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**BILLS AND NOTES — STATUTORY LIMITATION ON BANK'S
COMMON LAW LIABILITY RESPECTING
FORGED INDORSEMENTS**

The desire for uniformity and certainty in the law as it relates to commercial paper led to the drafting of the Uniform Negotiable Instruments Act and its subsequent recommendation to the legislatures of the several states for adoption in 1896.¹ It is now in force in all of the states and territories of the United States and in the District of Columbia. Although generally the act has been preserved in its original form and content, various states have from time to time enacted modifications and additions. Wisconsin's most recent turn in that direction occurred April 30, 1947, when Chapter 80 of the Laws of Wisconsin was published creating Section 116.285 of the Wisconsin Statutes which reads as follows:

"116.285 Bank; Forged Indorsements; Limitation. No bank shall be liable to a depositor for the payment by it of a check bearing a forged indorsement unless, within 2 years after the return to the depositor of the voucher for such payment, such depositor shall notify the bank that the check so paid bore such forged or unauthorized indorsement."²

It is to be observed at the outset that the statute purports to deal with forged or unauthorized indorsements only. It is silent as to the depositor's duty to his bank with respect to altered items, raised amounts, etc., and it imposes a duty upon the drawer of a check to inform the drawee bank of a forgery of a signature the genuineness of which in all likelihood he does not know and cannot reasonably be expected to know.

The Uniform Negotiable Instruments Act generally has attempted to codify the law merchant, the rules of which were evolved by judicial decisions. The common law has developed land-mark principles relating to the duty owed by a depositor to his bank and the duty owed the customer by the bank. As a general proposition it is the duty of the bank to determine the identity of the payee and to pay a check only to whom the depositor directs such payment, and if the bank pays contrary to the genuine order of the drawer, it cannot charge his account.

"The holder of a check must bring himself within the order contained in the check. If the check was originally payable to order and not to bearer, the holder will be unable so to bring himself if one of the indorsements under which he must derive his title has

¹ For a succinct declaration of the primary purpose of the Uniform Negotiable Instruments Act see *State Bank of Halstad v. Bilstad*, 162 Iowa 433, 136 N.W. 204 (1912).

² Laws of Wisconsin, No. 23-A, Chapter 80; approved April 29, 1947; published April 30, 1947.

been forged. Therefore he is not the person authorized to receive payment of the check. A payment made to such a holder will not be an authorized payment, and a bank paying a check to such a holder, even though it has not been negligent in not discovering the fact of the forgery, cannot charge the drawer's account. The risk arising from forged indorsements is thus thrown upon the bank and not upon the drawer."³

Also as between the drawer and the drawee bank the latter is bound at its peril to ascertain the genuineness of indorsements upon which a check is paid. A bank impliedly contracts with its depositor to pay the latter's checks from his deposits to the person to whom he orders payment, and not to pay checks upon the forged indorsement of the payee's name.⁴ It has been held that the drawee bank should withhold payment until fully satisfied as to the genuineness of the indorsement.⁵ Nor does the genuineness of the last indorsement relieve the bank from looking to the genuineness of preceding indorsements.⁶ The conclusion is inescapable that, generally, when a banker pays a forged check, he is bound to pay again to his depositor because he paid in the first instance without authority.

The foregoing, of course, assumes lack of negligence and absence of fault on the part of the depositor. If it be the fault of the depositor that the banker pays when he should not or pays more than the drawer orders paid, the banker should not be called upon to pay again.⁷ What constitutes such negligence depends upon the facts and circumstances of each particular case. The drawer of a check may leave a signed blank check in the custody of one not ordinarily expected to have good business judgment, and as a result a third party may seize upon such a situation to raise the amount of the check.⁸ One may be found negligent by a jury if he so draws a check that items may be inserted without exciting suspicion.⁹ Where one draws an instrument in pencil rather than by the use of pen and ink, he may be found negligent, although it is true that the mere writing of an instrument in pencil cannot, of itself, be said to be negligence since the law recognizes the validity of such instruments equally with those written with ink or printed.¹⁰ Professor Williston indicates, however, that negligence on the part of

³ Williston, "Negotiable Instruments," published by the American Institute of Banking, 1931, p. 235.

⁴ *New York Title and Mortgage Co. v. First National Bank of Kansas City*, 51 F. (2d) 485, 77 A.L.R. 1053 (1931).

⁵ *Armstrong v. Pomeroy National Bank*, 46 Ohio 512, 22 N.E. 866, 6 L.R.A. 625 (1889).

⁶ *Atlanta National Bank v. Burke*, 81 Ga. 597, 7 S.E. 738, 2 L.R.A. 96 (1888); see also *Life Insurance Company of Virginia v. Edisto National Bank of Orangeburg*, 16 S.C. 505, 165 S.E. 178 (1932).

⁷ *Young v. Grote*, 4 Bing. 253, Common Pleas (1827).

⁸ *Ibid.*

⁹ *Timbel v. Garfield National Bank*, 121 App. Div. 870, 106 N.Y.S. 497 (1907).

¹⁰ *Walsh v. Hunt*, 120 Cal. 46, 52 P. 115, 15 A.L.R. 146 (1898).

the drawer is rarely, if ever, responsible for a forged indorsement or a forged check. Discussing the drawer's duty to care for his check book, he points out that even though a depositor has carelessly left his check book lying around his office, accessible to any one of his staff, and a blank is stolen, forged, and paid by the drawee bank, this does not seem to be such negligence on the part of the depositor as to charge him with responsibility. He may still insist that the bank must not charge his account with the forged check.¹¹ The law is reluctant to fix responsibility upon one antecedent to a conscious wrongdoer.

At any rate, it seems well established that while a bank cannot charge the drawer's account for the amount of a check bearing a forged indorsement, the bank, under some circumstances, can seek protection in the drawer's negligent or other conduct of such nature as to create an estoppel against him. Moreover, it is equally clear that the duty of a depositor includes examination of his statement of account and cancelled checks and reporting within a reasonable time any errors, because the bank legally may regard continued silence as an admission that the entries shown are correct.¹² The drawer may, by such silence and failure to be alert, create an estoppel against himself. However, the reluctance with which some courts have applied this doctrine is shown by the attitude of the Supreme Court of Minnesota when it stated that when a bank returns a check to a depositor, the depositor has the right to assume that the bank has ascertained the genuineness of indorsements.¹³ It is to be remembered in this connection, of course, that any negligence on the part of the drawer is immaterial unless it is a proximate cause of the bank's conduct in paying before discovery of error.

At this point it may be well to point out that the cases which give the bank a defense upon the basis of the depositor's negligence do so in a wide variety of fact situations, covering a broad range of negligent conduct possible in the handling of checks. This raises the question as to the effect of Section 116.285 on the common law defense of the bank. Normally, where a statute is clear, it controls, and former adjudications in the jurisdiction yield to the legislative enactment;¹⁴ but where the statute is silent, resort must be had to the law merchant or to the common law regulating commercial paper.¹⁵ What then is the effect of this statute on a situation not expressly covered by it where the drawer, by his negligent conduct, would be estopped from asserting his right

¹¹ Williston, "Negotiable Instruments," p. 237.

¹² First National Bank of Philadelphia v. M. Walter Farrell, 272 Fed. 371, 16 A.L.R. 651 (1921).

¹³ City of St. Paul v. Merchant's National Bank, 151 Minn. 485, 187 N.W. 516, 22 A.L.R. 1221 (1922).

¹⁴ First National Bank v. Miller, 139 Wis. 136, 120 N.W. 820 (1909).

¹⁵ Mechanic's and Farmer's Savings Bank v. Katterjohn, 137 Ky. 427, 125 S.W. 1071 (1910).

against the bank for paying a check bearing a forged indorsement? Does the statute wipe out this defense? Unquestionably the statute does not destroy defenses available to the bank when the depositor's negligence consists in carelessly drawing a check, or in other respects heretofore discussed. Nor does it seem reasonable to conclude that because the legislature has spoken as to the matter of forged indorsements and has given the banks of the state immunity from liability after the expiration of a two year period, depositors are thereby relieved of their responsibility of acting reasonably and prudently within that two year period. As a matter of fact, the Uniform Negotiable Instrument Act itself provides that in any case not provided for by the act the rules of the law merchant shall govern.¹⁶ Wisconsin's statutory provision is similar.¹⁷

Section 116.285 makes it the duty of a drawer of a check to inform the drawee bank of a forged indorsement within two years after the return to him of the voucher for such payment in order to hold the bank for the amount of any check paid under such forged indorsement.¹⁸ By the force of this statute one who draws a check must investigate, ascertain, and be aware of the signatures of all whom he makes payees of checks he draws and of all subsequent indorsers. The practical difficulty to the drawer of such a burden was recognized by the Minnesota Supreme Court in *St. Paul v. Merchant's National Bank* when it said:

"The bank's obligation is to pay the checks only upon a genuine indorsement. The drawer is not presumed to know, and in fact seldom does know, the signature of the payee. The bank must, at its own peril, determine that question. It has the opportunity, by requiring identification when the check is presented of ascertaining whether the indorsement is genuine or not."¹⁹

In the ordinary course of business dealings where checks are involved and are given in payment of debts or other current obligations, probably no problem will arise. One who pays his grocery bill by a check which falls into the hands of a forger, will without doubt be informed by his creditor within two years that the account has not been paid. The likelihood of his being promptly informed is less, however, if the payee's indorsement is genuine and a subsequent indorsement is forged. In the ordinary case probably no hardship will result to the depositor. But it is the out-of-the-ordinary case that makes hard law. If the customer is to be charged with negligence, it is submitted it should not be on the

¹⁶ Uniform Negotiable Instruments Law, Title IV, Art. I, Sec. 196: "In any case not provided for in this act the rules of the law merchant shall govern."

¹⁷ Wisconsin Statutes, Section 116.01: "In any case not provided for in this chapter the rules of the law merchant shall govern."

¹⁸ *Supra*, note 2.

¹⁹ *Supra*, note 13.

arbitrary basis provided by this statute, but rather according to the well-tested, flexible principles developed in the common law.

Nor does the Wisconsin statute under consideration here seem to be as complete as it might be. If it was the intention of the legislature to provide relief by way of a statute of limitations from what is admittedly a difficult burden on a bank, it does not seem reasonable to omit from the law matters equally as important as forged indorsements. The statute ignores identical problems arising from material alterations and raised amounts. The Texas legislature enacted a similar statute in 1943; and while it is subject to some of the objections made to Section 116.285, it does appear to deal more comprehensively with the problem. It provides:

"A bank may notify a depositor by mail at his address as reflected by the records of the bank to call for cancelled items charged to his account, or may mail such cancelled items to the depositor at such address. No depositor shall be permitted to dispute any charge to his account on the ground that the same is based upon a *forged, unauthorized, raised or altered item*,²⁰ unless within one (1) year from the time the check was paid, he shall notify the bank in writing that the item in question is forged, unauthorized, raised or altered."²¹

No Texas case, to the time of this writing, has interpreted the foregoing statute, but a United States District Court considered it in *United States Fidelity and Guaranty Company v. Beall*.²² There the defendant, an employee of a pipeline company, had charge of writing checks. Because of his peculiar knowledge of the inactivity of certain oil leases he was able to write checks payable to these customers, forge their indorsements, and secure funds for his own use without the knowledge of his employer. When the forgeries were discovered after passing through the hands of several indorsers, the plaintiff surety company paid the pipeline company, took an assignment of the latter's rights of action, and sued the employee and the drawee bank. The bank called attention to the Texas statute, and since more than the statutory period of one year had expired, the bank prevailed. It does not appear from the opinion whether the pipeline company had actual knowledge of these forgeries, but it is entirely conceivable that under similar circumstances such a depositor would not reasonably discover such forgeries within a year. In that regard the Texas statute is open to the same criticism as Section 116.285. In other respects it at least is more complete than the newly-enacted Wisconsin law.

²⁰ Italics, the writer's.

²¹ Art. 342-711, Act 1943, 48th Legislature of Texas, p. 154, ch. 97, sub-ch. VII, art. 11, Vernon's Ann Civ. St., art. 342-711.

²² *United States Fidelity and Guaranty Company v. Beall*, 73 F. Supp. 977 (1947).

It has been the purpose of this comment to point out first, that such simplicity and certainty as can be achieved through codification of the law are always at the expense of desired flexibility; second, that the knowledge of the payee's or indorsers' signatures demanded by this statute is not within the usual scope of what a drawer of a check can reasonably be expected to know (such knowledge is necessary if 116.-285 is to operate without real hardship); and third, the new Wisconsin statute might have been drafted with an eye to cover more completely the more common causes of mistaken bank payments, of which the forged indorsement is but one.

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