1-1-1991

Allocation of Loss for Forged Checks under Articles 3 and 4 of the U.C.C. and the Proposed Revisions Thereto

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TABLE OF CONTENTS

I. BACKGROUND .................................. 1267

II. THE U.C.C. PROVISIONS .................... 1271
   A. U.C.C. Section 3-406 .................... 1271
   B. U.C.C. Section 4-406 .................... 1272
   C. U.C.C. Section 3-405 .................... 1272

III. PROPOSED REVISIONS ..................... 1273
   A. U.C.C. Section R3-406 ................... 1274
   B. U.C.C. Section R4-406 ................... 1274
   C. U.C.C. Section R3-405 ................... 1275
   D. U.C.C. Section R3-404(b) ............... 1276

IV. A HYPOTHETICAL ........................... 1277
   A. Statement of Hypothetical ............... 1277
   B. Does Drawer Have the Ability to Compel Drawee Bank
to Recredit Drawer’s Account? ............... 1277
      1. Resolution Under the Current Code .... 1277
      2. Resolution under the Proposed Code .... 1279
   C. Drawee’s Defenses to Drawer’s Action .... 1279
      1. Current U.C.C. Section 3-406 .......... 1280
      2. Revised U.C.C. Section 3-406 .......... 1282
      3. Another Defense Under Current U.C.C. Section
         4-406 .................................. 1283
      4. Revised U.C.C. Section 4-406 .......... 1284
   D. Drawer’s Defenses to Drawee Bank’s Claim that
      Drawer is Precluded from Recovery ........ 1286
      1. Resolution Under the Present Code .... 1286

1263
2. Resolution Under the Proposed Revisions to the Code ........................................ 1287

E. A Possible Third Defense--Section 3-405 ........................................ 1287
   1. Resolution Under the Present Code ........................................ 1288
   2. Proposed Revisions to U.C.C. Section 3-404 and 3-405 ...................... 1292

F. Whether Drawer May Assert a Claim Directly Against Depositary Bank ............. 1295
   1. Can Drawer Assert a Breach of Warranty Against Depositary Bank? .............. 1296
      a. Resolution Under the Current Code ........................................ 1296
         i. Warranties ........................................ 1296
         ii. Other Causes of Action ........................................ 1298
      b. Resolution Under the Revised Code ........................................ 1299
         i. Warranties ........................................ 1299
         ii. Other Causes of Action ........................................ 1300

V. CONCLUSION ........................................ 1301
In the case of *Ed Stinn Chevrolet, Inc. v. National City Bank*,¹ Ed Stinn had an employee who embezzled $284,000 over the course of several years from Stinn’s checking account at National City Bank.² The embezzler, Julie Hajjar, maintained the dealership’s cash box, wrote business checks, and with little or no supervision reconciled Stinn’s account at National each month.³ These responsibilities, combined with Stinn’s lax accounting procedures, enabled Hajjar to remove money from Stinn’s cash box and replace the funds with checks drawn on Stinn’s account at National.⁴ In this way the daily receipts of customer payments equaled the combined total of the cash and checks in the cash box.⁵ These forged checks were routinely deposited in the accounts on which they were drawn, resulting in a “wash” transaction.⁶ Because Hajjar reconciled the bank statement, her embezzlement scheme went undetected for several years.

In Stinn’s suit against National for improper payment of forged instruments, each party alleged that the other’s negligence caused the loss.⁷ To determine who between the innocent parties was to bear this loss, the trial court instructed the jury according to Ohio’s comparative negligence statute.⁸ The jury determined that Stinn’s negligence resulted in eighty-five percent of the loss, and that

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¹ 28 Ohio St. 3d 221, 503 N.E.2d 524 (1986), rev’d in part, 31 Ohio St. 3d 150, 509 N.E. 2d 945 (1987).
² *Id.* at 221-22, 503 N.E.2d at 526.
³ *Id.* at 221, 503 N.E.2d at 526.
⁴ *Id.* at 222, 503 N.E.2d at 526. Stinn’s business checks required two drawers’ signatures, thus Hajjar used her own valid drawer’s signature with a forged second drawer’s signature, or the signature of another drawer who was deceived as to the purpose of the check. *Id.* Additionally, Hajjar could forge the endorsement on a check made payable to an employee or fictitious person. *Id.* Finally, rather than forging the endorsement, Hajjar could use Stinn’s rubber-stamp deposit endorsement. *Id.*
⁵ *Id.* at 221, 503 N.E.2d at 526.
⁶ *Id.* A wash transaction is one in which the funds are first debited and then credited to the same account in an in-and-out process. *Id.* at 224, 804 N.E.2d at 528.
⁷ *Id.* at 222, 503 N.E.2d at 527.
National’s negligence resulted in the other fifteen percent. Because Stinn’s negligence was greater than National’s, and because the Ohio comparative negligence statute denies recovery to a plaintiff who was more at fault than the defendant, the trial court entered judgment in favor of National.

Stinn’s argument that the trial court erred in applying the law of comparative negligence was accepted on appeal by the Ohio Supreme Court. The Ohio Supreme Court held that under Ohio’s version of the Uniform Commercial Code, National’s failure to exercise ordinary care precluded National from asserting Stinn’s negligence as a shield, making National fully liable for Stinn’s loss. Although the Ohio Supreme Court noted that the loss from forged instruments should be shifted to the party bearing responsibility for the loss, the court permitted a party eighty-five percent at fault to recover regardless of that party’s culpability.

The Uniform Commercial Code (Code) allocates the risk of loss for forged checks in Articles 3 and 4. This Comment analyzes the allocation of loss under the current version of the Code, and the proposed revisions thereto. Parts II and III of this Comment will briefly examine the pertinent sections of the current Code and the proposed revisions to the Code. The major issues arising from these sections are discussed in Part IV by first examining the handling of a hypothetical fact pattern under the present Code, and then analyzing the treatment of those facts under the proposed revisions. Finally, Part V of this Comment will analyze whether the proposed revisions to the Code deal adequately with the

9. Stinn, 28 Ohio St. 3d at 222, 503 N.E.2d at 527.
11. Stinn, 28 Ohio St. 3d at 222, 503 N.E.2d at 527.
12. Id. at 231-32, 503 N.E.2d at 534.
13. Id. at 226, 503 N.E.2d at 530. Stinn was unable to recover on any theory other than consequential damages, because the bank’s liability for the forged checks was extinguished when the improperly withdrawn funds were redeposited. Id. at 236-37, 503 N.E.2d at 537-38. Cf. infra note 91 and accompanying text (a bank is not liable to a drawer of a check with a forged endorsement when the funds reach the intended payee).
14. See infra notes 42-82 and accompanying text.
15. See infra notes 42-82 and accompanying text.
16. See infra notes 83-239 and accompanying text.

1266
problems arising in this area of the law and those presented in cases such as *Ed Stinn Chevrolet*.17

I. BACKGROUND

In *Ed Stinn Chevrolet*, the Ohio Supreme Court applied the Uniform Commercial Code properly in reaching its conclusion, yet the result seems somewhat inequitable.18 In its present form the Code attempts to allocate the loss from forged checks to the person who is in the best position to avoid the loss.19 The risk of loss as between a depositary bank20 and a drawee bank21 is allocated differently in the context of a forged drawer’s22 signature and a forged endorsement.23 However, in either situation the drawee

17. See infra notes 240-250 and accompanying text.
18. The Ohio Supreme Court ultimately held that Stinn would be permitted to recover if Stinn could assert that payment of checks containing a forged drawer’s signature was made in bad faith, or if such damages were within the contemplation of the contracting parties. *Ed Stinn Chevrolet, Inc. v. National City Bank*, 28 Ohio St. 3d 221, 227, 503 N.E.2d 524, 538. See CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS, § 8-37 (3d ed. 1990) (hereinafter CLARK) (although Stinn suffered no direct loss from the “wash” transactions, consequential damages were recoverable if the bank acted in bad faith).19. *Ed Stinn Chevrolet, Inc. v. National City Bank*, 28 Ohio St. 3d 221, 226, 503 N.E.2d 524, 530 (1986). See *Perini Corp. v. First Nat’l Bank of Habersham County*, 553 F.2d 398, 405 (5th Cir. 1977) (one of the policies of the Code is to allocate the loss to either the drawee bank or prior parties in the collection chain according to their ability to detect different forgeries). Cf. U.C.C. § 3-405 comment 4 (1987) (an employer is in a better position to prevent forgeries by the selection and supervision of his employees, and thus bears the risk of loss for their forged endorsements).
20. See BLACK’S LAW DICTIONARY 396 (5th ed. 1979) (the depositary is the party or bank which receives a deposit).
21. See id. at 444 (the drawee is the bank on which the check is drawn, and is requested to pay the amount of money mentioned therein).
22. See id. (the drawer is the person who signs the check or draft).
23. J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE, § 689 (3d ed. 1988). Circuit Judge Goldberg stated the framework of the Code as:

Perpetuating a distinction introduced into the legal annals by Lord Mansfield in the eighteenth century, the Code accords separate treatment to forged drawer signatures (hereinafter "forged checks") and forged endorsements. In general, the drawee bank is strictly liable to its customer drawer for payment of either a forged check or a check containing a forged endorsement. In the case of a forged endorsement, the drawee generally may pass liability back through the collection chain to the party who took from the forger and, of course, to the forger himself if available.

*Perini Corp. v. First Nat’l Bank of Habersham County*, 553 F.2d 398, 403 (5th Cir. 1977).
bank will generally have to bear the initial loss, and must recredit the drawer’s account.\textsuperscript{24}

In the case of a forged drawer’s signature, where there is no negligence on the part of any party, the drawee bank is considered to be in the best position to detect the forged signature and generally must bear the ultimate loss.\textsuperscript{25} This is because of the drawee bank’s familiarity with the drawer’s signature. The drawee’s payment on a forged drawer’s signature is final in favor of a holder in due course,\textsuperscript{26} or one who in good faith\textsuperscript{27} has changed position in reliance on the payment.\textsuperscript{28} Prior parties in the collection chain meeting these requirements are immunized from liability for negligence in dealing with the forged check.\textsuperscript{29}

Compare this treatment with the allocation of loss for a forged endorsement under the Code. Generally, the drawee bank, after bearing the initial loss, will assert the statutory warranties of presentment\textsuperscript{30} against prior parties in the collection chain.\textsuperscript{31} With

\begin{itemize}
  \item [24.] White & Summers, supra note 23, at 689. See infra notes 84-92 and accompanying text (discussing recredit of the drawer’s account by the drawee bank).
  \item [25.] Perini, 553 F.2d at 404. See H. Bailey, Brady on Bank Checks, 26-31 (6th ed. 1987) (drawee bank generally not entitled to recover from collecting bank for forged drawer’s signature).
  \item [26.] See U.C.C. § 3-302(1) (1987) (definition of holder in due course). A holder in due course is a person who in good faith takes an instrument for value without notice that it is overdue, dishonored, or that another person has a defense against or a claim to it. Id. Hereinafter all references to the U.C.C. will be to the 1987 edition unless otherwise indicated.
  \item [27.] See id. § 1-201(19) (defining good faith as honesty in fact). Compare with Proposed U.C.C. § 3-103 (proposed final draft May 10, 1990) (defining good faith as honesty in fact, and the observance of reasonable commercial standards of fair dealing) (hereinafter all citations to the proposed revisions to the code will be prefixed by an “R” i.e. U.C.C. § R3-103).
  \item [28.] U.C.C. § 3-418.
  \item [29.] Perini, 553 F.2d at 404. See U.C.C. § 3-418 (payment of an instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on payment). Section 3-418 is a codification of the rule in Price v. Neal, 3 Burr. 1354 (K.B. 1762), which held that a drawee who accepts or pays an instrument with a forged drawer’s signature is bound on acceptance and cannot recover any payment. Id. § 3-418 comment 1.
  \item [30.] See U.C.C. §§ 3-417, 4-207(1)(a) (warranties of presentment). The warranties of presentment are substantially similar. Section 4-207 provides in part:

  (1) Each customer or collecting bank who obtains payment or acceptance of an item and each prior customer and collecting bank warrants to the payor bank or other payor who in good faith pays or accepts the item that

    (a) he has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title.

\end{itemize}
a forged endorsement, the party that accepts the check from the forger is considered to be in the best position to prevent the loss since that party is able to detect improprieties in the endorsement. Ultimately, the loss will be borne by the first solvent party who received the check after the forger, or ideally the forger himself. Thus, in the absence of negligence on the part of the drawer, the drawer bears no risk of loss for either forged endorsements or forged signatures. However, if the drawer negligently facilitates the making of an unauthorized signature, or fails to report an unauthorized signature within a reasonable time, the Code shifts the loss to the drawer.

Where both the drawer and a transferee are negligent, the question arises as to how the risk of loss should be allocated between the negligent parties. One possibility is an allocation of loss based on culpability, where each party’s liability is in

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Id. § 4-207 (1)(c).
31. Perini, 553 F.2d at 404.
32. CLARK, supra note 18, at 6-35. See also Perini, 553 F.2d at 405 (one of the policies upon which the Code rests is an "outmoded notion" that a drawee bank is in the best position to detect a forged endorsement); Girard v. Mount Holly State Bank, 474 F. Supp. 1225, 1230-31 (D. N.J. 1979) (identifying the scheme of the Code as placing liability on the person who takes from the forger because they are in the best position to detect and avoid the fraud).
33. Perini, 553 F.2d at 404. See Ed Stinn Chevrolet, Inc. v. National City Bank, 28 Ohio St. 3d 221, 226, 503 N.E. 2d 524, 530 (1986) (stating that the loss should be borne by the thief, or the party responsible for the loss). In Stinn the plaintiff was able to recover $108,000 from the forger. Id. at 222, 503 N.E.2d at 526.
34. See U.C.C. §§ 3-406 (drawer bears risk of loss if only drawer is negligent), 4-406 (drawer bears risk of loss if drawer breaches duty to promptly inspect statement of account).
35. See infra notes 100-109 and accompanying text (discussing the preclusion defense of U.C.C. § 3-406).
36. See infra notes 115-120 and accompanying text (discussing the customer’s duties to inspect his statement of account under U.C.C. section 4-406). This liability is only for future forgeries by the same forger. U.C.C. § 4-406(2).
37. See U.C.C. §§ 3-405, 3-406, 4-406. See also CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS 6-4 (Rev. ed. 1981) (hereinafter CLARKE REV.) (drawer will be able to recover unless the drawer negligently facilitates the forgery, or fails to discover the forgery within a reasonable time). Under common law, if the drawer negligently facilitated a material alteration or forgery of an instrument then the drawer was liable to a drawee who paid the instrument in good faith. Young v. Grote, 4 Bing. 253 (K.B. 1827). This position is expressly adopted by the Code. U.C.C. § 3-406 comment 1.
proportion to their fault. Alternatively, the risk may be allocated to the person who had the last chance to avoid the injury. The present Code adopts the latter position, and distributes the loss through the application of the law of contributory negligence. Although most states have adopted a form of comparative negligence in areas other than commercial transactions, courts and commentators have been hesitant to urge the judicial adoption of a comparative negligence standard for negotiable instruments without legislative approval.

Because the law of contributory negligence contemplates all or nothing liability, an entire court judgment may turn on minor factual distinctions, or on a jury's determination of credibility. Moreover, as the Stinn case shows, a party eighty-five percent at fault may potentially still recover for the full amount of its loss, arguably an inequitable result. This inequity has helped create a lack of uniformity between jurisdictions as they struggle for just solutions.

38. See, e.g., Li v. Yellow Cab Co., 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858 (1975) (California's adoption of pure comparative negligence allocating the damages according to a percentage of total fault).


40. See White & Summers, supra note 23, at 714 (urging that comparative negligence not be judicially adopted). See also Girard Bank v. Mount Holly State Bank, 474 F. Supp. 1225, 1242 (D. N.J. 1979) (suggesting that comparative negligence may be a better solution, but leaving that step for the legislature or the New Jersey Supreme Court); Ed Stinn Chevrolet, Inc. v. National City Bank, 28 Ohio St. App. 3d 221, 222-23, 503 N.E.2d 524, 527 (1986) (approval of appellate court's reasoning that comparative negligence statute does not apply to negligence in negotiable instruments, because the action was governed by the U.C.C. and sounded in contract, not in tort). But see Sun 'N Sand, Inc. v. United California Bank, 21 Cal. 3d 671, 699-700, 582 P.2d 920, 939-40, 148 Cal. Rptr. 329, 348-49 (1978) (suggesting that the principles of contributory negligence may be used for section 4-406 defenses); Clark Rev. Ed., supra note 37, at 6-16 (comparative negligence is a more rational approach); Cf. Gresham State Bank v. O & K Construction Co., 231 Or. 106, 126, 370 P.2d 726, 735-36 (1962) (arising before the adoption of the Code, holding that where a payee's "commercial unreasonableness" outweighed the negligence of the payor, the payor will be permitted to recover); Coffin v. Fidelity-Philadelphia Trust Co, 374 Pa. 378, 390-91, 97 A.2d 857, 863 (1953) (a rejection of comparative negligence under negotiable instruments law because the bank's liability is for breach of contract). For a statute adopting a comparative negligence approach, see Ark. Stat. Ann. §§ 4-3-406; 4-4-406 (1987).

II. THE U.C.C. PROVISIONS

The Code allocates the risk of loss for forgery and forged endorsements with three principle sections. Section 3-406 deals with situations in which the drawer's negligence substantially contributes to the making of the unauthorized signature or material alteration. Under section 4-406 a customer has a duty to discover and report unauthorized signatures to the bank. Finally, section 3-405 makes unauthorized endorsements effective under specific circumstances.

A. U.C.C. Section 3-406

Section 3-406 provides that if a drawer's negligence "substantially contributes" to the material alteration of an instrument, or the making of an unauthorized signature, the drawer is precluded from asserting the alteration against a drawee or other payor. However, if in paying the instrument, the drawee fails to act in good faith and in accordance with reasonable commercial standards of the drawee's business, then the Code places the risk of loss on the drawee. Section 3-406 incorporates principles of contributory negligence to place the loss on the party who had the last chance to avoid the forgery. Thus, if the bank is negligent, the drawer is entitled to recredit of his account regardless of the drawer's negligence.

42. See U.C.C. §§ 3-406 (allocation of loss when drawer's negligence contributes to forgery), 4-406 (drawer's duty to inspect statements of account), 3-405 (allocation of loss when forger is drawer's employee).

43. See id. § 1-201(43) (definition of unauthorized signature or endorsement). Case law suggests that "unauthorized signatures" includes forged endorsements. See, e.g., Girard Bank v. Mount Holly State Bank, 474 F. Supp. 1225, 1233 (D. N.J. 1979) (unauthorized signatures includes both forged drawer's signature, and forged endorsements); Allied Concord Fin. Corp. v. Bank of America Nat'l Trust & Savings Assn., 275 Cal. App. 2d 1, 5, 80 Cal. Rptr. 622, 626 (1969) (applying U.C.C. § 4-406 to a forged endorsement). See also U.C.C. § 3-406 comment 7 (specifically referring to a forged endorsement situation).

44. U.C.C. § 3-406. See infra notes 47-48 and accompanying text (discussing U.C.C. § 3-406).

45. U.C.C. § 4-406. See infra notes 49-51 and accompanying text (discussing U.C.C. § 4-406).

46. U.C.C. § 3-405. See infra notes 52-54 and accompanying text (discussing U.C.C. § 3-405).

47. U.C.C. § 3-406.

48. Id.
B. U.C.C. Section 4-406

Under section 4-406, if a customer fails to use reasonable diligence and promptness in examining the customer’s canceled checks, the customer is precluded from asserting an unauthorized signature or alteration against the drawee bank unless the bank was negligent in paying the items. The customer is precluded from recovery to the extent the customer’s failure causes a loss, or if the subsequent unauthorized signature is by the same wrongdoer. More importantly, section 4-406 also creates a statute of limitations. If the customer fails to discover and report an unauthorized signature within one year, or fails to discover and report an unauthorized endorsement within three years, the customer is absolutely barred from asserting that defect against the bank. When the bank is negligent, the bank will be the last party capable of avoiding the injury, and the principles of contributory negligence dictate that the bank must bear the loss regardless of the customer’s negligence. Thus, unless the drawer’s action for recredit is time-barred, negligence on the part of the bank permits the drawer’s recovery, regardless of the drawer’s negligence in failing to examine his statement of account.

C. U.C.C. Section 3-405

Section 3-405 is another principle section of the Code governing the allocation of the risk of loss. For example, under section 3-405(1)(b), an endorsement by a person in the name of the payee is effective if the person signing as, or on behalf of the drawer intends for the payee to have no interest in the instrument. Thus, regardless of subsequent negligence, the drawer will bear the entire loss for the fraudulent endorsement.

49. Id. § 4-406(2), (3).
50. Id.
51. Id. § 4-406(4).
52. Id. § 3-405(1)(b).
53. Id. §§ 3-405(1)(b), 3-405 comment 3.
These sections have been called a "carefully designed machine" which were intended by the drafters to make the drawer's negligence operate as an estoppel, with the bank's contributory negligence reopening a claim on the unauthorized signature.54

III. PROPOSED REVISIONS

Present articles 3 and 4 were drafted almost exclusively by banker's attorneys, and have been termed "a deliberate sell-out . . . to the bank lobby . . . for their support of the rest of the 'Code.'"55 With the development of the consumer movement, the orientation towards the bank lobby has become increasingly controversial.56 Although the revisions do not create any new consumer rights, there is some movement towards consumer protection in specific provisions.57 Significant among these provisions are those adopting a system of comparative negligence.58

Arguably, the seeming inequities inherent in a system of contributory negligence helped motivate the Code's switch to a comparative negligence standard. Where only one party is negligent, the revisions to articles 3 and 4 will generally allocate the risk of loss to the same person who would bear the loss under the present Code.59 However, where both parties have failed to exercise ordinary care,60 the proposed revisions to the Code allocate the risk of loss through the doctrine of pure comparative negligence.61 Under this form of comparative negligence, the loss

54. WHITE & SUMMERS, supra note 23, at 689-90.
57. Id. at 627-28.
58. See U.C.C. §§ R3-404, R3-405, R3-406, R4-406 (provisions adopting comparative negligence).
59. See, e.g., U.C.C. §§ R3-406 (negligent drawer is precluded from recovery), R4-406 (a failure of drawer to inspect statement of account precludes recovery).
60. See U.C.C. § R3-103(a)(7) (definition of ordinary care).
61. See, e.g., U.C.C. §§ R3-406, R4-406(5), R3-404(b), R3-405(b).
is allocated between the parties to the extent their negligence contributed to the loss.62

A. U.C.C. Section R3-406

Although section R3-406 is expressly limited to forged signatures,63 it is clear the term "forged signatures" is intended to be broad enough to include forged endorsements.64 Under the proposed revisions to section 3-406, as under the current version of the Code, a drawer who substantially contributes to the making of a forged signature is precluded from asserting that defect against a person who in good faith pays the instrument or takes it for value.65 However, unlike the current version of the Code, section R3-406 states that if the person asserting this preclusion against the drawer was negligent, then the loss is allocated between the parties to the extent their negligence contributed to the loss.66 Proposed section R3-406 now allocates the loss to each party to the extent their negligence caused the forged signature.

B. U.C.C. Section R4-406

The customer’s existing duty to discover and report the customer’s unauthorized signature under section 4-406 is continued in the proposed revisions to section 4-406.67 The customer has a duty to exercise reasonable promptness in examining a statement of account68 provided by the bank, to determine whether any

62. See Li v. Yellow Cab Co., 13 Cal. 3d 804, 811, 532 P.2d 1226, 1232, 119 Cal. Rptr. 858, 864 (1975) (pure comparative negligence allocating the damages according to a percentage of total fault).
63. U.C.C. § R3-406(a).
64. See id. §§ R3-406 comment 2, case 2 (explicitly applying section R3-406(a) to a forged endorsement situation), R3-406 comment 4 (explicitly applying section R3-406(b) to a forged endorsement situation). See also id. § R3-406 comment 2 (stating that the law of agency should control to determine whether the signature binds the principal, or is an unauthorized signature).
65. U.C.C. § R3-406.
66. Id. § R3-406(b).
67. Id. § R4-406
68. See id. § R4-406(1) (requirements for a statement of account).
payment or signature was unauthorized. A customer who fails to comply with this duty of inspection is precluded from asserting specified improprieties against the bank. However, under section R4-406, if the bank failed to exercise ordinary care, and that failure substantially contributed to the loss, then the loss is to be allocated between the parties according to the extent their negligence contributed to the loss.

C. U.C.C. Section R3-405

Proposed section R3-405 is limited to forged endorsements where the employer has entrusted an employee with responsibility for instruments as a part of the employee’s duties. When an employer has given such responsibilities to the employee, proposed section R3-405 allocates the risk of loss to the employer for the employee’s fraudulent endorsement of an instrument. However, if the bank has also been negligent, the employer may shift the loss to the bank to the extent the bank

69. Id. § R4-406(3).
70. Id. § R4-406. If the customer neglects the section R4-406(3) duties, the customer is precluded from asserting a claim that the signature was unauthorized if the bank suffered a loss caused by the customer’s failure. Id. § R4-406(4)(a). The customer is also precluded from asserting subsequent forgeries by the same person if the payment was made before the bank received notification of the unauthorized signature. Id. § R4-406(4)(b).
71. Id. § R4-406(5). The R4-406(4) preclusion does not apply if the customer proves the bank did not pay the item in good faith. Id. § R4-406(5).
72. See id. § R3-405(a)(2) (definition of forged endorsement for section R3-405). If the instrument is payable to the employer, the forged endorsement is the purported signature of the employer. Id. § R3-405(a)(2)(i). If the employer is the drawer of the instrument, the forged endorsement is the purported signature of the payee. Id. § R3-405(a)(2)(ii).
73. Id. § R3-405(a)(1) (definition of employee). This definition includes an independent contractor retained by the employer. Id.
74. See id. § R3-405(a)(3) (definition of responsibility with respect to instruments). An employee has responsibility with respect to instruments if the employee can: (1) Sign or indorse instruments on behalf of the employer; (2) processes instruments for deposit to an account for bookkeeping purposes; or (3) prepare or process instruments to be issued in the employer’s name. Id.
75. Id. § R3-405.
76. Id. § R3-405 comment 1.
contributed to the loss. To allocate the loss to either party, the party’s failure must have substantially contributed to the loss. As with the sections discussed above, the adoption of comparative negligence will allocate the loss between the parties according to their fault.

D. U.C.C. Section R3-404(b)

Under section R3-404(b), if the drawer does not intend the payee to have an interest in the instrument, then any endorsement in the name of the payee is effective as to a person who in good faith pays the instrument or takes it for value. If, however, the person who pays the instrument or takes the instrument for value fails to exercise ordinary care, then the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure substantially contributed to the loss.

In addition to these four sections, which represent the adoption of comparative negligence in the proposed revisions to articles 3 and 4, the proposed revisions attempt to limit the jurisdictional variations created by articles 3 and 4. Although a full analysis of the changes is beyond the scope of this Comment, the significant changes dealing with risk allocation are discussed in the following section. Because much of the law of negotiable instruments is factually dependant, the present jurisdictional variations and the

77. Id. § R3-405(b). See U.C.C. §§ R3-405 comment 1 (if bank was negligent, employer may shift to the bank that part of the loss to which the bank’s failure contributed), R3-405 comment 4 (if trier of fact finds that bank failed to exercise ordinary care, and such failure substantially contributed to the loss, then the trier of fact could find a bank liable to the employer to the extent bank’s failure contributed to the loss).

78. Id. § R3-405(b).

79. See id. § R3-404(c) (an endorsement is in the name of the payee if it is substantially similar to the name of the payee).

80. Id. § R3-404(b). Section R3-404(b) also applies where the drawer makes the instrument payable to a fictitious person. Id. Any person in possession of the instrument is the holder of the instrument. Id. § R3-404(b)(1). See id. § R3-404 comment 2 (R3-404 applies to forged check cases).

81. Id. § R3-404(d).

82. See infra notes 148-176 and accompanying text (discussing the allocation of the risk of loss).
solutions proposed by the revised Code will be discussed through the use of a hypothetical.

IV. A HYPOTHETICAL

A. Statement of Hypothetical

Ed Stinn (Stinn), has a bookkeeper, Julie Hajjar (Hajjar), who prepares checks for the signature of Stinn. Hajjar prepares a check payable to Creditor, and gets Stinn to sign the check. Thief, a vice president at Stinn, finds the signed check in Stinn’s office, forges Creditor’s endorsement on the check, and cashes the check at Local Bank (LB). Before hiring Thief, Stinn did not check Thief’s references, ignoring company policy at the time. The check passes through normal banking channels, and is eventually charged to Stinn’s account at Big Bank (BB). Thief disappears without giving the money to Creditor.\textsuperscript{83}

B. Does Stinn Have the Ability to State a Prima Facie Case to Compel BB to Recredit Stinn’s Account?

1. Resolution Under the Current Code

BB, as a drawee bank, may debit only those items from Stinn’s account which are properly payable.\textsuperscript{84} An unauthorized signature

\textsuperscript{83} Several cases arising before the adoption of the Code held that by pursuing a claim against the forger the drawer ratifies the forger’s conduct. \textit{See, e.g.}, Insurance Co. of North America v. Fourth Nat’l Bank of Atlanta, 28 F.2d 933, 935 (5th Cir. 1928) (drawer’s suit against forger ratified forger’s action). Under the Code, however, courts have generally held that the drawer does not ratify the forgery by pursuing the forger. \textit{See, e.g.}, Valley Bank & Trust Co. v. Zions First Nat’l Bank, 656 P.2d 425, 427 (Utah 1982) (declining to require an election of remedies); Twellman v. Lindell Trust Co., 534 S.W. 2d 83, 93-94 (Mo. Ct. App. 1976) (declining to require an election of remedies). \textit{See also} U.C.C. § 3-404(2) (unauthorized signature may be ratified); § 3-404 comment 3 (ratification is to be determined by the rules of agency). \textit{See generally} BAILEY, supra note 25 at 26-14, 26-16-17 (arguing that a good faith claim against the forger should not ratify a forged endorsement, and noting that an explicit reservation of rights by giving notice to the bank under U.C.C. section 1-207 can protect a depositor).

\textsuperscript{84} U.C.C. § 4-401(1).
is "wholly inoperative." An item containing a forged or unauthorized signature is not properly payable. Therefore, a forged signature generally imposes no liability on the person whose name was forged.

The law implies an agreement between the bank and its customer to pay the depositor's checks only in conformity with the depositor's order. Payment of a forged check does not comply with the depositor's order, and therefore payment of a forged check is a breach of contract, which remains actionable under the Code. However, there are several ways that Stinn may be precluded from denying the validity of the unauthorized signature. If the payee of Stinn's check, Creditor, receives the proceeds from the check, then Stinn has no cause of action against BB even though Creditor's endorsement was forged. Another

85. Id. § 3-404(1). See Bridgeport Firemen's Sick & Death Benefit Ass'n v. Deseret Fed. Sav. & Loan Ass'n, 735 F.2d 383, 386 (10th Cir. 1984) (an unauthorized signature is wholly inoperative as that of the person whose name is signed unless the person ratifies it or is precluded from denying it).

86. See Western Casualty & Surety Co. v. Citizens Bank of Las Cruces, 676 F.2d 1344, 1345 (10th Cir. 1982) (item with forged endorsement is not properly payable because the unauthorized endorsement is wholly inoperative); Perini Corp. v. First Nat'l Bank of Habersham County, 553 F.2d 398, 403 (5th Cir. 1977) (a check containing a forged endorsement is not properly payable).

87. BAILEY, supra note 25, at 25-4.

88. See Taylor v. Equitable Trust Co., 269 Md. 149, 157, 304 A.2d 838, 842-43 (1973) (U.C.C. codifies the underlying contract implied between the bank and its customer that the bank will pay only those items which are properly payable); BAILEY, supra note 25, at 25-6 (an implied agreement exists that a drawee bank will pay out the funds of the drawer only on order from the depositor).


90. See U.C.C. § 3-404(1) (an unauthorized signature is wholly inoperative unless the drawer ratifies the signature, or is precluded from denying the signature). There currently exists a jurisdictional split on whether the standards for preclusion under sections 3-404(1) and 3-406 are the same. U.C.C. § R3-403 comment 1 (noting that split of judicial opinion presently exists).

91. See Gotham-Vladimir Advertising, Inc. v. First Nat'l Bank, 27 A.D.2d 190, 277 N.Y.S.2d 719, 722 (1967) (drawer is precluded from recovering from drawer bank where the proceeds of the check reach the intended recipient); Coplin v. Maryland Trust Co., 222 Md. 119, 123, 159 A.2d 356, 358 (1960) (where payee receives proceeds drawer has suffered no loss from drawee bank's breach of duty). Cf. First City Nat'l Bank v. Federal Deposit Ins. Corp., 782 F.2d 1344, 1348 (5th Cir. 1986) (constructive receipt is narrow equitable defense where drawer suffers no injury, thus although funds reached payee beneficially, they were not applied for drawer's intended purpose, and doctrine is
1991 / Allocation of Loss for Forged Checks

way in which Stinn will be precluded from recovery is if the endorsement was authorized through agency principles such as ratification, estoppel, or apparent authority. Under the facts of the hypothetical, Thief had no authority to sign the check, and Creditor did not receive the proceeds of the check. Thus, because estoppel and apparent authority are not implicated by the facts, Stinn has a right to have his account recredited for the amount of the check to Creditor absent a ratification of the unauthorized signature.

2. Resolution under the Proposed Code

The proposed revisions to the Code continue the position that an unauthorized signature is wholly ineffective. Proposed section 4-401(a) states that the bank can only pay those items which are properly payable. Comment 1 to section R4-401 explicitly states that instruments containing forged signatures or endorsements are not properly payable. Thus, under the proposed revisions to the Code, Stinn will continue to have a right to have its account at BB recredited.

C. BB's Defenses to Stinn's Action

The current Code provides two principal defenses which are available to BB under the facts of the hypothetical. One of these defenses, section 3-406, provides that Stinn will be precluded from asserting the unauthorized signature if Stinn's negligent conduct "substantially contributes" to the making of the unauthorized signature.

92. CLARKE, supra note 18, at 6-36.
93. U.C.C. § R3-403(a). While the unauthorized signature is wholly inoperative as that of the person whose name is signed, it does transfer all rights the forger may have in the instrument. Id. § R3-403 comment 2.
94. Id. § R4-401.
95. Id. §R4-401 comment 1.
96. See id. §§ 3-406, 4-406. A third defense arising under section 3-405 is discussed infra notes 148-176 and accompanying text.
97. See infra notes 101-109 and accompanying text (meaning of "substantially contributes").
signature. The other defense is provided in section 4-406, under which Stinn will be precluded if Stinn failed to exercise ordinary care in discovering or reporting the unauthorized signature. The facts of the hypothetical will be analyzed under each of these defenses in the following sections.

1. Current U.C.C. Section 3-406

Under the hypothetical, the issue arises whether Stinn’s failure to examine Thief’s references constitutes negligence substantially contributing to the unauthorized signature. If the answer to this issue is yes, then section 3-406 will preclude Stinn from recovery on the instrument. Thus the crucial inquiry under section 3-406 is what constitutes a substantial contribution to an unauthorized signature.

Although it is uniformly held that a causal connection must exist between the drawer’s negligent act and the loss, jurisdictions disagree as to the standard of causation required by section 3-406. A number of courts have held that the phrase “substantially contributes” creates a negligence test that is no broader than the “substantial factor” test adopted by the Restatement (Second) of Torts. These jurisdictions suggest that

98. U.C.C. § 3-406.
99. Id. § 4-406.
100. WHITE & SUMMERS, supra note 23, at 693-94. See Commercial Credit Equipment Corp. v. First Alabama Bank of Montgomery, 636 F.2d 1051, 1056 (5th Cir. 1981) (failure to examine references of employee who was placed in a position of trust handling large sums of money constitutes negligence).
102. Compare infra notes 101-104 (courts implementing a direct and proximate cause standard) with infra notes 105-109 (courts holding that the term “substantially contributes” implements a shortened chain of causation).
103. See, e.g., Bagby v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 491 F.2d 192, 196-97 (8th Cir. 1974) (“substantially contributes” creates a negligence test no broader than “direct and proximate cause,” because the chain of causation is not shortened, the drawer merely needs to show that the drawer’s negligence was a “substantial factor” in bringing about the forgery). Cf. Dominion Constr., Inc. v. First Nat’l Bank, 271 Md. 154, 163, 315 A.2d 69, 73-74 (1974) (“substantial contribution” test replaced the proximate cause test of pre-Code law with the substantial factor test of Restatement (Second) of Torts section 431). See also Gresham State Bank v. O & K Constr. Co, 231 Or. 106, 119-20, 370 P.2d 726, 732-33 (1962) (“substantially contributes” is equivalent to the
section 3-406 was intended to continue the narrow doctrine of pre-Code estoppel, precluding the drawer only where the drawer’s negligence contributes to the forgery, not merely to the issuance of the checks. Within these jurisdictions the drawer will be precluded from asserting a claim against the drawee less often. Because Stinn’s failure to examine Hajjar’s references contributed to the issuance of the check, not to the forgery itself, it is unlikely that Stinn’s negligence was a substantial factor in bringing about Hajjar’s forgery.

Other courts adopt the view that the Code’s requirement that the negligence must substantially contribute to the loss shortens the chain of causation that the drawee must establish in order to preclude the drawer’s cause of action. These courts hold that if the intent of the Code was to continue the strict estoppel doctrine of prior law, the term “precluded” could have been used without the additional requirement of “substantially contributes.” The negligence need not be a proximate cause of the loss, but need only be a cause in fact by contributing substantially to the loss before the drawer will be precluded. By eliminating the requirement of proximate cause, these jurisdictions shorten the chain of causation, and increase the drawer’s duty to the drawee. Because the chain of causation is shortened, it is more likely that Stinn’s claim will be precluded. However, it is doubtful that a mere

"substantial factor" test of negligence); Commonwealth v. Nat’l Bank and Trust Co., 469 Pa. 188, 193-95, 364 A.2d 1331, 1334-35 (1976) (section 3-406 does not require a showing of more than mere negligence to bar the drawer and rejecting a shortened chain of causation); RESTATEMENT (SECOND) OF TORTS § 431 (1965) (actor’s negligent conduct is legal cause of harm if it is a substantial factor in bringing about the harm). See generally Annotation, supra note 101, at 159-60 (whether substantially contributes is equivalent to a substantial factor test, or shortens the chain of causation).

104. Bagby, 491 F.2d at 197.
106. Thompson, 211 Pa. Super. at 47, 234 A.2d at 34.
107. Fidelity & Deposit Co., 65 Misc. 2d at 621, 318 N.Y.S.2d at 959. In Fidelity the trial court’s use of a proximate cause limitation was held to be error. Id.
108. Id.
failure to examine references would contribute in a substantial manner to the making of the forgery.\textsuperscript{109}

2. Revised U.C.C. Section 3-406

Under the proposed revision to the Code, Stinn will likewise be precluded from asserting the forged signature if Stinn's negligence substantially contributed to the forgery.\textsuperscript{110} The proposed revisions to the Code state that the "substantially contributes" test is intended to be less rigorous than the "direct and proximate cause" test.\textsuperscript{111} The comments to the Code state that conduct will substantially contribute to the loss if the conduct is a contributing cause of the loss, and a substantial factor in bringing the forgery about.\textsuperscript{112} Accordingly, if Stinn's negligence is a contributing cause of the signature and a substantial factor in bringing the forgery about, then Stinn will be viewed as having substantially contributed to the result.\textsuperscript{113} There appears to be no requirement that the conduct be the proximate cause of the loss. This will increase the duty of the drawer to the drawee bank, and preclusion should be established with greater ease.\textsuperscript{114} Thus, the proposed revisions to the Code appear to embrace those cases that have been decided under the present Code interpreting "substantially contributes" as shortening the chain of causation.

If an examination of Thief's references or background would have brought out information which would have prevented the forgery, then Stinn's negligence is a contributing cause of the forgery. However, it is a question of fact whether the failure to


\textsuperscript{110} U.C.C. § R3-406(a).

\textsuperscript{111} Id. § 3-406 comment 2.

\textsuperscript{112} Id.

\textsuperscript{113} Id.

\textsuperscript{114} See id.

1282
1991 / Allocation of Loss for Forged Checks

examine references was a substantial factor in bringing about the forgery.

3. Another Defense Under Current U.C.C. Section 4-406

Section 4-406 differs from section 3-406 by imposing a duty on the customer after the forgery has taken place. Stinn must use reasonable care and promptness in examining its statement of account. Upon discovery of any alterations or unauthorized drawer's signatures Stinn must promptly notify BB, or otherwise be precluded from asserting the existence of subsequent unauthorized signatures or alterations by the same wrongdoer against BB. Stinn's failure to promptly discover and report an altered or forged check renders Stinn liable for the bank's loss on checks within Stinn's statement. However, a customer is less likely to be familiar with the signature of an indorser, and therefore, is not responsible under section 4-406(1) for discovering or reporting a forged endorsement.

Because Stinn is not responsible for reporting a forgery of Creditor's endorsement, Stinn's claim cannot be precluded under section 4-406(1). However, had Thief forged Stinn's signature, or altered the check, then Stinn must act with reasonable care and

115. WHITE & SUMMERS, supra note 23, at 694.
116. U.C.C. § 4-406(1).
117. Although ambiguous, "unauthorized signatures" should not be construed to include forged endorsements. Rapson, Risk of Loss Allocation: Under Articles 3 and 4 as Affected by the Proposed Revisions Thereto, ALI-ABA COURSE OF STUDY; THE EMERGING NEW UNIFORM COMMERCIAL CODE 143, 156 (1990) (hereinafter Rapson).
118. U.C.C. § 4-406(1)-(2). The customer will be precluded from asserting an unauthorized signature or alteration if the bank establishes that it suffered loss by reason of the customer's failure. Id. § 4-406(2)(a). The customer will also be precluded from asserting subsequent forgeries or alterations by the same wrongdoer after the statement was available to the drawer for a reasonable time not exceeding fourteen calendar days. Id. § 4-406(2)(b).
119. U.C.C. § 4-406(2)(c). See WHITE & SUMMERS, supra note 23, at 695 (a customer's failure to promptly discover and report forged checks renders customer liable for the bank's loss on checks reported on the customer's statement of account, and also for any checks written by the same wrongdoer).
120. U.C.C. § 4-406(1). Although there is little excuse for a customer failing to recognize the customer's own signature, the customer does not know the signature of indorser, and may be delayed in discovering the endorsements are forged. Id. § 4-406 comment 5.
promptness in discovering the defect, or be precluded from asserting the defect against BB. Section 4-406 also applies the law of contributory negligence permitting Stinn’s claim, regardless of Stinn’s own negligence, if BB failed to exercise ordinary care in paying the check.¹²¹

Finally, section 4-406(4) provides a statute of limitations, giving a customer an absolute time limit to assert their rights on forged or altered instruments.¹²² Regardless of Stinn’s care, Stinn will be precluded from asserting any impropriety against the bank if Stinn fails to report an unauthorized endorsement within three years from the time of the statement, or if Stinn fails to report an unauthorized signature or alteration.¹²³ No cause of action based on a forger’s signature or alteration survives the application of section 4-406(4), including causes of action for conversion, monies had and received, and breach of contract.¹²⁴

4. Revised U.C.C. Section 4-406

The drawer’s duty to examine a statement of account with reasonable promptness is continued in the proposed revisions to the Code.¹²⁵ The bank must either return the items¹²⁶ paid, or provide information sufficient to allow the customer to identify the items.¹²⁷ The information is sufficient if it describes the item by number, amount, and date of payment.¹²⁸ Upon receipt of sufficient information or the items paid, the customer has a duty to examine the statement or items and determine whether any item

¹²¹ Id. § 4-406(3).
¹²² Id. § 4-406 comment 5.
¹²³ Id. § 4-406(4).
¹²⁵ U.C.C. § R4-406.
¹²⁶ See id. § R4-104(1)(h) (defining “item” as an instrument or promise to pay money handled by a bank for collection or payment).
¹²⁷ Id. § R4-406(a).
¹²⁸ Id. § R4-406(a). See id. § R4-406 comment 1 (number, amount, and date of payment chosen because such information can be obtained from the bank’s computer).
was unauthorized, altered, or contained a forged signature.\textsuperscript{129} If the customer should reasonably discover an unauthorized payment, the customer has a duty to give prompt notification of any impropriety to the bank.\textsuperscript{130} If the customer fails to comply with these duties, the customer is precluded from later asserting the customer’s unauthorized signature, and if the bank suffered a loss due to the customer’s failure, the customer is precluded from later asserting an alteration of the item.\textsuperscript{131} Moreover, if the customer fails to notify the bank of the customer’s unauthorized signature or an alteration of the item within a reasonable time,\textsuperscript{132} the customer will be precluded from asserting subsequent improprieties by the same wrongdoer.\textsuperscript{133} Finally, alterations or forged customer signatures must be reported within one year from the time of the statement, or the customer will be precluded from recovery.\textsuperscript{134}

Because the proposed revisions to section 4-406 deal only with the customer’s unauthorized signature or alterations of the instrument, section R4-406 no longer covers forged endorsements.\textsuperscript{135} Thus, the three year statute of limitations for forged endorsements present in section 4-406 is no longer available under the proposed revisions to section R4-406.\textsuperscript{136} However, proposed section R4-111 imposes a three year statute of limitations on all rights arising under Article 4.\textsuperscript{137} This statute of limitations covers the customer’s right to have its account recredited for improperly paid items under revised section R4-401(1).\textsuperscript{138} Thus,
the drawer, Stinn, must still assert a forged endorsement within three years from the date on which the cause of action accrues. This is the same result as would be provided for under the current U.C.C. section 4-406.139

D. Stinn’s Defenses to BB’s Claim that Stinn is Precluded from Recovery

1. Resolution Under the Present Code

Assuming Stinn is negligent, BB may claim that Stinn’s action for recredit of Stinn’s account is precluded, unless Stinn can assert that BB is contributorily negligent.140 Under the present Code, only a drawee or other payor who in good faith paid the instrument in accordance with reasonable commercial standards can assert the section 3-406 preclusion against a drawer.141 Accordingly, if the bank fails to use ordinary care in paying the instrument, the bank cannot assert the customer’s failure to discover and report unauthorized signatures under section 4-406 as a defense to the customer’s action for recredit of its account.142 Thus, BB’s failure to observe reasonable commercial standards permits Stinn’s claim against BB that the check with Creditor’s forged endorsement was not properly payable, regardless of Stinn’s culpability.143

139. U.C.C. § 4-406(4).


141. U.C.C. § 3-406. Reasonable commercial standards are those prevalent within the drawee’s business. Id.

142. Id. § 4-406(3).

143. Id.
2. Resolution Under the Proposed Revisions to the Code

In comparison to the all or nothing liability imposed by the present Code, the proposed revisions to sections 3-406 and 4-406 adopt a scheme of comparative negligence for negotiable instruments. If the bank fails to exercise ordinary care in paying the check, the loss is allocated between the parties according to the extent their negligence contributed to the loss. Under the hypothetical facts, Stinn would be able to recover from BB only to the extent that Stinn’s negligence did not contribute to the forgery. In clear contrast to the present Code, there are no circumstances where Stinn would be allowed full recovery, if Stinn’s negligence contributed to the forgery.

E. A Possible Third Defense

Where the drawer is an employer, a third defense is available within the Code. To analyze this defense it is necessary to alter the facts of the hypothetical to indicate that Hajjar, Stinn’s bookkeeper, wrote a check to Thief, whose name had fraudulently been added to the books as a creditor, with the intention of forging Thief’s endorsement after obtaining Stinn’s signature. Hajjar obtains Stinn’s signature, forges Thief’s endorsement, and cashes the check at BB.

144. Id. §§ R3-406(b), R4-406(5).
145. Visual examination of the check is not required by a payor bank if the bank’s procedure is reasonably and commonly used by other comparable banks in the area. See id. § R4-406 comment 4 (rejecting prior split of authority between jurisdictions as to whether visual examination is required).
146. Id. §§ R3-406(b), R4-406(5). However, if the bank fails to pay the item in good faith, the preclusion provision of section R4-406(4) does not apply and the bank will be liable for all of the loss. Id. § R4-406(5).
147. Compare id. §§ R3-406, R4-406 (adopting a system of comparative fault allocating loss as a percentage of total fault) with Ed Stinn Chevrolet, Inc. v. National City Bank, 28 Ohio St. 3d 221, 226, 503 N.E.2d 524, 530 (1986) rev’d in part 31 Ohio St. 3d 150, 509 N.E. 2d 945 (1987) (party 85% at fault could potentially recover from party 15% at fault).
1. Resolution Under the Present Code

Section 3-405 provides that an endorsement by any person in the name of the payee is effective in three circumstances.\(^{148}\) The first is where an imposter induces the drawer to issue the instrument to the imposter or a confederate.\(^{149}\) The second is where a person who signs as, or on behalf of, the drawer intends for the payee to have no interest in the instrument.\(^{150}\) Finally, the situation in which an agent or employee of the drawer supplies the drawer with the name of the payee, intending the payee to have no interest in the instrument.\(^{151}\) Fact patterns which arise under these three situations are generally referred to as the imposter, fictitious payee, and the padded payroll cases, respectively.\(^{152}\)

Unlike sections 3-406 and 4-406, the drawer is not precluded from asserting that the item is not properly payable because of a forged endorsement. Instead, when section 3-405(1) applies, the endorsement is effective as though it were the endorsement of the true owner.\(^{153}\) Moreover, because the endorsement is effective, a

\(^{148}\) U.C.C. § 3-405(1). See May Department Stores Co. v. Pittsburgh Nat’l Bank, 374 F.2d 109, 110 (3rd Cir. 1967) (employee caused drawer to issue checks to fictitious payee, then forged endorsement and cashed the checks); Fidelity & Casualty Co. v. First City Bank, 675 S.W.2d 316, 317 (Tex. App. 1984) (employee submitted required check forms purportedly on behalf of a creditor, and forged the endorsements); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Chemical Bank, 57 N.Y.2d 439, 456 N.Y.S.2d 742, 744, 442 N.E.2d 1253, 1255 (1982) (employee provided employer with false creditor’s names, intercepted checks, and forged the endorsements on the checks). While a detailed examination of section 3-405 is beyond the scope of this Comment, a broader discussion of this section can be found in Triantis, Allocation of Losses from Forged Endorsements on Checks and the Application of § 3-405 of the Uniform Commercial Code, 39 OKLA. L. REV. 669 (1980); Note, U.C.C. Section 3-405: Of Impostors, Fictitious Payees, and Padded Payrolls, 47 FORDHAM L. REV. 1083 (1979); Comment, The Resolution of Padded Payroll Cases by the Uniform Commercial Code: A Pandora’s Box, 9 B.C. INDUS. & COM. L. REV. 257 (1968); and Harbus, The Great Pretender: A Look at the Impostor Provision of the Uniform Commercial Code, 47 U. CIN. L. REV. 385 (1978).

\(^{149}\) U.C.C. § 3-405(1)(a).

\(^{150}\) Id. § 3-405(1)(b).

\(^{151}\) This provision applies only to an agent or employee of the drawer who supplies the drawer with the name of the payee. Id. § 3-405 comment 4. See Snug Harbor Realty Co. v. First Nat’l Bank of Toms River, 103 N.J. Super. 372, 373, 253 A.2d 581, 582, (1969) aff’d 54 N.J. 95, 253 A.2d 545 (1969) (section 3-405 is inapplicable where employee supplies employer with name of actual creditor who had submitted invoices for work performed).

\(^{152}\) See Triantis, supra note 148, at 680.

\(^{153}\) WHITE & SUMMERS, supra note 23, at 699.
subsequent holder is unable to assert a breach of the warranty of good title and the warranty of presentment against a prior holder in the stream of endorsements. Thus, the check is valid, must be paid, and the loss will be borne by the drawer.

Section 3-405 reflects the policy that the loss should fall on the employer, because the employer is in the best position to prevent the loss by the careful selection and supervision of employees. The present Code does not require the bank to pay the instrument with ordinary care, or with the observance of reasonable commercial standards. Because of the absence of these requirements, section 3-406 has been referred to as a banker’s provision, and should be expanded with great reluctance.

Under section 3-405, the drawer will always bear the risk of loss, even when the bank fails to exercise ordinary care. Therefore, courts have attempted to limit the scope and impact of section

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154. See U.C.C. § 4-207(a)(1) (warranty of good title).
155. See id. § 3-417(1) (warranty of presentment).
156. E.F. Hutton & Co. v. City Nat’l Bank, 149 Cal. App. 3d 60, 71, 196 Cal. Rptr 614, 621 (1983) (plaintiff’s breach of warranty action was defective where plaintiff failed to plead facts negating padded payroll, exclusion which made the forged endorsement effective); Brighton Inc. v. Colonial First Nat’l Bank v. Avenel Realty Co., 176 N.J. Super. 101, 422 A.2d 433, 439 (1980) aff’d 86 N.J. 259, 430 A.2d 902 (1981) (because the endorsement is effective, a collecting bank’s liability under the section 4-207 warranty is precluded); Sun ‘N Sand v. United California Bank, 21 Cal. 3d 671, 687, 582 P. 2d 920, 931, 148 Cal. Rptr. 329, 340 (1978) (because the endorsement is effective no warranty has been breached). See Triantis, supra note 148, at 681 (the effective endorsement preserves the chain of title and satisfies the Code’s warranties of title under sections 3-417 and 4-207).
158. U.C.C. § 3-405 comment 4. The loss is a risk of the employer’s business enterprise, and the cost of fidelity insurance is an expense of the employer’s business. Id. Arguably, the employer is also in the best position to guard against the loss from impostors by identifying the proper party to whom to issue the check. Triantis, supra note 148, at 680. Also, the employer is in the best position to prevent fictitious payees by exercising care in granting the authority to issue checks on the employer’s behalf. Id.
160. WHITE & SUMMERS, supra note 23, at 710 (a banker’s provision written “by them and for them”).

1289
To avoid this apparent inequity, a few jurisdictions require strict compliance with the language of the Code, requiring a precise match between the endorsed name and the name of the payee. Although section 3-405 does require the endorsement to be in the name of the payee, compliance with the spirit of the Code should require only a "substantial similarity" between the endorsed name and the name of the payee. This is because the Codes definition of a signature is purposefully broad to include any symbol executed with the present intention of authenticating a writing. Moreover, under the Code, a signature consists of the use of any name on an instrument, or the use of any word or mark in lieu of a written signature. To be so liberal in defining a signature and so restrictive by requiring an exact match appears inconsistent.

There are other techniques courts utilize to limit the effect of section 3-405. One is to expand the duty of good faith that section 1-203 of the Code imposes on all transactions governed by the Code. Consistent with this duty most courts require the bank to have acted in good faith before the bank may assert that the

161. Triantis, supra note 148, at 680. See WHITE & SUMMERS, supra note 23, at 707 (arguing that where both parties have been negligent the bank should bear the loss, as with sections 3-406 and 4-406).

162. See Consolidated Public Water Supply District No. C-1 v. Farmers Bank, 686 S.W.2d 844, 850 (Mo. Ct. App. 1985) (citing Twellman v. Lindell Trust Co., 534 S.W.2d 83, 92-93 (Mo. Ct. App. 1976)) (a forged endorsement must be exactly the same as the named payee for the section 3-405 preclusion provision to apply); First Nat'l Bank of Neenah v. Security Nat'l Bank of Springfield, 32 U.C.C. Rep. Serv. 926, 934 (Mass. Dist. Ct. 1981) (imposter defense of section 3-405 is not applicable where the endorsement is in a name slightly different than that of the named payee); Seattle-First Nat'l Bank v. Pacific Nat'l Bank, 22 Wash. App. 46, 587 P.2d 617, 623 (1978) (requiring endorsement to be in the exact name of the payee to be effective under section 3-405). See also Triantis, supra note 148, at 682 (courts may require an exact match to limit the impact of section 3-405).

163. U.C.C. § 3-405(1).

164. See Kraftsman Container Corp. v. United Counties Tr., 169 N.J. Super. 488, 404 A.2d 1288, 1291 (1979) (endorsement must be "substantially identical" to the name of the named payee); Western Casualty & Surety v. Citizens Bank of Las Cruces, 676 F.2d 1344, 1346 (10th Cir. 1982) (difference in spelling in no way affects the purposes of section 3-405, which are to ensure: (1) The normal appearance of the check; and (2) the person negotiating the check can be identified as the named payee).

165. U.C.C. § 1-201(39).

166. Id. § 3-401(2).

167. See U.C.C. § 1-203 (duty of good faith).
1991 / Allocation of Loss for Forged Checks

endorsement is effective against the drawer. The Code and a majority of jurisdictions define good faith as honesty in fact. However, other jurisdictions have broadened bad faith to include gross negligence or willful ignorance, so that the bank's culpability is a factor in determining whether the bank will bear the loss.

Another technique employed by a few jurisdictions, including California, is to limit the application of section 3-405 by utilizing common law actions. This enables these jurisdictions to hold that it is irrelevant whether the endorsement is effective because the bank's negligence was a breach of a duty to the drawer independent of the Code. Still other jurisdictions do not permit a bank that cashes a check to assert the section 3-405 defense that

168. Trantis, supra note 148 at 683. See Kraftsman Container Corp. v. United Counties Trust Co., 169 N.J. Super 488, 404 A.2d 1288, 1291 (1979) (although simple negligence does not bar a bank from invoking section 3-405 as a defense, bad faith will bar the bank's claim). Bad faith may be evidenced by a consistent failure by the bank to monitor and investigate a series of irregular transactions. Id. 404 A.2d at 1293. Cf. Prudential-Bache Securities, Inc. v. Citibank, 73 N.Y.2d 263, 536 N.E.2d 1118, 1124-25, 539 N.Y.S.2d 699, 705-06 (1989) (a bank cannot use section 3-405 to shield its own dishonesty, because such conduct false outside the allocation of risk encompassed by section 3-405); Consolidated Public Water Supply Dist. No. C-1 v. Farmers Bank, 686 S.W.2d 844, 853 (Mo. App. 1985) (section 3-405 does not permit recovery against a bank that pays an instrument in good faith).


171. Trantis, supra note 148, at 685. See International Industries, Inc. v. Island State Bank, 348 F. Supp. 886, 888 (S.D. Texas 1971) (drawer permitted to sue a collecting bank under a theory of money had and received); Sun N' Sand, Inc. v. United California Bank, 21 Cal. 3d 671, 696, 582 P.2d 920, 937, 148 Cal. Rptr. 329, 346 (1978) (section 3-405 does not preclude a common law negligence action). But see Western Casualty & Surety v. Citizens Bank, 676 F.2d 1344, 1347 (10th Cir. 1982) (section 3-405 displaces a common law negligence action); Consolidated Public Water Supply Dist. C-1 v. Farmers Bank, 686 S.W.2d 844, 853 (Mo. App. 1985) (section 3-405 permits no common law negligence action); Fidelity & Casualty Co. v. First Nat'l Bank, 675 S.W.2d 316, 319 (Tex. Civ. App. 1984) (because the endorsement is effective, the final payment rule of section 3-418 precludes liability for negligence, conversion, and monies had and received).

the endorsement is effective.\textsuperscript{173} These jurisdictions refuse these banks the right to assert a section 3-405 defense by considering the bank which cashes a check to be a purchaser of the check and not a collecting bank as required under section 3-405.\textsuperscript{174}

Returning to the facts in this variation of the hypothetical, Hajjar supplied Stinn with Thief’s name, not intending for Thief to have an interest in the instrument. This falls within the padded payroll rule of 3-405(1)(c), and Hajjar’s forgery of Thief’s endorsement is effective.\textsuperscript{175} Because the endorsement is effective, the check becomes properly payable and when BB pays the item, it does so properly. The Code allocates the loss to Stinn, regardless of his culpability, and anticipates that Stinn will absorb the loss as a cost of Stinn’s business.\textsuperscript{176}

2. Proposed Revisions to U.C.C. Section 3-404 and 3-405

The proposed revisions to the Code separate the work done by present section 3-405 into two sections, R3-404 and R3-405. Section R3-404 covers only those situations where a person does not intend\textsuperscript{177} for the payee to have an interest in the instrument, or where the payee is a fictitious person.\textsuperscript{178} In either of those situations, the proposed revisions to the Code provide that any person in possession of the instrument is the holder of the instrument, and an endorsement in the name of the payee is effective in favor of any person who in good faith pays the instrument or accepts the instrument for value.\textsuperscript{179} These are the


\textsuperscript{174} Bd. of Higher Educ., 383 N.Y.S.2d at 511 (bank that cashes check is a "purchaser," not a collecting bank).

\textsuperscript{175} U.C.C. § 3-405.

\textsuperscript{176} See U.C.C. § 3-405 comment 4(b).

\textsuperscript{177} See U.C.C. § R3-110(a) (defining person whose intent determines to whom an instruments is payable).

\textsuperscript{178} Id. § R3-404(b).

\textsuperscript{179} Id. §§ R3-404(b)(1)-(2).
same consequences as would be achieved in these situations under
the present Code.

Rejecting those cases which limited the impact of current
section 3-405 by not permitting a bank which cashed a check to
assert the present section 3-405 defenses, the proposed
revisions to the Code now expressly permit a bank which cashes a
check to raise section R3-404 as a defense. Section R3-404(b)(2) accomplishes this by providing that any person who takes
the instrument for value may assert that the endorsement is
effective. Since a bank that cashes a check takes the instrument
for value, that bank may assert that the endorsement is effective.
Also, section R3-404 rejects those cases which require the
endorsement to be in the exact name of the named payee.
Rather, the proposed revisions to the Code adopt the position that
the endorsement must be only substantially similar to the name of
the payee for the endorsement to be effective. Although this
will decrease a drawer's chances of recovery, it is in compliance
with the spirit of the Code, which requires that the Code be
liberally construed and applied to promote a policy of
simplification.

Although proposed section R3-405 governs those cases covered
by the existing padded payroll provision, section 3-405(1)(c),
proposed section R3-405 is broader, covering situations where an
entrusted employee forges the employer's signature on an
endorsement. If an employee did not intend to misappropriate
the instrument until after the instrument was drawn, then proposed
section R3-405 controls. Where an employee has been

180. See supra notes 148-176 and accompanying text (discussing section 3-405 limitations).
181. U.C.C. § R3-404(b).
182. Id. § R3-404(b)(2).
183. See, e.g., Consolidated Public Water Supply District No. C-1 v. Farmers Bank, 686 S.W.2d 844, 850 (Mo. Ct. App. 1985) (forged endorsement must be exactly the same as that of the
named payee). See also supra note 162 and accompanying text (cases holding endorsed name must
be in the exact name of the payee).
184. U.C.C. § R3-404(c). See id. § R3-404 comment 1 (noting that section 3-404(c) only
requires that the endorsement be substantially similar to that of the named payee).
185. U.C.C. § 1-201(1)-(2).
186. Id § R3-405.
187. U.C.C. § R3-404 comment 2, case 2.
entrusted with responsibility for instruments, section R3-405 makes the employee’s fraudulent endorsements effective for a person who in good faith pays an instrument or accepts the instrument for value. Section R3-405 reflects the belief that the employer is in a much better position to avoid the loss through the careful selection and supervision of employees.

Despite the above limitations, section R3-405 is favorable to an employer in at least one respect. Under the present Code, the bank is entitled to assert the section 3-405 defense regardless of the bank’s culpability, so long as the bank accepted the check in good faith. However, under the proposed revisions to the Code, part of the loss may be recovered by the employer from the bank, to the extent the bank’s failure to exercise ordinary care contributed to the loss. This recovery by the drawer is now permitted under both section R3-404 and R3-405. Specifically, the statute provides that if the person who pays the instrument fails to exercise ordinary care, the person bearing the loss may recover from that person to the extent the failure to use ordinary care contributed to the loss. In this way the drawer may recover from the bank the amount of the loss that the bank caused by its negligence. The effect is to limit some of the harsh result under the present section 3-405.

Returning to the hypothetical, as a bookkeeper who has the authority to prepare a check payable to a fictitious creditor, Hajjar has the authority to prepare instruments for the employer’s signature. This authority defines Hajjar as an employee entrusted with responsibility, and under section R3-405 Hajjar’s fraudulent endorsement is effective.

188. Id. § R3-405(a)-(b).
189. Id. § R3-405 comment 1.
190. Cf. id. § R3-405 comment 2 (section R3-405 is more favorable than present Code section 3-405 by permitting the drawer to assert the bank’s negligence).
191. Id. § R3-405 comment 2 (explaining differences with present Code).
192. Id. §§ R3-405(b), R3-404(d). This failure must substantially contribute to the loss. Id.
193. See id. §§ R3-404, R3-405.
194. Id. §§ R3-405(b), R3-404(d).
195. See id. § 3-405(a)(3) (definition of responsibility).
196. Id. § 3-405(b).
negligence by BB, Stinn will be unable to have its account recredited because the item was properly payable.\textsuperscript{197} If, however, BB was negligent, then Stinn will recover to the extent BB's negligence contributed to the loss.\textsuperscript{198}

\textbf{F. Whether Stinn May Assert a Claim Directly Against LB}

Before the Code was adopted, the law was unclear on whether the drawer had a direct cause of action against a collecting bank or against another person who took a check with a forged endorsement and received payment.\textsuperscript{199} This uncertainty has continued under the Code, producing mixed and uncertain case law.\textsuperscript{200} The Code does not expressly provide for such an action. It can be argued that the absence of such a provision indicates an intention to not permit such an action.\textsuperscript{201} Other jurisdictions, encouraged by the policy of preventing circuity of suits\textsuperscript{202} permit a direct suit against the collecting bank, manipulating the language of the Code to fit their needs.\textsuperscript{203} Within the jurisdictions permitting suit, several potential causes of action are permitted,
including causes of action for breach of warranty,\textsuperscript{204} negligence,\textsuperscript{205} and conversion.\textsuperscript{206}

1. Can Stinn Assert a Breach of Warranty Against LB?

a. Resolution Under the Current Code

i. Warranties

There is a clear split of authority among jurisdictions on whether the warranty of good title provided for in section 4-207(1)(a) and the warranty of presentment provided by section 3-417(1) run to the drawer.\textsuperscript{207} The warranty of presentment present in section 4-207(1) is available only to a payor bank or any other payor who pays or accepts the item.\textsuperscript{208} Several jurisdictions, including California, have held that the drawer is an "other payor," so that the warranty of title runs directly to the drawer.\textsuperscript{209} These courts hold that because the drawer's account is debited for the amount of the check, the drawer is the party that ultimately pays and, thus, is a payor entitled to assert the warranty of good title.\textsuperscript{210} Support for this conclusion arises from the argument that because section 4-207 (b)(ii) and (c)(ii) expressly exempt the drawer from the warranties of a holder in due course, the drawer should be given the warranty of good title by negative

\textsuperscript{204} See supra notes 207-217 and accompanying text (discussing cause of action for breach of warranty).

\textsuperscript{205} See supra notes 221-222 and accompanying text (discussing cause of action for common law negligence).

\textsuperscript{206} See supra notes 224-226 and accompanying text (discussing cause of action for conversion).


\textsuperscript{208} U.C.C. § 4-207(1).

\textsuperscript{209} Sun 'N Sand, 21 Cal. 3d at 682, 582 P.2d at 928, 148 Cal. Rptr. at 337; Insurance Co. of North America v. Atlas Supply Co., 172 S.E.2d 632, 636 (Ga. App. 1970) (drawer whose account is debited is a payor entitled to assert the section 4-207 warranties).

\textsuperscript{210} Insurance Co. of North America, 172 S.E. 2d at 636.
implication.\textsuperscript{211} For these reasons, and because the drawer is a person who pays in good faith, these cases state that the warranty of presentment under section 3-417(1) also runs to the drawer.\textsuperscript{212}

It has also been suggested by other courts that the drawer is a third party beneficiary of a collection warranty under common law contract principles.\textsuperscript{213} Several jurisdictions have permitted this cause of action for breach of warranty, finding that the drawer is the legal assignee of the drawee's warranty claims under sections 4-207(1)(a) and 3-417(1).\textsuperscript{214} Other jurisdictions which have permitted recovery include Illinois,\textsuperscript{215} Indiana,\textsuperscript{216} and Wisconsin.\textsuperscript{217}

Other jurisdictions do not permit the drawer to directly sue the depositary bank.\textsuperscript{218} These courts recognize that the drawer's remedy against the drawee bank for recredit of the drawer's account is sufficient.\textsuperscript{219} Moreover, these cases conclude that the drawer is not an "other payor," and that the warranties of title made by the depositary bank do not run to the drawer.\textsuperscript{220} These

\begin{itemize}
\item \textsuperscript{211} \textit{Sun N' Sand}, 21 Cal. 3d at 682, 582 P.2d at 928, 148 Cal. Rptr. at 337.
\item \textsuperscript{212} Id.
\item \textsuperscript{213} Allied Concord Fin. Corp. v. Bank of America, 275 Cal. App. 2d 1, 3-4, 80 Cal. Rptr. 622, 624 (1969) (the benefit of warranties by a bank which negotiates a check extends to drawer).
\item \textsuperscript{214} International Indus., Inc. v. Island State Bank, 348 F. Supp. 886, 888 (S.D. Tex. 1971) (assignment of drawee's breach of warranty to drawer); Nat'l Bank & Trust Co. of Central Penn. v. Commonwealth, 9 Pa. Commw. 358, 305 A.2d 769, 770 (1973) (assignment of rights from drawee bank to drawer).
\item \textsuperscript{216} Insurance Co. of North America v. Purdue Nat'l Bank of Lafayette, 401 N.E.2d 708, 714 (Ind. Ct. App. 1980) (drawer is an "other payor" who may claim the benefit of the warranties created by the Code).
\item \textsuperscript{217} See Fidelity & Deposit Co. of Md. v. First Nat'l Bank of Kenosha, 98 Wis. 2d 474, 297 N.W.2d 46, 49 (1980) (indicating that a direct action may lie, although bank not liable because of drawer's negligence); Prudential Ins. Co. v. Marine Nat'l Exch. Bank, 315 F. Supp. 520, 522 (E.D. Wis. 1970) (permitting a direct suit by the drawer against a depositary bank under Wisconsin law).
\item \textsuperscript{218} See Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 184 N.E.2d 358, 363 (1962) (drawer not permitted to directly sue a collecting bank); Brighton Inc. v. Colonial First Nat'l Bank, 176 N.J. Super. 101, 422 A.2d 433, 442-43 (1980) (only claim drawer could assert against collecting bank was a claim sounding in fraud, which fell outside the scope of the Code); Life Ins. Co. of Virginia v. Snyder, 141 N.J. Super 539, 358 A.2d 859, 862 (1976) (drawer not permitted to sue collecting bank on a theory of warranty).
\item \textsuperscript{219} Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 184 N.E.2d 358, 363 (1962),
\item \textsuperscript{220} Brighton Inc. v. Colonial First Nat'l Bank, 176 N.J. Super 101, 422 A.2d 433, 442 (1980).
\end{itemize}
jurisdictions recognize that the drawer is not a payor merely because the drawer's account is debited. In the author’s opinion, this should represent the preferred view, because this view probably more closely tracks the meaning and intent of the Code.

ii. Other Causes of Action

There is also a judicial split on whether Stinn will be able to assert an affirmative claim of negligence or conversion against LB. Although a few courts permit a cause of action for common law negligence, generally a negligence cause of action is denied.

In addition, an action for conversion of a forged endorsement may also be available. The Code explicitly permits an action for conversion on a forged endorsement. To the extent that an action for conversion under the Code is not available to a plaintiff, a common law action for conversion may be available. However, for an action in conversion to exist, the drawer must have a property interest in the check. Many courts maintain that the

221. Compare Stone & Webster, 184 N.E.2d at 363 (drawer is not permitted to sue a collecting bank using a negligence cause of action) with Sun N' Sand, Inc. v. United California Bank, 21 Cal. 3d 671, 696, 582 P.2d 920, 937, 148 Cal. Rptr. 329, 346 (1978) (permitting a common law negligence action).

222. See, e.g., Sun N' Sand, 21 Cal. 3d at 696, 582 P.2d at 937, 148 Cal. Rptr. at 346. See generally Triantis, supra note 148, at 677 (failure to verify the identity of holder of check or validity of endorsement has been held to be actionable on grounds of negligence).

223. See Western Casualty & Surety v. Citizens Bank, 676 F.2d 1344, 1347 (10th Cir. 1982) (section 3-405 displaces a common law negligence action); Fidelity & Casualty Co. v. First Nat'l Bank, 675 S.W.2d 316, 319 (Tex. Civ. App. 1984) (because the endorsement is effective, the final payment rule of section 3-418 precludes liability for negligence, conversion, and monies had and received); Consolidated Public Water Supply Dist. C-1 v. Farmers Bank, 686 S.W.2d 844, 853 (Mo. Ct. App. 1985) (section 3-405 permits no common law negligence action). See also WHITE & SUMMERS, supra note 23, at 711 (arguing that courts should be hesitant to adopt affirmative claims of negligence).

224. U.C.C. § 3-419(1)(c). Clearly, where the right to the check has passed to the payee, the payee has a cause of action for conversion. See Annotation, Payee's Right of Recovery in Conversion Under U.C.C. § 3-419(1)(c), for Money Paid on Unauthorized Indorsement, 23 A.L.R. 4th 855 (1983).

225. Triantis, supra note 148, at 673.
rights of ownership belong not to the drawer but to the intended payee only, thus precluding an action for conversion.\textsuperscript{226}

\textbf{b. Resolution Under the Revised Code}

\textit{i. Warranties}

The proposed revisions to the Code do not give the drawer the benefit of the warranties provided by the Code. The presentment warranties found in sections R3-417\textsuperscript{227} and R4-208\textsuperscript{228} provide that only the drawee has the right to recover damages based on these warranties.\textsuperscript{229} By deleting the words "other payor" found in present section 4-207(1)(a) from the current presentment warranties, the drafters of the revised Code reject those cases which held that the drawer can be held to be an other payor.\textsuperscript{230} The result in these cases is expressly rejected by comment 2 to section R3-417.\textsuperscript{231} Additionally, comment 2 to section 3-417 states that no warranty is made to the drawer when presentment is made to the drawee under section 3-417(a).\textsuperscript{232} The apparent procedure mandated by the proposed Code is that the drawer must sue the

\textsuperscript{226} See Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 184 N.E.2d 358, 362 (Mass. 1962) (check would be valuable property in the hands of the payee); Central Cadillac, Inc. v. Stern Haskell, Inc., 356 F. Supp. 1280, 1287 (S.D.N.Y. 1972) (drawer has no action against collecting bank for conversion of checks bearing forged endorsements); Life Ins. Co. of Virginia v. Snyder, 141 N.J. Super. 359, 358 A.2d 859, 862 (N.J. Dist. Ct. 1976) (because drawer did not have the right to possession of check the elements of conversion were lacking).

\textsuperscript{227} The presentment warranty under section R3-417 provides that a person obtaining payment or acceptance of a draft, at the time of presentment, and previous transferrers of the draft, at the time of transfer, warrant to drawee who pays or accepts the draft in good faith that: (1) They are, or were, persons entitled to enforce the draft at the time they transferred the draft; (2) that the draft has not been altered; and (3) that the warrantor has no knowledge that the drawer's signature is unauthorized. U.C.C. § R3-417(a). See id. § R3-104(f) (definition of draft).

\textsuperscript{228} The presentment warranties provided for under the proposed revision to section R4-208 conform to those given by section R3-417. However, the term "draft" is defined by section R4-104(1)(g) to include those items, other than instruments, which are orders. Id. § R4-208 comment. See id. § R4-104(1)(g) (definition of draft).

\textsuperscript{229} Id. § R4-104(1)(g).

\textsuperscript{230} U.C.C. §§ R3-417(a), R4-208(1). See Sun N' Sand, Inc. v. United California Bank, 21 Cal. 3d 671, 682-83, 582 P.2d 920, 928, 148 Cal. Rptr. 329, 337 (1978) (drawer of check is payor of check and may assert an action for breach of warranty against a collecting bank).

\textsuperscript{231} U.C.C. § R3-417 comment 2.

\textsuperscript{232} Id. § R3-417 comment 2.
drawee bank for recredit of the drawer's account. The drawee bank can then recover from the depositary/collecting bank under the presentment warranties. Thus, under the proposed revisions, Stinn will be unable to assert a claim against LB for breach of warranty.

**ii. Other Causes of Action**

Although a conversion action still exists in the proposed revisions to the Code, the drawer is unable to bring such an action. The drawer's right to have its account recrated under section R4-401(1) is considered an adequate remedy. Arguably, because the drawer's remedy is adequate, no negligence action should be allowed under the proposed revisions to the Code. However, there is no clear impediment for a court to permit an affirmative claim based on negligence, which may continue to be viewed as proper under certain circumstances.

Because the apparent procedure mandated by the proposed revisions to the Code is for the drawer to sue the drawee bank, Stinn will have no claim against LB on Stinn's warranties of presentment. Moreover, the drawer's remedy for recredit of the drawer's account is stated to be adequate. In sum, absent causes of action falling outside the Code, Stinn will be unable to assert any claim against LB.

233. *Id.* § R4-401(1).
235. U.C.C. § R3-420(a). Code section R3-420 provides that a drawer, a maker, or an acceptor of an instrument may not assert an action for conversion. *Id.*
236. *Id.* § R3-420 comment 1.
237. *Cf.* WHITE & SUMMERS, *supra* note 23, at 712 (common law negligence action may be proper in certain circumstances).
238. U.C.C. § R4-401(1).
239. *Id.* § R4-401(1).
V. CONCLUSION

The proposed revisions to the Code dealing with the allocation of the risk of loss may be placed into two broad categories. The first category consists of those changes which are attempts to clarify and correct those provisions of existing law that have caused interpretive difficulties for the courts. These modifications can be characterized as changes motivated by a desire for interjurisdictional uniformity. In the area of negotiable instruments uniformity will breed certainty, allowing a bank to adopt cost-effective policies which its employees can follow. This area is one in which it may be more important to have the law settled, rather than having it settled right. Any movement towards uniformity is to be applauded.

However, this attempt to encourage uniformity will continue to be frustrated by the refusal of the Code’s drafters to expressly deal with the availability of remedies outside the ambit of the Code. It appears that at one time a blanket prohibition on such suits was considered, and then rejected because of potentially wide ranging and unpredictable effects. The proposed revisions to the Code suggest that the drawer’s account under section 4-401 is sufficient, implying that actions outside the Code are prohibited. However, this suggestion may be limited to denying the drawer an action in conversion because of its placement within the conversion section, and should not affect the availability of a common law negligence action. Moreover, the refusal to adopt an explicit prohibition against actions outside the Code may be seen as condoning suits within those jurisdictions that currently allow

240. Rubin, supra note 56, at 628.
242. Id. (quoting Burnet v. Coronado Oil & Gas Co., 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting)) ("It is more important that the applicable rule of law be settled than that it be settled right.").
243. See supra notes 233-239 and accompanying text (discussing whether causes of action such as negligence are available to a drawer under the proposed revisions to the Code).
244. Rubin, supra note 56, at 653.
245. U.C.C. § R3-420 comment 2.
common law actions. These suits include actions claiming negligence. Also, commentators have suggested that because of uncertainties in the drafting and intent of the proposed Code, common law principles are necessary to fill the gaps left by the drafters. However, by failing to deal with this issue, the proposed Code will cause needless confusion, costs, and litigation.

The second category, the allocation of the risk of loss through the adoption of comparative fault, may be considered equitable in nature. An allocation of loss according to fault comports with an intuitive sense of justice, and will eliminate the seemingly inequitable result of cases like *Ed Stinn Chevrolet, Inc. v. National City Bank*. In a change favoring the drawer, the adoption of comparative fault in sections R3-404, and R3-405 is especially significant because of its recognition of a bank's culpability in allocating fault. These changes will create a more equitable result which will further a goal of uniformity, because courts will not feel the need to look beyond the Code for just solutions.

It can also be argued that any movement away from all or nothing liability will promote settlements. Each side will want to avoid costly litigation, and may be willing to settle the claim rather than leave a disputed amount up to the impulses of a jury. Also, each party may recognize partial responsibility for the loss, and a compromise position may be easier to reach than one where the liability is all or nothing. However, because comparative negligence may invite arbitrary and inconsistent jury findings, a rule which mandates a sure outcome may have been better for this area of the law to increase the certainty of a particular outcome. Any uncertainty in the outcome of litigation may have significant ramifications for the policies that a bank may adopt. Under the present version of the Code, a bank that was negligent was

247. *Id.*
248. 28 Ohio St. 3d 221, 221, 503 N.E.2d 523, 526 (1986) (holding a party 85% at fault could potentially recover the full amount of liability from a part 15% at fault).
249. *See supra* notes 190-194 and accompanying text (contrasting proposed sections R3-404 and R3-405 with present section 3-405).
responsible for the full amount of the forged check. Under the proposed revisions such a bank will be liable only to the extent that its negligence contributed to the loss. Thus, it may become cost-effective for a bank to relax its preventative policies and absorb the cost of suits as a cost of doing business. Finally, comparative negligence also invites factual hearings involving substantial expense, which may disable some drawers from pursuing a recovery.²⁵⁰

Proposed Articles 3 and 4 continue to remain bankers’ provisions. The adoption of the comparative negligence principles, while equitably justifiable, may exact an economically excessive price on both litigants and the banking industry. The movement towards uniformity, while admirable, falls short of the certainty required in this area.

James Stuart Bailey

²⁵⁰ Rubin, supra note 56, at 650.