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BANKS AND BANKING — LIABILITY OF BANK FOR PAYMENT OF CHECKS WITH IMPROPER SIGNATURES — DUTY OF DEPOSITOR TO INSPECT MONTHLY STATEMENTS — Plaintiff, trustee, a man of banking experience, opened an account with the defendant bank, instructing that only checks signed by him, or by one of his agents, and countersigned by one of two different agents should be honored. Over a period of three years there were numerous departures from the original instructions given to the bank, participated in by the plaintiff as well as by his agents. Two of the agents misappropriated trust funds by cashing checks through defendant bank without the instructed countersignatures, and

without knowledge of the plaintiff, but during this period the plaintiff failed to inspect his monthly reports from which he could have discovered the misappropriations. Plaintiff sues the bank on thirty-three checks representing misappropriated funds among which are several checks signed by him without the proper countersignatures.[1] *Held*, the plaintiff could not recover because of failure to inspect the monthly statements, and payments were ratified by his own participation in the deviations from the original instructions given the bank. *Phillip v. First National Bank of Chicago*, 297 Ill. App. 498, 18 N. E. (2d) 57 (1938).

Since the payment of checks is a matter of contract between the bank and the depositor, the bank must pay only those checks signed in accordance with the depositor's instructions.[2] But, in order to protect the bank, there is a correlative obligation upon the depositor to inspect monthly bank statements,[3] and his failure to do so will ordinarily obviate recovery, if the bank is prejudiced.[4] If, however, the bank has been guilty of negligence in paying, there can be no

[1] Antedating the checks upon which suit was brought were a series of twenty-two checks not bearing the correct signatures, upon which no suit was brought.

[2] 5 MICHIE, BANKS AND BANKING, § 170 (1932); BRADY, BANK CHECKS, § 193 (1926); Carr v. Fidelity Bank, 126 N. C. 186, 35 S. E. 246 (1900).

[3] 1 PATON'S DIGEST, § 2022 (1926); 5 MICHIE, BANKS AND BANKING, § 192 (1932); BRADY, BANK CHECKS, 2d ed., § 177 (1926); Leather Manufacturer's Nat. Bank v. Morgan, 117 U. S. 96, 6 S. Ct. 657 (1886); Critten v. Chemical Nat. Bank, 171 N. Y. 219, 63 N. E. 969, 57 L. R. A. 529 (1902); Weinstein v. Nat. Bank of Jefferson, 69 Tex. 38, 6 S. W. 171 (1887); Woodward, "The Risk of Forgery or Alterations of Negotiable Instruments," 24 COL. L. REV. 469 (1924); 9 TEX. L. REV. 41 (1930); Arant, "Forged Checks—The Duty of the Depositor to His Bank," 31 YALE L. J. 598 (1922). Contra: Weisser v. Denison, 6 Selden (10 N. Y.) 68 (1854), cited with approval in Manufacturer's Nat. Bank v. Barnes, 65 Ill. 69, 16 Am. Rep. 576 (1872). However, Illinois has since consistently held that there is a duty on the depositor to inspect monthly statements. Kaszab v. Greenbaum Son's Bank & Trust Co., 252 Ill. App. 107 (1929); Kaszab v. Metropolitan State Bank, 264 Ill. App. 358 (1932); Cosmopolitan Bank v. Lake Shore Bank, 343 Ill. 347, 175 N. E. 583 (1931); Illinois Tuberculosis Assn. v. Springfield Marine Bank, 282 Ill. App. 14 (1935); but, these cases do not overrule the Barnes case, for that was a case where the bank was negligent. Merchant's Nat. Bank of Peoria v. Nichols & Shepherd Co., 223 Ill. 41, 79 N. E. 38 (1906).

[4] Citizens Bank & Trust Co. v. Hinkle, 126 Ark. 266, 189 S. W. 679 (1916). Courts are in conflict as to what results follow from a failure to give notice by the depositor. One view is that depositor loses all right of action against the bank. Dana v. Nat. Bank of Republic, 132 Mass. 156 (1882). The better view seems to be that the depositor suffers only so much of the loss as was actually caused by this failure. National Surety Co. v. President and Directors of Manhattan Co., 252 N. Y. 247, 169 N. E. 372 (1929). The depositor's liability has been predicated upon five bases: (1) account stated—United Sec. Co. v. Central Nat. Bank, 185 Pa. 586, 40 A. 97 (1898); (2) ratification—Fay v. Slaughter, 194 Ill. 157, 62 N. E. 592 (1901); (3) adoption—Wellington v. Jackson, 121 Mass. 157 (1876); (4) estoppel—Trader's Nat. Bank v. Rogers, 167 Mass. 305, 45 N. E. 923, 36 L. R. A. 539 (1865); (5) violation of a duty to the bank transfers liability to the depositor—Neal v. First Nat. Bank, 26 Ind. App. 503, 60 N. E. 164 (1901).

shifting of loss to the depositor in the absence of special circumstances.[5] The body of law imposing an obligation on the depositor to check monthly statements originated in the field of forgery, where courts took cognizance of the fact that the only practical way of checking continuing forgeries was to require notification from the depositor after inspection of monthly statements.[6] But, where there are express instructions to the bank as to what signatures are necessary, the reason for the rule of notification fails, because the bank already has notice by virtue of the signature cards as to what constitutes the proper signatures.[7] Reliance upon the negligence of the depositor in the principal case as a foundation for shifting the loss to the depositor seems unwise and inconsistent with prior decisions in view of the bank's negligence and breach of contractual duty.[8] In fact, in cases where estoppel is asserted, if the bank is negligent, or has paid out contrary to its contractual duty, the negligence of the depositor is no defence.[9] It is submitted, then, that if the depositor is to bear the loss in the principal case, it should be upon another basis. It seems equitable that the bank should not bear the loss as to those checks bearing the signature of the plaintiff, for the plaintiff by his own conduct through deviation from the original in-

[5] 2 MORSE, BANKS AND BANKING, 5th ed., § 466 (1917); Merchant's Nat. Bank v. Nichols & Shepard Co., 223 Ill. 41, 79 N. E. 38, 7 L. R. A. (N. S.) 752 (1906); Glassel Development Co. v. Citizens Nat. Bank, 191 Cal. 375, 216 P. 1012 (1923); National Dredging Co. v. President, etc., of Farmer's Bank, 6 Pen. (Del.) 580, 69 A. 607 (1908).

[6] Practically, of course, the bank does not continue to pay on forged checks because it relies on the failure of the depositor to protest, but because the bank is actually deceived by a clever forgery.

[7] In forgery cases, the claim of the bank based upon the depositor's negligence is defeated, if the bank is itself negligent. Kenneth Inv. Co. v. Nat. Bank, 96 Mo. App. 125, 70 S. W. 173 (1902); Leather Manufacturer's Nat. Bank v. Morgan, 117 U. S. 96, 6 S. Ct. 657 (1886); Union Tool Co. v. Farmer's & Merchant's Nat. Bank, 192 Cal. 40, 218 P. 424 (1923).

[8] In cases where the depositor has not been negligent, the bank has been held for not paying in accordance with signature instructions. Shoe Lasting Mach. Co. v. Western Nat. Bank, 70 App. Div. 588, 75 N. Y. S. 627 (1902); Cutler v. Colonial Bank, 170 N. Y. S. 438 (S. Ct. 1918); Rogosin v. City Trust Co. of Passaic, 107 N. J. Eq. 79, 151 A. 834 (1930); American Nat. Bank v. Fidelity & Deposit Co., 129 Ga. 126, 58 S. E. 867 (1907); Ellis v. Western Nat. Bank, 136 Ky. 310, 124 S. W. 334 (1910). See Granby Mining & Smelting Co. v. Laverty, 159 Pa. 287, 28 A. 207 (1893), in which the bank would have been liable, but for the fact that depositor received benefits of the checks; also, Industrial Savings Bank v. People's Funeral Service Corp., 54 App. D. C. 259, 296 F. 1006 (1924).

[9] Crab v. Citizens State Bank, 22 Idaho 408, 126 P. 520 (1912); Gladstone Exchange Bank v. Keating, 94 Mich. 429, 53 N. W. 1110 (1892); Hamburger v. Bank of Detroit, 218 Mich. 173, 187 N. W. 535 (1922); Fidelity & Casualty Co. of New York v. Farmers Nat. Bank of Hudson, 275 N. Y. 194, 9 N. E. (2d) 833 (1937); Cline-Clark Co. v. State Trust & Savings Bank, (Tex. Civ. App. 1935) 81 S. W. (2d) 541. Contra: Calvin Coal Co. v. First Nat. Bank, (Tex. Civ. App. 1926) 286 S. W. 901, where the Texas court held that a depositor was estopped even though the bank was negligent, but there it is to be noted the party giving signature instructions to the bank participated in the deviation from those instructions given the bank.

structions consented to the bank's payment.[10] But the plaintiff had no knowledge that the bank was honoring checks drawn by his agents without proper countersignatures, and it has been generally held that there can be no ratification without knowledge.[11] Where the agent is authorized to act and departs from his original instructions, some authority holds that the principal is presumed to know the facts and silence will be ratification; [12] however, the sounder rule is clearly otherwise.[13] Moreover, what little authority supports ratification in agency without knowledge has never applied it to facts where the agent is known to be violating his duty, or is acting in fraud of his principal.[14] Thus, it seems unwise to apply the doctrine of ratification to the principal case, when the bank realized by virtue of the signature cards that the agents were acting in excess of authority, and plaintiff had no actual knowledge of his agent's acts. Furthermore, plaintiff's deviations from the original instructions did not constitute a representation to the bank that his agents had like authority to deviate; and since there is no factual evidence of the bank's actual reliance upon the plaintiff's deviation as a basis of honoring the agent's checks, doctrines of estoppel do not apply.[15] For the above reasons, it is submitted that the plaintiff should recover

[10] If the depositor signs in accord with his original instructions to the bank, ordinarily the bank will be protected as to payments made accordingly, and it will not be protected as to payments made contrary to signature instructions; here, however, where the depositor signs, knowingly deviating from his original instructions, such deviation should act as an estoppel to prevent recovery against the bank on those checks bearing the depositor's signature.

[11] Newmark Grain Co. v. Merchants Nat. Bank of Los Angeles, 166 Cal. 203, 135 P. 958 (1913); Bank of Ukiah v. Mohr, 130 Cal. 268, 62 P. 511 (1900); Coleman v. Connolly, 242 Ill. 574, 90 N. E. 278 (1909). Since the relation of the bank and depositor is one of debtor and creditor, strictly construed the doctrine of ratification has no application, for it springs from the law of agency. Arant, "Forged Checks—The Duty of the Depositor to His Bank," 31 YALE L. J. 598 (1922). However, the plaintiff could ratify the unauthorized acts of his own agents in signing those checks in disregard of their instructions.

[12] HUFFCUT, AGENCY, § 35 (1895); Hyatt v. Clark, 118 N. Y. 563, 23 N. E. 891 (1890).

[13] MECHEM, AGENCY, 3rd ed., § 136 (1923); Corbin, "Ratification in Agency Without Knowledge of Material Facts," 15 YALE L. J. 331 (1906). A principal is not bound to ratify the unauthorized acts of an agent, nor make inquiries to ascertain the facts. Combs v. Scott, 12 Allen (94 Mass.) 493 (1866); Meehan v. Forrester, 52 N. Y. 277 (1873). Instead, it is the duty of the third party dealing with the agent to disclose the material facts to the principal. Corbin article cited, supra.

[14] Innerarity v. Merchants' Nat. Bank, 139 Mass. 332, 1 N. E. 282 (1885); Fouche v. Merchant's Nat. Bank, 110 Ga. 827, 36 S. E. 256 (1900).

[15] BIGELOW, ESTOPPEL, 5th ed., 570 (1890). Of course a principal may by his own actions render an agent's representations and acts credible, though innocent of intention to do so and unaware of the agent's unauthorized acts; in which case an "assist" estoppel may apply. EWART, PRINCIPLES OF ESTOPPEL 19 (1900). However, the application of such a rule seems unwise in the present case, where the bank by its continued action of honoring both "estoppel" checks and those in conformance with instructions, refuted a contention of reliance, especially when it made no inquiry from the depositor as to what constituted correct signing during this strange course of conduct. 5 MICHIE, BANKS AND BANKING, § 170 (1932).

on the non-conforming agential checks honored by the bank, in accord with the judgment of the trial court.