

Court of Appeals  
STATE OF NEW YORK

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TOMÁZ MENDES REGATOS,

*Plaintiff-Appellee,*

– against –

NORTH FORK BANK AND  
NEW COMMERCIAL BANK OF NEW YORK,

*Defendants-Appellants.*

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ON APPEAL PURSUANT TO CERTIFICATION BY  
THE UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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**BRIEF OF THE CLEARING HOUSE ASSOCIATION L.L.C.  
AS AMICUS CURIAE**

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TABLE OF CONTENTS

*Page*

TABLE OF CONTENTS..... i

TABLE OF AUTHORITIES ..... ii

CORPORATE DISCLOSURE STATEMENT ..... v

QUESTIONS CERTIFIED ..... 1

PRELIMINARY STATEMENT..... 2

STATEMENT OF INTEREST OF *AMICUS CURIAE*..... 7

STATEMENT OF FACTS ..... 9

ARGUMENT ..... 12

I. THE EXPRESS TERMS OF THE N.Y. U.C.C. PERMIT A  
COMMERCIAL CUSTOMER TO AGREE TO VARY THE ONE-YEAR  
STATUTORY PERIOD ESTABLISHED BY SECTION 4-A-505 ..... 12

A. Pursuant to Section 4-A-505, a Commercial Customer Is Obligated To  
Discover and Report an Unauthorized Transfer Within a Specified  
Period as a Condition Precedent to Seeking a Refund From Its Bank ..... 13

B. Section 4-A-501 Permits the Parties To Vary the Specified Period  
Within Which a Customer Must Discover and Report an  
Unauthorized Transfer ..... 16

C. Section 4-A-204 Does Not Grant a Customer the “Absolute Right” to  
a Refund for an Unauthorized Funds Transfer ..... 18

D. Permitting the Parties To Agree To Vary the Period Set Forth in  
Section 4-A-505 Would Provide Uniform Interpretation of Similar  
Language Used in Comparable Statutes ..... 19

E. The District Court’s Unconventional Interpretations of Article 4-A  
Contravene Sound Banking Practices and Public Policy ..... 22

II. THE FIFTEEN-DAY PERIOD PROVIDED IN REGATOS’  
AGREEMENT, WITHIN WHICH HE AGREED TO DISCOVER AND  
REPORT AN UNAUTHORIZED TRANSFER, IS NOT PROHIBITED  
BY ARTICLE 4-A..... 24

III. ARTICLE 4-A DOES NOT REQUIRE ACTUAL NOTICE;  
CONSTRUCTIVE NOTICE IS SUFFICIENT ..... 26

CONCLUSION ..... 30

## TABLE OF AUTHORITIES

<b>Cases</b>	<b>Page(s)</b>
<i>American Airlines Employees Federal Credit Union v. Martin</i> , 29 S.W.3d 86 (Tex. 2000).....	21
<i>Bender v. Jamaica Hospital</i> , 40 N.Y.2d 560 (1976).....	4, 17
<i>Bluebird Partners, L.P. v. First Fidelity Bank, N.A.</i> , 97 N.Y.2d 456 (2002).....	4, 17
<i>Borowski v. Firststar Bank Milwaukee</i> , 579 N.W.2d 247 (Wisc. Ct. App. 1998).....	21
<i>Centre-Point Merchant Bank v. American Express Bank</i> , 913 F. Supp. 202 (S.D.N.Y. 1996).....	20
<i>Five Towns College v. Citibank, N.A.</i> , 108 A.D.2d 420 (2d Dep’t 1985).....	15
<i>J. Sussman, Inc. v. Mfrs. Hanover Trust Co.</i> , 2 U.C.C. Rep. Serv. 2d 1605 (N.Y. Sup. Ct. 1986).....	21
<i>Josephs v. Bank of New York</i> , 756 N.Y.S.2d 518, 302 A.D.2d 318 (1st Dep’t 2003).....	15
<i>N.Y. Credit Men’s Adjustment Bureau, Inc. v. Mfrs. Hanover Trust Co.</i> , 343 N.Y.S.2d 538, 41 A.D.2d 912 (1st Dep’t 1973).....	21
<i>Parent Teacher Assn., Public School 72 v. Manufacturers Hanover Trust Co.</i> , 524 N.Y.S.2d 336, 138 Misc. 2d 289 (N.Y. Civ. Ct. 1988).....	15, 21
<i>Qassemzadeh v. IBM Employee Fed. Credit Union</i> , 561 N.Y.S.2d 795, 167 A.D.2d 378 (2d Dep’t 1990).....	20
<i>Regatos v. North Fork Bank</i> , 257 F. Supp. 2d 632 (S.D.N.Y. 2003).....	<i>passim</i>
<i>Regatos v. North Fork Bank</i> , 396 F.3d 493 (2d Cir. 2005).....	2
<i>Sheerbonnet, Ltd. v. American Express Bank</i> , 905 F. Supp. 127 (S.D.N.Y. 1995).....	20

<i>Steffes v. Heritage Bank NA Willmar</i> , No. C9-01-1940, 2002 WL 1363985 (Minn. Ct. App. June 19, 2002) .....	19
--	----

<i>Stowell v. Cloquet Co-op Credit Union</i> , 557 N.W.2d 567 (Minn. 1997).....	21
--	----

**Statutes**

N.Y. U.C.C. § 1-102.....	3, 4, 18, 25
N.Y. U.C.C. § 1-109.....	16
N.Y. U.C.C. § 1-201.....	27, 28
N.Y. U.C.C. § 2-725.....	18
N.Y. U.C.C. § 4-103(a).....	20
N.Y. U.C.C. § 4-406(2)(b).....	25
N.Y. U.C.C. § 4-A, Prefatory Note.....	24
N.Y. U.C.C. § 4-A-102.....	20
N.Y. U.C.C. § 4-A-103.....	9
N.Y. U.C.C. § 4-A-104.....	3
N.Y. U.C.C. § 4-A-105.....	16, 18
N.Y. U.C.C. § 4-A-202.....	<i>passim</i>
N.Y. U.C.C. § 4-A-204.....	<i>passim</i>
N.Y. U.C.C. § 4-A-501.....	<i>passim</i>
N.Y. U.C.C. § 4-A-505.....	<i>passim</i>

**Other Sources**

<i>Bank Secrecy Act Reporting Requirements: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit</i> , 106th Cong. 70 (1999) .....	6, 28
---	-------

BLACK’S LAW DICTIONARY (6th ed. 1990).....	14
---	----

BARKLEY CLARK & BARBARA CLARK, THE LAW OF BANK DEPOSITS,  
COLLECTIONS AND CREDIT CARDS (rev. ed. 1995) ..... 25

Committee on Payment and Settlement Systems, Bank for International  
Settlements, “Payment Systems in the United States” (2003) ..... 22

JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE  
(4th ed. 1995)..... *passim*

## **CORPORATE DISCLOSURE STATEMENT**

Pursuant to New York Court of Appeals Rule of Practice 500.1(a), counsel for The Clearing House Association L.L.C. (the “Clearing House”) certifies that it has no parent or subsidiary corporations and has issued no shares or publicly traded securities. The Clearing House is affiliated with The Clearing House Payments Company L.L.C. and New York Clearing House Building Company.

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**QUESTIONS CERTIFIED**

With the Court’s leave, The Clearing House Association L.L.C. (the “Clearing House”) submits this brief as *amicus curiae* in connection with this Court’s consideration of the questions certified by the United States Court of Appeals for the Second Circuit, pursuant to New York Court of Appeals Rule 500.17.

The certified questions are:

1. Can the one-year statute of repose established by New York Uniform Commercial Code (“N.Y. U.C.C.”) Article 4-A-505 be varied by agreement? If so, are there any minimum limits on the variation thereof (such as “reasonable time”) that estop the Commercial Bank of New

York<sup>1</sup> (“CBNY” or the “Bank”) from denying Tomáz Mendes Regatos (“Regatos”) recovery in this case?

2. In the absence of agreement, does N.Y. U.C.C. Article 4-A require actual notice, rather than merely constructive notice? If so, can this requirement be altered by agreement of the parties and was such achieved here? (A-368.)<sup>2</sup>

### PRELIMINARY STATEMENT

The questions certified arise from the decision of the District Court in *Regatos v. North Fork Bank*, 257 F. Supp. 2d 632 (S.D.N.Y. 2003) (Scheidlin, J.) (A-325), which would eliminate two standard banking industry practices. *First*, the District Court’s decision prohibits banks and their commercial customers from agreeing that a customer must discover and report an unauthorized transfer within a specified period of less than one year, *i.e.*, prohibits them from agreeing to shorten the one-year statutory period provided in Section 4-A-505. This decision converts a customer obligation into a customer right. *Second*, the District Court’s decision abolishes the use of constructive notice to trigger the customer’s obligation set forth in Section 4-A-505, by requiring that a customer receive “*actual notice* of a funds transfer before the duty to notify is invoked.” *Id.* at 645 (emphasis in the original).

The Second Circuit certified these questions because they present “unsettled and significant issue[s] of state law that will . . . undoubtedly recur.” *Regatos v. North Fork Bank*, 396 F.3d 493, 498 (2d Cir. 2005). The Clearing House submits this brief because the ramifications of the District Court’s decision extend far beyond the

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<sup>1</sup> Regatos also sued North Fork Bank, the successor to CBNY by merger.

<sup>2</sup> References to “A- ” are to the Appendix herein.

confines of this case. The limitations imposed by the District Court are inconsistent with the plain meaning of the N.Y. U.C.C., untenable as a matter of banking practice and unsound as a matter of public policy, including the deterrence and prevention of fraud.

The first set of questions presented concern the interplay of four sections of N.Y. U.C.C. Article 4-A:<sup>3</sup> (i) Section 4-A-202, which defines when a funds transfer is unauthorized; (ii) Section 4-A-505, which obligates the commercial customer to discover and report an unauthorized transfer within a maximum of one year as a condition precedent to bringing a claim for a refund and gives banks the right to receive such notice; (iii) Section 4-A-501, which states that the “rights and obligations of a party to a funds transfer may be varied by agreement . . . [e]xcept as otherwise provided in this Article”;<sup>4</sup> and (iv) Section 4-A-204, which provides that if the customer fulfills its obligation to timely report an unauthorized transfer, the bank is obligated to refund the unauthorized transfer, and that the bank’s obligation cannot be varied by agreement of the parties.

The plain meaning of these provisions mandates reversal of the District Court’s decision. As is clear, Article 4-A makes a careful distinction between (i) the

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<sup>3</sup> Article 4-A applies to funds transfers for commercial customers, such as the transfers at issue in this case. *See* N.Y. U.C.C. § 4-A-104. “Regatos . . . has admitted that the purpose of the account in question was purely commercial . . . .” *Regatos*, 257 F. Supp.2d at 638 n.10.

<sup>4</sup> Article 1-102(3), which applies to all articles of the N.Y. U.C.C., also permits provisions of the N.Y.U.C.C. to be varied by agreement, except as otherwise provided in the Code, and except that prescribed obligations of diligence may not be disclaimed by agreement, although the parties may determine by agreement the standard by which diligence obligations shall be measured, so long as those standards are not manifestly unreasonable.

period during which a customer must fulfill its obligation to discover and report an unauthorized transfer in order to avoid liability for a fraudulent transfer, which Article 4-A does permit the parties to vary by agreement, and (ii) the bank's liability, which Article 4-A does not permit the parties to vary by agreement if the customer timely reports the unauthorized transfer.

Thus, under the plain language of Article 4-A, an account agreement that shortens the one-year statutory period provided by N.Y. U.C.C. § 4-A-505 is permissible. This should be dispositive. *See, e.g., Bluebird Partners, L.P. v. First Fidelity Bank, N.A.*, 97 N.Y.2d 456, 460-461 (2002) (holding that statutes must be construed in accordance with their plain meaning); *Bender v. Jamaica Hospital*, 40 N.Y.2d 560, 561-62 (1976) (same). The Uniform Commercial Code treatise by James J. White and Robert S. Summers, which is cited favorably by the District Court, provides an explanatory note demonstrating that the statutory period in Section 4-A-505 may be shortened by agreement of the parties. *See* 3 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 22-4 (4th ed. 1995) (hereinafter "WHITE AND SUMMERS"). This conclusion is also aligned with a primary principle of the Uniform Commercial Code that was recognized by the District Court, the "freedom of contract," *Regatos*, 257 F. Supp. 2d at 640 (citing N.Y. U.C.C. § 1-102), a principle that applies most clearly to the arrangements between sophisticated commercial parties governed by Article 4-A. Indeed, even if the conclusion were less clear from the plain language, this primary principle should guide the analysis.

The Second Circuit sought further guidance on this issue by asking if there were any minimum limits, such as a "reasonable time," on the period within which a

customer could, by agreement, be obligated to discover and report an unauthorized transfer. Although the parties' ability to shorten the statutory period in Section 4-A-505 may not be without limit (on the basis that an unjustifiably short period for objection would be tantamount to disclaiming liability, which is not permitted under Article 4-A), nothing in the plain language of Article 4-A requires any specific minimum period for objection. Similarly, nothing in the plain language of the article proscribes Regatos' agreement to discover and report an unauthorized transfer within a period of fifteen days as a method to detect and prevent fraud.

In addition to inconsistency with the principle of freedom of contract, the District Court's decision on the first set of certified questions invokes a second public policy consideration. If the customer has the invariable right to be made whole for fraud by the simple expediency of providing notice within one year, there is no incentive for the customer to exercise any diligence—on a timely basis—in reviewing its account for fraud. Of course, after one year, the potential for even identifying, much less receiving any recovery remedy from, the perpetrator of the fraud is severely diminished. Stated simply, the unintended, but undoubted, consequence of the decision below is to encourage fraud—a consequence that can be remedied by enabling banks and their customers to continue their standard practice of agreeing to a reasonable time period for detection of fraud.

The second set of certified questions asked what sort of notice of the unauthorized transfer the bank must give its customer. The District Court's decision declares that constructive notice is insufficient under Article 4-A and, therefore, Regatos

did not receive notice of the unauthorized transfers at issue via the hold-mail procedure.<sup>5</sup> To the contrary, reference to the definitions applicable to Article 4-A establishes that constructive notice is authorized under Article 4-A and, thus, the hold-mail procedure that was used by the parties in this case satisfies the Section 4-A-505 notice requirement.

The answers to this second set of questions also have policy implications. Numerous banking customers use the hold-mail option to safeguard their personal security. Not only are hold-mail customers concerned with privacy and identity theft, but numerous customers in many parts of the world, such as Brazil (Regatos' home country), are concerned that receiving bank statements by mail can lead to kidnappings and ransom requests. *See, e.g., Bank Secrecy Act Reporting Requirements: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit, 106th Cong. 70 (1999)* (explaining that "South Americans have bank accounts in which their identity is concealed where they hold their assets to prevent themselves from becoming a target of kidnapping."); A-35 ("Brazilian customers frequently routed their facsimile payment orders to CBNY" through a representative office "to avoid creating a telephone call record of communication with a bank in New York.") Banks should not have to choose between surrendering either their ability to meet legitimate customer needs for hold-mail arrangements or their ability to hold customers accountable for fraud when the customer fails to provide timely notice of an unauthorized transfer.

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<sup>5</sup> Customers that elect to use the hold-mail system instruct their banks to hold account statements at the bank for later collection or review, as opposed to having their banks mail the account statements to them. The District Court's decision undercuts the utility of the hold-mail system, which largely depends on the principle of constructive notice.

## STATEMENT OF INTEREST OF *AMICUS CURIAE*

The Clearing House is an association of leading commercial banks and regularly appears as *amicus curiae* before appellate courts in cases that raise significant legal issues related to banking.<sup>6</sup> The member banks of the Clearing House process millions of commercial funds transfers each day, and the Clearing House, as the operator of the Clearing House Interbank Payments System, processes an average of 270,000 funds-transfer payment orders with a total value of \$1.4 trillion per day. The Clearing House and its member banks thus have a substantial interest in the questions presented in this case.

The decision of the District Court below, if upheld, would affect fundamentally the business practices of banks because it would expose the banks to substantial additional losses from fraud and alleged fraud against commercial customers who fail to review their bank statements for up to one year.

In a financial marketplace where funds transfers are a principal form of payment, and where, unfortunately, there is a significant amount of fraud, it is essential that there be an effective system for promptly identifying and dealing with instances of fraud. Banks such as those in the Clearing House and commercial customers of these banks have a vital interest in the preservation of that system.

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<sup>6</sup> The members of the Clearing House are Bank of America, N.A., The Bank of New York, Citibank, N.A., Deutsche Bank Trust Company Americas, HSBC Bank USA, N.A., JPMorgan Chase Bank, N.A., LaSalle Bank N.A., UBS AG, U.S. Bank N.A., Wachovia Bank, N.A., and Wells Fargo Bank, N.A.

The N.Y. U.C.C. recognizes that the system for dealing with fraudulent funds transfers must balance two competing objectives. First, funds transfers must be processed nearly instantaneously. Second, the losses resulting from fraudulent funds transfers must be distributed equitably. This balance is maintained by allocating the risk of a fraudulent funds transfer to the receiving bank, if it receives timely notice of the fraud from the customer, and to the customer, if it fails to provide that timely notice. The timeliness of the notice can be established by agreement but, in default of an agreement, the customer has one year within which to provide timely notice.

The District Court, however, approached as a “vexing” proposition, and one that should be limited to the greatest extent possible, the legislature’s determination in Section 4-A-505 that a customer must, as condition precedent to bringing a claim against a bank, discover and report an unauthorized transfer within a specified period. *Regatos*, 257 F. Supp. 2d at 640, 642. It then rejected the plain language of Article 4-A in favor of a strained construction designed to implement its weighing of the policy issues over that of the legislature. There is no support for the District Court’s interpretation rejecting a plain meaning approach that can be divined from commercial practice, legislative history, judicial precedent or sound public policy. Moreover, the District Court’s approach has the practical effect of enabling fraudulent funds transfers by shackling the receiving bank with the risk of loss while the customer may wait for up to

one year to provide notice of the fraud.<sup>7</sup> Of course, after such an extended period, the prospects of recovery against the perpetrator of the fraud are sharply reduced.

In addition, the District Court's rejection of "constructive notice" would needlessly undermine the hold-mail system that is in place to protect the confidentiality and security of customers, in contravention of the plain meaning of Article 4-A and sound public policy concerns.

### **STATEMENT OF FACTS**

The facts stated below are derived from the appendix, the briefs of the parties, the decision by the District Court and the certification from the United States Court of Appeals for the Second Circuit.

Regatos is a citizen and resident of Brazil. On July 11, 1997, Regatos opened a commercial account with CBNY. The relationship between Regatos and CBNY was governed by an account agreement, which stated, in pertinent part:

The Bank will, unless the depositor has authorized to the contrary, send to the depositor at his address of record not less frequently than quarterly, a statement of accounts accompanied, when applicable, by items paid in support of the debit entries on such statement. The depositor will exercise reasonable care and promptness in examining such statement and items to discover any irregularity including, but not limited to, any unauthorized signature or alteration and will notify the Bank promptly in writing of any such discovery, and in no event more than fifteen (15) calendar days subsequent to the time that such statement and items were first mailed or available to the depositor. In those

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<sup>7</sup> A "receiving bank" is the "bank to which the sender's instruction is addressed." N.Y. U.C.C. § 4-A-103(a)(4). The "sender" is "the person giving the instruction to the receiving bank." *Id.* § 4-A-103(a)(5). Here, CBNY is the receiving bank and Regatos is the sender.

situations in which the depositor has authorized the Bank to hold his correspondence, this section shall apply as if the depositor received such statement on the date shown on the statement.

A-26. Thus, there is no question that the agreement between Regatos and the bank clearly provided a specified time within which to notify the bank, which compels a decision in favor of CBNY unless the agreement is found to violate New York law.

In connection with opening his account, Regatos instructed CBNY to hold his bank statements, rather than mail them to him. *Regatos*, 257 F. Supp. 2d at 635-36. Pursuant to this hold-mail agreement, Regatos was, however, provided with copies of his account statements upon his request.<sup>8</sup> *Id.* at 636; A-67. It is uncontested in this case that Regatos knew how to and did receive his bank statements when he wanted to do so. *Regatos*, 257 F. Supp. 2d at 636 (“Regatos admits that he requested and received bank extracts on a monthly basis in 1997, and as needed in 1998, 1999, 2000 and 2001.”)

In March and April 2001, two purportedly fraudulent transfers were made from Regatos’ commercial bank account at CBNY. *Id.* at 636-37. The transfers at issue totaled \$600,000. *See* A-296; A-297.

Regatos failed for a period of approximately five months from the first challenged transfer, and four months from the second challenged transfer, to request and review his account statement, *see* A-311, thereby substantially reducing the prospects of

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<sup>8</sup> Regatos’ hold-mail agreement stated that “[a]ll correspondence and statements shall be held by the Bank and will be considered delivered to me (us), and the Bank is hereby released and discharged from all liabilities and obligations in respect thereof. We hereby waive all rights we might otherwise have in respect of such correspondence or statements, arising or resulting, directly or indirectly, from any failure to send all such correspondence and statements to us at any other location.” A-29.

recovery on any fraud committed through his account. Upon viewing the statements from March and April 2001, Regatos informed CBNY on August 9, 2001, that the two transfers were unauthorized. *Regatos*, 257 F. Supp. 2d at 634. Regatos then sued CBNY for reimbursement of the \$600,000, and interest thereon. *Id.*

CBNY initially opposed Regatos' lawsuit on the basis that it had followed a commercially reasonable security procedure before executing the purportedly unauthorized funds transfers. *Id.* at 646. As explained by the District Court, had CBNY followed a commercially reasonable security measure, it would not have been liable for the unauthorized transfers:

The default rule of the UCC is that the bank will bear the loss of any unauthorized funds transfer. That rule is subject to a broad exception when the bank and its customer agree on a "security procedure" to ensure that payment orders received by the bank are authorized and error-free. Specifically, if such a security procedure is in place, the loss from an unauthorized funds transfer will be shifted to the customer when (1) the security procedure is commercially reasonable, and (2) the bank accepted the payment order (i) in good faith and (ii) in compliance with the security procedure.

*Id.* at 640-41 (internal citations omitted).

The agreed security procedure required Regatos to fax a signed payment order to CBNY's São Paulo, Brazil office, where a designated CBNY employee would confirm the order with Regatos by telephone. *Id.* at 646. Following the telephone confirmation, the CBNY employee would countersign the order and send it to CBNY's New York office, where another CBNY employee would check the signature against Regatos' signature card before executing the order. *Id.*

At trial, CBNY presented evidence of the bank’s security procedures and that, although its employee did not recall the specific transactions at issue, she was “certain” that the security procedures were followed because the orders maintained by the bank were properly countersigned, which she would do after those procedures were complete. (A-36.) Despite this evidence, the jury “found that CBNY had failed to prove that it had executed the transfers ‘in compliance with the security procedure.’” *Regatos*, 396 F.3d at 496.

Accordingly, the Court must now determine whether CBNY is entitled to the second protection provided to banks—the customer’s obligation to provide timely notification of the fraud. Generally, Article 4-A provides that a commercial customer is precluded from seeking a refund for an unauthorized transfer unless the customer discovers and reports the unauthorized transfer within one year, or such shorter period as is established by agreement. Here, *Regatos* expressly agreed to discover and report any unauthorized transfer within fifteen days of the relevant hold-mail statement being available at the bank. It is this fifteen-day period and the hold-mail notice that are at issue in this case.

## **ARGUMENT**

### **I. THE EXPRESS TERMS OF THE N.Y. U.C.C. PERMIT A COMMERCIAL CUSTOMER TO AGREE TO VARY THE ONE-YEAR STATUTORY PERIOD ESTABLISHED BY SECTION 4-A-505.**

The first set of questions presented requires a determination of the respective rights and obligations of a bank and its commercial customer in connection with an unauthorized transfer. These rights and obligations appear in four sections of Article 4-A of the N.Y. U.C.C., which generally provide as follows:

- Section 4-A-202 defines when a funds transfer is not authorized and not effective. N.Y. U.C.C. § 4-A-202.
- Section 4-A-505 provides that before a commercial customer may bring a claim for a refund of an unauthorized transfer, the customer is obligated to discover and report an unauthorized transfer within one year of receiving notification of the transfer, and a bank has a right to receive such notification. *See* N.Y. U.C.C. § 4-A-505. If the customer does not fulfill this obligation within the specified period, the condition precedent is not met and the customer is precluded from asserting a claim against its bank for the unauthorized transfer.
- Section 4-A-501 states that “[e]xcept as otherwise provided in this Article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.” N.Y. U.C.C. § 4-A-501.
- Section 4-A-204 provides that “to the extent” that a bank has an obligation to refund an unauthorized transfer—*e.g.*, if the customer has fulfilled the requisite conditions precedent and has a valid claim—the bank cannot vary this obligation through agreement with its customer. N.Y. U.C.C. § 4-A-204.

To bring these four sections into harmony and give each its natural meaning and due effect, the first certified questions must be answered so that a bank and its commercial customer are permitted to agree to vary the period in which a customer is obligated to discover and report an unauthorized transfer.

**A. Pursuant to Section 4-A-505, a Commercial Customer Is Obligated To Discover and Report an Unauthorized Transfer Within a Specified Period as a Condition Precedent to Seeking a Refund From Its Bank.**

An initial question posed by the decision below is whether Section 4-A-505 creates a “right” or “obligation” that can be varied by agreement of the parties. *See* N.Y. U.C.C. § 4-A-501. To avoid the conclusion that Section 4-A-505 can be varied by

agreement of the parties, the District Court inexplicably found that Section 4-A-505 does not create any right or obligation. *Regatos*, 257 F. Supp. 2d at 644.

The terms “right” and “obligation” are not defined in the N.Y. U.C.C., and they are thus used in their commonly understood sense. A “right” is “[a] power, privilege, or immunity guaranteed under a constitution, statutes or decisional laws, or claimed as a result of long usage.” BLACK’S LAW DICTIONARY 1324 (6th ed. 1990). An “obligation” is “[t]hat which a person is bound to do or forebear; any duty imposed by law, promise, contract, relations of society, courtesy, kindness, etc.” *Id.* at 1074. In the context of a banking relationship, the most straightforward understanding of an obligation and concomitant right is something that one party is legally required to perform for a second party under the terms of the N.Y. U.C.C., such as the legal requirement in Section 4-A-505 that a customer discover and report an unauthorized transfer to its bank within a specified period in order to avoid being charged for its transfer:

If . . . the customer received notification reasonably identifying the [unauthorized] order, the customer is precluded from asserting that the bank is not entitled to retain the payment *unless the customer notifies the bank of the customer’s objection to the payment within one year after the notification was received by the customer.*

N.Y. U.C.C. § 4-A-505 (emphasis added). The commercial customer has the obligation to provide the notice and the bank has the concomitant right to receive the notice.

The New York courts have held that the analogous provisions in Article 4 create “rights and duties” for customers and their banks.<sup>9</sup> *Five Towns College v. Citibank, N.A.*, 108 A.D.2d 420, 430 (2d Dep’t 1985). In *Five Towns*, the court interpreted portions of Article 4 that set forth the time period for a customer to discover and report an unauthorized check. *Id.* (noting that “recovery is barred as to those items with respect to which the bank’s customer does not within one year from the time the statement and the items are made available to him discover and report his own unauthorized signature”). The court held that the “the foregoing balancing of the respective *rights and duties*” established “the underlying pattern of liability” for customers and their banks. *Id.* (emphasis added). Further, New York courts have held that the duty to discover and report an unauthorized check is a “condition precedent,” *i.e.*, an obligation, a customer must fulfill before bringing a claim against its bank. *See Josephs v. Bank of New York*, 756 N.Y.S.2d 518, 519-520, 302 A.D.2d 318 (1st Dep’t 2003); *Parent Teacher Assn., Pub. Sch. 72 v. Mfrs. Hanover Trust Co.*, 524 N.Y.S.2d 336, 338, 138 Misc. 2d 289, 292 (N.Y. Civ. Ct. 1988).

The District Court ignored the plain meaning of the statute, common sense and these closely analogous decisions, concluding instead that Section 4-A-505 is a “jurisdictional bar.” *Id.* Apparently solely because Section 4-A-505 appears in the portion of Article 4-A entitled “Miscellaneous Provisions,” the District Court held that Section 4-A-505 “prescribes neither the rights nor the obligations of a party to a funds

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<sup>9</sup> *See* discussion *infra* Section I.D. (concerning the importance of providing a uniform interpretation of similar language used in comparable statutes, provided that the interpretation is consistent with the objectives of Article 4-A).

transfer agreement” and, thus, Section 4-A-505 could not be varied by agreement. *Id.* at 644, n.19.

The District Court’s analysis is ill-founded. To begin with, the District Court overlooks its own subsequent acknowledgment that Section 4-A-505 creates a “duty” (which is a type of obligation) to discover and report an unauthorized transfer. *Regatos*, 257 F. Supp. 2d at 645 (“Article 4A requires actual notice of a funds transfer before *the duty* to notify is invoked.”). Additionally, the District Court does not cite to any authority in support of its designation of Section 4-A-505 as a “jurisdictional bar” or explain the significance of such a label. *Id.* Moreover, the fact that Section 4-A-505 is a “Miscellaneous Provision” is irrelevant to the interpretation of that provision. Not only is there no basis for concluding that a right or an obligation is precluded by being “miscellaneous,” the N.Y. U.C.C. explicitly directs that “[t]he subsection headings in the article . . . are not parts of this Act for purposes of construction.” N.Y. U.C.C. § 1-109; *see also* N.Y. U.C.C. § 4-A-105 (noting that “Article 1 contains general definitions and principles of construction and interpretation applicable throughout” Article 4-A). Thus, it was incorrect to reach the sweeping conclusion that there can be no rights or obligations created in Miscellaneous Provisions.

**B. Section 4-A-501 Permits the Parties To Vary the Specified Period Within Which a Customer Must Discover and Report an Unauthorized Transfer.**

As explained above, Section 4-A-505 creates both an obligation for a customer to discover and report an unauthorized transfer within a specified period as a condition precedent to exercising its right to assert a claim against its bank for that transfer, and a right of a bank to be so notified. Section 4-A-501 states in clear language

that “[e]xcept as otherwise provided in this Article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.” N.Y. U.C.C. § 4-A-501.

Neither Article 4-A nor the Official Comments thereto expressly prohibit parties from shortening the one-year period in Section 4-A-505. Thus, the plain language of Article 4-A permits a bank and its commercial customer to vary this period as they wish, provided that the variance is not prohibited by provisions that appear elsewhere in Article 4-A. *See* 3 WHITE AND SUMMERS § 22-3 (explaining that “[i]n an electronic funds transfer case an agreement between the parties may be the most significant source of law in the entire transaction”).

It is, of course, a basic tenet of statutory construction that laws should be interpreted in accordance with their plain meaning; exceptions are strictly limited. *See Bluebird Partners, L.P.*, 97 N.Y.2d at 460-461; *Bender*, 40 N.Y.2d at 561-62. The District Court provided no principled reason to depart from this plain reading of Article 4-A. Rather, the District Court posited that Section 4-A-505 cannot be varied by agreement of the parties because this section does not expressly state that it may be amended by agreement. In support of this position, the District Court pointed to two provisions in the N.Y. U.C.C. that expressly permit the parties to vary statutory time limits. Specifically, Section 4-A-204 provides a customer a “reasonable time, . . . not to exceed ninety days, to object to the unauthorized transfer,” if the customer is seeking to recover interest on the unauthorized transfer from its bank, and leaves it to the customer and the bank to define a “reasonable time” within that ninety-day period. *Regatos*, 257 F.

Supp. 2d at 643-44. In addition, Section 2-725 “explicitly authorize[s] parties in typical contract cases to change [a] statute of limitations by agreement. . . .” *Id.* at 644.

Fundamentally, the District Court’s ruling *prohibits* the variance of a time period, unless variance of that time period is expressly *permitted* by Article 4-A. This position, based solely on unsupported inference from two other provisions, turns the legislature’s approach in Section 4-A-501 on its head. Section 4-A-501 expressly *permits* parties to vary the provisions of Article 4-A, unless such variance is *prohibited* elsewhere in Article 4-A. *See* N.Y. U.C.C. § 4-A-501.

Perhaps even more important for the development of New York law, the District Court’s decision disregards a basic interpretive principle of construction for the N.Y. U.C.C.: “The presence in certain provisions of this Act of the words ‘unless otherwise agreed’ or words of similar import does not imply that the effect of other provisions may not be varied by agreement . . . .” N.Y. U.C.C. § 1-102(4); *see also* N.Y. U.C.C. § 4-A-105 (explaining that Article 1 provides general “principles of construction” for Article 4-A). Such an approach could have many important consequences not just for the interpretation of Article 4-A, but for all of the N.Y. U.C.C., a basic pillar of New York commercial law.

**C. Section 4-A-204 Does Not Grant a Customer the “Absolute Right” to a Refund for an Unauthorized Funds Transfer.**

The District Court further attempted to call into question the right of the parties to vary the time period in Section 4-A-505 by finding that, pursuant to Section 4-A-204, if a transfer is not authorized and not effective “the customer has an *absolute right* to recover.” *Regatos*, 257 F. Supp. 2d at 643 (emphasis added). Article 4-A provides no

such “absolute right.” To the contrary, Section 4-A-204 recognizes that a bank will *not* be obligated to refund an unauthorized transfer if it has taken the appropriate actions to require payment or if the customer has not fulfilled its obligations:

If a receiving bank accepts a payment order . . . [that is] not authorized and not effective as the order of the customer under Section 4-A-202 . . . , the bank shall refund any payment . . . to the extent the bank is not entitled to enforce payment. . . .

N.Y. U.C.C. § 4-A-202 (emphasis added).

The District Court’s characterization of Section 4-A-204 as giving a commercial customer an “absolute right” to recover an unauthorized transfer manifestly overstates the right that appears in Article 4-A.

**D. Permitting the Parties To Agree To Vary the Period Set Forth in Section 4-A-505 Would Provide Uniform Interpretation of Similar Language Used in Comparable Statutes.**

The District Court further failed to provide any justification for rejecting how Section 4-A-505 has been interpreted by a sister court and how similar provisions have been interpreted by courts examining Article 4 of the N.Y. U.C.C.

At least one other court has considered Section 4-A-505 (as codified in the Minnesota Uniform Commercial Code) and concluded that it is variable by agreement of the parties. *See Steffes v. Heritage Bank NA Willmar*, No. C9-01-1940, 2002 WL 1363985 (Minn. Ct. App. Jun. 19, 2002). In *Steffes*, a group of investors sued Heritage Bank for, among other things, conversion, contending that the bank improperly allowed unauthorized funds transfers out of a deposit account. *Id.* at \*1. The appellate court upheld summary judgment in the bank’s favor on the ground that the plaintiffs failed to examine the monthly account statements that revealed the unauthorized debits within

thirty days, as required by the terms of the deposit agreement. *Id.* at \*5. In reaching this conclusion, the appellate court recognized that Section 4-A-505 provides customers one year to discover and report an unauthorized transfer, but found that Article 4-A “provides that the parties may vary by agreement ‘the rights and obligations of a party to a funds transfer.’” The 30-day limitation period in the account agreement therefore time-barred Steffes’s conversion claim.” *Id.* at \*5 (internal citations omitted).

The District Court’s ruling is also at odds with decisions examining comparable provisions regarding checks and other paper-based payment instruments that appear elsewhere in the N.Y. U.C.C. (*see* Articles 3 and 4). New York courts consistently have held that contractual provisions shortening to as little as fourteen days the period within which an account holder must notify the bank of unauthorized items in the account statement are valid under N.Y. U.C.C. § 4-103(a).<sup>10</sup> *See, e.g., Qassemzadeh v. IBM Employee Fed. Credit Union*, 561 N.Y.S.2d 795, 796, 167 A.D.2d 378, 379 (2d

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<sup>10</sup> The District Court’s opinion offers conflicting views on the utility of examining other provisions of the N.Y. U.C.C. On the one hand, the District Court maintained, without any stated rationale, that cases that “discuss Article 4, not Article 4-A . . . are of no help here.” *Regatos*, 257 F. Supp. 2d at 643, n.18. On the other hand, the District Court no less categorically points to a provision in Article 2 as “strong evidence” in support of its holdings. *Id.* at 644. It is the District Court’s latter approach that is correct, even though its conclusion with respect to Article 2 is flawed. Time and again, courts have examined judgments made in examining other provisions of the Uniform Commercial Code to understand what result would be consistent with the provisions of Article 4-A and other principles of law or equity. *See, e.g., Centre-Point Merchant Bank v. American Express Bank*, 913 F. Supp. 202, 206 (S.D.N.Y. 1996); *Sheerbonnet, Ltd. v. American Express Bank*, 905 F. Supp. 127, 131 (S.D.N.Y. 1995). Such an examination is useful in this case because the question of whether parties may agree to vary the time to object to an unauthorized check has been addressed in numerous instances, as described herein. Such analysis is only prohibited if the analogous “principles of law or equity outside of Article 4-A” are “inconsistent” with those stated in Article 4-A. N.Y. U.C.C. § 4-A-102, Official Comment.

Dep't 1990) (affirming summary judgment against a customer who had failed to comply with an agreement requiring the customer to notify credit union of unauthorized drafts within thirty days of mailing of account statement); *N.Y. Credit Men's Adjustment Bureau, Inc. v. Mfrs. Hanover Trust Co.*, 343 N.Y.S.2d 538, 540, 41 A.D.2d 912, 913 (1st Dep't 1973) (upholding an agreement that required the customer to discover and report a forged check within thirty days as a "condition precedent" to seeking a refund from the bank); *Parent Teacher Ass'n*, 524 N.Y.S.2d at 343 (granting summary judgment for bank where account holder's treasurer failed to comply with contractual duty to notify bank within fourteen days of mailing); *J. Sussman, Inc. v. Mfrs. Hanover Trust Co.*, 2 U.C.C. Rep. Serv. 2d 1605 (N.Y. Sup. Ct. 1986) (granting summary judgment for bank where there was no notice within fourteen days of mailing). Courts outside of New York have reached similar conclusions. *See, e.g., American Airlines Employees Federal Credit Union v. Martin*, 29 S.W.3d 86, 99 (Tex. 2000) (finding that a customer's agreement to notify its bank of error within sixty days is reasonable); *Stowell v. Cloquet Co-op Credit Union*, 557 N.W.2d 567, 574 (Minn. 1997) (upholding agreement to notify bank of error within twenty days of mailing as not manifestly unreasonable); *Borowski v. Firststar Bank Milwaukee*, 579 N.W.2d 247, 252-53 (Wisc. Ct. App. 1998) (holding that a fourteen-day period to notify bank of unauthorized signature not manifestly unreasonable).

Where possible, courts should provide a uniform interpretation of similar language used in comparable statutes.<sup>11</sup> The District Court has provided no valid argument for a special interpretation here that would displace the plain meaning of the statute.

**E. The District Court’s Unconventional Interpretations of Article 4-A Contravene Sound Banking Practices and Public Policy.**

Underlying the statutory construction at issue here are important public policy considerations. Fraudulent transfers occur with sufficient frequency to create substantial potential for both illicit windfalls to dishonest individuals and commensurate harm if banks are left without the ability to obligate commercial customers to take reasonable steps to detect and prevent fraudulent funds transfers. By answering the questions certified so that a bank and its commercial customer are permitted to agree to requisite notification within a specified time period of less than one year, this Court will help deter fraud.

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<sup>11</sup> If variance of the time to object to unauthorized checks is permissible, it is even more important, as a matter of policy, to permit variance when dealing with funds transfers, given their accelerated pace and much greater average value. (In 2001—the last year for which statistics are available—the average check written in the United States was worth about \$950 (\$38.9 trillion in total value divided by 41.2 billion checks), while the average funds transfer was worth \$4.25 million (\$735.7 trillion in CHIPS and Fedwire transfers divided by 172.9 million transfers). *See* Committee on Payment and Settlement Systems, Bank for International Settlements, “Payment Systems in the United States” (2003) *available at* <http://www.bis.org/cpss/paysys/UnitedStatesComp.pdf> (text) and <http://www.bis.org/cpss/paysys/UnitedStates.pdf> (statistical tables).)

Such a ruling would be consistent with the important role the drafters of Article 4-A envisioned for customers in deterring fraud:

Since cases of unauthorized payment orders will almost always involve fraud, the bank's remedy is normally to recover from the beneficiary of the unauthorized order if the beneficiary was party to the fraud . . . . [I]n some cases, prompt notification may make it easier for the bank to recover some part of its loss from the culprit. . . . The customer has a duty to exercise ordinary care to determine that the order was unauthorized after it has received notification from the bank, and to advise the bank of the relevant facts within a reasonable time. . . ."

N.Y. U.C.C. § 4-A-204, Official Comment (2).

Such an outcome is also consistent with the observations of Messrs. White and Summers, who similarly note that, because the most likely perpetrators of electronic funds transfer fraud are the associates of customers that use the system, the customer should bear some risk of loss from those unauthorized transfers. *See* WHITE AND SUMMERS § 24-5 ("[M]ost of the losses committed by . . . those who steal by wire transfer and not by check, will be placed [by Article 4-A] where they generally should be, on the customer (sender) who employs the embezzler.")

Further, as a practical matter, if New York banks are not permitted to require their customers to assist in a meaningful manner in detecting fraud, it would increase the costs associated with funds transfers and frustrate one of the main objectives of Article 4-A, to facilitate a low-cost system for the electronic transfer of significant value:

The typical funds transfer involves a large amount of money . . . [at] extremely low cost. A transfer that involves many millions of dollars can be made for a price of a few dollars. . . . This system of pricing may not be feasible if

the bank is exposed to very large liabilities in connection with the transaction. . . . [Thus, a] major policy issue in the drafting of Article 4-A is that of determining how risk of loss is to be allocated given the price structure in the industry.

N.Y. U.C.C. § 4-A, Prefatory Note, at 591-92.

It is vital that banks be permitted to enlist commercial customers' assistance in promptly detecting and preventing fraud. This is best accomplished by permitting a commercial customer to agree to shorten the period in which it will give a bank notice of an unauthorized transfer.

**II. THE FIFTEEN-DAY PERIOD PROVIDED IN REGATOS' AGREEMENT, WITHIN WHICH HE AGREED TO DISCOVER AND REPORT AN UNAUTHORIZED TRANSFER, IS NOT PROHIBITED BY ARTICLE 4-A.**

In *Regatos*, the District Court concluded that “[e]ven assuming, *arguendo*, that the parties could vary the one-year notice provision, the fifteen-day period . . . is demonstrably unreasonable and effectively guts the invariable rights of the customer under Sections 4-A-202 and 4-A-204.” 257 F. Supp. 2d at 644-645. The District Court did not provide any basis for this conclusion, but rather relied on the following musings by Messrs. White and Summers:

Can the parties shorten the one-year provision of 4A-505 . . . to sixty days? . . . Surely a one day cutoff would violate . . . 4A-204[2]. What about six months or sixty days? We are sure that a one-day period would fail; where the line should be drawn we are not sure, but we are skeptical of [a] 60-day rule.

*Regatos*, 256 F. Supp. 2d at 644-45 (quoting WHITE AND SUMMERS).

First, the District Court exaggerates the thrust of Messrs. White and Summers' remarks. Second, as Messrs. White and Summers note, “[t]he extent of EFT

fraud within this system remains a mystery to an outsider. . . . [Thus, w]e are uncertain about the significance of fraud and fraud-risk rules.” *See* WHITE AND SUMMERS § 24-5.

Stated differently, they correctly conclude that the one-year time period in Section 4-A-505 may be varied by agreement, as the plain language mandates.<sup>12</sup> Beyond that, Messrs. White and Summers may speculate about a minimum notice period, but they certainly cannot be fairly read as having reached a definitive personal view on what that should be. Other respected commentators would sustain a fourteen-day notice period in dealing with slower-moving paper-based payment instruments. *See* BARKLEY CLARK & BARBARA CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS § 3.01[3][c] at 3-28 (rev. ed. 1995) (noting that “[t]he reduction in notice from one year to fourteen days does not seem out of line” in the context of the analogous provision in Article 4, “although a bank would be pushing it by attempting to reduce the period further.”).

We respectfully submit that a period of fifteen days to discover and report an unauthorized transfer is permissible under Article 4-A, as it is under Article 4. *See* N.Y. U.C.C. § 4-406(2)(b). We suspect that the District Court failed to reach this conclusion because, like Messrs. White and Summers, it did not consider sufficiently the substantial fraud concerns that underpin agreements to shorten the time period in Section 4-A-505.

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<sup>12</sup> To the extent Article 4-A expressly prescribes “obligations of good faith, diligence, reasonableness and care,” as noted, such obligations cannot “be disclaimed by agreement by the parties,” but the parties may determine by agreement the standard by which diligence obligations shall be measured, so long as those standards are not “manifestly unreasonable.” N.Y. U.C.C. § 1-102(3).

With regard to the notice period in this case, Regatos expressly agreed that he would discover and report any unauthorized transfer within fifteen days. We are unaware of any evidence presented that would permit Regatos to disclaim his agreement, or any evidence that it was anything less than a freely negotiated agreement representing the parties' reasonable intentions. Regatos was a sophisticated businessman, who surely understood the implications of this agreement. *See Regatos*, 257 F. Supp. 2d at 638, n.10 (noting that Regatos worked "with Andrade Gutierrez Empreendimentos Ltda., a large and long-established Brazilian construction firm carrying out international building projects"). Moreover, although Regatos subscribed to a hold-mail system, nothing prevented him from exercising reasonable care to access his account information by telephone, by Internet or by collecting his account statement from the bank with more regularity. Indeed, prudence would seem to dictate that a commercial customer such as Regatos should have appropriate internal controls to monitor bank accounts to ensure prompt detection of embezzlement or other types of fraud.

**III. ARTICLE 4-A DOES NOT REQUIRE ACTUAL NOTICE;  
CONSTRUCTIVE NOTICE IS SUFFICIENT.**

The specified period within which a commercial customer must discover and report an unauthorized transfer is measured from the time that "the notification was received by the customer." N.Y. U.C.C. § 4-A-505. Use of the phrase "notification was received"—terms carefully defined in the N.Y. U.C.C.—answers the second set of questions that has been certified to this Court. Constructive notice is sufficient under the plain meaning of the statute.

To achieve the “notification” required under Section 4-A-505, the bank must “give” notice and the customer must “receive” the notification. These concepts have comprehensive, clear definitions, as set forth in Sections 1-201(26) and (27):

(26) A person “notifies” or “gives” a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person “receives” a notice or notification when (a) it comes to his attention; or (b) it is duly delivered at the place of business through which the contract was made or at any other such place held out by him as the place for receipt of such communications.

(27) Notice, knowledge or a notice or *notification received by an organization is effective* for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence.

N.Y. U.C.C. §§ 1-201(26), (27) (emphasis added). Inexplicably, the District Court did not mention these definitions in its opinion, although they directly and clearly answer the second certified question.

In this case, Regatos instructed the Bank to hold his mail for pickup, and CBNY did as the customer instructed. In other words, the Bank’s hold-mail file was the “place held out by him [Regatos] as the place for receipt of such communications,” and by making the statements available for pickup by the customer in accordance with his instructions, the Bank gave Regatos notice under Section 1-201(26). Similarly, Regatos must be deemed to have received the statements because, through the exercise of “due diligence” (such as by mail, internet or telephone), he could have received copies of the statements being held, or at least the relevant information. In short, the notification

requirement of Section 4-A-505 can be met—and in this case was met—through constructive notice.

There is no basis for the District Court’s attempted judicial revision of these statutory definitions to require actual knowledge. If actual knowledge were required, the statute would not have contained clause (b) of Section 1-201(26) or would have stated that the customer must “know” about the unauthorized transfer before Section 4-A-505 becomes relevant. *Cf.* N.Y. U.C.C. § 1-201(25) (“A person ‘knows’ or has ‘knowledge’ of a fact when he has actual knowledge of it.”).

The District Court’s decision not only ignores the plain language of the statute, but it also, without basis, undermines the hold-mail system. The hold-mail option is vital for many bank customers. As this Court well knows, an individual’s interest in keeping banking information private is substantial. One concern is that disclosure of information on bank statements can expose individuals and businesses to a heightened risk of identity theft. Another significant concern in certain areas outside the United States is that even the receipt of bank statements by mail can lead to kidnappings and blackmail. *See, e.g., Bank Secrecy Act Reporting Requirements: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit, 106th Cong. 70 (1999)* (“In South America, for example, kidnapping is a serious problem, and so . . . South Americans have bank accounts in which their identity is concealed where they hold their assets to prevent themselves from becoming a target of kidnapping. As a result, South American banking laws forbid banks doing business in that context from revealing the true identity of their customers.”). Even if the statutory language were not clear, these concerns would weigh heavily against the District Court’s decision to deem constructive

notice inappropriate in all circumstances and, thus, threaten one of the foundations of the hold-mail system.<sup>13</sup>

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<sup>13</sup> In any event, a bank and its commercial customer are free to agree contractually that constructive notice is sufficient, N.Y. U.C.C. § 4-A-501, as they did here: “In those situations in which the depositor has authorized the Bank to hold his correspondence, this section shall apply as if the depositor received such statement on the date shown on the statement.” (A-26.)

## CONCLUSION

For the foregoing reasons, the Clearing House urges the Court to answer the certified questions to permit a commercial customer to agree to discover and notify its bank of an unauthorized funds transfer within a specified period of less than one year from constructive notice of the transfer.

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