must hold no matter what the size or extent of the planned invasion and no matter what may be the detriment to third parties of withholding the use of that client's funds.

Fourth, the practice of writing escrow checks at a closing drawn on the funds of other clients and against undeposited or uncleared bank or certified checks, if prohibited as unethical, can be argued to have a greater adverse impact upon persons of moderate or low income. This is because, where the price of real estate in a given community is lower, the legal fees associated with the closings are often lower as well. There is more pressure upon attorneys who practice in these communities to generate fees on a volume basis and less time may be spent in preparing for closings generally with a view toward "working out" what title and other problems exist at that time. It is these attorneys who may be compelled to raise their fees in order to carry on their residential real estate practices if more pre-closing preparation time is required to satisfy ethical obligations. Alternatively, if additional pre-closing preparation time is eschewed in favor of an occasional adjournment of a closing in order to allow the seller additional time to clear an unexpected title objection or to allow the purchaser additional time to obtain a bank or certified check in a previously uncalculated or uncommunicated pay-off amount, this is still likely to result in additional cost to the parties, as the purchaser's lender will often charge a fee to adjourn a closing and the lender itself will often charge a fee to extend a loan commitment.

Although the Committee is sympathetic to the concerns of all parties to a residential real estate transaction who quite understandably would prefer to avoid the increased legal fees or costs that might be associated with an adjournment of a closing, these considerations are insufficient to overcome the fiduciary obligation that an attorney owes to the attorney's other clients whose funds must not be invaded.

Fifth, it has been suggested that Client A, by allowing his funds to be deposited in an unsegregated attorney escrow account has implicitly consented to the possibility that those funds might be drawn upon in behalf of a Client B, including the small risk that a bank or certified check deposited into the escrow account for the benefit of Client B might be dishonored. The implied consent is said to arise from knowledge of the widespread practice of attorneys writing escrow checks against undeposited or uncleared bank or certified checks. Far from assuming Client A's consent to the practice, this Committee would assume the very opposite — that Client A, if asked, would vigorously object to putting his funds at risk and granting a no-interest loan for the benefit of Client B with whom Client A shares neither a social nor a business bond.

Nor can we ascertain any conditions or qualifications to the issuance of attorney escrow checks against undeposited or uncleared bank or certified checks that might ethically purify the practice. For example, the practice has been found acceptable provided, among other things, that the attorney immediately makes good any loss. *See* N.C. Eth. Op. RPC 191 (1997). But if the attorney is personally willing to take the risk that the checks will not clear, we see no reason why the attorney should not simply advance the disbursements necessary to effect the closing out of his own operating account and await a refund from his escrow account if and when the bank or certified check clears. From a practical as well as a fiduciary perspective, it is far more appropriate for the attorney for both Client A and Client B to make a temporary, no-interest loan to Client A than it is for Client B to make such loan. The attorney has knowledge of the facts and circumstances pertaining to the closing and can evaluate the degree of risk associated with acceptance of the proffered bank or certified check. Client B, on the other hand, neither knows or controls anything and has consented to nothing.

Finally, we note that our conclusion appears to be in seeming conformance with several recent disciplinary determinations of the Appellate Division, Second Department, and we are unaware of any determinations of the First, Third or Fourth Departments which suggest a contrary result. *See Matter of Abbatine*, 263 A.D.2d 228, 700 N.Y.S.2d 211 (2d Dept. 1999) (five year suspension ordered for attorney who, *inter alia*, issued escrow check for $4,147.18 from unsegregated escrow account against $10,000 deposit made 16 days later); *Matter of Ferguson*, 259 A.D.2d 186, 694 N.Y.S.2d 113 (2d Dept. 1999) (one year suspension ordered for attorney who, *inter alia*, issued escrow check against "wired" funds not yet received); and *Matter of Joyce*, 236 A.D.2d

116, 119, 665 N.Y.S.2d 430, 431 (2d Dept. 1997) (indefinite suspension ordered for attorney who, *inter alia*, "[o]n at least four occasions...issued checks from his escrow account for a particular transaction in advance of depositing the subject funds into his escrow account, causing checks to clear against the funds of other clients or third parties").

## CONCLUSION

The Committee welcomes further study of the problem addressed in this opinion with a view toward devising solutions that adhere to ethical requirements. However, for the reasons stated, the question is answered in the negative.

(22-00)

NEW YORK STATE BAR ASSOCIATION

# Committee on Professional Ethics

Opinion 693 - 8/22/97 (68-96)

Topic: Nonlawyer Employees; Escrow Accounts; Attorney's Signature

Digest: Attorney may allow paralegal to use attorney's signature stamp to execute escrow checks under certain circumstances

Code: DR 1-104; DR 9-102(A), (B); DR 9-102(E); EC 3-6

## QUESTION

May a lawyer allow a paralegal to use a stamp bearing the lawyer's signature to execute checks drawn on a client escrow account?

## OPINION

This Committee and others have frequently addressed issues arising from a lawyer's delegation of tasks to a nonlawyer employee. *See, e.g.*, N.Y. State 677 (1995); N.Y. State 255 (1972); N.Y. State 44 (1967); N.Y. City 1995-11 (1995); N.Y. City 666 (1985); Nassau County 90-13; ABA 316 (1967). The question in this inquiry is whether, consistent with DR 9-102(E), a lawyer may allow a nonlawyer employee to use a signature stamp to execute checks drawn on the lawyer's client escrow account. *See* DR 9-102(B). The inquirer notes that the purpose of the signature stamp is to facilitate procedures at the closings of real estate transactions.

The New York Lawyer's Code of Professional Responsibility contemplates that lawyers will delegate tasks to nonlawyers. DR 1-104; EC 3-6; *See* N.Y. City 1995-11. We have recently opined that it is permissible for lawyers to delegate attendance at a real estate closing to a paralegal, where the delegating lawyer is available by telephone as necessary, the particular closing is "ministerial" and several other conditions are satisfied. N.Y. State 677 (1995). In our opinion we noted that all tasks assigned to a paralegal must be "within the limits prescribed by law" and "clearly limited to those functions not involving independent discretion or judgment." N.Y. State 677; *see* ABA 316 (1967); N.Y. State 255 (1972); N.Y. City 666 (1985). We acknowledged that many real estate and mortgage closings do not require the paralegal to exercise independent discretion or judgment. N.Y. State 677.

It is the attorney or a member of the attorney's firm who is the custodian of the funds of the client. DR 9-102; N.Y. State 570 (1985); Nassau County 88-31. DR 9-102(A) and (B) generally require that a lawyer deposit client funds in identifiable bank accounts within the state and segregate such funds from the lawyer's general funds. N.Y. State 570 (1985). An attorney is personally and professionally liable for funds and property entrusted to him or her by a client and must exercise the highest degree of care in preserving and protecting such funds and property. Nassau County 88-31. Consistent with these principles, DR 9-102(E) provides that "[o]nly an attorney admitted to practice law in New York State shall be an authorized signatory of a special account." A nonlawyer may not be a signatory on a special account and a lawyer may not give such a person signatory power on such account. *In re Gambino*, 205 A.D.2d 212, 619 N.Y.S. 2d 305, (2d Dep't 1994) (lawyer violated DR 9-102(E) by permitting nonlawyer daughter to be signatory on special account); *In re Stenstrom*, 194 A.D.2d 277, 605 N.Y.S. 2d 603 (4th Dep't 1993) (lawyer violated DR 9-102(E) by permitting nonlawyer ex-wife to be signatory on special account).

Although it is clear that only a lawyer may control the lawyer's client escrow account and be a signatory of it, the Rule does not address whether a lawyer may delegate the task of signing his or her name to escrow account checks to others, and if so whether a signature stamp can be used for that purpose. Based on the analysis of proper delegation in our previous opinions, we believe that it is ethically permissible for a lawyer to authorize a paralegal to make use of the lawyer's signature stamp on checks drawn from a special account at closings under certain conditions and with proper controls. As with the rest of a paralegal's duties at a real estate closing, N.Y. State 677, the lawyer must consider in advance how the paralegal will use the signature stamp – including approving the purpose of the anticipated payments to be made by such checks, the nature of the payee and the authorized dollar amount range for each check to be issued – and review afterwards what actually happened to assure that the delegation of authority has been utilized properly. As a practical matter, compliance with these restrictions will limit the use of the signature stamp by a paralegal to those circumstances in which the lawyer can reliably forecast events at the closing.

Attorneys must be aware that responsibility for client funds may not be delegated, and attorneys authorizing paralegals to use signature stamps on checks drawn from escrow accounts are "completely responsible" to the client for any errors or misuse of the stamp. N.Y. State 677; DR 1-104. Attorneys must take steps to safeguard the use of the signature stamp to avoid any misappropriation of client funds.

## CONCLUSION

A lawyer may allow a paralegal to use a signature stamp to execute escrow checks from a client trust account so long as the lawyer supervises the delegated work closely as provided in this Opinion and exercises complete professional responsibility for the acts of the paralegal.

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**NEW YORK STATE DEPARTMENT OF LAW**

**MODEL FORM OF ESCROW AGREEMENT**

AGREEMENT made this _____ day of _____, 20___, by and among _____ ("PURCHASER"), _____ ("SPONSOR"), as sponsor of the _____offering plan ("Plan") and _____ ("ESCROW AGENT").

**WHEREAS**, SPONSOR has filed the Offering Plan with the Attorney General to offer for sale [cooperative/condominium/homeowners association/time shares] [ownership/membership/fractional] interests at the premises located at _____, subject to the terms and conditions set forth in the Plan; and

**WHEREAS**, ESCROW AGENT is authorized to act as an escrow agent hereunder in accordance with New York General Business Law ("GBL") Sections 352-e(2-b), 352-h and the New York Department of Law's regulations promulgated thereunder; and

**WHEREAS**, SPONSOR and PURCHASER desire that ESCROW AGENT act as escrow agent for deposits, down payments, and advances (referred to herein as "Deposit") pursuant to the terms of this Agreement.

**NOW, THEREFORE**, in consideration of the covenants and conditions contained herein and other good and valuable consideration, the parties hereby agree as follows:

## 1. ESTABLISHMENT OF THE ESCROW ACCOUNT.

1.1. ESCROW AGENT [shall/has] establish[ed] an escrow account for the purpose of holding the Deposit made by PURCHASER pursuant to that certain purchase agreement for the purchase and sale of [shares/unit/membership interest/fractional interest] [__] (the "Purchase Agreement") at [NAME OF BANK] located at _____, in the State of New York ("Bank"), a bank authorized to do business in the State of New York. The escrow account is entitled _____("Escrow Account"). [The account number is _____.]

1.2 ESCROW AGENT has designated the following attorneys to serve as signatories: _____. All designated signatories are admitted to practice law in the State of New York.

All of the signatories on the Escrow Account have an address of _____, and a telephone number of _____.

1.3 ESCROW AGENT and all authorized signatories hereby submit to the jurisdiction of the State of New York and its Courts for any cause of action arising out of this Agreement or otherwise concerning the maintenance of or release of the Deposit from escrow.

1.4 Neither ESCROW AGENT nor any authorized signatories on the Escrow Account are the Sponsor, Selling Agent, Managing Agent (as those terms are defined in the Plan), or any principal thereof, or have any beneficial interest in any of the foregoing .

1.5 The Escrow Account is not an IOLA account established pursuant to Judiciary Law Section 497.

## 2. DEPOSITS INTO THE ESCROW ACCOUNT.

2.1 All Deposits received from PURCHASER prior to closing, whether in the form of checks, drafts, money orders, wire transfers, or other instruments which identify the payor, shall be placed into the Escrow Account. All instruments to be placed into the Escrow Account shall be made payable directly to the order of _____, as ESCROW AGENT, pursuant to the terms set forth in the Plan. Any instrument payable to, or endorsed other than as required hereby, and which cannot be deposited into such Escrow Account, shall be returned to PURCHASER promptly, but in no event more than five (5) business days following receipt of such instrument by ESCROW AGENT. In the event of such return of the Deposit, the instrument shall be deemed not to have been delivered to ESCROW AGENT pursuant to the terms of this Agreement.

2.2 Within five (5) business days after the Purchase Agreement has been tendered to ESCROW AGENT along with the DEPOSIT, ESCROW AGENT shall place the DEPOSIT into the Escrow Account. Within ten (10) business days of placing the DEPOSIT in the Escrow Account, ESCROW AGENT shall provide written notice to Purchaser and Sponsor, confirming the Deposit. Such notice shall set forth the Bank, the account number, and the initial interest rate earned thereon. If the PURCHASER does not receive notice within fifteen (15) business days after tender of the Deposit, the PURCHASER may cancel the Purchase Agreement within ninety (90) days after tender of the Deposit. Complaints concerning the failure to honor such cancellation requests may be referred to the New York State Department of Law, Real Estate Finance Bureau, 28 Liberty Street, New York, NY, 10005. Rescission shall not be afforded where proof satisfactory to the Attorney General is submitted establishing that the Deposit was timely placed in the Escrow Account in accordance with the New York State Department of Law's regulations concerning the Deposit and requisite notice was timely mailed to the Purchaser.

## 3. RELEASE OF FUNDS

3.1 Under no circumstances shall SPONSOR seek or accept release of the Deposit of PURCHASER to SPONSOR until after consummation of the Plan, as evidenced by the acceptance of a post-closing amendment by the New York State Department of Law. Consummation of the Plan shall not relieve SPONSOR or ESCROW AGENT of any obligation to PURCHASER as set forth in GBL §§ 352-e(2-b) and 352-h.

3.2 ESCROW AGENT shall release the Deposit to PURCHASER or SPONSOR as directed:

3.2.1 pursuant to terms and conditions set forth in the Purchase Agreement and this Agreement, upon closing of title to the [shares/unit/membership interest/fractional interest];

3.2.2 in a subsequent writing signed by both SPONSOR and PURCHASER; or

3.2.3 by a final, non-appealable order or judgment of a court.

3.3 If Escrow Agent is not directed to release the Deposit pursuant to paragraph 3.2 above, and Escrow Agent receives a request by either SPONSOR or PURCHASER to release the Deposit, then Escrow Agent must give both the Purchaser and Sponsor prior written notice of not fewer than thirty (30) days before releasing the Deposit. If Escrow Agent has not received notice of objection to the release of the Deposit prior to the expiration of the thirty (30) day period, the Deposit shall be released and Escrow Agent shall provide further written notice to both PURCHASER and SPONSOR informing them of said release. If Escrow Agent receives a written notice from either PURCHASER or SPONSOR objecting to the release of the Deposit within said thirty (30) day period, Escrow Agent shall continue to hold the Deposit until otherwise directed pursuant to paragraph 3.2 above. Notwithstanding the foregoing, Escrow Agent shall have the right at any time to deposit the Deposit contained in the Escrow Account with the Clerk of the county where the [unit/building] is located and shall give written notice to both SPONSOR and PURCHASER of such deposit.

3.4 Sponsor shall not object to the release of the Deposit to:

3.4.1 Purchaser, if Purchaser timely rescinds in accordance with an offer of rescission contained in the Plan or an Amendment to the Plan; or

3.4.2 Purchaser after an Amendment abandoning the Plan is accepted for filing by the New York State Department of Law.

## 4. RECORDKEEPING.

4.1 ESCROW AGENT shall maintain all records concerning the Escrow Account for seven years after release of the Deposit.

4.2 Upon the dissolution of the law firm which was ESCROW AGENT, the former partners or members of the firm shall make appropriate arrangements for the maintenance of these records by one of the partners or members of the firm or by the successor firm and shall notify the New York State Department of Law of such transfer.

4.3 ESCROW AGENT shall make available to the Attorney General, upon request, all books and records of ESCROW AGENT relating to the funds deposited and disbursed hereunder.

## 5. GENERAL OBLIGATIONS OF ESCROW AGENT.

5.1 ESCROW AGENT shall maintain the Escrow Account under its direct supervision and control.

5.2 A fiduciary relationship shall exist between ESCROW AGENT and PURCHASER, and ESCROW AGENT acknowledges its fiduciary and statutory obligations pursuant to GBL§§ 352-e(2-b) and 352-h.

5.3 ESCROW AGENT may rely upon any paper or document which may be submitted to it in connection with its duties under this Agreement and which is believed by ESCROW AGENT to be genuine and to have been signed or presented by the proper party or parties and shall have no liability or responsibility with respect to the form, execution, or validity thereof.

## 6. RESPONSIBILITIES OF SPONSOR.

6.1 SPONSOR agrees that it shall not interfere with ESCROW AGENT'S performance of its fiduciary duties and statutory obligations as set forth in GBL §§ 352-e(2-b) and 352-h and the New York State Department of Law's regulations.

6.2 SPONSOR shall obtain or cause the selling agent under the Plan to obtain a completed and signed Form W-9 or W-8, as applicable, from PURCHASER and deliver such form to ESCROW AGENT together with the Deposit and Purchase Agreement.

## 7. TERMINATION OF AGREEMENT.

7.1 This Agreement shall remain in effect unless and until it is canceled by either:

7.1.1 Written notice given by SPONSOR to ESCROW AGENT of cancellation of designation of ESCROW AGENT to act in said capacity, which cancellation shall take effect only upon the filing of an amendment to the Plan with the Department of Law providing for a successor escrow agent that meets the requirements set forth in applicable regulations of the New York State Department of Law. PURCHASER shall be deemed to have consented to such cancellation;

7.1.2 The resignation of ESCROW AGENT, which shall not take effect until ESCROW AGENT is replaced by a successor escrow agent that meets the requirements set forth in applicable regulations of the New York State Department of Law, and notice is given to PURCHASER of the identity of the successor escrow agent, the Bank in the State of New York where the Deposit is being held, and the account number therefor.

7.2 Upon termination of the duties of ESCROW AGENT as described in paragraph 7.1.1 or 7.1.2 above, ESCROW AGENT shall deliver the Deposit held by ESCROW AGENT and the Purchase Agreement and any other documents maintained by ESCROW AGENT relating to the Deposit to the successor escrow agent.

## 8. SUCCESSORS AND ASSIGNS.

This Agreement shall be binding upon SPONSOR, PURCHASER, and ESCROW AGENT and their respective successors and assigns.

**9. GOVERNING LAW.**

This Agreement shall be construed in accordance with and governed by the laws of the State of New York.

**10. ESCROW AGENT'S COMPENSATION.**

Prior to release of the Deposit, ESCROW AGENT'S fees and disbursements shall neither be paid by SPONSOR from the Deposit nor deducted from the Deposit by any financial institution under any circumstance.

**11. SEVERABILITY.**

If any provision of this Agreement or the application thereof to any person or circumstance is determined to be invalid or unenforceable, the remaining provisions of this Agreement or the application of such provision to other persons or to other circumstances shall not be affected thereby and shall be valid and enforceable to the fullest extent permitted by law.

**12. INDEMNIFICATION.**

SPONSOR agrees to defend, indemnify, and hold ESCROW AGENT harmless from and against all costs, claims, expenses, and damages incurred in connection with or arising out of this Agreement or the performance or non-performance of ESCROW AGENT'S duties under this Agreement, except with respect to actions or omissions taken or suffered by ESCROW AGENT in bad faith or in willful disregard of this Agreement or involving gross negligence of ESCROW AGENT. This indemnity includes, without limitation, disbursements and attorneys' fees either paid to retain attorneys or representing the hourly billing rates with respect to legal services rendered by ESCROW AGENT to itself.

**13. ENTIRE AGREEMENT.**

This Agreement, read together with GBL §§ 352-e(2-b) and 352-hand the New York State Department of Law's regulations, constitutes the entire agreement between the parties with respect to the subject matter hereof.

**IN WITNESS WHEREOF**, the undersigned have executed this Agreement as of the day and year first written above.

ESCROW AGENT:

[LAW FIRM]

By: _____
Name: _____
Title: _____

SPONSOR

[INSERT NAME]

By: _____
Name: _____
Title: _____

PURCHASER

[INSERT NAME]

By: _____
Name: _____
Title: _____