

NOTICE: This order was filed under Supreme Court Rule 23 and may not be cited as precedent by any party except in the limited circumstances allowed under Rule 23(e)(1).

IN THE
APPELLATE COURT OF ILLINOIS
SECOND DISTRICT

| | | |
|------------------------|---|-------------------------------|
| BETTY ELLIS, |) | Appeal from the Circuit Court |
| |) | of Stephenson County. |
| Plaintiff-Appellee, |) | |
| |) | |
| v. |) | No. 14-SC-437 |
| |) | |
| BANK OF AMERICA, N.A., |) | Honorable |
| |) | John F. Joyce, |
| Defendant-Appellant. |) | Judge, Presiding. |

JUSTICE BURKE delivered the judgment of the court.
Justices Jorgensen and Birkett concurred in the judgment.

ORDER

¶ 1 *Held:* The trial court erred in holding defendant liable for funds that plaintiff's bank sent to defendant from plaintiff's account: in light of doubts about the validity of the endorsements on a check drawn against defendant, defendant lawfully asserted a breach of warranty, and plaintiff's bank, as the bank of first deposit, chose to return the funds rather than defend the warranty; thus, it was plaintiff's bank that caused plaintiff's loss.

¶ 2 Defendant, Bank of America, N.A., appeals from a judgment of the circuit court of Stephenson County that found that defendant improperly obtained \$7,580 from plaintiff Betty Ellis's bank account at First Northern Credit Union (First Northern). Defendant contends that, because it was authorized under section 4-208(a) of the Uniform Commercial Code (UCC) (810

ILCS 5/4-208(a) (West 2014)) to challenge First Northern's warranty as to the validity of the endorsements on a \$7,580 third-party check deposited by plaintiff, it did not cause plaintiff's loss. Because section 4-208(a) of the UCC authorized defendant to challenge the warranty, we reverse.

¶ 3

I. BACKGROUND

¶ 4 Plaintiff filed *pro se* a small-claims action against defendant, alleging that defendant improperly obtained funds from her account at First Northern for a \$7,580 third-party check that she had deposited into her account, that defendant had debited from the issuer's account, and that defendant had subsequently claimed was fraudulently endorsed. Defendant denied liability,¹ and the trial court conducted a trial.

¶ 5 The following evidence was established at the bench trial. Plaintiff's sister, Diane Adams, received a \$7,580 insurance check from USAA General Indemnity Company (USAA). According to plaintiff, in April 2014, Adams was incarcerated, but, while Adams was furloughed for medical care, Adams came to plaintiff's home. Because Adams owed plaintiff money, Adams endorsed the check and made it payable to plaintiff. Plaintiff, in turn, endorsed the check and deposited it into her First Northern account.

¶ 6 Because the check was drawn on USAA's account with defendant, First Northern transferred the check to defendant. Defendant, in turn, debited USAA's account in the amount of \$7,580.

¶ 7 According to plaintiff, in July 2014, Adams, who was "running from the police" and "need[ed] money," contacted USAA in Texas and signed a fraud statement, asserting that Adams

¹ No attorney appeared for defendant. Instead, a corporate representative, Roxanne Hollinsworth, appeared on behalf of defendant. See Ill. S. Ct. R. 282(b) (eff. July 1, 1997).

did not receive any benefit from the check, that plaintiff stole the check, and that plaintiff had forged Adams's signature. The fraud statement included Adams's declaration that, under the penalty of perjury, the information was true and correct and that she would testify accordingly. USAA submitted the fraud statement to defendant.

¶ 8 In September 2014, defendant, relying on the fraud statement, contacted First Northern, asserting that plaintiff fraudulently endorsed Adams's signature on the check. First Northern withdrew \$7,580 from plaintiff's account and transferred that amount to defendant. Defendant credited USAA's account for \$7,580.

¶ 9 Once plaintiff learned that her account had been debited \$7,580, she sent a letter to defendant's fraud department, stating that Adams had committed the fraud. According to plaintiff, defendant ignored her letter and issued a check to USAA for \$7,580. Plaintiff filed a report with the Freeport police department regarding Adams's purported fraud.

¶ 10 According to plaintiff, First Northern called her and told her that it had withdrawn the money and transferred it to defendant. It explained to her that it did so because the check was alleged to be fraudulently endorsed. Plaintiff told First Northern that she did not object to it holding the funds until the fraud was established.

¶ 11 According to Jon Pick, the district manager for First Northern, First Northern received a statement from defendant asserting that the check was fraudulently endorsed. First Northern, in turn, sent a check to defendant for \$7,580. Pick explained that it is not customary in such situations to obtain a police report. Rather, when someone completes a fraud statement under penalty of perjury, the bank does not investigate whether a fraud actually occurred. Pick referred to internal notes stating that plaintiff had indicated that she had witnesses to prove that Adams signed the check over to her, and that a hold was placed on the funds. When asked why First

Northern did not continue to “freeze the funds” until a fraud was proved, Pick answered that First Northern’s attorney advised it that, because this was a third-party check and the payee (Adams) claimed that it was stolen, First Northern had “no choice but to send the funds back to [defendant].”

¶ 12 According to plaintiff’s husband, Edmond Ellis, Adams, accompanied by her son, came to the house and signed the check over to plaintiff. Ms. Nes Adams, plaintiff’s niece, also testified that Adams signed the check over to plaintiff.

¶ 13 Hollinsworth told the trial court that the check was drawn on USAA’s account and made payable to Adams. USAA submitted to defendant a fraud statement on behalf of Adams that was based on Adams’s assertions that she had never received the check and that plaintiff had stolen it and forged Adams’s signature. In response to the fraud claim, defendant made a prelitigation warranty claim to First Northern, which, as the bank of first deposit, was liable for any forged endorsement. First Northern, in turn, honored the warranty claim, debited plaintiff’s account, and transferred \$7,580 to defendant for deposit into USAA’s account.

¶ 14 In ruling for plaintiff, the trial court stated that USAA might have been a “bit negligent” for failing to investigate Adams’s fraud claim before issuing Adams a second check and submitting a fraud statement to defendant. The court added that USAA “goes to [defendant] and says, [t]his was a fraud and so [defendant] should get [USAA’s] money back.” Defendant then used what the court understood to be “accepted bank procedures” by contacting First Northern. First Northern then was advised by its attorney to transfer the money without First Northern first contacting plaintiff. Thus, the court described plaintiff as “just a pawn” and the “offended person here.”

¶ 15 The trial court found that, although plaintiff was not defendant's customer, it "got the money from [her]." According to the court's "way of thinking equitable wise," plaintiff should receive a judgment against defendant for \$7,580 plus costs. The court commented that plaintiff "should have gone and sued *** [USAA] and the First Northern" and "then let the Court decide who gets stuck." Nonetheless, the court "hope[d] that [its judgment] [stood] up." Defendant filed a timely appeal.

¶ 16

II. ANALYSIS

¶ 17 On appeal, defendant contends, among other things, that it did not cause plaintiff's loss, because it was authorized to seek the funds from First Northern under section 4-208 of the UCC. 810 ILCS 5/4-208 (West 2014). Plaintiff responds *pro se* that defendant improperly relied on the fraud statement and was not entitled to the funds until the alleged fraud was proved.²

¶ 18 Generally, when a party appeals a ruling after a bench trial, the standard of review is whether the trial court's judgment was against the manifest weight of the evidence. *Commercial Mortgage & Finance Co. v. Life Savings of America*, 129 Ill. 2d 42, 49 (1989). A finding is against the manifest weight of the evidence when an opposite conclusion is apparent or when the finding appears to be unreasonable, arbitrary, or not based on the evidence. *Zebra Technologies Corp. v. Topinka*, 344 Ill. App. 3d 474, 480 (2003). However, *de novo* review applies to an appeal from a bench trial where the question is whether the trial court applied the correct legal test to the evidence. *In re A.H.*, 207 Ill. 2d 590, 593 (2003).

² Although plaintiff's brief does not comply in certain respects with Illinois Supreme Court Rule 341(h) (Ill. S. Ct. R. 341(h) (eff. Feb. 6, 2013)), we need not strike it, as we understand plaintiff's contentions and are able to resolve the merits of this appeal. See *O'Callaghan v. Satherlie*, 2015 IL App (1st) 142152, ¶ 15.

¶ 19 Section 4-208(a) of the UCC provides as follows:

“(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) the warrantor is or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered; and

(3) the warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized.” 810 ILCS 5/4-208(a) (West 2014).

¶ 20 Section 4-208(c) of the UCC provides that “[i]f a drawee asserts a claim for breach of warranty under [section 4-208(a)] based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3-404 or 3-405 or the drawer is precluded under Section 3-406 or 4-406 from asserting against the drawee the unauthorized indorsement or alteration.” 810 ILCS 5/4-208(c) (West 2014).

¶ 21 Under section 4-208(c), a bank that accepts and pays a check with an unauthorized or forged endorsement warrants to subsequent transferees the validity of that endorsement and may be held liable on that warranty. *First National Bank of Chicago v. MidAmerica Federal Savings Bank*, 303 Ill. App. 3d 176, 181 (1999). The purpose of the warranty is to place on the bank taking the check from a person making an unauthorized or forged endorsement the responsibility of collecting from that person. *First National Bank of Chicago*, 303 Ill. App. 3d at 182. To

facilitate the collection and transfer of checks, and to remove the burden from each bank to meticulously check the validity of the endorsement of every check transferred, the first bank taking the check is primarily responsible for checking the validity of the endorsement. *First National Bank of Chicago*, 303 Ill App. 3d at 182. Indeed, the burden is placed directly upon the first bank in the collection chain to ensure that the endorsement is valid, because the first bank is better positioned to insure that it is taking an item from someone with good title. *First National Bank of Chicago*, 303 Ill. App. 3d at 182. Put another way, the rule recognizes that, although it might not have had reason to suspect a fraud, the bank that took from the forger was the closest to the person causing the loss and is considered to have had the best opportunity to have prevented the loss. *First National Bank of Chicago*, 303 Ill. App. 3d at 183.

¶ 22 In this case, First Northern, as the bank of first deposit, took the check. Therefore, under section 4-208(a), it warranted to defendant that the endorsements on the check were valid. Once defendant had reason to suspect that the endorsements might not be valid (based on the fraud statement submitted by USAA), it, as the drawee, was authorized to assert a claim for breach of warranty. Once defendant asserted its claim for breach of warranty, it was up to First Northern, as the bank taking the check, to defend under section 4-208(c), by attempting to prove that the endorsement was effective. Instead, First Northern chose to transfer the funds without defending its warranty. It was that action that resulted in plaintiff's account being debited. Therefore, it was First Northern's conduct, and not defendant's, that resulted in plaintiff's loss.³ Thus, the trial court erred in entering a judgment against defendant.

³ We express no opinion on whether First Northern could or should be held liable to plaintiff.

¶ 23 In so holding, we recognize that the underlying issue of whether the endorsements on the check were fraudulent has yet to be resolved.⁴ Irrespective of whether the endorsements were valid, however, defendant, as a subsequent drawee, is not liable to plaintiff.

¶ 24 III. CONCLUSION

¶ 25 For the reasons stated, we reverse the judgment of the circuit court of Stephenson County.

¶ 26 Reversed.

⁴ Although the trial court intimated — by its comments that Adams committed a crime, that plaintiff was an innocent party, and that plaintiff was the offended party — that it believed plaintiff's version of events, the record does not establish that the trial court conclusively found that the endorsements were valid.