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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

DUCOING MANAGEMENT, INC.,

Plaintiff and Respondent,

v.

PALMYRA CORPORATION,

Defendant and Appellant.

G045825

(Super. Ct. No. 30-2009-00120768)

O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, B. Tam Nomoto Schumann, Judge. Affirmed.

Guy R. Lochhead for Defendant and Appellant.

Foley Bezek Behle & Curtis, Roger N. Behle, Jr., Justin P. Karczag, and Stephanie R. Hanning for Plaintiff and Respondent.

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Defendant Palmyra Corporation, a check cashing business, appeals from a judgment for plaintiff Ducoing Management, Inc., on its negligence cause of action. Defendant contends the California Uniform Commercial Code¹ forecloses liability for cashing plaintiff's payroll checks fraudulently endorsed by plaintiff's employee. But the code permits this kind of liability if defendant was negligent and plaintiff was not. The court expressly made these findings, and substantial evidence supports them. We affirm.

FACTS

The Checks

Plaintiff, a commercial painting contractor, hired a person named Navarro in July 2002. Navarro was "a perfect fit" for the office, and was quickly entrusted with greater responsibility.

Navarro began assisting plaintiff's office manager with the payroll. Plaintiff's foremen at each jobsite would turn in a form identifying who worked that day, and how many hours they worked. The office manager would manually transfer that information onto a payroll log showing each worker's hours for the biweekly pay period. Then the office manager would send each worker's total hours to a payroll service, which would generate checks. The office manager would pick up the checks, compare each one to her log, stamp a signature, and give them to Navarro to hand out.

As Navarro eased into her payroll duties, the office manager would double check Navarro's work. She was accurate. After the office manager made sure Navarro understood the payroll process, she gradually increased Navarro's duties. Navarro "gave [her] no reason whatsoever" to distrust her.

¹ All further statutory references are to the California Uniform Commercial Code.

Plaintiff's field superintendent noticed a discrepancy in July 2008. A payroll check had been generated for someone he knew personally, and who had not done any work for plaintiff. The office manager examined the cashed check. The endorsement was not the payee's signature.

The next day, the field superintendent distributed the payroll checks — 18 went unclaimed. The office manager checked the employment applications for those checks' payees, which contained copies of the applicant's identification card (ID). The field superintendent confirmed those persons had not been working for plaintiff. Payroll checks issued previously to those persons contained endorsements similar to each other.

The office manager confronted Navarro. Navarro "broke down in tears and said that it was a mistake." The office manager called the police. Navarro eventually pleaded guilty to falsifying records and money laundering.

Plaintiff was able to contact some the payees of the unclaimed checks. They had submitted applications to plaintiff, and some had actually worked for plaintiff, but none were actively working during the relevant pay period.

Plaintiff's bank provided affidavits to plaintiff so "that [plaintiff could] have [the] individuals sign that [it] was not their signature or . . . endorsements on the checks." The forms were entitled "**AFFIDAVIT OF CLAIMANT: ENDORSEMENT FORGED.**" The bank instructed plaintiff on how to complete the forms. Pursuant to the bank's instructions, plaintiff had the payees execute the affidavits. Plaintiff submitted the completed affidavits to its bank. The bank then "credit[ed plaintiff's] account back for these checks that were wrongly cashed."

Plaintiff discovered defendant, a check cashing business, had cashed several of the fraudulently endorsed payroll checks. Defendant had cashed checks totaling \$16,788.70. Plaintiff's bank credited back \$3,948.88 pursuant to the affidavits. The remaining, unreimbursed total of the fraudulently endorsed checks cashed by defendant was \$12,839.82. Plaintiff also dedicated more than \$14,000 in employee time

to investigating the fraud, correcting records, and procuring the fraudulent endorsement affidavits.

The Trial

Plaintiff sued defendant and two other businesses that cashed its fraudulently endorsed payroll checks. Plaintiff asserted causes of action for negligence and conversion. As an affirmative defense, defendant alleged “[p]laintiff’s complaint . . . is barred to the extent that the indorsements on the checks . . . were effective indorsements under [section] 3405.”

At the bench trial, defendant’s president testified about its check cashing practices. When a new customer comes in, defendant requires them to fill out a card with their name, date of birth, telephone number, employer, and signature. They also must present a valid photo ID; a photocopy of the ID is attached to the card. The card is then filed for future reference if the customer returns. Defendant makes three telephone calls: to the customer, to verify his or her telephone number; to the employer, to verify the check is valid; and to the drawee bank, to verify the availability of funds.

Defendant “will not cash a check for a customer unless they have an ID,” its president explained. And “the person that presents you the check must have an ID and the name on their ID and the person must match the name on the check.” This is the “one person, one check” rule. The president agreed defendant “would not have cashed [the fraudulently endorsed] checks unless [it] followed [its] policy with regard to cards and IDs” — “no cash leaves [the] business unless the person that’s standing there with the check fills out a card and presents an ID.” Even “somebody coming in assuming to be [the payee] has to fill out a card and has to present an ID.”

Defendant’s president agreed he was “familiar with the policies and procedures followed by other check cashing facilities in Southern California.” Most check cashing companies use the same banks, and he has “friends and colleagues that are

in the check cashing business.” The president stated defendant’s check cashing practices were consistent with, and in fact exceeded, the industry standard. His theory was that the payees or someone assuming their identities presented the payroll checks to defendant.

Defendant had check cashing cards for three payees on plaintiff’s payroll checks. Defendant had cards for a Mr. Hernandez and a Mr. Rodriguez. But the payroll checks payable to those men that defendant cashed contained different addresses than the addresses on their cards.

Defendant also had a card for a Mr. Bustos dated February 2010, but it cashed payroll checks payable to him in February 2008. The president claimed this was “a different card”; defendant destroyed the card it had for Bustos back in 2008. In any event, defendant would not have cashed Bustos’s check unless it was sure the offered ID matched the person presenting the check. The president conceded he warned defendant’s employees about the fraud related to Bustos back in 2009, but defendant still created a check cashing card for Bustos in 2010.

A banking and check cashing expert testified defendant’s stated policy more than met the industry standard — it “ran a tighter ship, so to speak.” He explained a check cashing business must examine the exact names, addresses, photos, and dates of birth to ensure the owner of the check, the person on the ID, and the person presenting the check are one and the same. He concluded the fraudulently endorsed checks “could not have been cashed” had defendant followed its policies. He did not have an opinion on whether the checks had, in fact, been fraudulently endorsed.

The court found for plaintiff on its negligence cause of action against defendant. It found defendant “was negligent despite evidence introduced at trial that [defendant] simply *must* have followed its check cashing procedures and therefore could not have cashed the Unauthorized Checks without ID.” It rejected the defense claim “that Plaintiff was negligent in supervising [Navarro] and therefore Plaintiff is responsible for its own losses . . . no evidence was presented establishing that Plaintiff

was negligent. Specifically, none of the Defendants called a testifying expert (a) to establish the industry standard for employee supervision or (b) to opine that Plaintiff had breached the standard.” The court found for defendant on the conversion cause of action.

The court entered judgment for plaintiff and against defendant in the amount of \$17,791.82, plus costs and postjudgment interest. This represented \$12,839.82 for the “amount still owing on the unauthorized checks” and \$4,952 for one-third “of [plaintiff’s] recovery expenditures.”

DISCUSSION

Defendant contends the court erred by “determining that [section] 3405 did not apply” “[S]ection 3405 articulates a loss distribution scheme that applies” (*Lee Newman, M.D., Inc. v. Wells Fargo Bank, N.A.* (2001) 87 Cal.App.4th 73, 79 (*Newman*), fn. omitted) when a company’s employee fraudulently endorses the company’s checks, “and therefore displaces common law negligence principles” (*id.* at p. 80). And it “adopts the fundamental principle that the risk of loss for fraudulent indorsements by employees entrusted with responsibility for checks should fall on the employer rather than the bank that takes the check or pays it. Section 3405 imposes that loss on the employer whether or not the employer was negligent.” (*Id.* at p. 83.)

“This loss allocation principle, however, is tempered by the doctrine of comparative negligence.” (*Newman, supra*, 87 Cal.App.4th at p. 83.) “If . . . the depository or collecting bank taking the checks, acted in good faith and with ordinary care, the entire loss falls on [the employer] regardless of whether [the employer] was negligent. To the extent [the employer] can prove that [the bank] failed to exercise ordinary care and can further prove that such lack of care contributed to the loss, [the employer] may recover from [the bank] pursuant to section 3405 to the extent that bank’s failure contributed to the loss.” (*Id.* at pp. 83-84.)

The statute provides: “For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee . . . makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.”² (§ 3405, subd. (b).)

“Ordinary care” is the “observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged.” (§ 3103, subd. (a)(7).)

Defendant contends this statute precludes its liability to plaintiff for three reasons. First, it claims the statute imposes a special standard of care that it met. Second, it asserts plaintiff’s own negligence renders it at least partially responsible for its losses. Third, it claims the fraudulent endorsements were effective even if it was negligent, and so plaintiff was not entitled to obtain “charge backs” from its bank.

None of defendant’s contentions have any merit.

First, substantial evidence established the relevant standard of care for defendant. Defendant asserts the court wrongly applied the common law standard of care instead of the statutory standard, but the record fails to support that. The only standard of care evidence was consistent with the statutory standard. Plaintiff’s expert and

² We quickly reject plaintiff’s assertion that section 3405 applies only to “banks,” not check cashing businesses. The statute applies to any “person who . . . pays an instrument or takes it for value or for collection” (*Id.*, subd. (b).) And the code broadly defines “Person” as “an individual, corporation . . . or any other legal or commercial entity.” (§ 1201, subd. (b)(27).)

defendant's president testified to the applicable standard of care. Both invoked the industry standards for local check cashing businesses. This is the standard called for by the code. (See §§ 3405, subd. (b), 3103, subd. (a)(7) [defining "Ordinary care"].) Because this standard was undisputed at trial, the court presumably applied it — defendant has not shown otherwise. (See *Fladeboe v. American Isuzu Motors Inc.* (2007) 150 Cal.App.4th 42, 58 [on appeal, "a judgment is presumed correct" and "all intendments and presumptions are indulged in favor of correctness"].)

And substantial evidence shows defendant failed to meet this standard. (See *Atlas Vegetable Exchange, Inc. v. Bank of America* (1970) 10 Cal.App.3d 868, 876 ["the question of whether a bank has been negligent in paying a fraudulently endorsed check is generally one for the jury"].) Defendant's industry-standard policy is to cash checks only for the person presenting them, and to verify that person's identity by checking a valid photo ID. And yet defendant cashed fraudulently endorsed checks. The expert concluded defendant could not have done so had it followed its policy. Moreover, there were discrepancies between defendant's check cashing cards for Hernandez, Rodriguez, and Bustos and the payroll checks issued to them. The court could have reasonably rejected defendant's untenable position that it both followed its policies and cashed checks to people impersonating the payees — imposters who, by definition, could not have had valid photo IDs. The court could have reasonably rejected defendant's president's claim that it had a valid check cashing card for Bustos that it later destroyed. We will not second-guess the court's credibility determinations. (See *Orange County Employees Assn. v. County of Orange* (1988) 205 Cal.App.3d 1289, 1293 (*Orange County Employees*) [appellate court may not "consider the credibility of the witnesses"].)

Second, substantial evidence shows plaintiff was not negligent. While section 3405 may impose a duty of care upon plaintiff as Navarro's employer, defendant did not offer any expert testimony or other evidence establishing the standard of care that

plaintiff should have met in supervising Navarro. Defendant left the question of plaintiff's negligence to the court sitting as the fact finder. (*Davis v. City of Sacramento* (1994) 24 Cal.App.4th 393, 405 ["Whether in a given situation a party was negligent, i.e., failed to act as a reasonably prudent person, is a question of fact".]) And the court reasonably could have found plaintiff properly supervised Navarro by slowly entrusting her with greater payroll responsibilities over six years and checking her work as she mastered payroll procedures. Defendant claims plaintiff could have done more to prevent fraud. But the issue is "whether there is *any* substantial evidence to support" the judgment. (*Orange County Employees, supra*, 205 Cal.App.3d at p. 1293.) If there is, we "will not disturb . . . the findings of the trial court." (*Ibid*, italics omitted.)

The court's negligence findings sufficiently support defendant's liability under section 3405. That statute sets a default position holding an employer liable for its employee's fraudulent endorsements, even if the employer was not negligent. (See *Newman, supra*, 87 Cal.App.4th at p. 83 [statute "adopts the fundamental principle that the risk of loss . . . should fall on the employer"].) But section 3405 authorizes liability for the paying institution on a comparative negligence basis. (*Ibid*. ["[t]his loss allocation principle . . . is tempered by the doctrine of comparative negligence".]) Here, the court's judgment and express findings suggest a comparative negligence allocation of 100 percent against defendant and 0 percent against plaintiff. In other words, the court impliedly found defendant's "failure to exercise ordinary care contributed to" all of plaintiff's loss.³ (§ 3405, subd. (b).) And so the court, consistent with section 3405, could find defendant entirely liable.

³ Defendant complains the court did not expressly address the elements of section 3405 in its statement of decision. But there is no serious dispute plaintiff employed defendant and entrusted her with responsibility for the checks, and that she fraudulently endorsed them. (*Id.*, subd. (b).) The relevant issue here is the extent to which defendant and plaintiff were negligent, if at all. And the court expressly found defendant was negligent and plaintiff was not. Thus, the statement of decision

Finally, plaintiff could recover all of its losses from defendant, even costs it incurred obtaining the charge backs. Defendant relies on the first sentence of section 3405, subdivision (b), which makes a fraudulent endorsement “effective.” But the statute has two sentences, and they must be “read together.” (*City and County of San Francisco v. Farrell* (1982) 32 Cal.3d 47, 54.) The second sentence allows plaintiff to “recover from [defendant] to the extent [defendant’s] failure to exercise ordinary care contributed to the loss.” (§ 3405, subd. (b).) Thus, as between plaintiff and defendant, defendant may be held liable for all of plaintiff’s losses. That would include the more than \$14,000 plaintiff incurred obtaining the charge backs — \$4,952 of which the court reasonably allocated to defendant.⁴ It matters not in this case whether the fraudulent endorsements may be effective for some purposes, e.g., as between plaintiff and its own bank.

adequately addressed the relevant ultimate findings. (See *Muzquiz v. City of Emeryville* (2000) 79 Cal.App.4th 1106, 1125 [statement of decision “is required only to set out ultimate findings”], see also *id.* at pp. 1124-1125 [statement “need not address all the legal and factual issues raised by the parties”].)

⁴ Nor is defendant entitled to a set off for the \$3,948.88 reimbursed by plaintiff’s bank. The charge backs are immaterial, except to the extent they reduce plaintiff’s damages for the \$16,788.70 in fraudulently endorsed checks that defendant cashed. There is no double recovery issue here — plaintiff has not sought to recover from defendant the same money that the bank reimbursed. Plaintiff has recovered from defendant only the \$12,839.82 that was not reimbursed. And defendant is liable for that total amount, without an offset for the \$3,948.88 plaintiff’s bank did reimburse.

DISPOSITION

The judgment is affirmed. Plaintiff shall recover its costs on appeal.

IKOLA, J.

WE CONCUR:

MOORE, ACTING P. J.

ARONSON, J.