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Article 8

Bills and Notes - Drawer's Right Against Drawee After Payment on a Forged Endorsement

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Bills and Notes — Drawer's Right Against Drawee After Payment on a Forged Indorsement — Klessig, agent for the Modern Woodmen of America, handled funds including insurance premiums for said organization in Milwaukee, and deposited such funds with defendant bank in the agent's name. At the end of each month Klessig sent a monthly statement of all receipts to the national organization in Illinois, accompained by a check payable to said organization drawn on defendant bank, for the total amount of said statement. In May of 1941 Klessig submitted his report with a check for $4,753.36. The Modern Woodmen presented the check to their bank in Chicago, and the latter dishonored the check because of insufficient funds. In the meantime the national organization mailed Klessig a check for $1000 payable to one Catherine Niebler for insurance benefits due her. Klessig forged the necessary indorsement and deposited the check with defendant bank thus making the account in the bank sufficient for payment of the outstanding check. When this check was again presented to the bank by the Modern Woodmen of America, it was honored. Upon an auditor's check-up of Klessig's accounts, the latter was removed from office, and the plaintiff, as surety on a bond indemnifying the society against forgery, paid the society its $1000 loss. Plaintiff, surety company, sued the defendant bank. *Held:* that defendant bank was not liable for paying on the forged indorsement, since the forgery had not caused the loss sustained by the Modern Woodmen of America. *National Surety Corporation v. City Bank and Trust Company (Wis. 1945), 20 N. W. 2d. 559.*

The general rule is that a bank must bear the loss when it pays on a forged indorsement.[1] But, in the case under consideration there is a qualification of that rule. In the instant case the proximate cause for the loss suffered by the drawer was the misappropriation of its money by its agent, Klessig. At the time Klessig forged the check the loss had already been incurred. The payment by the bank merely postponed detection of the loss. Generally a bank is liable to the drawer of a check for paying it on a forged indorsement, in the absence of estoppel, contributing negligence or ratification, or unless the money has reached the intended person.[2] By the same token, if the proceeds of the forged check ultimately reach the drawer, the bank should also be relieved from liability. The Kentucky court has said if the depositor has actually received the proceeds of the check, the fact that the check was forged does not render the bank responsible for the amount.[3] However, a New York court reached a

[1] 7 Am. Jur. section 587, page 425; 9 Corpus Juris Secundum, page 730.
[2] Board of Education of Jefferson Tp. v. National Union Bank of Dover, 1 A. 2d. 383, 121 N.J.L. 177, affirming 196 A. 352, 16 N. J. Misc. 50 (1938); Seidman v. North Camden Trust Co., 7 A. 2d 406, 122 N.J.L. 580 (1939).
[3] Phoenix Nat. Bank v. Taylor, 67 S.W. 27, 113 Ky. 61, 23 Ky. L. 2307 (1902).

different decision. In the New York case[4] the name of the plaintiff firm on a check was forged by its confidential bookkeeper. The check was drawn upon defendant bank to order of another bank and deposited in such other bank to credit of plaintiff and paid by the defendant. The court said that the forgery should have been discovered by the defendant and that the deposit could not be deemed a payment to plaintiff, where the payment of the forged check enabled the bookkeeper to cover up his defalcations. The court stated:

> "Defendant's payment of the forged check enabled Pratt, (confidential bookkeeper) not only to cover up his defalcations up to July, 1917, for an indefinite period, but enabled him thereafter to increase his ill-gotten gains by a sum in excess of the $5,000 check deposited in the Bank of New York. The plaintiff thus derived no benefit whatever from this deposit —."[5]

This case seems to be just the converse of the instant case. There is, however, a distinction. In the instant case the proceeds of the forged check made restitution for past defaults while in the New York case the proceeds of the check enabled the bookkeeper not only to conceal prior defaults but also subsequent defalcations.

There is a Minnesota case in which the factual situation was almost identical with the instant case. In the Minnesota case[6] the plaintiffs drew a check payable to a customer to whom they were indebted, and forwarded the same to their agent, to be delivered to the payee. The agent forged the payee's name to an indorsement of the check, and deposited it in a bank to his own credit, paying the proceeds thereof to the plaintiffs with other money in settlement of a shortage in his accounts. The drawee bank paid the check on the forged indorsement in the ordinary course of business. The court stated that the plaintiffs, as drawers, were not entitled to recover the amount of the check from the bank, since the proceeds thereof came back to them, and the debt of their agent remained unpaid. They suffered no damage by reason of the payment of the check by the bank. The language of the court was as follows:

> "The appellants (drawers) made an ingenious argument, but the result which they desire to bring about would be so unjust and inequitable as to suggest a fallacy lurks somewhere in the process of reasoning. The appellants have not been injured by the fact that the Northwestern National Bank (drawee) paid this check upon a forged indorsement, and their theory, if accepted, would merely result in substituting the bank for

[4] Stumpp v. Farmers' Loan and Trust Co., 178 N.Y.S. 811, 109 Misc. 24 (1919).
[5] *Ibid.*, page 812.
[6] Andrews v. Northwestern National Bank, 117 N.W. 621, 107 Minn. 196, 25 L.R.A. (N.S.) 996, rehearing 117 N.W. 780, 107 Minn. 196, 25 L.R.A. (N.S.) 996, and judgment affirmed (1908).

the defaulting employee as the creditor of Andrews and Gage (appellants)."[7]

This case seems to be one of first impression passing upon the question as to the effect of proximate cause in the application of the general rule that a bank, and not the depositor, must sustain the loss when the bank pays on a forged indorsement.

However, an opposite conclusion was reached by a South Carolina case[8] where the drawer's agent forged the payee's indorsement, indorsed as agent, and used the proceeds of the check to pay an indebtedness to his principal. It was held this did not bar the drawer's action against the bank. The court applied the general rule and ignored the factor of causation of loss. In the cases cited in the court's opinion the drawer had never regained the money in any manner. Each drawer had suffered a loss as a direct result of the drawee paying on a forged indorsement. But, in the South Carolina case the drawer suffered no loss as a result of the bank's payment. Its loss was occasioned by the defaults of its agent which had occured long before the bank paid the forged check.

The decision of the Wisconsin case and the Minnesota case supporting it seem to be more reasonable and just. It is submitted that the Wisconsin Court, in determining the liability of a bank for payment on a forged indorsement, will require that the payment be the proximate cause of the loss for which recovery is sought.

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[7] *Ibid.*, page 623.
[8] Life Insurance Company of Virginia v. Edisto National Bank of Orangeburg et al., 165 S.E. 178 (S. Car., 1932).