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BILLS AND NOTES-NEGLIGENCE OF THE DEPOSITOR-RIGHT OF THE DRAWEE TO CHARGE THE ACCOUNT

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BILLS AND NOTES—NEGLIGENCE OF THE DEPOSITOR—RIGHT OF THE DRAWEE TO CHARGE THE ACCOUNT—A depositor in the defendant bank was a large firm with a payroll clerk who prepared the employees' checks for signing by the proper officer. The clerk prepared checks for employees not then on the payroll,

which the officer signed without investigation. The clerk then indorsed as the named payee, signed in her own name as final indorser, and cashed the checks at various banks. Such conduct did not seem unusual to the banks, as she would frequently cash properly indorsed checks as a favor to other employees. The returned vouchers were not examined by the depositor to detect errors. The plaintiff surety company sued on the depositor's claim against the drawee bank for improperly charging these checks against the depositor's account. *Held*, judgment for the bank affirmed. Depositor's negligence in issuing the checks caused the loss and precluded recovery. *United States Guarantee Co. v. Hamilton National Bank*, (Tenn. 1949) 223 S.W. (2d) 519.

The courts are agreed that where a fraudulent employee has induced an employer to draw checks in favor of "fictitious"¹ employees, the indorsement by this employee as the named payee is a forgery. Such paper cannot be considered payable to bearer under the N.I.L.² Nor can the fraudulent clerk be considered the intended payee through his merely being given possession of the checks intended for delivery to others.³ The courts also agree with the general principle that negligence of a depositor which is the proximate cause of the drawee's loss bars the depositor's recovery for money not paid in accordance with his genuine order.⁴ In the application of this principle to situations similar to the present case the courts are not agreed. Many hold that mere reliance on a trusted employee who prepared the checks does not constitute a breach of the depositor's duty toward his drawee.⁵ Confidence must be placed somewhere in a large business. Neither is failure to examine returned vouchers considered negligence in the cases of forged indorsements, for forgeries cannot ordinarily be detected by examination.⁶ This is held even if the forgeries could have been detected by checking the named payees with the authorized list on the payroll and time sheets, the depositor not being required to check more than the office record of checks

¹ "Fictitious" is used to mean payees not intended to be benefited by the drawer, whether in existence or not, this being the legal meaning of the word as used in the N.I.L. §9(3). See *United States Cold Storage Co. v. Central Mfg. Dist. Bank*, 343 Ill. 503, 175 N.E. 825 (1931).

² Sec. 9(3) does not apply when knowledge of the fictitiousness of the payee is known only to an employee, himself unauthorized to draw checks, who induces another so authorized. See *American Sash and Door Co. v. Commerce Trust Co.*, 332 Mo. 98, 56 S.W. (2d) 1034 (1932); *United States Cold Storage Co. v. Central Mfg. Dist. Bank*, supra, note 1.

³ See *American Sash and Door Co. v. Commerce Trust Co.*, supra, note 2; *McCornack v. Central State Bank*, 203 Iowa 833, 211 N.W. 542 (1926). But see *Defiance Lumber Co. v. Bank of California*, 180 Wash. 533, 41 P. (2d) 135 (1935), where the court suggests that a foreman, who procured extra checks fraudulently by inserting time cards for non-existent person, was the intended payee.

⁴ For a collection of cases see 99 A.L.R. 439 (1935). See also *Washington Loan and Trust Co. v. United States*, (App. D.C. 1943) 134 F. (2d) 59. N.I.L. §23 (Tenn. Code §7347) allows a party to be precluded from denying the authority of a signature.

⁵ See *Detroit Piston Ring Co. v. Wayne County and Home Savings Bank*, 252 Mich. 163, 233 N.W. 185 (1930); *Los Angeles Investment Co. v. Home Savings Bank*, 180 Cal. 601, 182 P. 293 (1919); *Shipman v. Bank of State of N.Y.*, 126 N.Y. 318, 27 N.E. 371 (1891).

⁶ Cases collected in 67 A.L.R. 1121 (1930).

issued for fraudulent alterations or forgeries of his own signature.⁷ Of course if peculiar warnings arise, the duty of the depositor to detect forged indorsements is increased.⁸ Other courts have held that such conduct of the depositor in issuing the check can in no event be the proximate cause of the loss, as the depositor has a right to rely on the drawee's absolute duty to determine the validity of the indorsement.⁹ There have been a few cases,¹⁰ however, including the principal case, in which the courts have held that it is negligent for a firm not to check carefully the names of those purported by reliable employees to be entitled to pay. Such negligence is also held to be the proximate cause of the loss. In thus increasing the depositor's duty toward his bank, the court here reaches a sensible result. The bank should be more protected in the performance of its contractual duty to honor the depositor's genuine order. Banks are frequently called upon to cash many payroll checks in the hands of an office representative.¹¹ The depositor should be liable for failure to exercise means within his control to check for this fraud, as he would be if he failed to check for fraudulent alterations.¹² Moreover, there is little difference between the present case and one in which an agent empowered to sign checks does so fraudulently, in which case the loss would be the drawer's.¹³

Thomas Hartwell

⁷ *Detroit Piston Ring Co. v. Wayne County Home and Savings Bank*, supra, note 5; *Critten v. Chemical Nat. Bank*, 171 N.Y. 219, 63 N.E. 969 (1902).

⁸ The depositor became aware of abnormally high cost accounts; *Detroit Piston Ring Co. v. Wayne County Home and Savings Bank*, supra, note 5. The depositor was informed by the named payee that checks sent in the mail had not arrived; *Prudential Ins. Co. v. Nat. Bank of Commerce*, 227 N.Y. 510, 125 N.E. 681 (1920). In these cases, the courts held that negligence could be found for failure to supervise employees carefully and for failure to examine indorsements.

⁹ *Los Angeles Invest. Co. v. Home Savings Bank*, supra, note 5; *American Sash and Door Co. v. Commerce Trust Co.*, supra, note 2; *Jordan Marsh Co. v. National Shawmut Bank*, 201 Mass. 397, 87 N.E. 740 (1909).

¹⁰ *Defiance Lumber Co. v. Bank of California*, supra, note 3; *C. E. Erickson v. Iowa Nat. Bank*, 211 Iowa 495, 230 N.W. 342 (1930). See also *Goodyear Tire and Rubber Co. v. First Nat. Bank of Denver*, 95 Col. 34, 32 P. (2d) 268 (1934) as to duty of depositor to audit his accounts to discover fictitious payees. In *Potts & Co. v. Lafayette Nat. Bank*, 269 N.Y. 181, 199 N.E. 50 (1935), the court found a duty of the depositor to examine his monthly deposit accounts for errors.

¹¹ See *Washington Loan and Trust Co. v. United States*, supra, note 4.

¹² *Critten v. Chemical Nat. Bank*, supra, note 7.

¹³ *Phillips v. Mercantile Nat. Bank*, 140 N.Y. 556, 35 N.E. 982 (1894).