**Fraudulent Signatures, Alterations and Negligence**

Welcome to this podcast on Fraudulent Signatures, Alterations and Negligence brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is to address the liability that arises when there is a fraudulent signature on an instrument, as well as the effect of alterations and negligence. Oh and yes, again, this deals with instruments, typically paper checks and promissory notes. While consumers and businesses don’t use paper checks as much as they did in the past, some of these are large value instruments and fraud remains a problem. Not only is this a practice issue, but these rules are covered in Article 3 of the Uniform Commercial Code, which is tested in a number of states on the bar exam. This set of basic rules frequently comes up on bar exams. It is important to try and use the correct terminology so in this podcast be on the lookout for the following: signature, representative, unauthorized signature, negligence, and alterations.

Let’s begin with the basic rules regarding signatures. One of the fundamental rules of Article 3 is that a person is not liable on an instrument unless they or their agent sign it. Of course, a signature can be made using a pen, but also using a stamp, symbol, or mark. When it comes to business entities, it is typical that a representative will sign the instrument either in the name of the represented person, the business, or the name of the signer. Such a signature will bind the business entity in such cases. Sometimes, an individual will authorize, either actually or under the apparent authority rule of agency, a representative to sign on their behalf and in such cases the signature is also binding. Imagine, for instance, that the electrician is coming to my house to install a new outlet, but I forget to leave a check. If my daughter, Emma, is at my house, I might call her and ask her to sign a check on my behalf. In such a case, Emma would be acting as my representative and I would be bound by her signature on my check written to the electrician.

Moving on, the basic rule with respect to fraudulent signatures, though, is that an unauthorized signature is not effective, except as the signature of the unauthorized signer. Suppose I have the electrician come to my house to install a new outlet. I get my checkbook out and write her a check, but I leave the checkbook on the kitchen counter. When I walk away, the electrician steals a blank check, writes payment out to herself for $2000 and signs my name. Under the basic rules regarding signatures, I have not signed the instrument and I am not liable. Moreover, the unauthorized signature that was made on my behalf by the electrician is ineffective, except as the signature of the electrician herself.

There’s also a special rule to address alterations to instruments under Article 3. Basically, it provides that the issuer of an instrument is only liable with respect to an instrument’s original terms or in the case of an incomplete instrument altered by unauthorized completion, according to the terms when completed. In the event that I write a check made out to the electrician for $200, but the electrician adds a zero to the number making it $2000, I am only liable for the original amount of $200. Moreover, my liability is only to a person taking the check for value, in good faith, and without notice of the alteration.

There’s one last piece of this rule that you should not miss regarding incomplete instruments. Sometimes people carelessly write out an instrument and sign it, leaving the amount incomplete. Suppose that I don’t know how much I’m going to pay the electrician, but I write the check nevertheless and leave the amount incomplete. If the electrician picks up the check, steals it and completes the instrument by filling in an amount of $2000, I will be responsible for the amount as completed. This is true even though the completion was unauthorized. Perhaps I should be more careful.

Okay, one last rule for this podcast. Let’s see how negligence that contributes to a forged signature or alteration might affect the allocation of loss as we know it. The basic rule is that a person who fails to exercise ordinary care that substantially contributes to an alteration or a forged signature on an instrument is precluded from asserting the alteration or forgery. That preclusion is good for a person who in good faith pays the instrument or takes it for value or collection, usually a bank or check-cashing service. The key to negligence is the failure to exercise ordinary care that substantially contributes to the forgery. However, if the person seeking to assert negligence also failed to exercise ordinary care that substantially contributed to the loss, then the loss is allocated between the parties. As you might expect, the burden of proof is on the person asserting a failure to exercise ordinary care.

As always, I find examples are helpful. Let’s presume that Employer prints checks using software that provides a check preprinted with the signature. The software has a password. Employer though, being forgetful, writes down the password and keeps it next to the computer. Janitor, while cleaning the office, is able to use the password and print a check for $500 to herself on Employer’s account and cashes the check at First Bank. When the fraud is discovered, Employer claims that it should not be liable due to the unauthorized signature. First Bank, though, will likely argue that Employer failed to exercise ordinary care with respect to the password and that keeping the password next to the computer substantially contributed to the making of the forged instrument. Accordingly, First Bank will argue that Employer should take the loss because it was negligent.

So, how about another example. Employer writes a check to Paula Payee for $15, writing the number 15 in the appropriate places on the check form. Employer, though, leaves a large blank space after the number 15. Paula Payee, using the same type of ink and a similar handwriting style writes the word thousand after the number 15 and uses a comma where needed. Paula Payee cashes the check at Second Bank, which pays $15,000 in good faith when the check is presented for payment and then takes the money out of Employer’s account. When Employer discovers the alteration and claims protection of 3-407, Second Bank will likely argue that Employer failed to exercise ordinary care that contributed to the alteration. As such, Employer should be precluded from asserting the alteration because Second Bank paid the item in good faith.

So, where might a student go wrong with these rules? Well, when it comes to fraudulent signatures, look out for someone who was actually a representative of the drawer such that the account holder is liable because the item is authorized. When it comes to alterations, be sure to note that the issuer of the instrument is liable for the instrument as originally issued. Finally, when it comes to the negligence rule, most simple acts are not negligence for purposes of Article 3. It takes some extraordinary behavior of an account holder to amount to the type of negligence required to shift liability to the account holder. Mere sloppy practices of business are typically not enough. The classic example is where the account holder leaves a rubber signature stamp near the unsigned checks. In such cases, that is enough to shift liability to the account holder. Liability is allocated among responsible parties if there are more than one negligent party.

At this point, you should be able to describe when a signature is sufficient to make a person liable on instrument, how Article 3 treats responsibility for alterations and when the failure to exercise ordinary care will shift responsibility on the grounds of negligence to an account holder.

I hope you’ve enjoyed this podcast on Fraudulent Signatures, Alterations and Negligence.

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