

Bank Liability for Fraudulent Wire Transfers – General Discussion

“Article 4-A of the New York U.C.C. 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). The drafters of Article 4-A “use[d] precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles.” N.Y. U.C.C. §4-A-102, Official Cmt.

The precision employed by the drafters is reflected in the definitions provided in Article 4-A:

- A “**payment order**” is “an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary”;
- A “**sender**” is “the person giving the instruction to the receiving bank”;
- The “**receiving bank**” is “the bank to which sender’s instruction is addressed”;
and
- A “**customer**” is “a person[] . . . having an account with a bank or from whom a bank has agreed to receive payment orders.”

Id. §§4-A-103-05.

Article 4-A also determines which party—the customer or the bank—bears the risk of loss for a fraudulent wire transfer. Specifically, §4-A-204(1)(a) provides:

If a receiving bank accepts a payment order issued in the name of its customer as sender which is . . . not authorized *and* not effective as the order of the customer under §4-A-202, the bank shall refund any payment of the payment order received from the customer.”

So for a bank’s refund obligations to be triggered under Article 4-A, the payment order must be neither authorized nor effective. In other words, if the payment order is *either* authorized *or* effective, the bank bears no refund obligation. *Jajati v. JPMorgan Chase Bank, N.A.*, 2024 U.S. Dist. LEXIS 4703, at *9-*10 (E.D.N.Y. Jan. 9, 2024).

Even if the customer does not *authorize* it, a payment order is *effective* as long as there is a “commercially reasonable” security procedure in place, and the bank accepts the payment order in good faith and in compliance with that security procedure. N.Y. U.C.C. § 4-A-202(2). Therefore, if the bank follows commercially reasonable security procedures, a loss resulting from an unauthorized transaction falls on the customer. *See 123RF LLC v. HSBC Bank USA, N.A.*, 2023 U.S. Dist. LEXIS 49920, at *17 (S.D.N.Y. Mar. 23, 2023).

Article 4-A does not identify any specific security procedures that a bank must follow. The procedures are, instead, to be “established by agreement” between the customer and the bank. N.Y. U.C.C. §4-A-201. The procedures “may require use of algorithms or other codes, identifying words or numbers, encryption, callback procedure, or similar security devices.” *Id.* Ultimately, the

question whether the security procedures are commercially reasonable is a question of law to be decided by the court. *123RF LLC*, 2023 U.S. Dist. LEXIS 49920, at *17. In deciding this question, courts consider:

1. the wishes of the customer expressed to the bank;
2. the circumstances of the customer known to the bank, including the size, type and frequency of payment orders normally issued by the customer to the bank;
3. alternative security procedures offered to the customer, and
4. security procedures in general use by customers and receiving banks similarly situated.”

Id. §4-A-202(3).

Finally, because the provisions of Article 4-A “represent a careful and delicate balancing of [competing] interests and are intended to be the exclusive means of determining the rights, duties, and liabilities of the affected parties,” Article 4-A generally preempts common-law claims of negligence and gross negligence. N.Y. U.C.C. §4-A-102, Official Cmt.; *see 123RF LLC*, 2023 U.S. Dist. LEXIS 49920, at *18 (quoting official comment and explaining preemption).

The same is generally true with respect to contract claims. In other words, an agreement between a customer and the bank may be relevant in determining whether the bank employed commercially reasonable security procedures, but the customer may be precluded from bringing a separate claim for breach of contract.