

News & Types: Corporate, Finance & Acquisitions Update

Scam Targeting Attorneys Causes Big Loss To Bank

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Practices: Corporate, Finance & Acquisitions, Litigation

As many attorneys know, attorneys have been the frequent target of scams, such as those promising a big fee to assist in transferring funds to or from overseas or to assist in a collection case. Bar associations have cautioned attorneys about these scams. Sometimes they are so obviously scams as to be comical. But they must be taken seriously, as they have succeeded in stinging attorneys and banks.

A recent case out of the 7th Circuit Court of Appeals illustrates how these scams work and who takes the loss. (*First American Bank v. Federal Reserve Bank of Atlanta, Citizens Bank, NA, and David M. Goodson*, 7th Circuit Court of Appeals, No. 16-1122, November 22, 2016).

Judge Posner, who wrote the opinion, described it as a "complicated case." But, as he tends to do, he simplified by boiling it down to a six page decision, suggesting the case was not hard to decide.

The facts are common to these types of scams. David Goodson was an Illinois attorney with nearly 40 years of practice. In 2013, he received an e-mail from "Fumiko Anderson." Fumiko is a Japanese woman's name. Fumiko wanted to hire Goodson to help her recover money that she claimed to be owed in a divorce proceeding. Later Fumiko gave Goodson the good news that her use of, or threat to use, an attorney had persuaded her ex-husband to settle. And it got better. Goodson should expect a check in a large amount, she said. He could use the check to pay his fee and pass on the rest to her. But Fumiko really needed the money quickly and asked Goodson to get her the funds as soon as possible.

Sure enough, Goodson received a check payable to "Law Office David M. Goodson" for \$486,750.33. The check was drawn on the account of First Aid Corporation, an Elgin, Illinois company selling maintenance and sanitation supplies. First Aid Corporation's account was at its bank, First American Bank. Unfortunately, unknown to Goodson, the check was totally bogus. Although looking real, it was counterfeit and First Aid had no connection with Fumiko or her supposed ex-husband.

Goodson deposited the check in his client trust account in Citizens Bank, N.A. Honoring Fumiko's request for quick access to the funds, Goodson directed Citizens Bank, N.A. to transfer the entire amount to a Japanese entity which Goodson believed to be Fumiko. But, Judge Posner noted, the entity was part of an Internet-based fraudulent check scheme known as the "Fumiko Bandit." First Aid lost all of the \$486,750.33 that was moved out of its account by the fraudulent check. The Fumiko Bandit had struck again, leaving several victims in its wake.

First American reimbursed its customer, First Aid, the most obviously innocent party. At that point, the loss was on First American.

But who would ultimately bear the loss – the attorney victimized by the scam, Citizens Bank, First American Bank or even the Federal Reserve Bank of Atlanta, peripherally involved in the transaction? First American did not think it should bear the loss, so it sued Goodson, Citizens Bank and the Federal Reserve Bank of Atlanta. Unfortunately, the district court did not agree with the claims made by First American Bank and dismissed First American's lawsuit. Judge Posner affirmed.

First American's first claim was breach of warranty against Citizens Bank, alleging that when Citizens deposited the \$486,750.33 in Goodson's account, Citizens warranted the information on the check. Actually, the deposit was by an electronic image of the check that was sent by Citizens Bank to First American through the Federal Reserve Bank of Atlanta and, in the process, some information was unavoidably missing, including physical security features (such as watermarks and microprinting) and a warning box on the back of the check, designed as an additional security feature. But this missing information gave no benefit to First American Bank, as federal regulations recognized that losing the information was unavoidable.

So what could have First American done? This was the problem, as there were steps First American could have taken to protect itself, but failed to take. First American could have demanded a "substitute check", which is a paper printout that is deemed the legal equivalent of the original paper check. This would have given First American the warranties and indemnification that it wanted. Another option to First American was to simply dishonor the check. It took none of these steps, so its claim for breach of warranty against Citizens Bank failed.

First American wasn't done. It claimed to be a victim of a "mistake" and sought restitution. But Illinois law provided no remedy for the victim of such a mistake. Here Judge Posner credited Goodson and the two banks with a good faith, reasonable belief that "they were engaged in the innocent, commonplace banking activity of forwarding a check to its intended final recipient on behalf of their clients. There is no claim or evidence that they knew they were siphoning money to criminals."

First American even accused Citizens Bank of "negligent spoliation of evidence" when Citizens Bank destroyed the original paper check after Citizens Bank transmitted the electronic copy to the Federal Reserve Bank of Atlanta. But, as Judge Posner noted, there is no duty to retain the paper copy. Requiring retention of the paper copy would defeat the purpose of permitting electronic images of checks for speed and efficiency.

Finally, First American sought to shift the loss to Goodson based on "professional negligence." But neither the district court nor Judge Posner was convinced.

"[Goodson] had received the \$486,750.33 check from First Aid believing it was part or all of the money that his client, Fumiko Anderson, had asked him to recover for her. The fact that the check came from Canada, from a company he didn't recognize, rather than from an individual (Fumiko's ex-husband), may have been suspicious circumstances, but maybe not, and in any event 'the traditional, general rule has been that the attorney is liable only to his client, not to third persons'."

First American was clearly not Goodson's client.

So, as often happens, the party bearing the loss, First American, may be innocent, in the sense First American acted honestly and in good faith. First American's mistake was in failing to take the steps necessary that would have protected it, and protected the other victims to this fraudulent scheme.