

# You May Pay Twice for Being Too Nice: When You May Have to Pay On an Original Check After Issuing a Stop Payment Order and a Replacement Check

The following scenario is an unfortunate situation many of our clients face. Imagine you issue a final paycheck to Ralph, your soon-to-be ex-employee. Ralph calls you a few weeks after leaving your employment saying that he lost his paycheck and that he needs to have a new one issued. You've always liked Ralph and want to help him out, so you issue a stop payment order on the original paycheck and send Ralph a replacement paycheck. You sleep well knowing you helped Ralph, but also protected yourself from paying on the original paycheck since you issued the stop payment order. Or did you?

Ralph cashes the replacement paycheck at his local bank. A few weeks later, Ralph finds the original paycheck and cashes it at Checks 'R Us, a check cashing store. Your bank returns the original paycheck to Checks 'R Us because you issued a stop payment order on it. Checks 'R Us then sends you a letter demanding payment on the original paycheck, stating it is a "holder in due course" and is entitled to payment. Does Checks 'R Us have any sort of claim?

Unfortunately, it does and you may be liable to Checks 'R Us for the amount of the original paycheck, even though you had placed a stop payment order on it and Ralph had previously cashed the replacement check. Under the Uniform Commercial Code, an entity becomes a holder in due course if it is (1) a holder (2) of a negotiable instrument, (3) who took it for value, (4) in good faith and (5) without notice that it is overdue, has been dishonored or that there is any defense to payment or claim to it on the part of any person. Checks 'R Us paid good money for the original paycheck and appears to have accepted the original paycheck in good faith, without notice of any claim or defense, so it is likely a holder in due course. As a holder in due course, Checks 'R Us is entitled to special protections under the Uniform Commercial Code and can take the original paycheck free from virtually all claims to it and free from your defenses to payment (i.e. the stop payment order).

Determining whether an entity is a holder in due course is largely a question of fact, often hinging on whether the entity took the instrument "in good faith." Good faith is defined as "honesty in fact" and "the observance of reasonable

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commercial standards of fair dealing." Both standards look at different aspects of the commercial transaction, and proving either will likely require extensive fact finding as to the circumstances of the transaction and, possibly, expert witnesses. In our scenario, for example, you may need an expert to describe what the reasonable commercial standards of fair dealing are in the check cashing store industry. Preparation for litigation over an entity's holder in due course status can be expensive, and you are wise to weigh the potential costs of litigation against the amount of the potential loss by satisfying the demand for payment by an entity claiming holder in due course status.

Outcomes in this type of scenario may seem unfair. In fact, the law acknowledges that the holder in due course doctrine is often applied at the expense of an innocent party. The policy behind the holder in due course doctrine is to encourage and to facilitate the transaction of negotiable instruments, which is vital to our economy. For the economy to function smoothly people need to believe that negotiable instruments in the hands of good-faith purchasers will be paid, and the special protections offered by the holder in due course doctrine advance this objective by allowing such good-faith purchasers to take the negotiable instrument free of virtually all claims and defenses.

In the situation outlined above, you are not necessarily without recourse. Even if Checks 'R Us is a holder in due course and you are required to pay the amount of the original paycheck, you still may bring claims against Ralph to recover any payments made to Checks 'R Us ( e.g. fraud).

Unfortunately, in many cases, refusing to issue a second check is not an option. Rather, the takeaway is to think twice before being too nice; in other words, understand the context in which you will be issuing a replacement check and know the risks of doing so. Additionally, where possible, use direct deposit and Automated Clearing House (ACH) credit transfers (as opposed to issuing checks) in the first instance.

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