

WRONGFUL APPLICATION: A NEW DEPOSITARY TORT

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In spite of the remedies available in the Uniform Commercial Code, the California Supreme Court recently saw fit to create a new depositary tort by extending to a drawer a cause of action for negligence against a collecting bank as a result of circumstances surrounding the negotiation of a check. The author analyzes this revolutionary change in the legal relationships between collecting banks and the victims of fraudulent schemes involving checks, examines its effect on subsequent litigation, and foretells its implications for banking law and prudent banking practices.

Banks have an insidious new litigation phenomenon to worry about. By and large, it has been confined to the state of California. It is a noncontractual cause of action, asserted by an allegedly aggrieved party against a bank, in connection with the negotiation, presentment, collection, or payment of the proceeds of a check. The term "noncontractual" is used to describe any cause of action that is not based upon the instrument itself, and the relationships between the parties which it creates; rather, it is based upon the circumstances surrounding the negotiation of the instrument. In this sense, noncontractual is roughly synonymous with extracontractual. Noncontractual causes of action find their origin in principles of tort law, and depend for their sufficiency and proof upon such esoteric concepts as negligence, duty of care, and proximate cause.

The new, noncontractual cause of action represents a developing trend of expanding bank liability. Given today's litigious climate, it is only a matter of time before this phenomenon not only takes root but also expands and multiplies in other jurisdictions. However, by becoming familiar with and learning to identify problem situations, it is hoped that the prudent bank will be able to position itself to avoid liabil-

ity. Each one of the scenarios discussed in this article can be avoided with simple countermeasures. The term "bank" in this context must be given the broadest possible interpretation, as there is no good reason why the concepts discussed herein should not also apply to savings and loan associations, credit unions, and stockbrokers—in short, any depositary institution, *de facto* or *de jure*, that accepts items for the accounts of its customers.

The Basic Alignment of the Parties

The motivation behind most litigation involving checks is the boundless variety of human greed, ingenuity, and chicanery. There are numerous different factual contexts in which such suits arise. This being so, classic negotiable instruments law (as presently articulated in the Uniform Commercial Code (UCC)) instructs us that there are only a few easily understood legal relationships created by the issuance and negotiation of a check.

By way of review, "the drawer of a check is the person who signs it"¹ (i.e., the person whose account with the payor bank will be charged upon presentment of the check by the collecting bank). The payee of a check is "the person in whose favor a . . . check is made or drawn; the person to whom or to whose order a . . . check is made payable."² The collecting bank is any bank "handling the item for collection"³; most often, the last collecting bank is also the depositary bank (i.e., "the first bank to which an item is transferred for collection").⁴ Finally, the payor bank is "the bank by which an item is payable as drawn or accepted"⁵—in other words, the drawer's bank.

"Collecting bank" in this context refers to a collection of the proceeds of the check from the payor bank. In the ordinary course, the drawer signs the check, transfers it to the payee, who indorses it and deposits it into his account at the

¹ *Black's Law Dictionary* 444 (rev. 5th ed. 1979).

² *Id.*

³ U.C.C. § 4-105(d).

⁴ U.C.C. § 4-105(a).

⁵ U.C.C. § 4-105(b).

depository bank. The depository bank then presents the check to the payor bank, most often through various intermediaries. The payor bank then debits the drawer's account, and forwards the proceeds of the check, most often through various intermediaries, back to the depository bank, which as a result metamorphosizes into a collecting bank.⁶

When a check goes awry, as is sometimes the case, these parties often end up suing each other. The drawer's cause of action against the payor bank (in the event, for example, that his signature is forged) is for breach of contract pursuant to Section 4-401 of the UCC. If, on the other hand, the check is intercepted, and the payee's indorsement is forged, the payee has a cause of action against the collecting bank for conversion, pursuant to Section 3-419(1)(c) of the UCC. In such a circumstance, if the payee instead sues the payor bank, the payor bank has a cause of action back over against the collecting bank for breach of warranty, pursuant to Section 4-207(1).

A number of reported decisions from across the country hold that the UCC sets forth exclusive remedies that are available to an aggrieved party in the event of an alleged loss

⁶ In California and some other jurisdictions, the courts have given a special interpretation to the concept of "proceeds," especially as it applies to collecting banks. U.C.C. § 3-419(3) provides in part that if a collecting bank "has in good faith and in accordance with . . . reasonable commercial standards . . . dealt with an instrument or its proceeds on behalf of one who was not the true owner," it is "not liable in conversion or otherwise to the true owner *beyond the amount of any proceeds remaining in [its] hands*" (emphasis added). It might be thought that this means what it says, and that a collecting bank would be liable to the true owner only if it had not yet remitted the proceeds of the instrument. Not so, however, at least in California: "the amounts a payor bank remits on a forged indorsement are not considered the proceeds of the instrument" because:

[T]he relationship between a payor bank and its customer . . . is one of debtor and creditor: the bank is indebted to the customer and promises to debit his account only at his direction. If the bank pays, on an instrument drawn by its customer, any person other than the designated payee or a person to whom the instrument is negotiated, the bank's indebtedness to the customer is not diminished. . . . Inasmuch as the full amount of the instrument remains in the account of the drawer when the bank pays on a forged indorsement, the bank manifestly does not part with the proceeds of the instrument but merely remits other funds from its own account.

Cooper v. Union Bank, 9 Cal. 3d 371, 376, 507 P.2d 609, 107 Cal. Rptr. 1 (1973); see also Ervin v. Dauphin Deposit Trust Co., 84 Dauph. 280, 38 Pa. D. & C.2d 473 (Pa. Ct. C.P. 1965). This result has provoked strenuous discussion among knowledgeable commentators. See H.J. Bailey, *Brady on Bank Checks* § 24.5 (5th ed. 1979); B. Clark, *The Law of Bank Deposits, Collections and Credit Cards* ¶ 6.4[5][b][i] (rev. ed. 1981); J.J. White & R.S. Summers, *Uniform Commercial Code* § 15-4 (2d ed. 1980).

on a check.⁷ Generally, those decisions hold that (1) the UCC is a comprehensive, interdependent, and internally consistent codification of existing law; (2) the UCC conclusively and exclusively defines all relationships that might exist between the parties to the issuance and negotiation of a check; (3) it would be inappropriate to grant to an allegedly aggrieved party additional superfluous remedies, especially considering that the ones set forth in the UCC are meaningful, adequate, and effective; and (4) it would frustrate the basic purposes and policies which underlie the UCC if it was to be circumvented by additional common-law causes of action, all of which it otherwise displaces.

As expressed in the Official Comment to Section 4-101:

The tremendous number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. . . . There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years.

The Break in the Wall: *Sun 'N Sand, Inc. v. United California Bank*

And there the matter lay until the California Supreme Court decided *Sun 'N Sand, Inc. v. United California Bank*.⁸

⁷ One of the most recent ones is *Childs v. Federal Reserve Bank*, 719 F.2d 812 (5th Cir. 1983), a suit by a payee against a collecting bank for negligence. Construing U.C.C. § 1-103, which provides in part that "unless displaced by the particular provisions of this code, the principles of law and equity . . . shall supplement its provisions," the court stated:

The . . . courts interpreting [§ 1-103] have held, in accordance with the section's plain language, that common law concepts only supplement the [U.C.C.], and that the section was not intended to create separate causes of action that would conflict with the [U.C.C.] . . . The objective of the Uniform Commercial Code is to displace scattered legislation or decisional law, and to state as fully as practicable a comprehensive and workable set of rules and principles for the governing of all aspects of transactions in the field to which it applies. . . .

719 F.2d at 815.

⁸ 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978). In fairness to the California Supreme Court, other jurisdictions have also held that a bank presented with checks payable to itself by one who proposes to deposit such checks in his personal account is put on some degree of inquiry. See, e.g., *Arvada Hardwood Floor Co. v. James*, 638 P.2d 828 (Colo. App. 1981); *Kaiser-Georgetown Community Health Plan, Inc. v. Bankers Trust Co. of Albany*, 110 Misc. 2d 320, 442 N.Y.S.2d 48 (1981); *Key Appliance, Inc. v. National Bank of N. Am.*, 75 A.D.2d 92, 428 N.Y.S.2d 238 (1980); *Bank of S. Maryland v. Robertson's Crab House, Inc.*, 39 Md. App. 707, 389 A.2d 388 (1978). None of these cases, however,

Sun 'N Sand is the authority for a number of propositions; among other things, it extends to a drawer a direct cause of action for breach of warranty against a collecting bank.⁹ It is not this aspect of *Sun 'N Sand*, however, with which we are concerned. For in another section of its opinion, the court extended to the drawer a cause of action for *negligence* against the collecting bank that depends primarily on its vitality upon the *circumstances surrounding the negotiation of the check*. To understand the nature of the problem, it is necessary to examine the facts of the case.

In *Sun 'N Sand*, an embezzler, Morales, was in charge of preparing the company's checks. She did not have the authority to sign the checks. Rather, after she prepared them, she was required to obtain the signature of a responsible corporate officer. Morales would then, presumably, transmit the checks to the appropriate payee.

articulates the conceptual basis for a negligence cause of action quite so forcefully, and other jurisdictions have yet to develop the continuing case law which expands the scope of application of the concept. Some jurisdictions have expressly rejected an application of negligence principles to a *Sun 'N Sand*-type situation. See, e.g., *Lasley v. Bank of Northeast Arkansas*, 627 S.W.2d 261 (Ark. App. 1982); *J. Gordon Neely Enters., Inc. v. American Nat'l Bank of Huntsville*, 403 So. 2d 887 (Ala. 1981).

⁹ Otherwise, the drawer would have to sue his payor bank for breach of contract, whereupon the payor bank would sue the collecting bank for breach of warranty, resulting in a perceived circuitry of action. The extending to a drawer of a direct cause of action for breach of warranty against a collecting bank has met with considerable resistance in other jurisdictions. See, e.g., *First Fed. Sav. & Loan of Broward County v. Blinn*, 422 So. 2d 1104 (Fla. App. 1982); *Brighton, Inc. v. Colonial First Nat'l Bank*, 176 N.J. Super. 101, 422 A.2d 433 (1980), *aff'd*, 86 N.J. 259, 430 A.2d 902 (1981); *First Nat'l Bank of Boston v. Hovey*, 412 N.E.2d 889 (Mass. App. 1980); *Life Ins. Co. of Virginia v. Snyder*, 141 N.J. Super. 539, 358 A.2d 859 (1976); *Jett v. Lewis State Bank*, 277 So. 2d 37 (Fla. App. 1973); *Brokerage Data Processing Corp. v. Eastchester Sav. Bank*, 39 A.D.2d 895, 334 N.Y.S.2d 222 (1972); *Central Cadillac, Inc. v. Stern Haskell, Inc.*, 356 F. Supp. 1280 (S.D.N.Y. 1972); *Low v. Merchants Nat'l Bank & Trust Co. of Syracuse*, 24 A.D.2d 322, 266 N.Y.S.2d 74 (1966); *Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co. of Greenfield*, 345 Mass. 1, 184 N.E.2d 358 (1962). Courts permitting recovery have done so on varying theories, such as construing the drawer to be a third-party beneficiary of the warranty of title, *Fidelity & Deposit Co. of Maryland v. First Nat'l Bank of Kenosha*, 98 Wis. 2d 474, 297 N.W.2d 46 (1980); *Prudential Ins. Co. v. Marine Nat'l Exch. Bank*, 315 F. Supp. 520 (E.D. Wis. 1970); holding that the drawer is an "other payor" within the meaning of U.C.C. § 4-207(1)(a), *Insurance Co. of N. Am. v. Purdue Nat'l Bank of Lafayette*, 401 N.E.2d 708 (Ind. App. 1980); *Insurance Co. of N. Am. v. Atlas Supply Co.*, 121 Ga. App. 1, 172 S.E.2d 632 (1970); and on the ground that the drawer is an assignee of the payor bank's cause of action, *Justus Co., Inc. v. Gary Wheaton Bank*, 509 F. Supp. 103 (N.D. Ill. 1981); *National Bank & Trust Co. of Cent. Pennsylvania v. Commonwealth*, 9 Pa. Commw. 358, 305 A.2d 769 (1973), *rev'd on other grounds*, *Commonwealth v. National Bank & Trust Co. of Cent. Pennsylvania*, 469 Pa. 188, 364 A.2d 1331 (1976); *International Indus., Inc. v. Island State Bank*, 348 F. Supp. 886 (S.D. Tex. 1971). The merits of this subject have also been hotly debated. See *Bailey*, note 6 *supra* § 23.28; *Clark*, note 6 *supra* ¶ 6.3[4]; *White & Summers*, note 6 *supra* § 15-5.

Over a three-year period, Morales prepared nine checks, payable to United California Bank (UCB). A responsible corporate officer signed the checks, which were for different, small amounts, believing that they were in payment of valid debts which the company owed to UCB. No such debts were in fact owed. After she received the signed checks back from the responsible corporate officer, Morales greatly increased the amounts of the checks. The court's opinion does not specify the amounts by which the checks were increased, or the way in which this alteration was accomplished.

Morales then took the checks to UCB, where she also maintained an account. Since the checks were payable to UCB, one might think that they ought to have been deposited into a UCB account. However, this is not what happened; the proceeds somehow ended up in Morales's account. The court's opinion does not specify how this occurred. It seems highly unlikely that the checks were initially deposited into a UCB account, then subsequently transferred to Morales's account. The opinion suggests that the checks were simply deposited directly into Morales's account, but this is unclear. What happened to the funds after that point is also subject to conjecture; presumably, Morales simply withdrew them from her account.

The checks were not drawn on UCB. Indeed, it does not appear from the court's opinion that the company had any banking relationship with UCB, whatsoever. Rather, the checks were drawn on the company's account at Union Bank. In due course, UCB presented the checks to Union Bank, whereupon they were paid, and Union Bank debited the company's account.

The case therefore involves the following factual relationships: the company was the drawer, UCB was *both the payee and the collecting bank*, and Union Bank was the payor bank.

The court held that, under the circumstances alleged in its complaint, the company could maintain a cause of action not only for breach of warranty but also for common-law negligence. Generally speaking, negligence is the doing of something which a reasonably prudent person would not do, or the failure to do something which a reasonably prudent person

would do under the circumstances presented by the case; in other words, the failure to use ordinary or reasonable care. It is traditionally regarded as involving the following: (1) a legal duty to use due care; (2) a breach of such legal duty; and (3) the breach as the proximate or legal cause of the resulting injury.¹⁰

The *Sun 'N Sand* court first held that, under the circumstances, UCB had a duty to investigate the situation. It stated that "an attempt by a third party to divert the proceeds of a check drawn payable to the order of a bank to the benefit of one other than the drawer or [payor bank] suggests a possible misappropriation." That duty had also been breached—the court continued that the circumstances were "sufficiently suspicious that UCB should have been alerted to the risk that Sun 'N Sand's employee was perpetrating a fraud. By making reasonable inquiries, UCB could have discovered the fraudulent scheme and prevented its success." In response to UCB's contention that the loss was not reasonably foreseeable, the court stated that "the duty is narrowly circumscribed: it is activated only when checks, not insignificant in amount, are drawn payable to the order of a bank and are presented to the payee bank by a third party seeking to negotiate the checks for his own benefit."

The court concluded:

[T]he bank's obligation is minimal. We hold simply that the bank may not ignore the danger signals inherent in such an attempted negotiation. There must be objective indicia from which the bank could reasonably conclude that the party presenting the check is authorized to transact in the manner proposed. In the absence of such indicia the bank pays at its peril.¹¹

¹⁰ See, e.g., W. L. Prosser, *Law of Torts* § 30 (4th ed. 1971); *Restatement (Second) of Torts* § 282 (1965).

¹¹ Illustrating *Sun 'N Sand*, see the recent decision of *City Nat'l Bank v. Crocker Nat'l Bank*, 150 Cal. App. 3d 290, 197 Cal. Rptr. 721 (1983). In that case, a person named Richard Warren intercepted eight cashier's checks payable to Crocker National Bank. The cashier's checks had been issued by City National Bank. (A cashier's check is just like any other check, except that the payor bank is also the drawer. Ordinarily, the payor bank "is not liable on the instrument until [it] accepts it." U.C.C. § 3-409(1). With a cashier's check, though, the payor bank debits its customer's account on issuance instead of on presentation, and in effect accepts the instrument in advance, incurring direct liability to the payee.) Warren then deposited the cashier's check into his own account at Crocker National Bank, from which he subsequently withdrew the proceeds. Under these circumstances, the court

Sun 'N Sand somewhat unceremoniously ushered in what can only be described as a revolution in the relationships between collecting banks and the victims of fraudulent schemes involving checks. It was not enough that the court extended to a drawer a direct cause of action for breach of warranty; such a result probably makes sense, and more important, is both derivable from and implements the underlying purposes and policies of the UCC. The court's creating a negligence cause of action, however, out of what is essentially an unambiguous problem involving a check, represents both a radical departure from and an extension of existing law.

Another way of expressing this proposition is that there is no evidence that the plaintiff in *Sun 'N Sand* would be able to marshal in support of a negligence cause of action that would not also have to be produced in support of a cause of action for breach of warranty. The conduct of UCB that was alleged to be negligent is precisely the conduct that would have constituted a breach of warranty under Section 4-207(1)—there are no differences either one way or the other. The plaintiff simply articulated one and the same set of underlying facts and circumstances in two different ways.

Why Negligence?

This raises the question of why bother to begin with. How did it happen that an expanded measure of liability involving a noncontractual cause of action came to be considered? In *Sun 'N Sand*, the impetus was an expired statute of limitations. In California, the statute of limitations for breach of warranty, under the circumstances alleged by the plaintiff, is one year.¹² The statute of limitations for negligence, on the other hand, under the circumstances alleged by the plaintiff, is three years.¹³ By recasting and parsing out the identical underlying facts in a new and different manner, then, the

held that City National Bank, occupying a position functionally equivalent to that of a drawer, could proceed on a negligence theory against Crocker National Bank, which was both the payee and the collecting bank.

¹² Cal. Com. Code § 4406(4) (West 1964); Cal. Civ. Proc. Code § 340(3) (West 1982).

¹³ Cal. Civ. Proc. Code § 338(3).

plaintiff was able to extend its statute of limitations by two years, with a concomitantly adverse result to UCB.

Although it was not the issue in *Sun 'N Sand*, another consequence of a negligence cause of action is an expanded measure of liability. California law, like that of many other jurisdictions, provides that damages for the breach of an obligation not arising from contract (i.e., negligence-based damages) are "the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not."¹⁴ Under the proper facts, that formulation can include a wide array of special and general damages, such as for loss of profit or for psychological distress, which have nothing to do with the underlying instrument itself and would not otherwise be available. By creating a negligence cause of action, the court essentially did away with the concept that damages in check cases can be determined on the basis of the amount of the instrument, together with, perhaps, interest.

Ease of proof is another factor. Although there is no particular reason why they should be, commercial law concepts are often considered to be unfathomably (and unfashionably) esoteric by much of the trial bar. The most sophisticated presentation in the world might not induce a jury to comprehend "holder in due course" or what is involved with a breach of warranty. The *Sun 'N Sand* court itself had considerable difficulty in explaining how a holder in due course, who takes an instrument "without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person,"¹⁵ could be charged with knowledge of "suspicious circumstances." Negligence, on

¹⁴ Cal. Civ. Code § 3333.

¹⁵ U.C.C. § 3-302(1)(c). Significantly, Cal. Code Comment 2 to Cal. Com. Code § 3302, which defines "holder in due course," is quite explicit that "the presence of suspicious circumstances sufficient to put a reasonably prudent person on inquiry does *not* negate existence of good faith" (emphasis added). "Good faith" in turn is defined in U.C.C. § 1-201(19) as "honesty in fact in the conduct or transaction concerned." Faced with an apparent contradiction, the court declined to decide this important issue. It stated: "Because we rely on specific provisions of [U.C.C. § 3-304] to find notice in the circumstances defined herein, we need not decide the extent to which facts constituting breach of duty (negligence) also constitute notice for purposes of the holder-in-due-course doctrine." *Sun 'N Sand*, 21 Cal. 3d at 697, 582 P.2d at 938, 148 Cal. Rptr. at 347.

the other hand, is much simpler to explain, without a labyrinthine maze of rules.

Finally, in the appropriate circumstances, conduct that is sufficiently wanton or reckless may expose a defendant to punitive damages that are traditionally unavailable in a contract context.¹⁶

Significantly, *Sun 'N Sand* failed to deal with the intersection between traditional negligence *defenses*, such as contributory negligence or comparative fault, and the new expanded measure of negligence liability. In an earlier decision,¹⁷ the California Supreme Court adopted the comparative fault doctrine, under which an injured individual's recovery is simply proportionately diminished, rather than completely eliminated, when he is partially responsible for the injury. It is not the purpose of this article to review that concept. Needless to say, it has had a tortuous history of subsequent litigation throughout the state. Rather, what is unclear is the way in which the concept of comparative fault ought to be applied in this context.

To begin with, it doesn't make much sense. The acts, transactions, events, and occurrences that typically give rise to check disputes are generally not amenable to analysis along this line. In short, the conceptual model of comparative fault is simply inappropriate when applied outside of its original field. By way of an example, with an automobile collision it may well be possible to determine who was in the best position to avert an impending incident. On the other hand, how is it possible to balance whether or not a bank followed its own internal rules with respect to the cashing of a check, with a drawer's failure to devise and implement an adequate system of internal controls that might have prevented or detected the embezzlement of a check by a defalcating employee? To employ a phrase, it would be like comparing apples with oranges—the two disparate sets of circumstances

¹⁶ *Restatement (Second) of Contracts* § 355; U.S.C. § 1-106(1). Compare *Z.D. Howard Co. v. Cartwright*, 537 P.2d 345 (Okla. 1975) (punitive damages recoverable on an "independent tort" theory), with *Waters v. Trenckmann*, 503 P.2d 1187 (Wyo. 1972) (punitive damages not recoverable).

¹⁷ *Li v. Yellow Cab Co.*, 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858, 78 A.L.R.3d 393 (1975).

simply have nothing to do with each other in assessing degrees of relative culpability.

Furthermore, several important bank defenses set forth in the UCC involve some concept of negligence, which may or may not be the same thing as comparative fault. Section 3-406, for example, precludes any person from recovering on an instrument if "by his negligence" he has "substantially contributed" to a material alteration of the instrument or to the making of an unauthorized signature. Is the quality and kind of negligence that would be sufficient to bar recovery under Section 3-406 the same thing as comparative fault? Should Section 3-406 be read as an absolute preclusion, or are concepts of comparative fault to be imported into that section?

These issues, among others, were unfortunately left up in the air by the *Sun 'N Sand* decision. In its urge to develop and extend the scope of remedies available against collecting banks, the court literally overlooked the flip side of the same coin: the implications of those expanded measures and theories of recovery upon the matrix of existing defenses available.

Sun 'N Sand's Progeny

If it is possible to derive a broad principle of bank conduct from *Sun 'N Sand*, it is simply this: If the collecting bank is also the payee of the check, it will dispose of the proceeds of that check at its peril. The reason: As articulated by *Sun 'N Sand*, such a circumstance is inherently suspicious and ought to present a "danger signal" of possible misappropriation.

Subsequent decisions have developed and refined *Sun 'N Sand's* rationale, generally with a view toward expanding the scope of a bank's potential liability. The important decisions are *Fireman's Fund Insurance Co. v. Security Pacific National Bank*,¹⁸ *Joffe v. United California Bank*,¹⁹ and *E.F. Hutton & Co. v. City National Bank*.²⁰

¹⁸ 85 Cal. App. 3d 797, 149 Cal. Rptr. 883 (1978).

¹⁹ 141 Cal. App. 3d 541, 190 Cal. Rptr. 443 (1983).

²⁰ 149 Cal. App. 3d 60, 196 Cal. Rptr. 614 (1983). Several other decisions simply apply the principles of these cases; they will not be discussed here. See, e.g., *Bullis v. Security*

Fireman's Fund Insurance Co. v. Security Pacific National Bank

In *Sun 'N Sand* the key liability-producing fact, which created the suspicious circumstance necessary for a finding of negligence, was that the collecting bank was also the payee of the check. What if the collecting bank is not also the payee? Can the drawer still sue it for negligence? This variation of *Sun 'N Sand* was explored in *Fireman's Fund Insurance Co. v. Security Pacific National Bank*. In *Fireman's Fund Insurance Co.*, the embezzler, Keyes, was one of two persons authorized to sign or draw checks on the account of Reeves & Co. at Banco Popular de Puerto Rico (Banco Popular). Keyes prepared a check for \$25,000, payable to an account which he established at or about the same time in the name of G.C. Associates, at Security Pacific National Bank (Security Pacific). He signed the check and then forged the other required signature. He then indorsed the check in the name of G.C. Associates and deposited it into the G.C. Associates account. Banco Popular subsequently paid the check, and debited the account of Reeves & Co. Later, Keyes withdrew the funds from the G.C. Associates account. Fireman's Fund Insurance Co. (Fireman's Fund) insured Reeves & Co. and paid it upon its apparent loss, after which it sued Security Pacific, claiming that it was subrogated to Reeves & Co.'s rights.

The case therefore involves the following factual relationships: Reeves & Co. was the drawer, Security Pacific was the collecting bank, Banco Popular was the payor bank, and G.C. Associates was the payee.

In such circumstances, the drawer clearly has a cause of action against the payor bank under Section 4-401 for breach of contract. Ordinarily, there the loss would lie. But for *Sun 'N Sand*, the drawer would have no cause of action against the collecting bank for breach of warranty.²¹

This leaves negligence. After a thorough discussion of *Sun 'N Sand*, the court concluded that no such cause of action

Pac. Nat'l Bank, 21 Cal. 3d 801, 582 P.2d 109, 148 Cal. Rptr. 22 (1978); *Danning v. Bank of Am.*, 151 Cal. App. 3d 961, 199 Cal. Rptr. 163 (1984).

²¹ The court went on to hold that no warranty of good title had been breached, as Keyes did in fact have authority to indorse the check on behalf of the payee, G.C. Associates.

existed under the circumstances alleged. “[U]nder the facts of this case, a noncustomer drawer whose signature was forged on a check drawn upon his account is precluded . . . from bringing a direct cause of action based upon statutory or common law negligence against a collecting bank after final payment has been made by a [payor] bank.”

The key factor upon which the court based its opinion is that, as far as forged drawer’s signatures are concerned, the UCC (and, in particular, Section 3-418—the final payment rule) does in fact “articulate a loss distributive scheme that displaces an action for common law negligence.” A collecting bank is under no duty to detect a forged drawer’s signature, that being “exactly the point in the collection process which marks the inception of the duty of the payor bank.” The court went on to state that it might countenance a drawer’s direct cause of action for common-law negligence against a collecting bank for the negligent handling of a check bearing a forged indorsement in some other circumstances—“when the alleged facts indicate that the bank participated in the acts resulting in the loss suffered by the drawer,” “for unreasonable conduct outside of the collection process,” or “for failure to detect a forged instrument” (apparently meaning an instrument bearing a forged indorsement). Those, however, were not the circumstances of that case, and no negligence cause of action was found to exist under the circumstances alleged.

Joffe v. United California Bank

What if the collecting bank is not the payee, but rather, the check is made payable to an escrow or to a trust? Such were the circumstances of *Joffe v. United California Bank*. In *Joffe*, the plaintiffs invested \$25,000 with a company called Continental Financial Systems (Continental). To pay for their investment, they withdrew funds which they had on deposit with Allstate Savings & Loan Association (Allstate); Allstate’s bank was UCB.²²

²² Allstate later assigned its rights to the plaintiffs, giving them a position functionally equivalent to that of a drawer.

The check was payable to "Continental Finance Systems—Wells Fargo Escrow Trust Account." Continental, though, did not deposit it into any account at Wells Fargo National Bank. Rather, it deposited it into an account which it maintained at Bank of America National Trust & Savings Association (Bank of America). Bank of America presented the check to UCB, whereupon it was paid.

The case therefore involves the following factual relationships: The Joffes stood in Allstate's shoes as the drawer, Bank of America was the collecting bank, UCB was the payor bank, and "Continental Finance Systems—Wells Fargo Escrow Trust Account" was the payee.

The Joffes sued Bank of America for breach of warranty of good title on the authority of *Sun 'N Sand*. They did not contend that the payee's indorsement had been forged. Rather, they contended that the check was payable only to an authorized representative of the payee (i.e., the escrow holder itself). Furthermore, Bank of America should not have accepted the check for deposit into some other account, absent the escrow holder's indorsement. The court did not completely adopt the Joffes' contentions; rather, it held simply that there was a factual question as to who should have indorsed the check and permitted them to state a cause of action.

The Joffes also sued UCB for breach of contract, on the ground that it had paid a check that did not bear the requisite indorsements. In view of the court's holding that the Joffes could state a cause of action for breach of warranty against Bank of America, the collecting bank, it also followed that they could state a cause of action against UCB, the payor bank.²³

The Joffes, however, did not stop there. In addition, they sued Bank of America and UCB for negligence. After reviewing both *Sun 'N Sand* and *Fireman's Fund Insurance Co.*, the court held that they could state a cause of action for negligence against Bank of America, but not against UCB.

²³ The opinion did not address any cause of action that UCB might have against Bank of America for breach of warranty.

The main reason why the court countenanced the stating of a negligence cause of action against Bank of America was because "while Continental's name appeared on the payee line, Continental was not the designated payee and was not identified as the authorized representative of the payee." The fact that the check was payable to an escrow, yet not deposited into an escrow account, also disturbed the court. The check was "for a substantial amount, payable to an escrow, or trust, or similar entity at another bank, with inadequate indicia on the face of the check regarding the representative authorized to negotiate the instrument." Therefore, the item itself did not provide sufficient "objective indicia from which the bank could reasonably conclude that the party presenting the check [was] authorized to transact in the manner proposed," to quote from *Sun 'N Sand*.

On the other hand, the court held that the Joffes could not state a cause of action for negligence against UCB, the payor bank. Though the court did not state its views in just the same way, it was obviously persuaded by the reasoning of *Fireman's Fund Insurance Co.* that with respect to payor banks, the "final payment rule" as set forth in Section 3-418 "articulates a loss distributive scheme that displaces an action for common law negligence."

The significant point to note about *Sun 'N Sand* and *Joffe* is that they both involved a nexus or intersection of some sort between the payee line of the check and the circumstances surrounding its negotiation. In *Sun 'N Sand*, the payee was also the collecting bank; in *Joffe*, a fiduciary, a type of payee worthy of special solicitude. Since the collecting bank (wearing its hat as depositary bank) is invariably the first entity to deal with the person negotiating the check, it is thought that the collecting bank is in a superior position both to verify the presence of all necessary indorsements and to make sure that the check is actually deposited into the right account. If an irregularity in indorsements appears on the face of the check, or the check is being deposited into an account not owned by the payee or a subsequent indorser (and without any indication that the owner of the account is that person's authorized

representative), it would be a relatively simple matter for the collecting bank to clarify the situation.

Given this rationale, how would it be possible to accuse a collecting bank of negligence if there is no discrepancy between the payee's name and the indorsement? Even if the indorsement is forged, that does not appear as a defect on the face of the instrument itself. The match between the payee's name and the indorsement may be fraudulent if the indorsement is forged, but that has nothing to do with the apparent integrity of the instrument, *as it appears*, which was the basis for the negligence cause of action in *Joffe*.²⁴

²⁴ Which brings us right back to the vexing problem of how much notice counts as negligence. In *Sun 'N Sand*, the court disapproved of the idea that "mere suspicious circumstances" do not impart notice; in other words, suspicious circumstances should impart notice, and they need not be so bizarre as to amount to bad faith before notice will be found. After quixotically observing that "the code is in need of clarification as to its varying standards of negligence," *Fireman's Fund Insurance Co.* then went on to state that the presence of "good faith" does not depend upon an absence of negligence; citing *Sun 'N Sand*, the court stated that "mere negligence of the holder in taking the instrument" does not amount to lack of good faith, rather, "the phrase 'reason to know' . . . suggest[s] an *objective notion of notice*" (emphasis added). It would seem that an "*objective notion of notice*" should involve nothing less than either actual knowledge of defects in the instrument, or actual bad faith; the entire thrust of *Sun 'N Sand*, however, is quite to the contrary.

Earlier decisions of the California courts validate the hypothesis that *Sun 'N Sand*'s equation of "suspicious circumstances" with "notice," absent something more, is fundamentally unsound. In *Szczotka v. Idelson*, 228 Cal. App. 2d 399, 405, 39 Cal. Rptr. 466 (1964), the court stated:

But the question is not what a reasonable man would do under the circumstances or whether a reasonable man would make inquiries. *It has been consistently held that mere suspicion of infirmities does not preclude the transferee from occupying the position of holder in due course.* [Emphasis added.]

See also U.C.C. §§ 1-201(25), 3-304; *Popp v. Exchange Bank*, 189 Cal. 296, 303, 208 P. 113 (1922); *Christian v. California Bank*, 30 Cal. 2d 421, 425, 182 P.2d 554 (1947); *Mann v. Leasko*, 179 Cal. App. 2d 692, 697, 4 Cal. Rptr. 124 (1960); *Hollywood Nat'l Bank v. International Bus. Machs. Corp.*, 38 Cal. App. 3d 607, 614, 113 Cal. Rptr. 494 (1974).

The holder should not be required to make inquiries or conduct an investigation in an effort to ferret out suspicious circumstances. As expressed in *Sasner v. Ornsten*, 93 Cal. App. 2d 467, 471, 209 P.2d 44 (1949):

[T]he purchaser . . . is not called upon to make inquiry concerning . . . execution or . . . consideration . . . , under penalty of having "bad faith" imputed to him. . . . And it may be stated . . . that mere knowledge of facts sufficient to put a prudent person upon inquiry will not affect the position of one as a *bona fide* purchaser. . . . More is required, actual knowledge unless "the circumstances or suspicions are so cogent and obvious that to remain passive would amount to bad faith."

See also *Howell v. Dowling*, 52 Cal. App. 2d 487, 494, 126 P.2d 630 (1942); *Harris v. Pollack*, 101 Cal. App. 2d 26, 28, 224 P.2d 824 (1950); *Cameron v. Security First Nat'l Bank*, 251 Cal. App. 2d 450, 458, 59 Cal. Rptr. 563 (1967).

At a minimum, it would seem that, in order to meet the "objective notice" requirement, a plaintiff would have to allege (and prove) that "the instrument is so incomplete, bears such

Such a result would not preclude an aggrieved plaintiff from stating a cause of action against the collecting bank. However, that cause of action is for conversion or for breach of warranty (based upon a forged indorsement), *not* negligence (based upon a discrepancy between the payee's name and the indorsement). Only in the latter circumstance, according to *Joffe*, would a negligence cause of action be appropriate.

This distinction may be subtle, but it is easy to see how it works, in practice. It would be tremendously burdensome for a collecting bank to verify the payee's indorsement on every instrument which it either cashes or accepts for deposit. As a mechanism of social policy, and in the absence of other loss-shifting alternatives, the authors of the UCC determined to fasten liability for a forged indorsement, first, on the thief, but second, on the next party that deals with the thief, which more often than not is the collecting bank. However, this outcome is clearly not based upon negligence or actionable fault; those concepts simply do not make sense when applied to the facts of a forged indorsement case.

On the other hand, a discrepancy between the payee's name and an indorsement can easily be spotted, simply by looking at the instrument itself. Failure to make such a comparison could well constitute negligence, which is the central point made by the *Joffe* court.

E.F. Hutton & Co. v. City National Bank

The most recent link in this continuing chain of cases is *E.F. Hutton & Co. v. City National Bank*. If what we have been hypothesizing with respect to payee lines was true—that is, in order to state a cause of action for negligence, there must be some kind of discrepancy between the payee's name and the indorsement—*E.F. Hutton & Co.* conclusively dispelled any such supposition. In fact, the nature of the payee in *E.F. Hutton & Co.* and the relationship between the

visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or create an ambiguity as to the party to pay." U.C.C. § 3-304(1)(a).

payee's name and the indorsement were completely irrelevant. Rather, the court relied solely upon the suspicious concatenation of facts and circumstances present at the time of the negotiation of the check, to fasten liability upon the collecting bank.

The facts of the case are simple. E.F. Hutton & Co. drew eighteen checks totaling \$638,598. The checks were payable to various named individual payees. One of the company's employees, somebody named Hamaoui, stole the checks, forged the payees' indorsements, and deposited them into his personal account at City National Bank, from which he subsequently withdrew the proceeds. The identity of the payor bank(s), i.e., the company's bank, is not specified in the court's opinion. It can be assumed that the payor bank (or banks) paid the checks upon presentment by City National Bank, which then collected the proceeds. City National Bank is therefore a collecting bank.

We know from *Sun 'N Sand* that a drawer (such as E.F. Hutton & Co.) has a direct cause of action for breach of warranty against a collecting bank (such as City National Bank), pursuant to Section 4-207. In addition, however, E.F. Hutton & Co. also sued City National Bank for negligence. The court held that it could maintain such a cause of action:

In the situation where a collecting bank is presented with one or more checks of a significant amount by a person the bank knows or should know is an employee of the drawer and the employee will receive the check proceeds, then sufficiently suspicious circumstances are present to alert the collecting bank that a fraud may be perpetrated on the drawer-employer. Given these factors, *Sun 'N Sand* says a duty of due care is imposed on the collecting bank.

* * *

In our instant case, the checks, either in the aggregate or individually, were for a substantial amount, payable to individual payees at another bank, with inadequate indicia on the face of the checks (as pleaded) regarding the authorization of Hamaoui (who, it appeared, was to benefit from each transaction) to negotiate the instruments. Under the circumstances, it must be concluded that the risk to the drawer plaintiff was sufficiently foreseeable to impose a duty on defendant City Bank, the collecting bank, not to ignore the danger signals

inherent in the forged negotiations by Hamaoui. The defendant bank proceeded at its peril when it failed to take reasonable steps to investigate Hamaoui's authority to negotiate the checks and to deposit the collected check funds in his personal account.

A powerful argument can be made that *E.F. Hutton & Co.* is simply wrong. Section 3-304(4)(e) provides that knowledge that a person negotiating an instrument either is or was a fiduciary does not give notice of a defense or claim, or defeat holder-in-due-course status. As noted in Official Comment No. 5, a collecting bank is therefore free to take the instrument on the assumption that the fiduciary is acting properly and may even "pay cash into the hands of the fiduciary without notice of any breach of the obligation." Under California law, together with that of many other jurisdictions, a person who is an employee is a fiduciary vis-à-vis his employer.²⁵ As such, his obligation of diligent and faithful service is the same as that of a trustee.

E.F. Hutton & Co. alleged that City National Bank either actually knew or should have known that Hamaoui was its employee. This being so, City National Bank should have been entitled to pay the proceeds of the checks to Hamaoui on the assumption that he in turn would remit those funds to *E.F. Hutton & Co.* The fact that he did not do so is not a basis for fastening liability on the collecting bank, which is entitled to affirmatively rely upon the employer-employee relationship and assume that the fiduciary is acting properly. Rather, the loss should fall upon the employer, who accredited the employee to begin with, and whose misplaced confidence in the employee (or lack of attention to what the employee was doing) permitted or enabled the employee to come into possession of the checks to begin with. To put it another way, if the employee had not been in possession of the checks from the start, the fraud would not have taken place; the employer is therefore primarily at fault.

The underlying basis for a holding that the employer remains liable for the acts of his employee is the concept of ostensible authority—that is, the type of authority that a

²⁵ Cal. Civ. Code § 2322(3) (West 1954); *Restatement (Second) of Agency* § 13 (1958).

principal, either intentionally or by want of ordinary care, causes or allows a third person to believe his agent to possess.²⁶ Ordinarily, as an abstract principle of law, an employee authorized to be in possession of his employer's checks may not have authority to negotiate them. On the other hand, the employee's course of conduct with the collecting bank may be such as to give him apparent authority to do just that. Under such circumstances, the employer is bound by his employee's acts on principles of estoppel.²⁷

E.F. Hutton & Co.'s reliance upon the collecting bank's alleged knowledge of an employer-employee relationship as being sufficient to constitute an inference of suspicious circumstances is, therefore, incorrect. The UCC holds the opposite view: There is nothing inherently suspicious about an employee being in possession of a check drawn by his employer; and even if there was, it is the employer's fault. To fasten liability on a collecting bank under such circumstances ought to require a greater quantum of information, such as actual knowledge that the employee was committing a breach of trust.

Even if it is correct, *E.F. Hutton & Co.* leaves unanswered more questions than it resolves. First and foremost: What counts as a sufficiently suspicious circumstance, such that liability ought to be imposed? The case involved a few very large items. Would the result have been the same if numerous small items had been negotiated over an extended period of time? It would seem that the collecting bank's right to rely upon the employee's apparent authority ought to be enhanced by the length of time over which the fraud is alleged to have occurred. The longer the employee continues to negotiate checks without any objection or detection of loss by the employer, the more the risk of loss detectable by the collecting bank, if any, would be lessened. The pattern of conduct and elapsed time alone should be sufficient to vali-

²⁶ Cal. Civ. Code § 2317 (West 1954); *Black's Law Dictionary*, note 1 *supra*.

²⁷ The court in *E.F. Hutton & Co.* conveniently ignored earlier California precedent to this effect. See, e.g., *Safeway Stores v. King Lumber Co.*, 45 Cal. App. 2d 17, 22, 113 P.2d 483 (1941); *Condor Corp. v. Cunningham*, 71 Cal. App. 2d 25, 33, 162 P.2d 21 (1945); *Liberty Mut. Ins. Co. v. Kleinman*, 149 Cal. App. 2d 404, 407, 308 P.2d 347 (1957).

date the procedure and constitute the “objective indicia from which the bank could reasonably conclude that the party presenting the check [was] authorized to transact in the manner proposed.”²⁸

What is the significance of the allegation in *E.F. Hutton & Co.* that the checks were deposited to a personal account instead of, for example, simply cashed? Depositing the checks to a personal account would seem to negate an inference of honest intention. On the other hand, the potential liability of a collecting bank is the same, regardless of whether a check is cashed or deposited. A dishonest employee might be able to cash a check on the express or implied representation that he would transmit the proceeds to his employer without suspicious circumstances being present.

Finally, is it significant that the employer in *E.F. Hutton & Co.* was a drawer instead of a payee? The checks were alleged to have been payable to individual payees at another bank. That should have raised a question in the mind of the responsible person at the collecting bank as to just what Hamaoui was doing with them to begin with. Such an issue would not seem to be present if the person attempting to negotiate the check was known to be the payee’s employee, as there is nothing suspicious about an employee of a business being in possession of a check payable to that business, especially if the employee is known by the collecting bank to perform accounting functions. If such a scenario presents an internal control deficiency, that should be the employer’s problem, not the collecting bank’s—the bank should be entitled to rely upon the employee’s apparent authority to negotiate checks, notwithstanding the fact that such authority might not actually exist.

The Cause of Action for Negligence Depends Upon Complicated Policy Considerations

Perhaps the most important point to emphasize about *Sun ‘N Sand, Fireman’s Fund Insurance Co., Joffe, and E.F.*

²⁸ *Sun ‘N Sand*, 21 Cal. 3d at 696, 582 P.2d at 937, 148 Cal. Rptr. at 346.

Hutton & Co. is that they all started with the basic assumptions that no negligence cause of action exists and that the aggrieved parties were afforded adequate remedies under the UCC. In order to justify an exception from this underlying principle, the respective courts felt compelled to engage in a complicated, even tortuous, analysis, the central theme of which was whether or not the UCC provided a complete and comprehensive loss allocation scheme under the particular facts alleged. If there was a meaningful, adequate, and effective remedy under the UCC, the court would not initially be inclined to sanction an additional remedy, such as negligence. Extra causes of action would be superfluous and cumulative, and would infringe upon an area that had already been displaced by legislation.

On the other hand, if there was a gap in the coverage of the UCC, or the situation presented was not covered, the court would be far more likely to approve a negligence cause of action. In such circumstances, the UCC does not suggest, much less compel, any particular outcome. "For every wrong there is a remedy," to quote a popular maxim of equity, and it would be unfair if an aggrieved party was left without a cause of action.

The central theme of this article is that the concept of negligence is inappropriately applied to most situations involving checks. The UCC in fact sets forth meaningful, adequate, and effective remedies under most circumstances, displacing common law. There is no socially useful or other reason why a negligence cause of action ought to exist. Additionally, there is a fundamental ambiguity and indeterminacy inherent in the concept of suspicious circumstances. Principles of law pertaining to checks ought to be ordered and settled, and not subject to constant reevaluation upon the caprice of the judiciary.

A review of those criteria commonly thought to be necessary for a finding that a given course of conduct is negligent reinforces this conclusion. These include²⁹:

²⁹ See, e.g., Prosser, note 10 *supra*, § 31; *Restatement (Second) of Torts* § 289 et seq. (1965).

- The foreseeability of harm to the plaintiff
- The degree of certainty that the plaintiff suffered injury
- The closeness of the connection between the defendant's conduct and the injury suffered
- The moral blame attached to the defendant's conduct
- The policy of preventing future harm
- The extent of the burden to the defendant and consequences to the community of imposing a duty to exercise care with resulting liability for breach
- The availability, cost, and prevalence of insurance for the risk involved

Assessing these criteria in light of existing case law compels a determination that a negligence cause of action, in the circumstances discussed and under the circumstances that it will undoubtedly be extended to in the future, is inappropriate.

Foreseeability of Harm to the Plaintiff

There are few procedures more common in the banking industry than the accepting for deposit of a check apparently indorsed by the named payee, be it negotiated by a person known to be an employee of the drawer or by anybody else. If it is assumed that the payee's indorsement has been forged, this still does not remove the transaction from the vast ambit of commercial reasonableness, as no defect in any indorsement is apparent from the face of the instrument itself. Even though it may later transpire that the indorsement was forged, such a circumstance is not "sufficiently suspicious, and the risks thus sufficiently apparent"³⁰ that the collecting bank ought to be held liable; there are no "indicia of misappropriation" or "danger signals."³¹ On the other hand, if the collecting bank is also the payee, as with *Sun 'N Sand*, or there is an ambiguity on the face of the instrument as to the identity or authority of the payee, as with *Joffe*, risk is still not reasonably foreseeable without reference to the circumstances surrounding the negotiation of the instrument, which partake

³⁰ *Sun 'N Sand*, 21 Cal. 3d at 693, 582 P.2d at 935, 148 Cal. Rptr. at 344.

³¹ *Id.* at 695, 582 P.2d at 937, 148 Cal. Rptr. at 346.

of varying degrees of ambiguity, uncertainty, and interpretation.

Degree of Certainty That Plaintiff Suffered Injury

A collecting bank ought to be liable for damages sustained or incurred only up to the value of the interest of the payee in the check.³² Other alternative theories of recovery (such as for loss of profits or for damages for mental suffering) are speculative, remote, and not within the contemplation of the parties at any relevant point in time. To the extent that it seeks damages only for the face amount of a check, a negligence cause of action is merely duplicative.

Closeness of Connection Between Defendant's Conduct and Injury Suffered

Any such connection is speculative and remote, as drawers and payees must bear primary responsibility for supervising the activities of their employees. As far as the collecting bank is concerned, an aggrieved employer and his employee are one operating unit. Further, it is difficult to see how a check made payable to a collecting bank or to an alleged fiduciary can, in and of itself, be turned into an instrumentality causing harm; the real-world intervention of an unscrupulous intermediary is always required to so transform it. If liability exists, it should be allocated to the party more comparatively at fault, which is either the forger or the entity of the plaintiffs' business; as expressed in *Sun 'N Sand*, "our strong policy favors fault-based liability."³³

Moral Blame Attached to Defendant's Conduct

No moral blame whatsoever can be assigned to a collecting bank in connection with its handling of a check; this concept simply doesn't make sense.

³² U.C.C. § 3-419(2).

³³ *Sun 'N Sand*, 21 Cal. 3d at 698, 582 P.2d at 939, 148 Cal. Rptr. at 348.

Policy of Preventing Future Harm

While everyone is in favor of preventing future harm, it is completely unclear that such a policy would be effectuated by imposing a cumulative negligence liability. Collecting banks are already more than adequately deterred from conduct that might tend to create harm by existing remedies afforded to other parties to negotiable instruments under the UCC.

Extent of Burden to Defendant and Consequences to Community of Imposing a Duty to Exercise Care With Resulting Liability for Breach

It is not that farfetched to assert that the wheels of commerce could grind to an inextricable halt as a result of the imposition of negligence liabilities of potentially indefinite scope. The reason is simple: The transactions that have been discussed were ordinary banking transactions with no foreseeable risk of harm.³⁴ The objectives that the UCC was designed to implement are simplicity, clarity, and uniformity.³⁵ It would be tremendously burdensome for a collecting bank to verify with a drawer that every payee was legitimate, or verify with every payee that its indorsement was genuine. Ordinary commercial transactions, such as these apparently were, would bog down. The various interests of other parties to negotiable instruments would be frustrated. Payees would complain to drawers that payment of their invoices or statements had been delayed. Drawers would inquire of their payor banks. The needless expenditure of valuable business and management time, which could otherwise be devoted to productive and socially useful purposes, would be horrendous. Even more important, it is highly unlikely that concomitant benefits would accrue to either payees or drawers.

It would be erroneous to blur or eliminate the distinctions, as defined by courts throughout the country, between notice, good faith, and negligence. Not only would doing that eliminate the concept of holder in due course, but it would also

³⁴ See text accompanying note 28 *supra*.

³⁵ U.C.C. § 1-102(2)(a).

result in the wholesale evisceration of the UCC itself. If it all comes down to negligence or comparative fault, what is the use of a statute like the UCC to begin with? The court in *Fireman's Fund Insurance Co.* stated that "statutory language . . . must be given such interpretation as will promote rather than defeat the objective and policy of the law."³⁶

Availability, Cost, and Prevalence of Insurance for the Risk Involved

Except in catastrophic situations, losses on misdirected or improperly paid commercial paper are generally borne directly by the depositary institutions involved.

The important policy considerations that a court must evaluate before concluding that an otherwise innocuous course of conduct really constitutes actionable negligence compel a determination that the existing case law discussed herein is misdirected and that it would be inappropriate to extend a negligence cause of action any further. Commercial banks cannot be subjected to a maze of nonstatutory rights of recovery. It is essential that a uniform measure of liability apply. This uniform standard is articulated in the UCC, which must govern despite the exigencies of various other rights of recovery which might otherwise be asserted against other types of defendants in other factual situations.

If anything else was the case, all depositary institutions would be subject to additional, possibly inconsistent, obligations under the UCC and decisional law. Indeed, a collecting bank would be subject not to one uniform law, but to a patchwork quilt of laws and rights of recovery, each potentially different from the other. The authors of the UCC recognized that this would be an impossible situation. To subject a collecting bank to such a matrix of conflicting duties and obligations would impose an unconscionable burden on the check collection process, painstakingly evolved over time. It would not only impinge upon those operations, but would in fact cause them to grind to a screeching halt.

The dominant interest in uniform regulation of the check

³⁶ *Fireman's Fund Ins. Co.*, 85 Cal. App. 3d at 815, 149 Cal. Rptr. at 896.

collection process ought to preempt any residual or alternative common-law theories of recovery. No cause of action should be assertable against a collecting bank, except as provided for in the UCC. The UCC does not provide for a negligence cause of action against a collecting bank; rather, it provides different, effective causes of action which are the remedies available to an aggrieved plaintiff.

Conclusion

Forewarned is forearmed. The fact situations discussed in this article are not excessively complicated. It is well within the capability of any depository institution to become familiar with them and implement appropriate countermeasures. Beyond that, though, what is required is an enhanced sensitivity to liability-creating scenarios. Some circumstances may be so inherently suspicious that they can be readily identified. These, however, will not present a problem. If the circumstances of an attempted negotiation are *that* suspicious, no prudent bank would ever accept the item to begin with. Now, as always, it is the borderline cases that are the most difficult. While an appeal to "intuition" is not particularly satisfying, it may be the best resource available.