

1949

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Repository Citation

Kenneth K. Luce, *Banks and Banking - Problems Involved Upon Payment by Drawee Bank of a Check Lacking the Payee's Endorsement*, 32 Marq. L. Rev. 272 (1949).

Available at: <https://scholarship.law.marquette.edu/mulr/vol32/iss4/5>

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COMMENTS

BANKS AND BANKING — PROBLEMS INVOLVED UPON PAYMENT BY DRAWEE BANK OF A CHECK LACKING THE PAYEE'S ENDORSEMENT

One Rudolph sold two stolen automobiles to Boyd, and received from him \$2,500 in cash and Boyd's check, payable to Rudolph, drawn on the Dees Bank of Hazel, Kentucky in the amount of \$600. Boyd resold the automobiles, and when the F.B.I. picked them up he made restitution to his purchasers. In the meantime Rudolph cashed the check at the Bank of Marshall County, Kentucky. The latter bank, following an unaccountable practice concerning which the writer has received disturbing reports of late,¹ did not require Rudolph's endorsement on the check, and forwarded it with the usual stamp, "all prior endorsements guaranteed", to the Citizen's Fidelity Bank and Trust Company of Louisville. It was in turn forwarded to the Louisville Branch of the Federal Reserve Bank and by it presented to the drawee, Dees Bank, where it was stamped "Paid", and the amount charged to Boyd's account. Boyd sued all four banks, and obtained judgment in the trial court against the drawee bank, which bank in turn obtained judgment against the cashing Bank of Marshall County for the amount of the check. The Bank of Marshall County appealed. In affirming the judgment, the Court of Appeals of Kentucky reasoned that the lack of an endorsement by the payee prevented the Bank of Marshall County from becoming a holder in due course, with the result that Boyd could plead against it the failure of consideration involved in his automobile deal with Rudolph!² *Bank of Marshall County v. Boyd*, (Kentucky, Court of Appeals, 1948) 215 S. W. (2d) 850.

It is submitted that Boyd's judgment against the drawee, Dees Bank, was proper, and that the judgment of the Dees Bank against the Marshall County Bank can be sustained, but certainly not on the reasoning advanced by the Court. If the commercial law is to make any sense at all, the rules which compose its complicated system of loss allocation should be properly applied. Otherwise the end result will not always be as happily correct as in the case stated.

For the fraud or failure of consideration (i.e. breach of warranty of title and quiet possession) involved in the automobile deal, Boyd

¹ In at least one case which arose during another period of prosperity and easy credit, evidence of a banking custom to pay order checks without endorsement by the payees was offered and excluded: *Dawson & White v. National Bank of Greenville*, 197 N.C. 499, 150 S.E. 38 (1929).

² The Court stated: "The crucial question in the case is: Can the appellee, drawer of the check, plead failure of consideration as against the appellant bank which cashed and endorsed it without obtaining the endorsement of the payee?"

has an affirmative action against Rudolph and no one else since the banks were not parties to the automobile contract.³ Being the drawer and issuer, Boyd has no right of recovery on the check, since the engagements of parties to negotiable instruments do not run backwards.⁴ The failure of consideration is available to Boyd as a defense to an action on the check brought by any holder not a holder in due course. A holder in his action against prior parties, is subject to defenses among them, and to defenses based on defects of title, depending upon whether he holds in due course, but in purchasing he makes no promises to prior parties and is not liable to them on the instrument in any event.⁵ Since the payee did not endorse, the first three banks who received the check were not even holders under the negotiable instruments law.⁶ As for the drawee bank, the better view is that it pays the check and thereby normally effects discharge, is not a purchaser, and cannot be classed upon payment as a holder, in due course or otherwise.⁷ In the instant case the analysis of the Court leads to the conclusion that the drawee bank in paying, and any other bank in purchasing a check other than as a holder in due course, becomes liable to reimburse the drawer for any loss suffered by him through fraud or breach of contract in the transaction with the payee of the check. This is simply not so.⁸ A defense is not the equivalent of a cause of action. The status of the drawee and other banks as holders or not, and as holders in due course or not, had no place in the legal analysis of Boyd's rights to recover against the banks in this case, or of the rights of the drawee bank against the forwarding bank.

The law of the banker-customer relation is that the bank can charge the customer's account only with payments made pursuant to the genuine order of the customer, and in meeting this duty to its customer the bank pays at its peril.⁹ Payment of a check on which the customer's hand has been forged, or a necessary endorsement has been forged or

³ Uniform Sales Act, Sec. 13, 69.

⁴ Britton, Bills and Notes, Sec. 144, 257 (1943); Negotiable Instruments Law, Secs. 61, 65, 66.

⁵ Uniform Negotiable Instruments Law, Secs. 57, 58.

⁶ Britton, Bills and Notes, Sec. 76 (1943); Uniform Negotiable Instruments Law, Sec. 191: "'Holder' means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof."

⁷ *Louisa National Bank v. Kentucky National Bank*, 239 Ky. 302, 39 S.W. (2d) 497 (1931); *National Bank of Commerce of Lincoln v. Farmer's & Merchants Bank of Lincoln*, 87 Neb. 841, 128 N.W. 522 (1910); *Bank of Pulaski v. Bloomfield State Bank*, (Iowa) 226 N.W. 119, 210 Iowa 817, 232 N.W. 124 (1930).

⁸ For a similar case, also involving a stolen automobile, where the drawer sued the drawee bank apparently on such a theory see: *Cooper v. People's Trust and Savings Bank*, 219 Ill. App. 447 (1920). See Britton, Bills and Notes, Sec. 144 (1943).

⁹ C.J.S., Banks and Banking, Secs. 330, 340.

omitted, is not according to the drawer's genuine order.¹⁰ Hence in this case customer-drawer Boyd had a clear right to recover from drawee Dees Bank.¹¹

The right of the Dees Bank to recover against the prior banks in the collection chain is not so clear. Defendant Bank of Marshall County, which cashed the check, stamped it "all prior endorsements guaranteed", but even assuming this endorsement runs to the drawee of the instrument as well as to its purchasers,¹² it is a bit difficult to give it any legal significance in this case since there were no prior endorsements to guarantee. The endorsement of the Marshall County Bank did not guarantee that the payee of the check received the money or anything else beyond the genuineness of a non-existent prior endorsement, and in addition under the Negotiable Instruments Law that the instrument was genuine,¹³ that the Marshall County Bank had good title to it,¹⁴ that prior parties had capacity to contract,¹⁵ and that the instrument was at the time valid and subsisting.¹⁶ Though the warranty of good title was broken, it is generally considered that the warranties in the Negotiable Instruments Law run to purchasers of the instrument but not to the drawee,¹⁷ with the result that the Dees Bank had no claim against the Marshall County Bank on any theory of warranty. There remains the familiar action in quasi-contract for money paid under mistake of fact, and if the Dees Bank had any action over in this case it was on this theory.¹⁸ The doctrine of *Price v. Neal*¹⁹ does not bar the action, but there may be question whether payment of a check absent the payee's endorsement is a mistake of fact. With all the facts apparent on the face of the check, a court might class the Bank's mistake as one of law as to the legal effect of the instrument, and deny recovery.²⁰ In *Price v.*

¹⁰ *Los Angeles Inv. Co. v. Home Savings Bank*, 180 Calif. 601, 182 Pac. 293, 5 A.L.R. 1193 (1919).

¹¹ There is dictum in *Dawson & White v. National Bank*, 197 N.C. 499, 150 S.E. 38 (1929) to the effect that the customer may estop himself from claiming against the bank by authorizing the bank to pay his order checks without requiring endorsement by the payees.

¹² *United States v. Guaranty Trust Co.*, 293 U.S. 340 at 349, 55 S. Ct. 221 at 225, 79 L.ed. 415, 95 A.L.R. 651 (1934); see note in 42 Mich. L. Rev. 1124 (1944) discussing *Hibernia Nat. Bank v. Nat. Bank of Commerce*, 204 La. 777, 16 So. (2d) 352 (1943).

¹³ Uniform Negotiable Instruments Law, Sec. 66-1.

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Ibid.*, Sec. 66-2.

¹⁷ *State Planter's Bank & Trust Co. of Richmond v. Fifth-Third Union Trust Co.*, 56 Oh. App. 309, 10 N.E. (2d) 935 (1937).

¹⁸ *Canal Bank v. Bank of Albany*, 1 Hill (N.Y.S.C.) 287 (1841); *First National Bank of Minneapolis v. City National Bank*, 182 Mass. 130, 65 N.E. 24, 94 Am. St. Rep. 637 (1902); *Clearfield Trust Co. v. United States*, 318 U.S. 363, 744, 63 S. Ct. 573, 87 L.ed. 838 (1943).

¹⁹ *Aigler, "The Doctrine of Price v. Neal,"* 24 Mich. L. Rev. 809 (1926); *Britton, Bills and Notes*, Sec. 133 (1943).

²⁰ Denial of recovery for money mistakenly paid on a supposed obligation has persisted, where elsewhere in the law mistake of law has largely lost its force. See Reporter's Notes to the Restatement of Restitution, comment on

Neal Lord Mansfield found both plaintiff and defendant without neglect, and concluded the loss might best remain where it rested prior to litigation.²¹ It has been said he took the case out of the ordinary doctrine of recovery for mistaken payments "from an impression of convenience rather than for any more academic reason".²² The same impression might prevail here where both banks were extremely careless with respect to the fact of endorsement of an order check, a fact the legal significance of which banks should be aware if anyone. Ordinarily the negligence of the payor does not prevent his recovery of money paid through mistake of fact.²³ But in the law of negotiable instruments there are certain cases of mistaken payment, accompanied by carelessness in routine checking of accessible facts, where the drawee bank has been denied recovery, by analogy to the situation in *Price v. Neal* or otherwise. Some of these are: (1) payment by a drawee bank of a check on which payment has been stopped, where the party receiving the money is likewise unaware of the stop payment order at the moment of payment;²⁴ (2) a payment by a drawee bank resulting in an overdraft on the customer's account;²⁵ and (3) payment of a draft on which the drawee is also drawer, or of a note, where the amount has been raised by alteration, to a person innocent and unaware of the alteration.²⁶ However in such cases the person receiving payment has been unaware of the mistake and without access to the sources of information which would disclose it. In the instant case the Marshall County Bank was at least as careless in cashing the check without endorsement as the Dees Bank was in paying it in such condition, and conceivably it was a fact that the Marshall County Bank was following a business practice usual and accepted with it. Thus the result of the case, placing of ultimate loss upon the Marshall County Bank, is not unexpected, and is in line with the broad tendency of our commercial law to place ultimate loss upon the person who purchases the instrument from the crook.

KENNETH K. LUCE*

Topic 3, "Mistake of Law," and notes to Secs. 44-54. See also 53 A.L.R. 949, and *Coburn v. Neal*, 94 Me. 541, 48 Atl. 178 (1901). However in Kentucky recovery of money paid under mistake of law has generally been allowed, contrary to the general rule, see *McMurtry v. Kentucky Central Railroad Company*, 84 Ky. 462, 1 S.W. 815 (1886), and cases cited in Woodward, *Quasi-Contracts*, Sec. 37 (1913).

²¹ *Price v. Neal*, 3 Burr. 1354 (K.B., 1762).

²² *Holmes, J. in Dedham National Bank v. Everett National Bank*, 177 Mass. 392, 59 N.E. 62, 83 Am. St. Rep. 286 (1901).

²³ *Chicago M. & St. P. R. Co. v. Malleable Iron Range Co.*, 187 Wis. 93, 203 N.W. 738 (1925); *In re Berry*, 147 Fed. 208, 77 C.C.A. 434 (1906).

²⁴ *National Bank of New Jersey v. Berrall*, 70 N.J.L. 757, 58 Atl. 189, 66 L.R.A. 599, 103 Am. St. Rep. 821 (1904); see note 53 Harv. L. Rev. 668 (1940).

²⁵ *First National Bank v. Memmoth Blue Gem Coal Co.*, 194 Ky. 580, 240 S.W. 78 (1922); *Citizens Bank of Norfolk v. Schwarzschild & Sultzberger Co.*, 109 Va. 539, 64 S.E. 954, 23 L.R.A. (ns) 1092 (1909).

²⁶ *United States v. National Exchange Bank of Baltimore, Md.*, 270 U.S. 527, 46 S. Ct. 388, 70 L.ed. 717 (1926).

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