Michigan Law Review

Volume 33 | Issue 5

1935

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Recommended Citation
BANKS AND BANKING - INCIDENCE OF LOSS RESULTING FROM PAYMENTS BY DRAWEE BANK NOT IN ACCORDANCE WITH DEPOSITOR'S ORDERS, 33 MICH. L. REV. 759 (1935).
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COMMENTS

BANKS AND BANKING — INCIDENCE OF LOSS RESULTING FROM PAYMENTS BY DRAWEE BANK NOT IN ACCORDANCE WITH DEPOSITOR'S ORDERS — The ordinary commercial deposit normally results in a debtor-creditor relationship between bank and depositor. It is familiar doctrine that in this situation a duty rests upon the bank to honor its creditor's properly drawn orders to the extent of the depositor's balance. Payments by the bank, ostensibly according to such orders, but which are in truth not in accordance therewith, are the bank's loss at least so far as the supposed drawer is concerned.[1] In bookkeeping terms this means that payments by the bank not strictly in pursuance of genuine orders ordinarily cannot be charged against the account of the apparent drawer.

Certain duties owing by the depositor to his bank are fully as important as those owing by the bank, but are not so commonly known. These duties become peculiarly important when it is remembered that a breach thereof may mean that the bank may charge items to the delinquent depositor's account, though according to the standard above noted they have been improperly paid.

Examples of payments not made in accordance with the depositor's orders which ordinarily cannot be charged to the depositor's account are those made on checks (1) never delivered, (2) altered by changing the amount or the name of the payee, (3) forged as to the drawer's signature, and (4) forged as to necessary indorsement.[2] However, in each one of these situations payments may possibly be charged to the ostensible drawer's account because of some failure on his part to live up to some duty which he owes the bank.[3]

[1] "The various deposits of money made from time to time by the plaintiffs with the defendant created the relation of debtor and creditor, and the law implies a contract on the part of the defendant to disburse the money standing to the plaintiffs' credit only upon their order and in conformity with their directions. The defendant is not entitled to charge against the plaintiffs' account any sums as payments unless they have been made to such persons as the plaintiffs directed. Such payments as were made without the order of the plaintiffs of their funds by the defendant, afford it no protection when called upon by the plaintiffs to account for the money deposited. Payments made upon forged indorsements are at the peril of the bank unless it can claim protection upon some principle of estoppel or by reason of some negligence chargeable to the depositor. These rules are so familiar and so well established and illustrated by the adjudged cases that a bare reference to them is all that is needful here." Shipman v. Bank of State, 126 N. Y. 318 at 326-327, 27 N. E. 371 at 372 (1891).

[2] This fourth category is broad enough to include those troublesome instances of payments by the bank to impostors who got the drawers' checks pretending to be the persons named therein as payees.

[3] Whether the breaches of these duties by the depositor result in liabilities *ex con-*

In the hands of a holder in due course the delivery of a completed negotiable instrument is now conclusively presumed,[4] but a drawee in paying the order upon it does not take as a holder in due course.[5] All of the reasons, however, that lie behind the presumption in favor of a holder in due course, and more, support the same conclusion in favor of a drawee bank. Moreover, the rule of *Baxendale v. Bennett*,[6] codified in section 15 of the N. I. L.,[7] denying the presumption as to instruments incomplete in the hands of the issuer, is deemed inapplicable to the check situation, as between banker and depositor.[8] If as against his bank honoring his check a depositor cannot resist the charge against his account if a check was incomplete when taken from him, *a fortiori* he cannot be any more successful when the document was complete. This, then, warrants the assertion that a depositor who has placed his signature upon checks, complete or incomplete, must keep them at his peril at least so far as the drawee bank is concerned.[9]

In *Hall v. Fuller*[10] it was concluded, after deliberation, that a check issued by the drawer as one for £3 but paid by the drawee after an alteration, so skillfully done as to defy detection, to £200, could be

tractu or *ex delicto*, the courts rarely discuss. The question invariably arises as one of preclusion of the drawer to contest the propriety of the bank's payment with its resultant effect upon the state of accounts between them. See infra, n. 12.

[4] Uniform Negotiable Instruments Act, sec. 16:

"Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. As between immediate parties, and as regards a remote party other than a holder in due course, the delivery, in order to be effectual, must be made either by or under the authority of the party making, drawing, accepting or indorsing, as the case may be; and in such case the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument. But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed. And where the instrument is no longer in the possession of the party whose signature appears thereon, a valid and intentional delivery by him is presumed until the contrary is proved."

[5] A drawee does not purchase the instrument when he takes it up, but discharges it and takes the instrument as a voucher. First Nat. Bank v. U. S. Nat. Bank, 100 Ore. 264 at 288, 197 Pac. 547 at 555 (1921).

[6] 3 Q. B. D. 525 (1878).

[7] "Where an incomplete instrument has not been delivered it will not, if completed and negotiated, without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery."

[8] Allen Grocery Co. v. Bank of Buchanan County, 192 Mo. App. 476, 182 S. W. 777 (1916); Trust Co. of America v. Conklin, 65 Misc. 1, 119 N. Y. S. 367 (1909); 33 MICH. L. REV. 431 (1935). But see Joseph Heimberg, Inc. v. Lincoln Nat. Bank, (N. J. 1934) 172 Atl. 528.

[9] Britton, "Negligence in the Law of Bills and Notes," 24 COL. L. REV. 695 (1924).

[10] 5 B. & C. 750, 108 Eng. Rep. 279 (1826).

treated by the bank as an order only for the original amount.[11] But in the famous case of *Young v. Grote*[12] it was held that the bank could charge to the drawer's account the larger amount when the alteration was in effect invited by the drawer's issuance of the check with blank spaces left in such relation to the stated amount as to make the alteration easy.[13] To what extent this doctrine applies to the conduct of the drawer facilitating the alteration in respects other than the leaving of these inviting blank spaces in connection with the amounts is not wholly clear.[14]

Instances in which the bank may shift the loss arising from payments on orders with a forged signature of the drawer[15] are almost exclusively those in which the drawer has been guilty of some breach of duty to the bank after the payment, as, for example, in his omission to scrutinize the vouchers and statements returned by the bank or in failure to discover or report the fact of such forgeries.[16] A considerable body of authorities in this situation takes the view that such omission or neglect by the depositor amounts to a ratification or adoption of the spurious items as his own.[17]

[11] Apparently the depositor was willing to have the original amount charged to his account. The probable answer to a contention that under the Uniform Negotiable Instruments Act the alteration would completely destroy the instrument is that section 124 has nothing to do with the alteration of checks as between the bank and the depositor. BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 5th ed., 947 (1932).

[12] 4 Bing. 253, 130 Eng. Rep. 764 (1827).

[13] For a discussion of the trend away from the doctrine of Young v. Grote, 4 Bing. 253, 130 Eng. Rep. 764 (1827), in England and its subsequent affirmance as to banker-depositor relationships in London Joint Stock Bank v. Macmillan & Arthur, [1918] A. C. 777, see 4 CORN. L. Q. 46 (1919) which also discusses the American cases illustrative of the various stages of the English development. See 22 A. L. R. 1139 (1923) for a collection of the American cases showing the split of authority as to whether the altered or the original amount shall control where either the drawee bank charges the depositor's account or the suit is by the holder in due course. 3 DANIEL, NEGOTIABLE INSTRUMENTS, 7th ed., sec. 1864 (1933).

[14] Gutfreund v. East River Nat. Bank, 251 N. Y. 58, 167 N. E. 171, 64 A. L. R. 1103 (1929), due to negligence in failing to note suspicious circumstances, the drawee bank was held unable to charge the depositor's account where the checks were so drawn as to invite the alteration of the payees' names.

[15] The bank is bound to know its depositor's signature. 3 DANIEL, NEGOTIABLE INSTRUMENTS, 7th ed., sec. 1858 (1933). See also 26 A. L. R. 611 (1923).

[16] Morgan v. U. S. Mortgage and Trust Co., 208 N. Y. 218, 101 N. E. 871 (1913). In Robb v. Pennsylvania Co., 186 Pa. 456, 40 Atl. 969 (1890), the court held that the depositor could contest the charge to his account of a check signed with a rubber stamp facsimile of his signature without authority, unless he could be shown to have been negligent in the keeping of the stamp, despite the fact that the drawer, himself, ordinarily signed checks in this manner.

[17] Arant, "Forged Checks — The Duty of the Depositor to His Bank," 31 YALE L. J. 598 (1922). For a collection of cases on the duty of the depositor, the extent of the duty, and the theories on which he may be precluded see 15 A. L. R. 159 (1921) and supplemental annotation in 67 A. L. R. 1121 (1930).

The duty of the depositor, however, does not extend to an examination of the cancelled vouchers for possible forged indorsements, so a preclusion to deny the propriety of the bank's payment on a forged indorsement would not arise out of the customer's neglect in examining his vouchers.[18] But if he did in fact discover from his examination that the bank had paid out money on a forged indorsement and failed to notify the bank, he might well be precluded as in the cases of failure to report forged orders.[19]

A recent case [20] in the federal courts raises the very interesting question as to whether a depositor may not be under a duty to his bank to keep certain types of partially executed order instruments from getting out of his hands and into the hands of a possible forger. The check involved was of the supposedly self-identifying type, that is, one upon the issuance of which the payee writes a sample signature thereon and payment is then made by the drawee upon a counter-signature by the payee which agrees with the sample. If a check of this sort, duly signed by the drawer, gets out of his hands without the proper sample signature it is, of course, obvious that a crook is in position to facilitate the perpetration of the fraud, as he may make the sample signature in his natural handwriting and then easily and accurately duplicate it in the counter-signature. In the recent case, to which reference is made, the court concluded on such facts that the drawer rather than the drawee bank suffered the loss, but the ground upon which the court reaches the result is most uncertain.[21] If the case is sound, it must be, it is believed, on the theory above outlined.[22] Placed on that ground the result is certainly not without reasonable basis,[23] though such lim-

[18] National Surety Co. v. President etc. of Manhattan Co., 252 N. Y. 247, 169 N. E. 372 (1929).

[19] National Surety Co. v. President etc. of Manhattan Co., 252 N. Y. 247, 169 N. E. 372 (1929). The court decided, however, that even though the depositor was negligent in failing to report the forgeries, the bank could only recover to the extent that it could show actual damage. In McNeely Co. v. Bank of North America, 221 Pa. 588, 70 Atl. 891 (1908), actual loss to the bank was held to be unnecessary.

[20] Thomas v. Standard Accident Ins. Co. of Detroit, Mich., (D. C. E. D. Mich. 1934) 7 F. Supp. 205.

[21] The court decided that the depositor was estopped in an action against the drawee bank because it had put it within the power of its employees to commit the fraud and that the N. I. L. as to the delivery of an incomplete instrument (Mich. Comp. Laws 1929, sec. 9264) is subject to the exception that such conduct on the part of the drawer would estop him from defending on the grounds of lack of delivery.

[22] The theory being that the depositor owes a duty to his bank to keep such partially executed order instruments from getting out of his possession, and in the event that they do get out of his possession he, not the bank, bears the risk of fraud and forgery.

[23] The possibility of fraud is as great as where blank spaces are left which permit the alteration of the sum. The situation is also analogous to that in which a blank check signed by the drawer is stolen from him. In neither case does the bank pay according

ited authority as there is seems to be squarely against it.[24]

Despite lack of delivery, the drawee bank may charge the check to the depositor's account, as has been pointed out, at least where a blank check signed by the drawer and thereafter completed, or one payable to bearer, is stolen from him and paid by the drawee.[25] Nor would the loss be on the bank if the named payee of an order instrument obtained it by theft and it was thereafter paid by the bank. However, where a person other than the named payee obtains such instrument, payment by the bank is normally at its own risk and there can be no charge to the depositor's account.[26]

It is generally stated that the bank is under a duty to ascertain the identity of the payee and the genuineness of indorsements at its peril and in such case may not charge the depositor's account [27] *unless* the latter has by some act of negligence or conduct on his part increased the risk of the bank or misled it into making payment — being, in effect, the cause of the improper payment.[28]

to the depositor's order, yet in both it may charge his account. See notes 40 and 42, infra.

[24] City of New York v. Bronx County Trust Co., 261 N. Y. 64, 184 N. E. 495 (1933). Self-identifying checks were fraudulently made out and collected by employees of the city. The drawee reimbursed the city and sought recovery from the collection banks. Recovery was allowed because each check was indorsed with the payee's counter-signature *before* being presented at the bank and then indorsed with the name, or assumed name, of the person presenting it. Thus it was held that neither the collection banks nor the drawee bank relied upon the identification signature, but rather upon the presenting party's indorsement, in each instance of payment. In this lack of reliance upon the self-identification feature, the case is distinguishable from Thomas v. Standard Accident Ins. Co. of Detroit, Mich., (D. C. E. D. Mich. 1934) 7 F. Supp. 205. A holder in due course of stolen traveler's checks so filled in as to appear valid was denied recovery in City Nat. Bank of Galveston v. American Express Co., (Comm. of App., Tex., Sec. A, 1929) 16 S. W. (2d) 278.

[25] See note 9, supra.

[26] Woodward, "The Risk of Forgery or Alteration in Negotiable Instruments," 24 COL. L. REV. 469 (1924); Los Angeles Inv. Co. v. Home Sav. Bank of Los Angeles, 180 Cal. 601 at 604, 182 Pac. 293 at 294 (1919): "If it pays out money on a check drawn to order, as were the checks in this case, upon a forged indorsement of the payee's name, it has not paid in accordance with the depositor's order, and, in the absence of anything further, has no right to charge such payment against the depositor's account."; Jordan-Marsh Co. v. Nat. Shawmut Bank, 201 Mass. 397, 87 N. E. 740, 22 L. R. A. (N. S.) 250 (1909).

[27] Gutfreund v. East River Nat. Bank, 251 N. Y. 58, 167 N. E. 171, 64 A. L. R. 1103 (1929); Miners & Merch. Bank v. St. Louis Smelting and Ref. Co., (Mo. App. 1915) 178 S. W. 211; Shipman v. Bank of State, 126 N. Y. 318, 27 N. E. 371 (1891); U. S. Cold Storage Co. v. Central Mfg. District Bank, 343 Ill. 503, 175 N. E. 825, 74 A. L. R. 811 (1931); Citizens Nat. Bank of Evansville v. Reynolds, 72 Ind. App. 611, 126 N. E. 234 (1920).

[28] Typical statements may be found in Land Title & Trust Co. v. Northwestern Nat. Bank, 196 Pa. 230 at 234, 46 Atl. 420 at 421 (1900): "The rule applies where a check has been lost or stolen and the payee's name has afterward been forged; but it does not protect a depositor who is in fault, as in entrusting a check to one who he

Instances in which the depositor has been precluded from contesting the charge to his account where payment has been made other than to the named payee or proper indorsee are those in which he (1) mistakenly sends the check through the mails to a person of the same name as the payee actually intended,[29] (2) adopts a system of self-protection in the issuance of checks and the fact of proper issuance to the indicated payee is evidenced on the face of the check,[30] (3) learns of the forgery of indorsements or of the payee's name and fails to report this fact to the bank,[31] (4) while not held to be negligent in relying upon a servant

has reason to suppose will make a fraudulent use of it, or in so carelessly filling up a check that it may readily be altered, or in issuing a check to a fictitious person. It is confined to cases in which the depositor has done nothing to increase the risk of the bank."; in Shipman v. Bank of State, 126 N. Y. 318 at 327, 27 N. E. 371 at 372 (1891): "Payments made upon forged indorsements are at the peril of the bank unless it can claim protection upon some principle of estoppel or by reason of some negligence chargeable to the depositor."; and in Grand Lodge, A. O. U. W. v. State Bank, 92 Kan. 876 at 889, 142 Pac. 974 at 978 (1914): "'It [estoppel] is a most valuable doctrine for the promotion of justice; but it can have no application except where the party invoking it can show that he has been induced to act or refrain from acting, by the acts or conduct of the adverse party, under circumstances that would naturally and rationally influence ordinary men.'" See also 30 MICH. L. REV. 1108 (1932).

[29] Weisberger Co. v. Barberton Sav. Bank Co., 84 Ohio St. 21, 95 N. E. 379 (1911), on the ground that due to the depositor's fault it was placed within the power of the party who so received the check to deceive the bank. *Contra*, State Bank of Chicago v. Mid-City Trust & Sav. Bank, 232 Ill. App. 186 (1924). Indorsee of such payee was allowed to recover as a holder in due course in Heavy v. Commercial Nat. Bank, 27 Utah 222, 75 Pac. 727 (1904). Drawer precluded from recovering funds received by collection bank on such check in Slattery & Co. v. Nat. City Bank, 114 Misc. 48, 186 N. Y. S. 679 (1920); criticized in 30 YALE L. J. 628 (1921).

[30] In C. E. Erickson Co. v. Iowa Nat. Bank, 211 Iowa 495, 230 N. W. 342 (1930), the court allowed the bank to charge checks made out by the depositor's clerk and signed by the depositor, which checks were intended to meet the depositor's payroll but were in fact made out to fictitious persons and indorsed by the clerk in their names. The reason given for the decision was that the face of the check carried the time clock number of the employee in each case and specified the work for which it was given, thus showing proper issuance upon which the bank might rely to the extent of considering the indorsement to be that of the employee. This case is criticized in American Sash and Door Co. v. Commerce Trust Co., 332 Mo. 98 at 112, 56 S. W. (2d) 1034 at 1039 (1932):

> "The case, without citing any of the authorities referred to in the preceding paragraph, holds the act of the treasurer in issuing the checks amounted to a representation that the payees were employed by the company, and says: 'If the drawee-bank in paying the check reasonably believed that the payee was a present employee, *it might also reasonably believe that the indorsement was genuine.*' (Italics ours. How the fact that the payee in a check was an employee could *identify* the person indorsing or presenting it for payment, is more than we can see.)"

Note that this objection is met in the case of self-identifying checks where the first signature shows proper issuance and the counter-signature is meant to identify the payees to whom such checks have apparently been properly issued.

[31] See note 19, supra.. In Fletcher American Nat. Bank v. Crescent Paper Co.,

who commits the fraud,[32] is precluded when he fails to compare the names of payees on his returned vouchers with his check register [33] or, perhaps, fails to make an investigation to detect the cause of increased costs of operation [34] and the bank thereafter continues to pay improper checks which could have been prevented by the suggested conduct on the part of the depositor, and (5) draws a check to the order of one person but intends the physical impostor taking the check to be the payee on the mistaken assumption that he really is the indicated payee.[35]

Though the result in some of the above situations has been criticized, they nevertheless show an attempt on the part of the courts to apply the exception which allows the bank to charge where it has been misled by the depositor.[36] All of the reasons that could be urged in those situations, and more, favor the result reached by the recent federal decision.[37] The evident purpose of self-identifying checks is to facilitate their collection by dispensing with the ordinary requisite of identification of the payee by some person known to the bank, a real problem in the larger cities. To deny the bank the right to rely upon these means of self-identification is to defeat the object of this form of check because thereafter identification will be required as in the case of the ordinary check.[38]

Aside from the fact that such checks would fail to subserve their intended purpose if the risk be placed on the bank, there is the further

193 Ind. 329, 139 N. E. 664 (1923), the court held that it was for the jury to determine whether or not the depositor was negligent in failing to examine indorsements where the checks were drawn by a clerk to fictitious payees or to a person to whom the depositor was not indebted and with whom he had done no business for eight months; and in Pannonia Bldg. & Loan Ass'n v. West Side Trust Co., 93 N. J. L. 377, 108 Atl. 240 (1919), the court held that the depositor could have discovered the forgeries by an examination of the vouchers where the depositor's clerk made out checks to fictitious payees, forged the indorsements of the payees, and then indorsed with his own name. The depositor was estopped from denying the propriety of the bank's charge.

[32] U. S. Cold Storage Co. v. Central Mfg. Dist. Bank, 343 Ill. 503, 175 N. E. 825, 74 A. L. R. 811 (1931). But it has been held that if the depositor retains a clerk in his employ who has been known to forge the names of payees, the question as to whether this is sufficient negligence to estop the drawer should go to the jury. Prudential Ins. Co. of America v. Nat. Bank of Commerce, 227 N. Y. 510, 125 N. E. 824 (1920).

[33] Union Tool Co. v. Farmers' and Merch. Nat. Bank, 192 Cal. 40, 218 Pac. 424 (1923).

[34] The question as to whether the depositor was negligent in failing to make such an investigation was reserved for the jury in Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank, 252 Mich. 163, 233 N. W. 185, 75 A. L. R. 1273 (1930).

[35] Montgomery Garage Co. v. Mfgrs. Liability & Ins. Co., 94 N. J. L. 152, 109 Atl. 296, 22 A. L. R. 1224 (1920); 52 A. L. R. 1326 (1928).

[36] See note 28, supra.

[37] Thomas v. Standard Accident Ins. Co. of Detroit, Mich., (D. C. E. D. Mich. 1934) 7 F. Supp. 205.

[38] 11 N. Y. UNIV. L. Q. REV. 101 (1933).

factor that the depositor has virtually induced the depositary to depart from its customary method of making payment. The conventional form of check is a notice to the bank that it must be on guard to identify the payee.[39] Since the self-identifying check on its face indicates to the bank that it may depart from its normal practices with the assent of the depositor, it is not without reason that a prudent banker should, in making payment, rely upon such check apparently filled out in the proper manner.[40] It would seem that the risk of loss is properly placed upon the depositor who adopts such form at his option rather than upon the bank which adopts the practice suggested to it.[41]

If the inability of the bank to protect itself in the course of its business is the reason for holding the drawer of a blank check under a duty to hold it at his peril,[42] it is not going far afield to hold the drawer to a similar duty with regard to order instruments so drawn that their form admits of completion which will give the wrongdoer the appearance of being the proper payee and whose express purpose is self-identification.[43]

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[39] See note 27, supra.

[40] To the banker the first signature indicates proper issuance to the payee, while the reasonable interpretation of the space left for the counter-signature to be compared therewith would seem to be that it is an order to pay the person whose signature, when there written, coincides with the prior one. Thus, in a sense, it could be said that the bank in paying when the signatures correspond does so in accordance with the depositor's order.

[41] City of New York v. Bronx County Trust Co., 261 N. Y. 64 at 75, 184 N. E. 495 at 499 (1933), Lehman, J., dissenting:

> "Here, however, the drawee [obviously *drawer*] has himself provided the means for such identification by the use of a check bearing a blank for an identification signature. Without other explanation for the use of such a form of check, the inference would be clear that the check itself contained an invitation, to the bank on which it was drawn, or to third parties dealing with the apparent holder of the check, to rely on the identification signature for the identification of the payee and the validity of the endorsement of the payee."

[42] It is evident that when such check is filled in it appears to have been properly issued and there is no difficulty on the part of the payee to have himself identified. Any efforts of the bank as to checking identity would be fruitless unless it communicated with the drawer of every check before honoring it.

[43] See note 40, supra.