2018

Exploring Banks' Duty of Care towards Non-Customers in U.C.C. Article 3 & 4

Anis A. Houssein
Indiana University Maurer School of Law, anhousse@iu.edu

Exploring Banks' Duty of Care towards Non-Customers in U.C.C. Article 3&4.

by

Anis A Houssein

A thesis submitted in conformity with the requirements
for the degree of Master of Laws
Maurer Law School
Indiana University

Accepted by the faculty, Indiana University Maurer School of Law, in partial fulfillment of the requirements for the degree of Master of Laws – Thesis.

Thesis Committee

Sarah Jane Hughes

Sarah Jane Hughes

University Scholar and Fellow in Commercial Law

05/09/2018

Exploring Banks' Duty of Care towards Non-Customers in U.C.C. Article 3&4.

Anis A Houssein

Master of Laws

Maurer Law School
Indiana University
2018

Abstract

This Thesis analyzes the bank transaction regarding cashing or accepting for deposit instruments over forged or unauthorized indorsements. Also, it investigates the development of conversion of instruments through the years and the courts' contribution to the development. It examines the U.C.C. former section 3-419 and the courts' reaction to the defense afforded to banks against an allegation of conversion and examines as well the current 3-420 and the reasons that led to the amendment. Besides all that, this Thesis discusses the banks' defenses regarding Impostors and Fictitious Payees under § 3-404, Employer's responsibility for fraudulent indorsement by his employee under § 3-405, and negligence contributing to forged signature or alteration of an instrument under§ 3-406. Eventually, it analyzes the courts' recognition for the reasonable commercial standards that banks must exercise when they cash or accept for deposit instruments over forged or unauthorized indorsements.

I. Introduction

In the United State, the common law perspective of the relationship between banks and clients is a relation of debtors and creditors. The common law established a duty on banks to pay out checks only by the client's instructions.

In 1952, Uniform Commercial Code (U.C.C.) was enacted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI). The UCC contains Article 3 that governs (Negotiable Instruments). Besides Article 4 which covers bank deposits and collections. The states have adopted Article 3 and 4, and they became applicable as a part of all 50 states' commercial code. The UCC regulates the duty of care that bank owes to the clients.

Under the Code, a relationship between the bank and its client accrued when the client deposits money in his account within the bank. The deposition starts the duty of the bank to do not withdrew money out of the account without the authorization of the client. Section 4-401 says that a bank may charge against a customer's account an item that is properly payable. A payment is properly payable if it is authorized by the customer and is in accordance with the agreement. Allowing someone to withdraw money from the client account without the client's permitting leads to breach of the contract with the client. The Uniform Fiduciaries Act makes bank potentially liable for their bad faith honoring a check drawn by fiduciaries to misappropriate funds from the principal who owns the account.

The duty of the bank under the contractual relationship with the client comprises good faith and ordinary care. The U.C.C. permits the parties to vary the contract's provisions, but it does not allow the waiver of the duty of good faith and ordinary care:

The parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.

In this thesis, I undertake an analysis of how the Code protect the interests of non-customers since banks have no duty of care toward towards any person outside the contractual relationship. Specifically, when a bank cashes or accepts for deposit an instrument over a forged or an unauthorized indorsement. How could the real owner of the instrument recover from the bank that dealt with the forger of the instrument?

The issue of an instrument bearing a forged or an unauthorized indorsement happens in many ways. For instance, after a drawer issued an instrument payable to a specific person or for a bearer, delivered the instrument to the payee. After the payee received the instrument, a forger stole the instrument and forged the signature of the real payee then took the instrument to a depositary bank. The depositary bank cashed the instrument or accepted for deposit into the forger account. Later, the depositary bank forwarded the instrument to the drawee bank for collection. The drawee bank transferred the amount of the instrument to the depositary bank.

The question that this Thesis answers is how the real owner of the instrument could recover from the depositary bank that cashed or accepted for deposit the instrument over a forged of an authorized signature in the absence of a contractual relationship.

a. Rationale of this Study

My focus on conversion is motivated by several considerations. How could the theory of conversion protect the interest of the owner of a forged instrument? How the courts have explicated the theory of conversion in the area of banking activities? How has the theory of conversion and its application developed through the time?

1. the application of the theory of conversion

It is attractive to study deeply the application of the theory of conversion and its protection regarding the instruments bearing forged or unauthorized indorsements. I wanted to understand the elements of an action for conversion and when we could consider that a bank converted property of another owner. Also, when could an owner of an instrument start an action for conversion? Moreover, could the bank encounter the conversion action and if so, what are the defenses that the bank could allege to prevail. However, if the owner of an instrument wins the suit, to any extent the bank would be liable. Is the bank liable to the amount of the instrument or to other amounts estimated by courts according to the facts presented in each case?

2. Interpretation of Conversion

It is significant to me as a researcher in banking law to understand how courts interpreted the conversion and whether the conversion action was sufficient and effective to protect the interest of the owner of an instrument. Also, when could the owner of the instrument lose his case of conversion against the depositary bank. It is interesting to study whether an owner of an instrument is going to win in every time a depositary bank converted his or her instrument, or there are occasions in which a depositary bank is going to prevail against the owner. Also, what could be the facts that may lead the courts to hold for the deposited bank and whether the depository bank really deserves to prevail in the eyes of public policies.

3. The development of Conversion under U.C.C.

Adopting to the theory of conversion within the U.C.C.'s sections was not a new suggestion by the Legislature of the Code. It is a development that has happened during a very long period. In the United State, the courts started hearing cases regarding conversion of instruments since the first quarter of the 19th century and after that the Negotiable Instrument Law, which was adopted by twenty states as well as the District of Columbia, had regulated the occasions of cashing or accepting for deposit instruments over forged in or unauthorized indorsements in section 23. It is really motivating to me to study how has the conversion action developed during this period and what are the reasons that have led the Legislature of the Code to amend the section that regulates the conversion action.

b. Overview of the Thesis

This work is divided into five chapters in addition to the present one. Chapter II sets out two theories under which jurisdictions allowed recovery against depositary banks. The owner of a forged instrument could sue the depository bank under the doctrine of conversion, or the theory of money had and received. Chapter II focuses on section 23 of Negotiable Instruments Law which regulated conversion. Also, the Chapter illustrates the exemption that the courts developed for a broker who dealt with negotiable securities in a bearer form. When a broker sold stolen bearer bonds and remitted the proceeds of the sale to his principal in good faith. Also, this

Chapter II defines the method by which an owner of an instrument could sue for conversion or money had and received a depositary bank to restore his instrument.

Chapter III consists of subsection § 3-419(3) which altered the former rules regarding depositary banks' liability on cashing or accepting for deposit instruments over an unauthorized or a forged indorsement. Examining the alteration of depositary banks' liability, its new elements under § 3-419(3), and the courts' reaction to the subsection shows the reasons that drove the legislatures to the recent amendment of the subsection in 1990. Chapter III discusses first the defense that subsection 3-419(3) afforded depositary banks to absolve from liability of dealing with an instrument bearing an unauthorized or forged indorsement and second, the court's response to the new defense and the alteration of the pre-U.C.C. legal doctrines. Lastly, the Chapter examines whether the courts' approaches were an appropriate cause that led to the amendment of the section 3-419.

Chapter IV discusses why the Article 3 is an applicable law for any conversion action. Chapter IV also addresses current 3-420 and its alteration on depositary banks' liability for conversion, and when an owner could sue a depositary bank for conversion. After that, the Chapter illustrates whether the drawer of an instrument could sue for conversion. Lastly, the Chapter concentrates on the depositary bank defenses to prevail in a suit for conversion.

Eventually, Chapter V addresses the conclusion of this thesis and presents the reflections which could be significant to any person who wants to understand deeply the doctrine of conversion in practices regarding negotiable instruments.

II. Depositary Bank's Liability Pre-U.C.C.

Before the enactment of the U.C.C.,[1] a real owner of an instrument[2] had an absolute right[3] to retrieve his instrument or its proceeds from at least four parties; the forger of the indorsement, the drawer of the instrument, the payor bank, and the depositary bank. Though the conflict among the jurisdictions as to which theories of recovery the real owner is entitled to, roughly all courts recognized the right of the actual owner to recover from a depositary bank that cashed an instrument before collection or accepted it for deposit in the forger account.

[1] - The Uniform Commercial Code published in 1952, which, after that, was adopted by all 50 states.

[2] - "A check is payable to order when by its terms it is made payable to an identified person." U.C.C. § 3-109 (1).

[3] - Forged signature; effect of. When a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority," Section 23 of Uniform Negotiable Instruments Act of The United States of 1896.

Jurisdictions allowed recovery against the depositary bank under two theories. The payee could sue the depository bank for conversion[4] or money had and received.[5] This Chapter focuses on section 23 of Negotiable Instruments Law which regulated an action for conversion and the exemption that the courts developed for a broker who dealt with negotiable securities in a bearer form. When a broker sold stolen bearer bonds and remitted the proceeds of the sale to his principal in good faith, the courts refused to find the broker liable for conversion. Also, Chapter II defines how an owner of an instrument could sue for conversion or money had and received a depositary bank to restore his property.

1. Section 23 of the Negotiable Instruments Law

Before the adoption of the U.C.C., section 23 of the Negotiable Instruments Law[6] regulated an action for conversion to an owner of a forged instrument to retrieve his instrument or its proceeds from the unlawful holder. Since section 23 decided that any person receive an instruments or its proceeds over a forged or an unauthorized indorsement has no right to them,[7] and the real owner of the instrument of its proceeds has the right to recover from the unlawful

---

[4] - In *Louisville & N. R. Co.* v. *Citizens' & Peoples' Nat'l Bank*, 74 Fla. 385, 77 So. 104 (1917), which was cited by 21 courts, the court hold that the act of the drawee bank shows a conversion.

Also, "It might be a hardship upon the defendant, but that by law a person is guilty of a conversion who intermeddles with my property and disposes of it; and it is no answer that he acted under authority of another who himself had no authority to dispose of it."

And, "The first count of the declaration may be considered as one in common-law action for the conversion of a check. The check was the property of the plaintiff; it was in the plaintiff's possession, for Weekly's possession was the plaintiff's possession; it was taken by the defendant upon whom it was drawn, and the proceeds paid to a person who had no authority from the plaintiff to receive it; the account of the drawer was charged with the amount paid and the check was returned to the drawer. It was unnecessary to allege a demand by the plaintiff and a refusal by the defendant to return the check, because the allegations of the declaration show a conversion." *Louisville & N. R. Co.* v. *Louisville & N. R. Co.*, 74 Fla. at 387-88.

[5] - "The basis of this action is that the indorsements were forged and the payments to the forger unauthorized. The depositary bank contends that this action cannot be maintained because of the provision of section 188 of the NIA, which reads: "A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check." Conceding the forgery for the purpose, it argues that payment on the forged indorsements was no payment at all; that the drawee banks could not charge the amounts paid against the respective accounts of the drawers; that it is liable to reimburse the drawee banks; that the drawers and the payee were in no way affected by the payment of the money by the drawee banks to it on the forged indorsements; that the money paid to it was the money of the drawee banks, in which neither the drawers nor the payee had any interest; and that there is no contractual relation between it and the payee which establishes an obligation to pay. This suit is not brought on the checks. We agree that under the NIA the payee of an unaccepted check, who holds it, cannot sue the drawee, and he certainly could not maintain an action against a bank, other than the drawee, which refused to pay the check on demand. The payee does not contend that it has a right to base its action on the check or on any contractual relation arising out of the check as such. It seeks to recover the value of its property which came into the hands of the depositary bank and for which the depositary bank refuses to account. The payee might have brought an action of trover against depositary bank for unlawful conversion of its property, but it chose to waive the tort and to bring its action in assumpsit for money had and received for its use. That it had a right to do this is well established by the great weight of authority. The payee ratifies the collection of the check for it, and by this act ratifies the assumed payment of the check. Both the drawer and the drawee of the check are released from paying it over again, because the payee, by ratifying the payment, is estopped from making a claim against either." *Independent Oil Men's Ass'n* v. *Ft. Dearborn Nat'l Bank,* 311 Ill. 278, 142 N.E. 458 (1924). at 280-81.

[6] - Uniform Negotiable Instruments Act of The United States of 1896.

[7] - "When depositor-drawer of check is precluded from setting up forgery of indorsement or want of authority against drawee bank." *Gresham State Bank* v. *O & K Constr. Co.*, 231 Or. 106, 370 P.2d 726 (1962).

holder. Section 23 stated that a forged or an unauthorized indorsement cannot be operative and therefore give no rights to the indorsee. Thus, a depositary bank who cashed or accepted an instrument for deposit without the real payee's authorized indorsement possess no title and when the depositary bank collects the proceeds of the instrument from the drawee bank, the depositary bank's dominion wrongfully exerted over the real payee's personal property in denial of or inconsistent with his title or rights therein, or in derogation, exclusion, or defiance of such title or rights, without the owner's consent and without lawful justification.[8]

Also, under general rule pre-U.C.C., the owner of an instrument has the right to recover his proceeds under the theory of money had and received. For instance, the Supreme Court of Missouri[9] stated that a depositary bank which accepted the check on a forged indorsement acquires no title and holds the proceeds of the check when collected from the drawee bank, for the real payee or rightful owner, who may recover from the depositary bank for money had and received. The actual owner is entitled to recovery even though the depositary bank has fully paid over and accounted for the same amount to the forger without awareness or suspicion of the forgery, and such rule applies to indorsements by a person bearing the same name as the payee, and to indorsements by the payee's agent without authority.[10]

Also, as a notice, the owner of the instrument in addition to the forger himself could sue either the drawer of the instrument. The cause of the action against the drawer is the underlying obligation for which the drawer gave an instrument.[11] The owner also could sue the payor bank which paid the check over the unauthorized indorsement unless the owner is precluded, by his ratification, negligence, or any facts creating an estoppel.[12]

2. The Broker's Exception

Under NIL[13] both brokers and depositary banks dealing with an instrument bearing an unauthorized or forged indorsement were liable to the real payee. A broker, as an agent for his principal, is liable for conversion to a real owner of an instrument as s/he was the principal.[14] Since the broker stood in the shoes of his principal when s/he sold personal property,[15] the broker

---

[8] - Frederick J. Jr. Murphy, *Depositary Bank Liability in Conversion under U.C.C. Section 3-419(3)*, 34 Wayne L. Rev.357 (1987) at page 360.
[9] - *Chemical Workers Basic Union* v. *Arnold Sav. Bank,* 411 S.W.2d 159 (Mo. 1966).
[10] - *Chemical Workers Basic Union,* 411 S.W.2d at 162.
[11] - "The payee could recover from the drawer of the check. The cause of action was generally recognized as one on the underlying obligation for which the check was given, since the genuine payee had never received any money. But when the check was stolen from the mails or otherwise diverted prior to the payee's physical receipt, in some jurisdictions the true payee was unable to recover from the drawer." *Hart* v. *Moore,* 158 So. 490 (Miss. 1935); *Siegel* v. *Kovinsky,* 93 Misc. 541, 157 N.Y.S. 340 (App. Term 1916).
[12] - "It is the general rule that a drawee bank is liable to the true payee of a check, which it has certified at his instance, if it pays out the money under a forged or unauthorized indorsement of his name, unless the payee is precluded, by his ratification, negligence, or facts creating an estoppel, from setting up the forgery or want of authority. At its peril, the bank must know that the one to whom it pays such an indorsed check prima facie had authority to make the indorsement, and its mere good faith is no defense." *Citizens & Southern Nat'l Bank* v. *Davis*, 54 Ga. App. 836, 188 S.E. 589 (1936).
[13] - Uniform Negotiable Instruments Act of The United States of 1896.
[14] - Paula J. Dalley, *A Theory of Agency Law*, University of Pittsburgh Law Review, Vol. 72, Issue 3 495 (2011) at p 515.
[15] - *Id* at p 515-16.

was not protected from liability by the mere fact that s/he performed on behalf of his principal and that s/he reasonably, although mistakenly, believed that the principal had been legitimately in possession of the property. Because a forged indorsement does not transfer any rights to the indorsee,[16] a principal had no power to transfer a fraudulently indorsed negotiable instrument to his broker for disposition,[17] and the broker obtains no power to carry a good title. Accordingly, a broker who innocently sold a negotiable instrument over a forged indorsement was fully liable for conversion to a real owner, even though the broker has transferred the proceeds to the principal. [18] In *Fidelity & Deposit Co.* v. *Hamilton Nat'l Bank*,[19] the court held that an agent who wrongfully converts another's property, or who assists his principal in so doing, is personally liable for conversion, even though he commits the act in good faith, in ignorance of the owner's rights and obedience to the command of his principal, and although he realizes nothing out of the transaction. If he knowingly assists his principal in converting another's property, he is liable.[20]

However, courts developed an exception for a broker who dealt with negotiable securities in a bearer form. When a broker sold stolen bearer bonds and remitted the proceeds of the sale to the principal in good faith, the courts refused to find the broker liable for conversion to the real owner.[21] The legal justification for this exception was dual. First, the real owner of bearer bonds has no outstanding rights against the broker since the bearer bonds move between people such as cash and the title pass by delivery alone.[22] Second, the courts found that the broker as an agent acquires a valid title and was protected from suit in conversion because the bonds were in bearer form and purchased from the broker in good faith. The reason for the defense of good faith, as New York appeals court held, is that the public policy does not demand the imposition of a cruel rule of liability on an innocent broker selling bearer bonds.[23] The broker, as the innocent conductive of valid bonds, should also be afforded such protection. The court recognized that

---

[16] - "When a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument." NIL Section 23.

[17] - "A forged indorsement transfers no rights. Therefore, when the principal took possession of the instrument without the true payee's indorsement took no right to the instrument and, so, had no authority to transfer title to his agent." NIL Section 23.

[18] - *Fidelity & Deposit Co.* v. *Hamilton Nat'l Bank*, 23 Tenn. App. 20, 126 S.W.2d 359 (1938); Also, "A purchase, in good faith, from one who has no title and no right to transfer the property, will not constitute a defense. Even an auctioneer or broker who sells property for one who has no title, and pays over to his principal the proceeds, with no knowledge of the defect of the title or want of authority, is held to be liable for its conversion to the real owner." *State* v. *Omaha Nat'l Bank*, 66 Neb. 857, 93 N.W. 319 (1903) at 869-70.

[19] - *Fidelity & Deposit Co.* 126 S.W.2d 359.

[20] - *Fidelity & Deposit Co.*, 126 S.W.2d at 363.

[21] - "An action for the conversion of interest coupons of United States bonds payable to bearer cannot be maintained by the owner from whom they were stolen where the defendant in good faith received them as an agent in exchange, and without gross negligence from a party to the theft, and paid the proceeds to his employer, receiving no benefit himself, and without any notice from the plaintiff." *Spooner* v. *Holmes*, 102 Mass. 503 (1869) at 508; "The true test is not whether compensation is received for the act which works the conversion of the negotiable security, or whether it was gratuitous. It is whether the transaction was entered upon in ignorance of the bearer's want of title, or any circumstances sufficient to put a reasonably cautious and prudent man upon inquiry, the ignoring of which amounts to proof of bad faith." *Pratt* v. *Higginson*, 230 Mass. 256, 119 N.E. 661 (1918) at 663.

[22] - "Bonds, being negotiable, pass by delivery, and the transferee to whom they are sold, who takes them for value and in good faith, obtains a good title as against the real owner. It would seem strange if the broker, who is thus the conduit of a valid title, should be held responsible for a conversion although he acted in the same good faith as the purchaser." *First Nat'l Bank* v. *Goldberg*, 340 Pa. 337, 17 A.2d 377 (1941).

[23] - "The harshness of such a rule has been recognized by the courts in repudiating his liability. Public policy does not demand the extension of liability for innocent acts to such a case. " *Gruntal*, 173 N.E. at 684.

these bonds were readily transferable and should remain the same without setting unreasonable risk on individuals dealing with negotiable papers.[24]

It might look like the defense of good faith was allowed only to the broker who is dealing with investment securities. However, the specific court decisions foster the rule to mean that the defense was even available when dealing with all forms of negotiable papers.[25]

3. Depositary Bank's Liability

Liability of depositary banks under the pre-U.C.C. was different from the unique treatment of brokers dealing with bearer bonds. The innocent broker who sold stolen personal bonds is liable to the real owner for conversion if s/he acted in negligence or bad faith.[26] However, a depositary bank is liable for conversion or for money had and received to the owner of the instrument[27] regardless whether the bank has cashed or accepted for deposit an instrument over a forged or an unauthorized indorsement in good faith and according to reasonable commercial standards. Also, the bank is liable for conversion regardless whether the bank has paid the proceeds to the forger.[28] The real owner of an instrument that bears an unauthorized or

---

[24] - "An innocent holder, appropriating or disposing of stolen property, is liable for conversion. Both at common law and under the Negotiable Instruments Law, a holder in due course of negotiable paper takes good title even from a thief. As to stock certificates, United States government bonds, payable to bearer, and like bonds of corporations, circulate to-day as freely as money; title passes by delivery. A broker accepting such securities for disposition on behalf of a customer has little or no means of warning or inquiry such as indorsements or other relationships might suggest. The securities pass from hand to hand by delivery. He is a mere conduit between the seller and the purchaser, for which he receives a small commission. The purchaser is not liable for conversion, yet the broker, acting without any ground for suspicion, is said to be liable for the full value of the security which he has sold, although he has paid the purchase money over to the seller. The harshness of such a rule has been recognized by the courts in repudiating his liability. Public policy does not demand the extension of liability for innocent acts to such a case." *Gruntal*, 173 N.E. at 684.

[25] - "To defeat the rights of one dealing with negotiable securities it is not enough to show that he took them under circumstances which ought to excite the suspicion of a prudent man and cause him to make inquiry, but that he had actual knowledge of an infirmity or defect, or of such facts that his failure to make further inquiry would indicate a deliberate desire on his part to evade knowledge because of a belief or fear that investigation would disclose a vice in the transaction. This test, that of good faith with respect to negotiable instruments, is prescribed alike at common law, by the Negotiable Instruments Law of 1901." *First Nat'l Bank* v. *Goldberg*, 340 Pa. 317 A.2d 377 (1941) at 340; *See* also Benton C. Tolley, *Depository Bank Liability under 3-419(3) of the Uniform Commercial Code*, 31 Wash. & Lee L. Rev. 676 (1974) at p 682 and note 31.

[26] - *Spooner*,102 Mass. 503; *Pratt,* 230 Mass. 256, 119 N.E. 661; *Gruntal,* 468, 173 N.E. 682 (N.Y. 1930); *First Nat'l Bank,* 340 Pa. 317 A.2d 377.

[27] - "A collecting bank which accepts a check on a forged indorsement acquires no title and holds the proceeds of the check, when collected from the drawee bank, for the payee or rightful owner, who may recover from the collecting bank as for money had and received, even though it has fully paid over and accounted for the same to the forger without knowledge or suspicion of the forgery; such rule being based upon the theory of the payee's ratification of the collection of the check from the drawee." *Chemical Workers Basic Union*, 411 S.W.2d 162; *See* also, "The bank acquires no title to either the check or its proceeds, but holds such check or its proceeds for the payee, who may elect to ratify the collection and hold the discounting [collecting] bank in an action for money had and received, or in an action for conversion." *Fabricon Products* v. *United California Bank*, 264 Cal. App. 2d 113, 70 Cal. Rptr. 50 (1968).

[28] - "If a negotiable instrument having a forged indorsement come to the hands of a bank and is collected by it, the proceeds are held for the rightful owners of the paper, and may be recovered by them, although the bank gave value

forged indorsement could sue the depositary bank that cashed his instrument or deposited it into the forger's account under two different legal justifications. The owner could sue either for conversion[29] or for money had and received.[30]

a. Recovery for Conversion

The justification behinds allowing the real owner of an instrument to sue for conversion[31] is that a depositary bank in receiving an instrument from a person who is not the owner obtains no title to the instrument. Since the forger depositing an instrument has no right to the instrument, the depositary bank retains on power over the instrument. The initial preparation of the instrument confirms the payee, the validity of the check, and the scope of the order to pay.[32] Therefore, after the depositary bank collected the instrument and credited the amount to the forger's account, the bank necessarily presupposed dominion over the instrument. The bank's authority over the instrument is conflicted with the real owner's right to control his property which means that the depositary bank converted the instrument.

The depositary bank is not able to succeed if it alleged that it has acted in good faith and according to rational commercial standards. The real owner need only show that s/he is the owner of the instrument and has the right to possess the instrument of its proceeds at the time the depositary bank converted it. Therefore, if the facts were real, the owner of the converted instrument is entitled to the remedy from the depositary bank. For instance, the appeals court of Missouri held that "the deposit for collection of an instrument bearing a forged signature confers no rights on the bank of deposit; therefore, the person defrauded by the collection of the instrument may sue the collecting bank for the proceeds of the collection on the theory that the bank was a converter, that it received the proceeds for the use of the one entitled to the instrument, that the one paying the instrument relied on the collecting bank's warranty of prior indorsements, or that it was negligent in undertaking the collection without exercising the proper degree of diligence in ascertaining the genuineness of all signatures and the identity of its customers." [33]

The amount that the owner could recover from suing for conversion against a person who took it unlawfully is its face value.[34]

---

for the paper, or has paid over the proceeds to the party depositing the instrument for collection." *National Union Bank* v. *Miller Rubber* Co., 148 Md. 449, 129 A. 688 (1925).

29 - *Gruntal* v. *National Surety Co*., 254 N.Y. at 684

30 - *National Union Bank* v. *Miller Rubber* Co. at 690.

31 - The term conversion has been defined as "any distinct act of dominion wrongfully exerted over one's property, in denial of his right, or inconsistent with it." *Good Rd. Mach. Co.* v. *Broadway Bank*, 267 S.W. 40 (Mo. Ct. App. 1924).

32 - "The validity of a check, the scope of the order to pay, and the person authorized by the drawer to receive payment are fixed at the inception of the instrument. And the damages for the conversion of a promissory note, bond, or other negotiable instrument is prima facie its face value." *Aetna Casualty & Surety Co. v. Lindell Trust Co*., 348 S.W.2d 558 (Mo. Ct. App. 1961).

33 - *Aetna Casualty & Surety Co.,* 348 S.W.2d at 561.

34 - "Personal property includes chooses in action such as notes, bills, checks and other representatives of value; for a representative of value is itself a thing of value. A check is so regarded. The measure of damages is prima facie the face value of the paper converted." *Good Rd. Mach. Co.* 267 S.W. 40 at 7; *Kansas City Casualty Co.* v. *Westport Ave. Bank*, 191 Mo. App. 287, 177 S.W. 1092 (1915); *Bennett* v. *Tower Grove Bank & Tr. Co.*, 325 S.W.2d 42 (Mo. Ct. App. 1959).

b. Recovery for Money had and received[35]

The owner of an instrument could sue for money had and received a depositary bank if the latter cashed or accepted for deposit an instrument over an unauthorized or forged indorsement.[36] An action for "money had and received" recovers money that should not in justice be retained by a depositary bank and which in equity and good conscience the depositary bank should return it to the real owner. The right to recover does not rely upon privity of contract but on the obligation to restore which the law implies "should be returned" when a person is unjustly enriched at another's expense.[37] Under the theory of money had and received, the reason to hold a depositary bank liable for cashing or accepting for deposit an instrument over a forged indorsement is that the bank kept the proceeds of the collection in the same way for the real owner as it had initially held the instrument. In the implied relationship, the depositary bank became the real owner's agent and agreed to be bound by the terms of the instrument, and created an obligation on the part of the bank to pay the proceeds only to the real owner. [38]

---

[35] - 2 Henry J Bailey & Richard B. Hagedorn, *Brady On Bank Checks* ¶ 30.03[1] (Revised ed. 1998).

[36] - "Where a check or draft drawn upon a bank has been fraudulently raised or altered after it was drawn, money which has been paid by a bank upon such a fraudulently raised or altered check may be recovered back from the party to whom it was paid, in an action for money had and received, on the ground that the payment was without consideration and made by mistake. The fact that the bank on which it was drawn has certified the check after the change has been made is not conclusive against such bank, nor does it preclude it from showing the fact of such alteration, nor prevent a recovery from the party who received the check on the faith and credit of the certification alone." *Metro. Nat'l Bank* v. *Merchants' Nat'l Bank*, 182 Ill. 367, 55 N.E. 360 (1899); *Reynolds* v. *Title Guar. Tr. Co.*, 196 Mo. App. 21, 189 S.W. 33 (1916).

[37] - *Rabinowitz* v. *People's Nat'l Bank,* 235 Mass. 103, 126 N.E. 289 (1920); Another definition of money had and received: "Where one man has in his hands money, which, according to the rules of equity and good conscience, belongs to and ought to be paid to another, this is the proper form of action for its recovery. If, then, at the commencement of this suit, the defendant held money, which *ex aequo et bono* he ought not to have retained from the plaintiffs, they are entitled to recover." *Wiseman* v. *Lyman*, 7 Mass. 286 (1811); Also, "Most of the leading cases which permit recovery upon the contract theory recognize the conversion but go on to reason beyond the conversion. It is said if the collecting bank, while it is in possession of a check which it has converted, by means of the forged or unauthorized indorsement collects on it from the bank upon which it is drawn (drawee), then the collecting bank holds the proceeds of the collection in the same way for the payee as it held the check, and that relationship creates a privity between the collecting bank and the payee. If under these circumstances the payee elects to ratify the collection of the check by the collecting bank, he may recover from it the amount collected as for money had and received without regard to any question of good faith, or of notice or knowledge or duty of inquiry, notwithstanding the fact that the collecting bank may have parted with the money in good faith." *E. Moch Co.* v. *Security Bank of New York*, 176 A.D. 842, 163 N.Y.S. 277 (App. Div. 1917).

[38] - "When the bank took the check for collection, it became the payee's agent and agreed to be bound by the terms of the check. One obligation derived from the terms of the instrument required the bank's payment of the check proceeds to the true payee only. As a consequence, it was the breach of this obligation which gave rise to the money had and received cause of action." *Mackey-Woodard, Inc.* v. *Citizens State Bank*, 197 Kan. 536, 419 P.2d 847 (1966).

Also, "Stated in other words, a collecting bank is said to be merely an agent for the purpose of collecting from the drawee bank the proceeds of the check delivered to it. When it takes the check for collection, it assents to the agency and becomes bound by the terms of the instrument received. Those terms include an obligation to pay the proceeds collected to the true payee owner in the absence of a valid indorsement. The moment the collecting bank receives the proceeds it holds money belonging to the owner of the check and becomes a debtor of such owner and

However, a necessary pre-requisite (ratification) imposed to allow courts to imply the transfer of the proceeds to the real owner[39]. The actual owner must ratify the depositary bank's collection of the proceeds from the payor bank.[40] Since a payor bank could only pay out its depositary's money consistent with the depositor's order, the owner could not claim that the proceeds collected by the depositary bank are his proceeds unless the owner ratifies the depositary bank's collection from the payor bank.[41] Therefore, when an owner of an instrument begins an action for money had and received, the act of suing a depositary bank is ratification to the transfer of the proceeds by the payer bank to the depositary bank.[42] Thus, ratifying a depositary bank's collection affords an owner of an instrument the right to recover the amount of the proceeds from the depositary bank regardless of acting in good faith[43], knowledge, or duty of inquiry.[44] The depositary bank is liable to recover the real owner the full amount of the proceeds regardless whether the bank has retained the proceeds or cashed them out to the forger.[45]

---

of no one else, in the absence of a valid indorsement." *Henderson* v. *Lincoln Rochester Trust Co*., 303 N.Y. 27, 100 N.E.2d 117 (1951).

[39] - "Where the payee in an action alleging conversion by a collecting bank by accepting a check containing a forged conversion elects to recover from a collecting bank for money had and received, a payee's ratification of the collection by an intervening bank operates to cut off recourse against a drawer of a check on an original demand, and to supply authority to collect which an intervening bank lacked. A payee's act of ratifying collection of a check for it also ratifies an assumed payment of a check, and both a drawer and a drawee of a check are released from paying it over again, because a payee, by ratifying a payment, is estopped from making a claim against either." *Mackey-Woodard, Inc.*, 419 P.2d at 855.

[40] - "Ratification is one of the characteristic rights that a principal may exercise in respect of the actions of his agent. It is said if a collecting bank, while it is in possession of a check which it has converted, by means of a forged or unauthorized indorsement collects on it from a bank upon which it is drawn, then a collecting bank holds the proceeds of the collection in the same way for a payee as it held the check, and that relationship creates a privity between a collecting bank and a payee. If under these circumstances a payee elects to ratify a collection of a check by a collecting bank, he may recover from it the amount collected as for money had and received without regard to any question of good faith, or of notice or knowledge or duty of inquiry, notwithstanding the fact that a collecting bank may have parted with the money in good faith."

[41] - "The act of suing the depositary bank meant that the drawee and the drawer released from paying it over again." *Mackey-Woodard, Inc.*, 419 P.2d at 854.

[42] - "Where the payee in cases of this type elects to recover from the collecting bank for money had and received, the payee's ratification of the collection by the intervening bank operates to cut off recourse against the drawer of the check on the original demand, and to supply the authority to collect which the intervening bank lacked. The payee's act of ratifying the collection of the check for it also ratifies the assumed payment of the check, and both the drawer and the drawee of the check are released from paying it over again, because the payee, by ratifying the payment, is estopped from making a claim against either." *Mackey-Woodard, Inc.*, 419 P.2d at 855.

[43] - "The true owner of a check, with a forged unauthorized indorsement may ratify the act of a bank, in receiving it, in that condition; and collecting the proceeds or paying them out without authority and yet not ratify the forged or unauthorized indorsement. In such cases the bank cannot avoid liability by showing that its conduct was governed by good faith and the payee is entitled to recover unless he has been guilty of fraud or negligence in the matter." *Schaap* v. *State Nat'l Bank*, 137 Ark. 251, 208 S.W. 309 (1918).

[44] - "It is no defense to a collecting bank that it has fully paid over and accounted for the proceeds of a check, which it collected from a drawee bank, to the forger or unauthorized indorser without knowledge or suspicion of the forgery or unauthorized indorsement in a suit by a payee for money had and received. A payee under these circumstances has an election of remedies to proceed either in tort or in contract against a collecting bank. If the payee elects to waive its remedy for a conversion, and prosecute an action to recover for the proceeds of the checks as for money had and received, it would be an irrevocable election whereby a payee would be confined to a remedy which it thus elected to prosecute." *Mackey-Woodard, Inc.*, 419 P.2d at 854.

[45] - "If a negotiable instrument having a forged indorsement come to the hands of a bank, and is collected by it, the proceeds are held for the rightful owners of the paper, and may be recovered by them, although the bank gave value

Depositary banks are entirely liable under both the conversion and the contract theories irrespective of any defenses founded in good faith, following reasonable commercial standards, or the absence of proceeds in the bank's hands. The depositary bank thereon treated as any agent who mistakenly, although innocently, converted the personal property of another owner. However, courts did not extend the protection of the broker who sold stolen bearer bonds to include depositary banks where a forged indorsement was involved. However, U.C.C. Article 3, has altered the liability of depositary banks for cashing or accepting instruments over an unauthorized or forged indorsement.

III. The Depositary Bank's Liability under old § 3-419(3)

The Uniform Commercial Code (1952) under § 3-419(3) altered the former rules regarding depositary banks' liability on cashing or accepting for deposit instruments over an unauthorized or a forged indorsement. Examining the alteration of depositary banks' liability, its new elements under § 3-419(3), and the courts' reaction to the subsection will show the reasons that drove the legislatures to the recent amendment of the subsection in 1990. This Chapter discusses first the defense that subsection 3-419(3) afforded depositary banks to absolve of liability for dealing with an instrument bearing an unauthorized or a forged indorsement and second, the court's response to the new defense and the alteration of the pre-U.C.C. legal doctrines. Last, the Chapter examines whether the courts' approaches were a proper reason that led to the amendment of section 3-419.The depositary bank's defense under old § 3-419(3)

After the adoption of the U.C.C. by all 50 states, the recovery from the depositary bank governed by Article 3, old § 3-419(3). Which seemingly altered the status of depositary bank liability when the depositary bank cashes an instrument from a person who is not entitled to enforce it or obtains its payment from the drawee bank. Old § 3-419(3) provided an absolute defense to a depositary bank cashing, taking by transfer other than a negotiation, obtaining payment, or receiving payment on forged instruments if the depositary bank acted in good faith and according to reasonable commercial standards.[46] Thus, the defense protected depositary banks from liability for conversion to the actual owner of the instrument. However, the only liability the bank may bear is the extent of the instrument's proceeds which might still be within the bank's money.[47]

The language of old § 3-419(3) seemingly requires that when a depositary bank acts honestly and in a commercially reasonable manner, but no longer has the proceeds of the check,

---

for the paper, or has paid over the proceeds to the party depositing the instrument for collection." *United States Portland Cement Co.* v. *United States Nat'l Bank*, 61 Colo. 334, 157 P. 202 (1916); *Home Indem. Co.* v. *State Bank of Fort Dodge,* 233 Iowa 103, 8 N.W.2d 757 (1943).

[46] - U.C.C. (1963) § 1-201(20) - Good faith means honesty in fact and the observance of reasonable commercial standards of fair dealing.

[47] U.C.C. (1963) § 3-419(3): "Subject to the provisions of this Act concerning restrictive indorsements a representative, including a depositary or collecting bank, who has in good faith and in accordance with the reasonable commercial standards applicable to the business of such representative dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands."

it is not liable for conversion or otherwise[48] to the real owner.[49] The determination of a depositary bank's ability to use the defense under old § 3-419(3) measured by the care exercised by a bank and location of the proceeds. While, as discussed previously, a pre-U.C.C. judicial determination would hold a depositary bank liable for conversion or contract had and received regardless of care exercised or the location of the proceeds.[50] Pre-U.C.C., the defense of exercising ordinary care and controlling the proceeds of the instrument was only available to the broker dealing with bearer bonds; later, the legislatures of U.C.C. made the defense possible to depositary banks. Although the justification of the broker defense came from the general rules of agent liability, reading the comments to 3-419 indicates that the purpose that led the legislatures of the U.C.C. to extend the protection to depositary banks is that the legislatures considered a depositary bank as a representative deserves identical protection as an innocent broker.[51] Other sources suggest that this new language was added to appease the banking community by expanding the traditional broker rule to absolve depositary bank.[52]

1. Courts' reaction to the defense of § 3-419(3)

Since the owner of an instrument, in the absence of proceeds in the bank's hand, must prove that the depositary bank did not act in good faith and according to the reasonable commercial standards, legal actions against depositary banks became harder.[53] However, courts have taken a creative approach to interpreting former § 3-419(3) in a way to find liability in depositary banks' activities regarding forged instruments. In making this approach, these courts focused on the terms "representative," "proceeds remaining" and "adherence to reasonable commercials standards."

The Pennsylvania appeals court in *Ervin* v. *Dauphin Deposit & Trust Co.,*[54] the California supreme court in *Cooper* v. *Union Bank,*[55] *and* the Michigan court of appeal in *Sherriff-Goslin Co. v. Cawood,*[56] were the first cases that encouraged the amendment of old § 3-419(3).[57] In these cases, courts interpreted the language of the subsection in a way to justify that

[48] - The phrase "or otherwise" implies that all theories of recovery which applied under pre-U.C.C. (1963) legal doctrine shall continue to apply, subject to the old § 3-419(3) defense.

[49] - Old § 3-419(3).

[50] - Tolley, *supra* note 25, at p 685

[51] - Julian B. McDonnell, Bank Liability for Fraudulent Checks: The Clash of the Utilitarian and Paternalist Creeds under the Uniform Commercial Code, 73 Geo. L. J. 1399 (1985) at p 1413.

[52] - Barbara Singer, Uniform Commercial Code Section 3-419 and the Battle to Preserve a Payee's Right to Sue Directly a Depositary or Collecting Bank That Pays on a Forged Indorsement, 15 Seton Hall Legis. J. 39. (1991) at p 55-65; Tolley, *supra* note 25, at p 686.

[53] - "An order of dismissal as to the conversion claims brought against a bank are to be affirmed insofar as it relates to drafts issued by the various insurance companies herein, because no conversion liability lies against a bank under old § 419(1)(c)." *Larkin General Hospital, Ltd*. v. *Bank of Florida*, 464 So. 2d 635 (Fla. Dist. Ct. App. 1985).

[54] - 38 Pa. D. & C.2d 473 (C.P. 1965).

[55] - 9 Cal.3d 123 507 P.2d 609, 107 Cal. Rptr. 1 (1973).

[56] - 91 Mich. App. 204, 283 N.W.2d 691 (1979).

[57] - Frederick Miller & Alvin Harrell, *The Law of Modern Payment Systems*, West Academic Publishing (2nd ed 2017) at p 338.

old § 3-419(3) did not amend the standards of depositary bank liability pre-U.C.C.[58] Therefore, the examination of these decisions will show how the courts provided the owner of the instrument with a sound legal basis to avoid the old § 3-419(3) defense. In *Ervin*, the appeals court of Pennsylvania held that a depository bank who cashed an instrument and forwarded for collection is not representative. The Michigan court of appeal citing policy considerations justified its holding by saying that a direct suit against a depositary bank avoids circuitous litigation. Finally, the California supreme court in *Cooper* rejected the defenses of old § 3-419(3) on a basis that the depositary bank has not parted with the proceeds of the checks.

a. The depository bank is not a representative:

The Pennsylvania appeals court decision represents the earliest reported case which interpreted the language of old § 3-419 differently (3). An employee of *Ervin* "the plaintiff" took checks payable to *Ervin*[59] and forged the indorsement of *Ervin* then got them paid by the defendant bank. After paying the checks, the defendant bank forwarded them to the payer bank and got the amount of its payment to the forger.

Accordingly, *Ervin* as the real owner of the checks sued the defendant bank for conversion. The defendant bank objected alleging the defense in old § 3-419(3) to *Ervin*'s complaint. Notwithstanding the language of former § 3-419(3), the appeals court decided to overrule the defendant bank's demurrer, holding that the defense was not applicable. The appeals court understood the law to be in the same manner as pre-U.C.C.

In overruling the defendant bank's demurrer, the Pennsylvania appeals court stated that when a depositary bank cashes a check over a forged indorsement, a different principle applies. The depositary bank cashes a check on a forged indorsement acquires no title whatever to the checks because the indorsement, its only source of title, is a nullity. The bank, therefore, is wrongfully in possession of the check and equity and good conscience holds the check for the real owner. If the bank, while in possession of it, used the forged indorsement to collect its proceeds, then the bank holds the proceeds for the real owner, and that relationship creates privity between the bank and the real owner. Moreover, if the real owner elects to ratify the collection of the check by the collecting bank, the real owner may recover from the bank the amount collected.[60]

The appeals court cited *Nat'l Union Bank* v. *Miller Rubber Co.*[61], in which the note-writer has collected the cases from some 30 jurisdictions, including Pennsylvania (more than half of which have adopted the U.C.C) on the question with which we are here concerned, and the conclusion reached in that note, at page 672, is that:

"The rule is established by the great weight of authority that in the absence of negligence, laches, or estoppel, a real payee or a check owner is entitled to recover against a collecting bank or any person, cashing a check bearing a forged or unauthorized indorsement of the real payee, and procuring payment thereof from the drawer of the check. The reasoning on which these cases

[58] - Irvin M. Weinstein, *Section 3-419(3) of the U.C.C. Does Not Limit the Liability of a Depositary Bank to the True Owner of a Check Paid on a Forged Indorsement*, Columbia Law Review, Vol. 74, No. 1 104 (Jan,1974).

[59] - Payable to order means to be paid only to a specific payee, old § 3-109(b).

[60] - *Ervin,* 38 Pa. D. & C.2d at 480.

[61] - 148 Md. 449, 129 A. 688 (1925).

proceed can perhaps be summed up in the statement that one who cashes a check on a forged or unauthorized indorsement does so at his peril."[62]

Moreover, the appeals court cited 9 C.J.S. Banks & Banking § 357 c: (1938), and 10 Am. Jur. 2d Banks 599, § 632 (1963), which says that "the general rule established by nearly all courts is that a bank who has obtained possession of a check upon an unauthorized or forged indorsement of the real payee's signature, and has collected the amount of the check from the payor bank, is liable for the proceeds thereof to the payee or other owner, notwithstanding they have been paid to the person from whom the check was obtained, and notwithstanding that his employee or agent forged the payee's signature."[63]

The defendant bank contended that old § 3-419(3) modified the pre-U.C.C. rules to the extent that a depositary bank who on good faith pays the proceeds of the checks to the person presenting them, it is now relieved from liability. The appeals court did not understand the law to be changed in this manner by the code section 3-419.

The appeals court stated that § 3-419(3) was intended to foster the rule of decisions which have held that a representative who deals with an instrument for his principal in good faith is not liable for conversion or otherwise to the real owner unless that he will be obliged to pay over any proceeds of the instrument remaining in his hands.[64]

Also, the appeals court stated that the leading case in Pennsylvania which is said to be in accord with this section of the code, and which was decided long before the adoption of the code with this new section in Pennsylvania, is *First National Bank of Blairstown* v. *Goldberg*, 340 Pa. 337 (1941). In which the court held that no liability on a broker or agent assisted another in the sale of stolen negotiable bonds, where all of the proceeds had been turned over to the principal, and the broker or agent had acted throughout guiltlessly, and in good faith.

The court recognized that the subsection included depositary banks within its broader concept of "representative," but the clear meaning is to include them only when the banks are acting as a "representative" which is the clear meaning of the subsection relying on old §1-201(35) that defined the term "representative."[65]

Also, the appeals court stated that the language of old § 3-419(3) does not include the activities of negotiating or honoring of a check when the subsection refers to a "representative" who dealt with an instrument or its proceeds as a representative of a client who was not the real owner.[66] Whereas, if the depositary bank cashed the check over the counter and after that received the proceeds from the payer bank, the bank in fact paid using its own money, and the bank and real owner enter into a debtor-creditor relationship.[67]

---

[62] - *Ervin,* 38 Pa. D. & C.2d at 480.

[63] - *Ervin,* 38 Pa. D. & C.2d at 481.

[64] - *Ervin,* 38 Pa. D. & C.2d 482.

[65] - U.C.C. (1963) §1-201(35): "Representative" includes an agent, an officer of a corporation or association, and a trustee, executor or administrator of an estate, or any other person empowered to act for another.

[66] - The entire subsection speaks of something other than the negotiating or the honoring of a check when it refers to the representative having "dealt with an instrument or its proceeds on behalf of one who was not the true owner." *Ervin*, 38 Pa. D. & C.2d at 483.

[67] - *Ervin*, 38 Pa. D. & C.2d.2d at 484.

Consequently, the appeals court held that the depositary bank is subject to the pre-U.C.C. doctrines of liability.[68] The appeals court said that when the depositary bank purchased or cashed the checks over the forged indorsement drawn on other banks, the depositary bank virtually used its own money, and then, in putting the checks through for collection, it obtained from the drawee bank money which belongs to the real payee. Thus, after collecting the check, the depositary bank is still holding the proceeds of the checks for the interest of the real payee.[69] The court read old § 3-419(3) narrowly, finding that the depositary bank was not acting as a representative of the real payee after the final payment to the forger. The depositary bank is not acting as a representative under old § 4-201(1)[70] at the time of the conversion, because the depositary bank paid the checks within the meaning of old § 4-213(1)[71] before collecting the proceeds. Therefore, the final payment to the forger prevented the depositary bank from being in the position of the representative which allows the bank to use § 3-419(3) as a defense. In other words, if a depositary bank cashes, or accepts a check for deposit and later allows the forger to withdraw its proceeds, the depositary bank is not an agent, and that is because the bank made a final payment before collecting the check.[72]

However, the appeals court's reasoning does not stand on its legal analysis.[73] The basic failure in the court's analysis comes from its total disregard of the condition of depositary banks as agents under § 3-419(3) while collecting negotiable instruments. Thence, the court denied the defense to the depositary bank on the assumption that the legislatures provided the defense under old § 3-419(3) to depositary banks when they deal with instruments as representatives. However, the legislative history shows nothing to support the court contention.[74] The language of old § 4-201[75] seems to establish without question that the purpose of old § 3-419(3) was to protect the depositary bank while acting as a representative for collection even if the bank made a provisional settlement over a forged indorsement. The U.C.C. limited the defense of old § 3-419(3) to situations in which a depositary bank is initially an agent but does not require the depositary bank to be a representative at the time the plaintiff sued for conversion. This construction backed by the language of the subsection 3-419(3), which reads "a representative, including a depositary bank." Thus, a depositary bank initially must act as a representative in accepting the check for negotiation over a forged indorsement to rely on the old § 3-419(3) defense. Reading the Code's use of the term "representative" as the appeals court read would require a depositary bank to be a representative at the time the payee sues for conversion. That would make the subsection useless because final payment within the meaning of old section 4-213 generally occurs before the time a real payee sues for conversion.[76] Each regular check

---

[68] - *Ervin*, 38 Pa. D. & C.2d at 483.

[69] - *Ervin*, 38 Pa. D. & C.2d at 483,84.

[70] - Old § 4-201. (1) "Unless a contrary intent clearly appears and prior to the time that a settlement given by a collecting bank for an item is or becomes final (subsection (3) of Section 4-211 and Sections 4-212 and 4-213) the bank is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional."

[71] - Old § 4-213. (1)(a) "An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first: (a) paid the item in cash ...."

[72] - Frederick J. Jr. Murphy, *supra* note 8, at p 369.

[73] - *Ervin* was criticized. *See* Tolley, *supra* note 25, at p 688.

[74] - Tolley, *supra* note 25, at p 688.

[75] - Old § 4-201(1).

[76] - Frederick J. Jr. Murphy, *supra* note 8, at p 376.

cashing transaction is different from a situation in which a bank accepts an instrument over a forged indorsement and pays cash because old § 4-201(1) presumes an agency status when a depositary bank accepts a check for deposit, collection, or payment. Despite wrong indorsements, the representative requirement does not limit the scope of the defense in the forged indorsement transaction.[77]

Moreover, the official comment indicates an obvious intent on the part of the legislatures to treat a depositary bank as a representative in this regard.[78] Further, there is no basis to conclude from the official comment to old § 3-419(3) that the agency status is not applicable when the depositary bank sued in conversion.[79] Thus, when the Pennsylvania court held that the depositary bank did not act as a representative when the bank did collect the check over the forged indorsement, the court fostered an interpretation obviously in contradiction with the language of 4-201.[80]

b. Avoid circulation

In restricting old § 3-419(3), The Michigan court of appeals in *Sherriff-Goslin Co*. v. *Cawood,*[81] citing policy considerations, permitted the real payee to directly sue the depositary bank for conversion if the bank took instruments bearing forged indorsements.[82] The appeals court of Michigan held that the defense in old § 3-419(3) is not granted to a depositary bank in a suit for conversion, regardless of whether the bank acted in good faith or within a standard of commercial reasonableness. The Michigan court justified its holding by saying that a direct suit against the depositary bank avoids circuitous litigation. The defendant contended that it is not liable in a direct suit by the real payee and relied on § 3-419(3) for support. However, the appeals court overruled the defendant bank's contention relying on the Code's allocation of the ultimate loss in a forged indorsement. The defendant bank here accepted for collection 300 checks drawn by various entities on many different banks. If the real payee cannot sue the depository bank directly, it would be necessary to sue either the drawee bank under old § 3-419(1)(c) or the drawer under old 3-804. Thus, instead of starting 300 lawsuits against multiple banks, one suit will do under the prevailing construction of old section 3-419. Also, in case of allowing the 300 lawsuits, the matter would not be closed. After the real payee recovers from the drawee bank or drawer, the latter, in turn, will pass the loss to the first party who dealt with the forger, here the defendant bank, under the warranty provisions of old 3-417.[83]

---

77 - *Id* at page 367-77.

78 - "The presumption of agency "applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn". Old § 4-201. Comment 1.

79 - Old § 3-419. Comment (5). Subsection (3), which is new, is intended to adopt the rule of decisions which has held that a representative, such as a broker or depositary bank, who deals with a negotiable instrument for his principal in good faith is not liable to the true owner for conversion of the instrument or otherwise, except that he may be compelled to turn over to the true owner the instrument itself or any proceeds of the instrument remaining in his hands. The provisions of subsection

80 - Tolley, *supra* note 25, at p 688; Henry J Bailey, *The Law of Bank Checks* § 15.14, at 496-501 (The Banking Law Journal. ed,.3rd ed. 1962).

81 - *Sherriff-Goslin Co.*, 283 N.W.2d 691.

82 - Medessa Cook Montgomery, *Conversion Liability of the Depositary Bank under U.C.C. Section 3-419(3)*, 94 Com. L.J. (1989) at p 207; *See* also, Singer, *supra* note 52, at p 86.

83 - *Sherriff-Goslin Co*., 204, 283 N.W.2d at 693-94.

The Michigan appeals court suggested that direct action by a real payee against a depositary bank would reduce circuitous litigation to single suit and ensure judicial efficiency. The direct action of conversion will transfer the loss to the party on whom the loss will ultimately lie. Otherwise, the real owner must sue the drawee bank, who will then sue the depositary bank on its presentment warranties. These policy reasons are likable, but they should not operate to exceed the language and the intent underlying old 3-419. Certainly, the drafters were cognizant of these common law policy reasons when they drafted old § 3-419(3). The Code prevented the depositary bank from citing the drawer's negligence in contributing to the forgery as a defense to the payee's conversion suit if the depositary bank was negligent.[84] Therefore, the depositary bank will bear the loss alone even with the negligence of other parties. Putting a depositary bank in this position is more harmful than merely foreclosing one of three possible defendants that a real payee may choose when suing for conversion based on an unauthorized or forged indorsement.[85]

c. The depositary bank has not parted with the proceeds

In 1973, the supreme court of California in *Cooper* v. *Union Bank* severely restricted the availability of the old § 3-419(3) defense to depositary banks. The court made the defense inapplicable unless an evidence such as the owner's negligence which prevents the owner of the instrument from alleging conversion. *Cooper* was a joint attorney whose secretary has forged his name and signature, as indorser, on numerous checks, and then cashed the checks over a period of approximately one and one-half years. *Cooper*'s secretary embezzled about twenty-nine checks of *Cooper* and forged the necessary indorsements, cashed some of these checks at the defendant "Union Bank" while depositing others to her accounts at the same bank. Then, Union Bank collected all the checks from the payor banks and the forger withdrew the entire amount of deposits before the detection of the unauthorized indorsements.

Cooper sued Union Bank for conversion[86] to recover the amounts of the checks handled by *Union Bank* on the forged indorsements. Concerning most of these checks, the trial court held that the plaintiff's negligent supervision of his secretary and his books of account precluded him

---

[84] - Old section 3-406. Comment. 5. "This section does not make the negligent party liable in tort for damages resulting from the alteration. Instead, it estops him from asserting it against the holder in due course or drawee. The reason is that in the usual case the extent of the loss, which involves the possibility of ultimate recovery from the wrongdoer, cannot be determined at the time of litigation, and the decision would have to be made on the unsatisfactory basis of burden of proof. The holder or drawee is protected by an estoppel, and the task of pursuing the wrongdoer is left to the negligent party. Any amount in fact recovered from the wrongdoer must be held for the benefit of the negligent party under ordinary principles of equity." Old § 4-406. Comment. 4. "even if the bank succeeds in establishing that the customer has failed to exercise ordinary care, if in turn the customer succeeds in establishing that the bank failed to exercise ordinary care in paying the item(s) the preclusion rule does not apply. This distribution of the burden of establishing between the customer and the bank provides reasonable equality of treatment and requires each person asserting the negligence to establish such negligence rather than requiring either person to establish that his entire course of conduct constituted ordinary care."

[85] - Frederick J. Jr. Murphy, *supra* note 8, at p 381.

[86] - The California supreme court stated that the plaintiff's suit was one in conversion, implying that the theory of suit was founded in tort law. *Cooper,* 507 P.2d at 612. However, the court in its analysis applied ratification concepts which were distinctive of all pre-U.C.C. contract has and received theory of recovery. *Id* at 613. A plausible explanation for the court's application of ratification where the plaintiff's suit was in conversion lies in the fact that the "proceeds" language of old § 3-419(3) demands reliance on ratification. Tolley, *supra* note 25, at p 689.

from alleging that the indorsements were unauthorized. The trial court held that *Cooper* was negligent in not discovering, within a reasonable time, that the forger had been placing the unauthorized indorsements of the payees on said checks and obtaining the proceeds of said checks for his benefit. Moreover, *Cooper* negligence virtually contributed to the making of the unauthorized indorsements on each of the checks that were accepted and paid after the specific period by the respective defendant herein.[87] After *Cooper* had alleged the impropriety of the indorsement, the trial court concluded that *Union Bank* is not liable to pay the amount of the checks since the bank acted in good faith, according to reasonable commercial standards, and had no proceeds remaining in their hands. In other words, *Union Bank* was held immune from liability and denied recovery relying on the defense provided in old § 3-419(3), limiting recovery for conversion only in case the amount of any proceeds remaining is still within the bank's control.[88]

However, the California supreme court had a different opinion. Regarding the location of the proceeds, the California supreme court allowed *Cooper* to allege the forged indorsement by which the court rejected the availability of the defenses under old § 3-419(3) on a ground that the *Union Bank* was found to have retained the proceeds of the checks in its hand.[89]

The California supreme court construed the language of old § 3-419(3) in a particular manner to find that *Union Bank* is still retaining the proceeds of the checks. The court relied first on the application of the pre-U.C.C. doctrine of ratification. The supreme court established that under the dominant theory of bank collection that preceding the code and which the code has left consistent, the amounts a drawee bank remits on a forged indorsement to the depositary bank are not the proceeds of the checks. It is a consequence of the relationship between a drawee bank and the depositor-drawer. The relationship is one of debtor and creditor, in which the drawee bank is under an obligation to his client and a commitment to debit the client's account only at his order. Thus, if the drawee bank pays, on a check drawn by its client, any person other than the designated payee or the indorsee, the drawee bank's obligations to the client stays the same. In case the drawee bank did debit the client's account, paying a forged check, the client has the right to compel the drawee bank to recredit the account. Since the full amount of the check remains in the account of the drawer when the drawee bank pays on a forged indorsement, the drawee bank manifestly does not part with the proceeds of the check but merely withdraws other funds from its account.[90] Consequently, when the real payee brought an action against a depositary bank for conversion of a check collected on a forged indorsement, the action is deemed to have ratified the collection of the proceeds from the payor bank. This ratification conveys the remittance of the funds by the payor bank into an authorized act for which the payor bank may debit the drawer's account.[91] However, ratifying the check collection does not

---

[87] - *Cooper,* 507 P.2d at 613-14.

[88] - Superior Court of Los Angeles County, No. 916635, John L. Cole, Judge. *Cooper,* 507 P.2d 609. The California official reports summary.

[89] - California Supreme Court hold that the code fails to define the word "proceeds" in the context of bank collection*. Cooper,* 507 P.2d at 609.

[90] - *Cooper,* 507 P.2d at 616.

[91] - General bank collection theory also instructs us that the true owner, in bringing an action against a collecting bank for conversion of a check collected on a forged indorsement, is deemed to have ratified the collection of the proceeds from the payor bank. This ratification transmutes the remittance of funds by the payor bank into an authorized act for which it may debit its customer's account. In the case at bar, it appears that plaintiffs' action

constitute ratification for the depositary banks' payment to the forger.[92] The dominant pre-U.C.C. established, on the contrary, that the depositary bank held the proceeds at the time the real payee filed his suit for conversion because that is the time to be considered ratification for the check collection. Subsequently, when the depositary bank collected the proceeds of the check, it did that for the benefit of the real payee. The court built its first analyzation that the depositary bank payment made on the forged indorsement upon receiving the check does not count as a payment by the proceeds of the check, at that moment, the depositary bank paid the forger utilizing its own funds.[93] Thereon, the court stated that at the time the depositary bank took such a check it has obviously not made any prior collection and, thus, has nothing that could be considered proceeds yet. The money that the forger received over the counter is, consequently, the bank's own money.[94] The court's approach relied on the bank's balance sheet by which the court in determining whether the bank's assets still inflated because of the payment of the check. If the forged check was taken on deposit, with provisional credit, and the credit becomes final, and after the collection, the forger withdrew it, then the depositary bank is not liable because that did not affect the assets on the bank balance sheet. However, if the depositary bank cashed over the counter or, presumably, if the forger withdrew the provisional credit before the collection of the check from the payor bank, the depositary bank is liable. The basis of depositary bank responsibility came from the idea that the bank still retains the proceeds of the check and the bank balance sheet will show the collection as a credit in the bank's assets. The balance sheet will prove that the depositary bank virtually received proceeds from the payor bank, and the depositary bank paid the forger before the collection with its own money.[95] Dependently, the supreme court concluded that *Union Bank* is still retaining the proceeds and built on that an agency status between *Union Bank* and the real payee. The agency status drove the court to find that the proceeds merged with the Union Bank's money. The court illustrated that upon the collection of the check, the proceeds of the check merged with *Union Bank's* general funds and therefore *Union Bank* retained them. Thus, the court held that upon the receiving of the proceeds, *Union Bank* became a debtor of the real payee.[96] After the depositary bank cashed the check and, received a final settlement for the check that had forwarded for collection, the agency status typically ends, and *Union Bank* becomes a mere debtor of the real

---

against defendant collecting banks constitutes such a ratification, and these banks, therefore, must be considered to have received the proceeds of the instruments. *Cooper,* 507 P.2d at 614.

92 - *Cooper,* 507 P.2d at 614.

93 - The California supreme court cited: E. Allan Farnsworth & Fairfax Jr. Leary, *U.C.C. Brief No. 10: Forgery and Alteration of Checks*, 14 Prac. Law. 75, 88 (1968). *Cooper,* 507 P.2d at 614.

94 - The California supreme court relied on the balance sheet approach that was mentioned in Farnsworth, *supra* note 94, at p 80.

95 - Farnsworth, *supra* note 94, at p 79-80.

96 - California supreme court cited the case: *Henderson* v. *Lincoln Rochester Trust Co*., 303 N.Y. 27, 100 N.E.2d 117 (1951). In which the court held relaying on 9 Corpus Juris Secundum (*Banks* and *Banking*, p. 763), "a collecting bank is merely an agent for collecting from the drawee bank the proceeds of the check delivered to it. When the bank takes the check for collection, it assents to the agency and becomes bound by the terms of the instrument received. Those terms include an obligation to pay the proceeds collected to the true payee owner in the absence of a valid indorsement. The moment the collecting bank receives the proceeds it holds money belonging to the owner of the check and becomes a debtor of such owner and of no one else in the absence of a valid indorsement."

payor.[97] As a mere debtor, *Union Bank* was entitled to mingle the check proceeds with its own.[98] *Union Bank*, on the contrary, became a debtor, and the proceeds of the check completely merged with the bank's money. The effect of this mingle is that *Union Bank* deemed to retain the proceeds of the check even though the amounts indicated in the check, in the bank's money, were remitted to the forger. The supreme court derived its conclusion by reference to the law of constructive trusts.[99] The constructive trusts established that money received by a bank and mingled with the bank's funds is traceable by the genuine owner.[100] Therefore, the forger withdrawal is unaffected so long as the cash that the bank has in its hand is more than the real owner's proceeds. Since in *Cooper, Union Bank's* money exceeded the amount that indicated in the claim, the court held that *Cooper* has the right to avoid the old § 3-419(3) defense and trace the proceeds into *Union Bank's* money.[101]

Also, the court attempted to support its conclusion that *Union Bank* did not part with the proceeds of the check on the intention of the legislatures of the U.C.C., whether they intended to absolve a depositary bank completely from liability by such payment. The court stated that if the legislatures intended to excuse depositary bank in this matter, they definitely would have employed language more obvious than that of retaining or parting with proceeds, such as the term "for value." The court compared the depositary bank status to that of a holder in *due course*[102] under U.C.C. or a *bona fide* purchaser under the law of constructive trusts[103] since both purchase properties and in return pay consideration to the transferor. In the U.C.C., the term of

---

97 - California Supreme court relied on *Justice Cardozo* opinion in *Jennings* v. *United States Fidelity & Guaranty Co.,* 294 U.S. 216, 55 S. Ct. 394 (1935). Justice Cardozo stated that " in Indiana in 1931 a statute known as the Bank Collection Code (Indiana Acts, 1929, c. 164.1), which is applicable to national banks in so far as it is consistent with the policy or provisions, express or reasonably implied, under that code § 2, the relation between the forwarding bank and the collecting bank is that of principal and agent until the agent has completed the collection. Whether a fiduciary relation continues even afterward, upon the theory that the proceeds of the collection until remitted to the forwarder are subject to a trust, depends upon the circumstances. In the absence of tokens of a contrary intention, the better doctrine is, where the common law prevails, that the agency of the collecting bank is brought to an end by the collection of the paper, the bank from then on being in the position of a debtor, with liberty, like debtors generally, to use the proceeds as its own. "One who collects commercial paper through the agency of banks must be held impliedly to contract that the business may be done according to their well-known usages, so far as to permit the money collected to be mingled with funds of the collecting bank."

98 - *Cooper,* 507 2d at 614. The court citied "4 A. Scott & William Franklin, *The Law of Trusts* (Little Brown & Company. eds., 4d ed. 1989) § 534" to establish that the bank, as a debtor, was entitled to use the proceeds as its own. This is the regular custom of banks and indeed it would seem that a bank could hardly function in any other way.

99 - Scott, *supra* note 98, at § 534.

100 - Scott, *supra* note 98, at § 540.

101 - The California supreme court attempted to support its conclusion that the defendant did not part with the proceeds of the check by looking to an additional side of Article 3. From the distinctive use of the term "proceeds" in old § 3-419(3), as opposed to the term "for value" which establishes holder in *due course* status for a bank under old § 3-302, the court reasoned that old § 3-419(3) was not meant to protect the depositary bank merely because it may have given value to the forger. *Cooper*, 507 P.2d at 616. However, this argument is not convincing in a conversion context. The Holder in *due course* language, even by analogy, would seem wholly inapplicable where a forged indorsement was involved since the party "depositary bank" taking from the forger cannot be considered as a "holder." See old § 1-201(21): Holder" means: (A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession. *Cooper,* 507 P.2d at 616.

102 - Old § 3-302.

103 - Scott, *supra* note 98, at § 534.

consideration is “value.”[104] Therefore, the court stated that the fact that the legislatures did not utilize the term “value.” Instead, the legislatures utilized a different terminology in old § 3-419(3) indicates that the language of this provision was not intended to refer to the bank’s payment to the forger as such consideration. If the legislatures had intended to protect depositary banks that had just given “value” for a check, they would have used a precise language to indicate that.[105]

The California supreme court structured its analysis on credible and effectual legal principles. Indeed, a ratification doctrine was the resolution of recovery by courts for a real payee against a depositary bank before the enactment of U.C.C., and nothing in old § 3-419(3) reveals that the legislatures rejected its rationale. Old Subsection 3-419(3) states that the depositary bank shall not be liable to a real owner “in conversion or otherwise.” This language recognizes the different theories of suits existed before the enactment of U.C.C. and expects the ratification suit to exist under the U.C.C., subject to the old § 3-419(3) defense; therefore, they utilized the term “otherwise.” Also, the court described the relationship between the real payee and a depositary bank after the collection of the check as a relation between a creditor and his debtor which appeared to be a sound legal position under U.C.C. Relying on old § 4-213(3) and its official comments, the court held that the U.C.C. supported the bank’s status as a debtor upon final settlement.[106] It is specifically because old § 4-213(3)[107] made a collecting bank, after receiving a final settlement for a check, accountable to its client for the amount of the check rather than for check’s proceeds.[108] The conclusion that the U.C.C. anticipated is the continuation of a bank’s pre-U.C.C. liability as a debtor to the real owner of a check until the final settlement seemed justified. The official comment[109] to old § 4-213 gave a further strengthen to the court’s conclusion. The official comment stated that after the settlement of the check, the given credit by the bank becomes final, and in the usual case the bank’s agency status terminates, and the bank becomes a debtor to its client for the amount of the proceeds.[110]

---

104 - Current § 1-204. Value. “Except as otherwise provided in Articles 3, 4, [and] 5, [and 6], a person gives value for rights if the person acquires them: (1) in return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; (2) as security for, or in total or partial satisfaction of, a preexisting claim; (3) by accepting delivery under a preexisting contract for purchase; or (4) in return for any consideration sufficient to support a simple contract.”

105 - *Cooper,* 507 P.2d at 616.

106 - *Cooper, id* at 615.

107 - The determination of when an item is finally paid is governed by U.C.C. (1963) § 4-213.

108 - After a collecting bank has received a final settlement for an item, it will be accountable to its customers for the amount of the item, and provisional credit given for the item in the customer's account will become final. U.C.C. § 4-213 (3).

109 - Old § 4-213, Comment 9. “Subsection (3) states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If previously it gave to its customer a provisional credit for the item in an account, its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When this credit given by it so becomes final, in the usual case its agency status terminates, and it becomes a debtor to its customer for the amount of the item. *See* also, Section 4-201(1).”

110 - Tolley, *supra* note 25, at p 691.

However, the only issue that faces the California supreme court analysis is its dependence on the law of constructive trusts which seems significantly unpractical. The reason that drove the California supreme court to apply the law of constructive trust, which allows the plaintiff to trace his proceeds into the insolvent bank's money is to give the plaintiff the right to rise above the insolvent bank's general creditors. The court reliance on the constructive trust seems inappropriate since the defendant bank was not bankrupt and, the requirement of the useful trusts doctrine to hold the depositary bank liable as a constructive trustee is to find that the depositary bank has, in fact, noticed that the deposit is unlawful. Accordingly, if the depositary bank fails, the real owner of the deposited money is entitled to a priority above other creditors of the bank.[111] However, it could have been appropriate for the court to rely on the tracing right from the equitable doctrines related to the conversion of personal property.[112] The tracing principles that are applicable to the conversion of personal property are identical to those discussed by the court. However, when a depositary bank does not act willfully, a court can only invoke an equitable lien for the true owner. The difference between the equitable lien and the constructive trust discussed by the court is simply that the constructive trust forces the wrongdoer to account for all profits derived by the wrongful act,[113] while the equitable lien only enforced to the extent of the property's value that the owner lost.[114]

In the conversion of personal property, a depositary bank as a converter which in transformed a real payee's property into cash proceeds earned a legal title to the proceeds.[115] Consistent with this legal title, the depositary bank has an equitable duty to convey the new product "cash proceeds" only to the real owner,[116] who can enforce his equitable rights against the depositary bank through the imposition of an equitable lien[117]. If the depositary bank mingles the new product "cash proceeds," with his funds, the equitable lien grants the owner the right to trace his cash proceeds within those funds.[118] Recovery is authorized so long as the depositary bank's funds are equal to or more than the amount of the real payee's claim.[119] Thus, the California supreme court's discussion of tracing rights might be accurate if it did build its argument on the equitable lien theory of relief.[120]

Regardless of the legitimacy of tracing right under a constructive trust or equitable lien concepts when conversion takes place, an inherent inconsistency becomes obvious in the California court's analysis. This inconsistency came from the doctrine of ratification which, as the court properly described, was substantial to the plaintiff's recovery from the bank under § 3-419(3). Ratification afforded a presumption which established that the proceeds of the check arrived at the depositary bank, but at the same time, the wrongful collection of the check became

---

111 - Scott, *supra* note 98, at § 528.

112 - Tolley, *supra* note 25, at p 692.

113 - Scott, *supra* note 98, at § 462.

114 - Tolley, *supra* note 25, at note 84.

115 - 11 Caryl A. Yzenbaard, *The Law of Trusts & Trustees* (West. eds., 4d ed. 2009) at § 476.

116 - Scott, *supra* note 98, at § 507 p 554.

117 - "The person whose property is wrongfully used is entitled at his option to enforce either a constructive trust or an equitable lien." Scott, *supra* note 98, at § 507; "the owner of property not only is entitled to enforce an equitable lien upon the product, but he may at his option charge the converter as constructive trustee of the product." Scott, *supra* note 98, at § 509 p 585,

118 - Scott, *supra* note 98, at § 515 p 605.

119 - Scott, *supra* note 98, at § 509, § 515 p 610.

120 - Tolley, *supra* note 25, at p 692.

legitimate.[121] When the California supreme court imposed the constructive trust law, it apparently overlooked this important effect of ratification. Therefore, the real payee has no longer the right to claim that the depositary bank committed conversion since the real payee had already ratified the collection of the check for its proceeds. The ratification action automatically omits the wrongdoing in the depositary bank action of possessing the proceeds,[122] and the relation between the real payee and the depositary bank becomes a debt relation; therefore, the bank is entitled to use the proceeds as its own since it is the debtor of the real owner. Accordingly, the supreme court should have limited the real owner to the legal remedies of the creditor against his debtor which has never included a right on the part of the creditor to trace his proceeds.[123]

Therefore, as long as ratification is a fundamental part of the real owner's theory of recovery as the court stated, it would make the equitable tracing principles inapplicable. Since ratification implies that the depositary bank did not commit any wrongful act, while the law of constructive trust should be used to protect a creditor only in the case of wrongful act (such as fraud), and where the general creditors would improperly benefit without such action.[124] Thereby, is the satisfaction that the California court granted against the defendant bank in the absence of ratification an equitable ruling? The answer is explicit in the language of old § 3-419(3) which demands an examination into the location of proceeds. The subsection says that a depositary bank can only be liable to the extent of any proceeds in its hands. Considering ratification as the only accurate method to establish the receipt of proceeds by the depositary bank when a conversion has occurred, the phrase of old § 3-419(3) authorizes ratification use to cover only the remained proceeds. Thus, rationally, utilizing the ratification theory by old § 3-419(3) precludes the application of equitable tracing principles as the California supreme court stablished to hold the defendant bank liable.[125]

The California supreme court decision certainly illustrates the absence of an exact definition of the phrase "proceeds remaining" in old § 3-419(3).[126] The absence of the definition justified the court to utilize an unforeseen sort of legal analysis to fulfill the requirement of the subsection and to hold the defendant bank liable. It would be helpful if there were a statutory definition that could serve to clarify the meaning of the phrase "proceeds" in the subsection. However, although the absence of a definition of "proceeds," there was a logical source from

[121] - The California court recognized this effect of ratification: "This ratification transmutes the remittance of funds by the payor bank into an authorized act for which it may debit its customer's account." *Cooper,* 507 P.2d at 614.

[122] - Scott, *supra* note 98, at § 525 p 679 "if the relation is one of debt, the banker may properly use it for his own purpose and is of course guilty of no crime in so doing."

[123] - Tolley, *supra* note 25, at p 692-93.

[124] - Scott, *supra* note 98, at § 525 p 680.

[125] - Tolley, *supra* note 25, at p 693.

[126] - The only definition of "proceeds" in the U.C.C. is located at U.C.C. (1963) § 9-306(1): "'Proceeds' includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." In the context of determining the meaning of the U.C.C. § 3-419(3) defense, a definition designed for application to security interests is not very helpful." *Id* at note 93.

which a definition could be concluded to get an accurate understanding of the phrase "proceeds." The source came from rulings that were adopted by the old § 3-419(3) official comments.[127]

Gruntal v. *National Surety Co*., deemed to be the substantial ruling of broker liability before the enactment of U.C.C. and considered to be the base of old § 3-419(3).[128] The New York appeals court emphasized that the application of the defense should be limited to the event when the broker "in good faith" had already paid the price of the bonds over to the seller. The primary focus of the decision was that a broker is a mere conduit between the seller and the purchaser. Thus, a broker who is "in good faith" and "without any ground of suspicion" received and sold bearer bonds should not be held responsible and endure a monetary loss if the broker has no previous knowledge that the bonds are stolen bonds. Therefore, it would be rational to infer that the legislatures of old § 3-419(3) intended to give depositary banks protection equal to the broker's protection when they expressly limited the bank's liability to the proceeds that are remaining within the bank treasury.

Further observation comes from the usage of the word "proceeds" to expand the protection of old § 3-419(3) to include depositary banks. Virtually, the protection before the adoption of the U.C.C. for an owner of an instrument against a depositary bank was determined regardless of the location of the check's proceeds. In this context, courts in applying NIL ruled a depositary bank to be liable to a real owner of an instrument in cashing or accepting an instrument over a forged indorsement regardless of whether the proceeds are remaining in the bank's hand.[129] The defense of *bona fide* or any other defense was not acceptable if the depositary bank had fully paid the forger and accounted the check's amount to the forger's account after the collection.[130] It would seem logical to assume that the legislatures of old § 3-419(3) had substantial knowledge of the courts' interpretation of the NIL when they decided to use a comparable language in old § 3-419(3). Thereon, the recognition of the legislature's use of the term "proceeds" must be in the logic that protects a depositary bank if it parted with the proceeds.[131]

2. Evaluating the courts' approaches and their influence on the latter amendment of old § 3-419(3)

[127] - Official Comment. 5. to old § 3-419(3) states in pertinent part: Subsection 3 is intended to adopt the rule of decisions which has held that a representative, such as a broker or depositary bank, who deals with a negotiable instrument for his principal in good faith is not liable to the true owner for conversion of the instrument or otherwise, except that he may be compelled to turn over to the true owner the instrument itself or any proceeds of the instrument remaining in his hands.

[128] - *Gruntal* v. *National Surety Co*., 254 N.Y. 468, 173 N.E. 682 (1930). *Gruntal* was cited in the official comment to old § 8-318 as the basis for the *bona fide* defense provided the broker who sells investment securities on behalf of his principal. the court determined that it would be unfair to hold a broker liable in conversion for accepting stolen bearer paper. The brokers did not participate in the initial fraud and could not have known that the bearer instruments were stolen. *Gruntal* is generally considered a leading case illustrating the justification for the exceptional pre-U.C.C. treatment afforded the seller of bearer bonds. *See* also, Frederick J. Jr. Murphy, *supra* note 8, at page 361.

[129] - *Id*.

[130] - *Mackey-Woodard, Inc*., 419 P.2d at 854.

[131] - Tolley, *supra* note 25, at p 694.

Although the improper plea of constructive trust doctrine and the illogical source of the linguistic meaning beyond the word "proceeds," the *Cooper* and *Ervin* rulings should not have impacted the future status the defense in old § 3-419(3). Both decisions involve unsound statutory analysis. The courts inappropriately interpreted the subsection in a manner to maintain the status that existed before the enactment of U.C.C. in which a depositary bank was liable for conversion to a real payee, regardless of the manifest intent of old § 3-419(3) to protect depositary banks. Therefore, discussing the courts' purpose to chose explication that did not coordinate with old § 3-419(3) is important to understand the later amendment of the subsection.

In both decisions, an appealing justification has been offered to promote justice by precluding circuity of action.[132] Traditionally, the real payee of a forged check has besides his right to sue the depositary bank, the right to litigate the drawer of the check on the underlying contractual obligation and also the right to litigate the drawee bank for recovery in conversion. Both actions enacted within the U.C.C. Article 3.[133] Ultimately, the U.C.C. has adopted the pre-U.C.C. policy which placed the loss for a forged indorsement on the party who dealt directly with the forger of the check.[134] Thus, regardless of the defense in old § 3-419(3), eventually, the depositary bank will sustain the loss incurred since the ability to recover from the forger is typically hard to occur. Thereon, it is logical to allow the real payee to sue the depositary bank directly instead of suing the drawee bank and the drawee bank sues the depositary bank. Precluding circuity of actions is the appealing reason that leads the courts to ignore the defense provided by old § 3-419(3). This policy was recognized before the enactment of U.C.C. and imposed to ask a substantial question regarding the necessity of the former § 3-419(3) defense.[135]

There is a single legitimate reason for requiring the real payee to pursue the traditional route of suit against the drawer or the drawee bank. The legal purpose is a possible detrimental consequence against the depositary bank. After the actual payee received his recovery from the depositary bank, the latter will be unable to pursue a recovery lawsuit if there is a negligent act on the side of the drawer.[136] A real payee by passing the drawer and starting a direct suit against a depositary bank, may show intent of the real payee to get his money without placing the loss on the party with whom he has done business, a move which might affect the upcoming business opportunities negatively with the negligent drawer.[137] Unfortunately, the U.C.C. has no clear

---

[132] - *Ervin,* 38 Pa. D. & C.2d at 318-19, and *Cooper,* 507 P.2d 609 at 617.

[133] - Old § 3-603 "The real owner's right of action against the drawer of the check is maintained by the fact that the drawer's underlying obligation to pay is not discharged yet when the check is paid over a forged indorsement." Also, "The payee's rights against the drawee bank are maintained at old § 3-419(1)(c) and (2)."

[134] - The loss on a forged indorsement is transferred back to the party who took from the forger via the transfer warranties of old § 3-417 and § 4-207.

[135] - *National Union Bank.*, 148 Md. 449, 129 A. at 699.

[136] - The most common form of drawer's negligence former to the amendment of 3-420 is a mis-mailing of an order instrument to a party with the same name as the payee. In old § 3-406, Comment 7. If a check has been mis-mailed, the payee may have the rights necessary to sue in conversion against the depositary bank. *Allen* v. *Mendelsohn*, 207 Ala. 527, 93 So.416 (1922); *Hoffman* v. *First Nat'l Bank*, 299 Ill. App. 290, 20 N.E.2d 121 (1939). In other cases, courts denied the rights, stating that without delivery the payee gets no title to the instrument. *Jones* v. *Bank of America*, 49 Cal. App.2d 115, 121 P.2d 94 (1942); *People ex rel. Nelson* v. *Kaspar American State Bank*, 364 Ill. 121, 4 N.E.2d 14 (1936). This issue resolved under current 3-420. The real payee has no right to sue for conversion before delivery. (discuss later).

[137] - "The absence of such a provision seems to deny to the bank the ability to use the "vouching-in" procedure of § 3-803. However, in a situation where the negligence of the drawer has caused the forgery, it would seem reasonable

method would allow the depositary bank to pursue an action to transform the loss to the drawer of the check if the latter is negligent. U.C.C. has an equitable policy in old 3-404, 3-405, and 3-406 that indicates a depositary bank should endure the loss incident to the collection of an instrument over a forged indorsement only when both the payee and the drawer are free from any negligence that might have been the direct cause of the unauthorized signature.[138] The defense of old § 3-419(3) implicitly indicated an inference which ensures that the real payee should demand recovery from the drawer.

Therefore, the unfairness towards the depositary bank happens when the actual payee litigates the depositary bank directly regardless of the negligence that the drawer might bear. The direct action against the bank serves to illustrate the hazard implicated when a court ignores the defense to enforce an economic policy. The outcome reached in both *Ervin* or *Cooper* may have been just attention to the specific facts presented in each case. However, when a court starts a case related to a new statutory provision, it must apply the statute with proper respect to the policy behind the legislative function. A court will be deemed to disregard its commitment when it ignores the apparent meaning of a statute which apparently produced rules altered the pre-U.C.C. judicial doctrines.

Also, the official comment to old § 3-419(3) is wholly inadequate to offer a satisfactory justification for the variation. However, when courts are examining the pre-U.C.C. judicial decisions on the liability of depositary banks, the language of old § 3-419(3) should have assumed a clarity that under old § 3-419(3) a depositary bank is protected from liability the same as the seller of bearer bonds was under the pre-U.C.C. judicial doctrines.

Courts in *Ervin* and *Cooper* and other cases[139] refused to accept the defense of acting in good faith and according to reasonable commercial standards if the bank cashed an instrument, deposited it in the forger's account, or took it for collection.[140] The reason led to the courts' refusal is different from one court to another. In *Ervin*, the court found that a depositary bank was not acting as a representative when it cashed an instrument and forwarded for collection. While the court in *Cooper* concluded that when the depositary bank cashes an instrument before collection, the bank, in fact, pays by using its own money and therefore the proceeds received from the payor bank is a property of the real owner. The court adopted an interpretation of the statutory term "proceeds" which eliminated the availability of the defense. In both *Sherriff-Goslin and Knesz,* the courts held that a depositary bank eventually will bear the loss under the breach of implied warranty old § 4-207(1) because the depositary bank is the person who

---

to grant the directly-sued depositary bank the same defense against the payee which the drawee bank could have asserted against the drawer, on the theory that the loss ultimately should be imposed upon the person whose negligence caused the forgery. A liberal construction of rules of impleader could allow the depositary bank to bring the drawer into any direct suit by the payee. Additionally, making the drawer a party would solve the evidentiary problem caused by the fact that the negligence of the drawer may be exclusively within the personal knowledge of the drawer and the payee." Tolley, *supra* note 25, at p 107.

138 - "Under the U.C.C. a payee whose negligence has caused the unauthorized signature is precluded from recovery against any bank under (old) § 3-404(1). If a payee settles with a negligent drawer, the drawer cannot get his account reinstated at his own bank. Where the negligent drawer is allowed a direct suit against a depositary bank, the bank is afforded the same defenses against the drawer which the drawee bank could have asserted against him." *International Indus., Inc*. v. *Island State Bank*, 348 F. Supp. 886 (S.D. Tex. 1971).

139 - *Knesz* v. *Central Jersey Bank & Trust Co.,* 477 A.2d 806 (N.J.1984); *Clients' Sec. Fund of the Bar* v. *Allstate Ins. Co.*, 219 N.J. Super. 325, 530 A.2d 357 (Super. Ct. App. Div. 1987).

140 - Current section 3-420 Official Comment. 3.

communicates with the forger. Courts had interpreted § 3-419(3) in different ways only to decide that a depositary bank is liable for conversion in cashing an instrument, deposit it, or take it for collection. Regardless of the obvious language of subsection 3-419(3) and the official comments indicating that the subsection was intended to adopt the reasoning of pre-U.C.C., decisions which dealt with the liability for the conversion of brokers selling stolen negotiable instruments and wanted to give the same protection to depositary banks. Also, since in most instances a forger would have cashed the check or withdrew the proceeds of the check before the real owner starts the lawsuit, commentators felt that the § 3-419(3) defense would absolve a depositary bank from any liability to a real owner.[141]

Admittedly, this interpretation of the old § 3-419(3) defense raises fundamental questions of public policy and justice. Under all these criticisms, the legislature found themselves in need to rewrite old 3-419 in a way corresponds with the courts' intent and the policies. Therefore, the legislature in 1990 amended old 3-419 and replaced it with current 3-420.[142]

The official comments to current 3-420 indicate that the amendment was a result of criticism from the courts to subsection (3) of former section 3-419. Courts saw no reason why a depositary bank should have the defense stated in the subsection. The official comment referred to *Knesz* v. *Central Jersey Bank & Trust Co.*[143] in which the supreme court of New Jersey stated that the depositary bank is ultimately liable because of its warranty to the payor bank under "old" § 4-208(a)(1) and it is usually the most convenient defendant in cases involving multiple checks drawn on various banks. The supreme court illustrated that the literal application of "old" § 3-419(3), blocking a direct action against the depositary-collecting bank, would result in a chain of litigation. First, the owner of a check may bring an action against the drawer for the fulfillment of the underlying obligation under "old" 3-804 or sue the drawee bank for conversion under "old" § 3-419(1)(c). The drawer will sue the drawee or payor bank for wrongfully debiting his or her account for payment to the forger under "old" § 4-401. The drawee or payor bank will be required to sue its transferor. The suit will proceed successively up the collection stream based on strict warranties of presentment and transfer under the U.C.C. until the depositary bank, ultimately liable for honoring the forged instrument, is reached.[144]

The recognition of single direct action by an owner against the depositary bank and the avoidance of circuitous or chain litigation overrides the plain terms of § 3-419(3). That policy was undoubtedly known to the legislatures of the U.C.C. It was presumably within their contemplation when § 3-419(3) was integrated granting immunity to these banks. The supreme court found itself constrained to adhere to the choice made by the legislatures. However, the legislatures did not give no comment regarding that this choice leads to intolerable or absurd results, a factor that would have given the supreme court pause in applying § 3-419(3) by its terms.

The supreme court cited *Ervin* v. *Dauphin Deposit Trust Co.*,[145] to hold that the defendant bank still retained the proceeds of the alleged checks. Also, the supreme court cited

[141] - 1 Ronald A. Anderson, Anderson's *Uniform Commercial Code* 687 (The Lawyers C. ed,.2d ed. 1961); Henry J Bailey, *The Law of Bank Checks* § 15.14, at p 517 (The Banking Law Journal. ed,.3rd ed. 1962).

[142] - Current 3-420 Official Comment. 3.

[143] - 477 A.2d at 806.

[144] - 477 A.2d at 811-12.

[145] - *Ervin*, 38 Pa. D. & C.2d at 311.

Cooper v. *Union Bank*,[146] to find that the defendant bank still held the entire "proceeds" of the forged checks, notwithstanding the fact that the forger's account with the defendant bank in which the forged checks had been deposited was depleted. The reason that the bank always retains the proceeds of the forged checks in trust for the real owner, unless the bank's assets dwindle below the amount of the checks.[147]

The official comment drew from *Knesz* that there is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised article 3, the defense provided by § 3-420(c) is limited to collecting banks other than the depositary bank. Therefore, if the owner of an instrument brought a suit against both the payor bank and the depositary bank, the owner, of course, is entitled to one recovery.[148]

IV. The Liability under current Section 3-420

The owner of an instrument that paid on a forged indorsement may wish to sue for conversion directly the individual who may be ultimately liable, which is, the person who dealt directly with the forger, which overwhelmingly, is depositary banks.[149] In that event, a forger after tampering a payee's indorsements will move to cash or deposit the checks in an account opened in one or several banks even when the checks drawn on numerous banks. Thence, a suit against a depositary bank is more efficient than multiple lawsuits against multiple payors.[150]

Before the amendment of old § 3-419(3), the Pennsylvania supreme court[151] found that a depositary bank was liable only to the extent of cash and other value it had recovered from the forger's assets. Full liability found by another court where stolen checks restrictively indorsed by the forger and deposited to his accounts, but the failure of the bank to be insulated from liability attributed to the failure to comply with the restrictive indorsements. Thus, a direct conversion action under old § 3-419(3) against other than the payor bank intended to be limited to the situation where the forger had left all or a portion of the unlawful gains on deposit, which was a doubtful occurrence.[152] As is discussed above, however, under essential cases, courts found a different interpretation to the definition of the words "representative" and "proceeds" to hold depositary or payee banks liable for conversion to the true owner[153]. Consequently, under current Article 3, the defense of acting according to reasonable commercial standards that a depositary bank could use is deleted because of the reasoning in the New Jersey superior court's opinion.[154]

---

[146] - *Cooper*, 507 P.2d at 613.
[147] - *Cooper*, 507 P.2d at 615.
[148] - Current 3-420 Official Comment. 3.
[149] - § 3-420(a).
[150] - Frederick J. Jr. Murphy, *supra* note 8, at p 367.
[151] - *West Penn Admin., Inc.* v. *Union Nat'l Bank,* 233 Pa. Super. 311, 335 A.2d 725 (1975).
[152] - *Jackson Vitrified China Co.* v. *People's Am. Nat'l Bank*, 388 So.2d 1059 (Fla.Dist.Ct.App.1980); *Denn* v. *First State Bank*, 316 N.W.2d 532 (Minn.1982); *Coulter Electronics, Inc*. v. *Commercial Bank*, 727 F.2d 1078, 38 UCC Rep. Serv. 239 (11th Cir.1984).
[153] - *Ervin*, 38 Pa. D. & C.2d 473.; *Cooper*, 9 Cal. 3d 371; *Knesz* v. *Central Jersey Bank & Trust Co.,* 477 A.2d 806 (N.J.1984).
[154] - 3-420 Official Comment. 3.

In the leading case under old Article 3, *Knesz* v. *Central Jersey Bank & Trust Co*.,[155] the court concluded that there is no reason why a depositary bank should have the defense since it is ultimately liable because of its warranty to the payor bank. Subsection 4-208(a)(1).[156] There is no ground for requiring an owner to bring multiple actions against several payor banks and to require those banks to assert warranty rights against the depositary bank. In revised Article 3, the defense provided by § 3-420(c) is limited to collecting banks other than depositary banks. Thus, a suit for conversion against a depositary bank is promoted and the owner, of course, is entitled to recovery.[157]

Therefore, this Chapter focuses on the applicable law to sue for conversion, the elements that will lead to holding a depositary bank liable for conversion, and when the owner could sue the depositary bank for conversion. After that, the Chapter discusses whether the drawer of an instrument could sue for conversion and then focus on depositary bank defenses to prevail in a suit for conversion.

1. Article 3 is the applicable Law

After the amendment of 3-419,[158] the subsection altered the treatment of depositary banks. A depositary bank who dealt with an instrument or its proceeds on behalf of one who was not the real owner of the instrument could be suing for conversion. Currently, the real owner's right to sue a depositary bank for conversion incorporated in § 3-420(c).[159]

A significant notice before moving to talk about conversion under 3-420 is that once an instrument is indorsed and delivered to a depositary bank, Article 3 is the applicable law. The owner of the instrument cannot withdraw from Article 3 merely because s/he chooses not to bring its action as one for conversion or sue for breach of contract. For instance, after a plaintiff argued that since she decided to pursue her claims under theories outside the U.C.C., and precisely because she did not bring an action of conversion, she thought the U.C.C. is not applicable. The appeals court of Mississippi overruled saying that the general negligence claim is alive and well in our law by section 1-103. The defense is accurate up to the time where the forger indorsed the check and delivered it to the defendant bank, after that moment the rights and responsibilities of the parties determined and governed by the code.[160] In a different case,[161] the

---

155 - Montgomery, *supra* note 82, at p 225.

156 - 3-420 Official Comment. 3. Subsection 3-419(3) drew criticism from the courts, that saw no reason why a depositary bank should have the defense stated in the subsection; *Knesz* v. *Central Jersey Bank & Trust Co*., 477 A.2d 806 (N.J.1984). The depositary bank is ultimately liable in the case of a forged indorsement check because of its warranty to the drawee bank under § 4-208(a)(1) and it is usually the most convenient defendant in cases involving multiple checks drawn on different banks.

157 - 3-420 Official Comment 3.

158 - Current 3-420.

159 - § 3-420(a); old § 3-419 Official Comments. 2: A negotiable instrument is the property of the holder; old § 3-419 Official Comments. 3: "Any payment on a forged indorsement, even though made in good faith, is an exercise of dominion and control over the instrument inconsistent with the rights of the owner and results in liability for conversion".

160 - *Hancock Bank* v. *Ensenat*, 819 So.2d 3, 46 UCC Rep. Serv. 2d 936 (Miss. App. 2001).

161 - *Southwest Bank* v. *Information Support Concepts, Inc.*, 149 S.W.3d 104, 55 UCC Rep. Serv. 2d 116 (Tex. 2004).

depositary bank attempted to escape liability for conversion by joining as an additional defendant "the employee who stole the checks." The bank would then have been liable only for its proportional share of the loss under a Texas proportionate responsibility statute. The court refused to apply the proportionate liability statute because it would ignore the U.C.C. itself and thwart the Code's specific statutory allocation of responsibility.

A further case, an insurance company, forwarded checks for fire damages to an apartment building, were made jointly payable to the owner, the repair contractor and the mortgagee, requiring indorsement by all three payees. The repair contractor forged the indorsement of the mortgagee and obtained payment of the check. The mortgagee sued the drawer (the insurance company), but the trial court granted the drawer's motion for summary judgment. The appellate court affirmed, limiting the plaintiff's right to recover to action in conversion under 3-420, against the banks that cashed or paid the checks. A check lacking a required indorsement is not properly payable under 4-401, and the depositing or payment of that check is invalid under § 3-420. Here, the plaintiff could not recover from the repair for a lost check under 3-309 because the location of the checks was known. Also, the plaintiff could not recover from the drawer on the underlying obligation because of the suspension by delivery of the check under § 3-310. Thus, a conversion claim against either the forger or depositary bank is the convenient remedy.[162]

In different facts, when the check is payable to co-payees, the payee who is indorsement forged has the right to sue the drawer of the check. Also, if a check were made payable to both the insured and the mortgagee, the indorsement would not be correct unless both of them indorse it.[163] When the check came to the hands of the insured, he cashed it without the mortgagee's indorsement. The mortgagee sued the insurer, but the trial court held in favor of the insurer who argued that delivery of the draft to the insured discharges the obligation of the insurer to the mortgagee. The appeals court of Texas reversed, noting that the claim of the mortgagee discharged by payment of the draft to the insured; since the mortgagee did not indorse the draft, there was no discharge for the drawer under § 3-602.[164] The court concluded that the plaintiff has the right to allege a cause of action to recover the amount of the check from the defendant drawer of the check under 3-309. Then, the drawer defendant may move to recover its loss from the subcontractor who apparently forged the indorsement on the check, or versus the bank which honored the forged check.[165]

2. The Elements of a Suit for Conversion

An action for conversion will not be accepted unless several elements have accrued. The suit for conversion will not be allowed unless the depositary bank has actually made a payment on the forged instrument to the forger. Then, the discussion will be on the availability of the defense of

---

162 - *Parkway Bank & Trust Co.* v. *State Farm Fire & Cas. Co*., 2013 IL App (1st) 122387, 371 Ill. Dec. 824, 990 N.E.2d 1202, 80 UCC Rep. Serv. 2d 920 (App. Ct. 1st Dist. 2013), appeal denied, 374 Ill. Dec. 569, 996 N.E.2d 16 (Ill. 2013).

163 - *ViewPoint Bank* v. *Allied Property and Cas. Ins. Co*., 439 S.W.3d 626, 84 UCC Rep. Serv. 2d 295 (Tex. App. Dallas 2014).

164 - The court citied *McAllen Hospitals, L.P.* v. *State Farm County Mutual Insurance Co.*, 433 S.W.3d 535 (Tex. 2014). *Id* at 634.

165 - *ViewPoint Bank* ,439 S.W.3d at 635. *See* also *Crystaplex Plastics* v. *Redevelopment Agency*, 77 Cal. App. 4th 990, 92 Cal. Rptr. 2d 197 (2000).

good faith and follow reasonable commercial standards and whether a depositary bank could allege that against a claim for conversion. Also, the actual payee must receive the instrument from the drawer or the indorser otherwise the suit will not be qualified. After that, the discussion will be on the statute of limitation and the amount of recovery to which the owner is entitled.

a. The Bank cashed the Instrument

The owner of an instrument bearing an unauthorized or forged indorsement cannot sue in conversion unless and until the depositary bank has made a payment to the forger. Therefore, if the bank did not cash or deposit the instrument into the forger's account, the claim for conversion would be dismissed.[166] There would be no cause of action for conversion unless an actual payment made for the instrument bearing forged indorsement. Thus, if a depositary bank gave provisional credit to a co-payee on the face amount of a check after the co-payee forged the indorsement of the plaintiffs, subsection 3-420(a) is not applicable because the depositary bank took a check for collection only.[167]

Moreover, the depositary bank must make a cash payment to be suing for conversion. The bank is not liable for conversion just because it deposits a check to the depositor's account or stamps the check paid. Also, the bank is not liable if deposited the amount of the check in the forger's account, but at the same time placed a "hold" upon the amounts deposited, and did not allow the forger to withdraw them until the receipt of the proceeds from the payor. Section 3-420 applies only when a bank paid a check on a forged indorsement and thus does not apply to the case in which the bank took a check for collection or did not pay its amount to the forger.[168]

Furthermore, a depositary bank would not be liable under § 3-420(c) for accepting a check with an improper indorsement, unless the drawee bank pays and transfer the proceeds of the check to the depositary bank. The depositary bank was not liable under 3-420 because the drawee bank subsequently dishonored the check and therefore no converted proceeds were forwarded to the depositary bank.[169]

b. Bank's Failure to Follow Reasonable Commercial Standards

A representative was liable under old Article 3 without regard to any proceeds remaining if it did not act in good faith or follow reasonable commercial standards.[170] Currently, the defense deleted from § 3-420(c). However, several cases have presented this situation. For example, where stolen checks restrictively indorsed by the forger and deposited to his account at the defendant bank, the court held not only that the bank had failed to comply by the restrictive indorsements but also that the defendant bank's conduct violated the standards of care for depositary banks.[171]

---

[166] - *Franklin* v. *Safeco Ins. Co.,* 303 Or. 376, 737 P.2d 1231 (1987).

[167] - 3-420 Official Comment. 1.

[168] - *Franklin* v. *Safeco Ins. Co.,* 303 Or. at 387-88.

[169] - *G.M.A.C.* v. *Citizens Commercial & Savings Bank*, 46 UCC Rep. Serv. 2d 489 (Mich. Ct. App. 2001).

[170] - This requirement is deleted under § 3-420(c), which also denies the defense to depositary, as opposed to collecting, banks. Bad faith also will remove the defense.

[171] - *Underpinning & Foundation Constr., Inc.* v. *Chase Manhattan Bank*, 46 N.Y.2d 459, 414 N.Y.S.2d 298, 386 N.E.2d 1319 (N.Y. 1979). See also *Continental Airlines, Inc*. v. *Boatmen's National Bank of St. Louis*, 13 F.3d 1254, 22 UCC Rep. Serv. 2d 841 (8th Cir.1994).

Also,[172] when the deviation consisted of an indorsement that was entirely missing, the court concluded that the test is comparing the defendant bank's practices with the familiar reasonable commercial standards in the locale or industry not the commercial standards of the specific representative. The deposition of Marine's Assistant Cashier presented to the district court admitted that the defendant bank had failed to comply with its own commercial standards in dealing with the instrument without obtaining the indorsement of plaintiff "*Central*." No material issue of fact presented regarding this issue.

However, courts in other cases presenting less damaging facts, probably induced by the perceived efficiency of the direct action,[173] worked hard to find a failure to follow reasonable standards to reject the depositary bank's defense in a suit for conversion. For instance, when the defendant bank allowed the deposit of checks payable for taxes into an account controlled by the plaintiff's accountant while the accountant was not entitled to the proceeds of those checks because the plaintiff did not indorse the checks to the accountant, the trial court permitted the defendant bank's defense of commercial reasonableness under section 3-406. The trial court found that the plaintiff' negligence in dealing with his accountant substantially contributed to the scheme and that the defendant bank followed "reasonable commercial standards" in paying the checks. Also, the trial court found that the policy of the bank in dealing with checks is identical to that of similar local banks. Following similar procedures of local banks would not expose the bank to liability. However, the appeals court held that the defendant bank failed to inquire whether the checks have the proper indorsement before depositing them in the accountant's account and the bank's failure constitutes an engagement in unreasonable commercial practices.[174]

As noted above, this defense was deleted from current § 3-420(c), allowing a direct action against depositary banks regardless whether they acted in good faith or according to reasonable commercial standards. However, suing a representative other than depositary banks restricts the representative's liability to the proceeds remaining, so long as the representative dealt with the instrument or its proceeds in good faith and followed customary commercial standards.

c. The Real Payee received the Instrument[175]

To sue a depositary bank for conversion under section 3-420, the actual payee must receive the instrument from the drawer; then the named payee only became the owner of the instrument. Also, if the drawer issued the instrument the bearer, the holder deemed to be the owner of the instrument. Moreover, if a co-owner of a company issued an instrument as the

---

172 - *Handel* v. *Manufacturers Hanover Trust Co*., 16 UCC Rep. Serv. 762 (N.Y.Sup.Ct.1975).

173 - A suit by the payee directly against the person who dealt with the forger is obviously more efficient than a suit by the payee against the payor, who then must sue in warranty, as others also may have to do, to place the loss ultimately upon the same person.

174 - *Govoni & Sons Const. Co., Inc*. v. *Mechanics Bank*, 51 Mass. App. Ct. 35, 742 N.E.2d 1094, 43 UCC Rep. Serv. 2d 1058 (2001).

175 - 2 Barkley Clark & Barbara Clark, *The Law of Bank Deposits, Collections, And Credit Cards* § 12.03[2] (LexisNexis A.S. Pratt. eds., 3rd ed. 2017).

company's representative and indoresed the instrument to himself, the other co-owners of the company are not entitled to conversion action under section 3-240.

Lopes the plaintiff owned stocks in the defendant Chase Bank. *Mellon* acted as Chase's agent for stock transfer services. In June 2004, an unknown imposter, pretending to be *Lopes* or someone acting on his behalf, instructed *Mellon* to sell plaintiff's shares and send the proceeds to an address in Rio de Janeiro, Brazil, the city in which *Lopes* lives. Someone who was not *Lopez* received the check and deposited in a Wachovia account that did not belong to *Lopes*. Wachovia negotiated the check; the real *Lopez* had no relationship with any account at Wachovia and did not receive the check or payment for his Chase stocks.

The court stated that the comment to the 1990 revision of the U.C.C. makes clear, delivery to a third party who is not a co-payee or agent of the payee does not give the payee standing to sue for conversion.[176]

Similarly, when the instrument indorsed in blank, the new holder is an owner of the instrument, and the intended owner is not entitled to sue the depositary bank for conversion because he does not hold the instrument. Georgia appeals court [177] discussed this matter saying that if a check indorsed in blank under section 3-205, the check is payable to bearer. When an instrument in a bearer form, any person is an owner of an instrument so long as that person possesses the instrument and thus under 3-301, the holder of an instrument is entitled to enforce it. The appeals court stated that an employee who stole cashier's checks indorsed in blank by their payees and deposited them in his bank account was a holder entitled to enforce the checks. Therefore, the defendant bank is not liable for conversion under § 3-420(a) because the indorsement in blank made the faithless employee a legitimate holder and entitled him to impose the instrument.

Moreover, there is no liability toward a depositary bank when the instrument bears an authorized indorsement by a person who is legitimately the owner of the instrument. The superior court of New Jersey[178] held in a case its facts say that the plaintiff (an attorney) and one of the defendants were co-owners of a limited liability company. The defendant co-owner provided a check-cashing company with documents indicating his ownership share of the company and authority to cash checks, and then cashed checks payable to the limited liability company under his indorsement and embezzled the funds. The plaintiff sued the faithless co-owner and the banks that paid the checks. The superior court concluded that Agency law, the rules on apparent authority, the U.C.C give the defendant as a co-owner the authority to indorse the checks.[179] When an authorized agent for a company signs his name as an indorsement, it is as if he signed as the company. Even if the faithless co-owner here did not have actual authority to cash checks, he had apparent authority to do so.[180] Therefore, no action for conversion against the depositary bank maintained because the depositary bank adequately relied on the check-

---

176 - *Lopes* v. *Mellon Inv'r Servs. LLC*, 2007 U.S. Dist. LEXIS 88910 (S.D.N.Y. Dec. 3, 2007).

177 - *Gerber & Gerber, P.C.* v. *Regions Bank,* 266 Ga. App. 8, 266 Ga. App. 8, 11(2), n. 1, 596 S.E.2d 174 (2004).

178 - *Kuhn* v. *Tumminelli, 366 N.J. Super.* 431, 841 A.2d 496 (Super. Ct. App. Div. 2004).

179 - § 1-103(b): "Unless displaced by the particular provisions of the Uniform Commercial Code, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions."

180 - Sections 3-401, 3-404.

cashing company's warranty that the co-owner was entitled to enforce the check and the indorsement was valid. Finally, the drawee banks relied on the depositary bank's warranty that entitled to compel the check and were also immune to action for conversion under 3-420.

After the delivery of the check,[181] the payee as an owner could sue only the depositary bank, not the drawer. For instance, when a drawer (an insurance company) proceeds checks for fire damage to an apartment building were made jointly payable to the owner, the repair contractor, and the mortgagee, requiring indorsement by all three payees. The contractor forged the indorsement of the mortgagee and obtained payment of the checks. The mortgagee sued the drawer, but the trial court granted the drawer's motion for summary judgment. The court of appeals affirmed, limiting the mortgagee's remedy to an action for conversion under 3-420, against the depositary bank that cashed or paid the checks. A check lacking a required indorsement is not properly payable under 4-401. Consequently, deposit or payment of that check is conversion under 3-420 (subject to a limited exception at 4-205, the mortgagee could not recover from the drawer for a lost check under 3-309[182] because the location of the checks was known. Also, the mortgagee could not recover from the drawer on the underlying obligation because the delivery of the check suspended them under 3-310.[183]

Further, cases in which an instrument is payable to two persons and the two persons are not alternative payees, such as a check payable to A and B. Under § 3-110(d) the check can be negotiated or enforced only by both payees co-operating. Consequently, neither payee acting without the consent of the other is a person entitled to enforce the check. If A indorses, the check and B does not, A's indorsement is not sufficient to allow negotiation of the check. So, if a depositary bank cashes or accepts the check for deposit to A's account, a depositary bank is liable to B for conversion of the check if B did not give his consent to the transaction. A, acting alone, is not the individual entitled to enforce the check because A is not the holder of the check.[184] The depositary bank does not get any greater rights under § 4-205(1). If the depositary bank acted for the interest of A, that does not entitle the depositary bank to become the holder of the check under § 4-205(1) because A, its client, was not a legitimate holder who could enforce his right on the instrument.[185]

d. Statute of Limitation

The three-year limitation period at § 3-118 begins at the time of the conversion, when the cause of action accrues, not its later discovery unless the defendant engaged in fraudulent concealment.[186] As an example, after an insurance claims draft issued to two payees, it was negotiated to the defendant bank by one of the co-payee without the required indorsement of the other. Thirteen months later, the other payee (whose indorsement was missing) sued the defendant bank for conversion. The court stated that the one-year limitation period for

---

[181] - § 3-310(b).

[182] - One of the requirement under § 3-309(a)(3) The person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannon be found or is not amenable to service of process.

[183] - *Parkway Bank and Trust Co.* v. *State Farm Fire and Cas. Co.*, 2013 IL App (1st) 122387, 371 Ill. Dec. 824, 990 N.E.2d 1202, 80 UCC Rep. Serv. 2d 920 (App. Ct. 1st Dist. 2013).

[184] - § 3-110(d) and 3-110. Official Comment. 4.

[185] - 3-420. Official Comment. 1.

[186] - *Peoples Bank of Biloxi* v. *McAdams*, 171 So.3d 505 (Miss. 2015).

conversion actions in Louisiana barred the claim. The court also adopted the majority position, limiting the discovery rule to exceptional circumstances such as where there has been fraudulent concealment. The court noted that this puts the burden of discovery on the party best able to discover the fraud.[187] The plaintiff asserting an action for conversion has the responsibility to find and prove the fraud.[188]

In a different case,[189] the court dismissed the client's claim against the depositary bank based on the three-year statute of limitations on actions for conversion of negotiable instruments contained in § 3-118(g). The undisputed facts indicated that the client was not aware of her claim of conversion until her new attorney discovered the conversion in March 2010, after the expiration of the statute of limitations on her allegation. Also, no facts are indicating that the plaintiff should have known about her conversion claim before the start day of the statute of limitations. The court ruled that the statute of limitations prevent the conversion's action. The claim for conversion was subject to the three-year statute of limitations provided in subsection 3-118(g), and the plaintiff had not alleged any fraudulent concealment on the part of the bank.

Also, if a plaintiff has an allegation on several checks, each check created a separate cause of action for conversion under section 3-420. After a medical office employee stole 269 insurance checks payable to her employer, she forged the employer's indorsement and deposited the checks in her account at the credit union. The Seventh Circuit reversed a district court ruling that all 269 checks constituted a single or continuous injury for purposes of the statute of limitations. Each check created a separate cause of action for conversion under 3-420.[190] Thus, if action on one of two of the checks barred by the statute of limitation, the plaintiff is still able to go forward in his action on the other checks.

e. Amount of Liability under Subsection 3-420(b)[191]

Subsection 3-420(b) creates an assumption that the measure of accountability for which the depositary bank is liable is the whole amount of an instrument unless and until proof introduced which would back a finding of the converse. Subsection 3-420(b) allowed depositary banks to provide evidence which may prove that the obligation is worth less because of an existence of a defense, or some other reasons. However, in the absence of evidence, subsection 3-420(b) explicitly limits the real owner's recovery to the presented interest on the instrument.

---

187 - *Specialized Loan Servicing, LLC* v. *January*, 119 So. 3d 582, 80 UCC Rep. Serv. 2d 1225 (La. 2013).

188 - UCC § 3-118(g): Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an instrument, for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty, or right arising under this Article and not governed by this section must be commenced within three years after the [cause of action] accrues.

189 - *Hawkins* v. *Nalick*, 363 Ill. Dec. 767, 975 N.E.2d 793, 78 UCC Rep. Serv. 2d 593 (App. Ct. 5th Dist. 2012).

190 - *Rodrigues* v. *Olin Employees Credit Union*, 406 F.3d 434, 57 UCC Rep. Serv. 2d 392 (7th Cir. 2005).

191 - § 3-420(b) In an action under subsection (a), the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

The measure of accountability for conversion is typically the face amount of an instrument.[192] However, subsection 3-420(b) added a clause by which the real payee's recovery may not exceed the amount of the plaintiff's interest in an instrument. In the case an instrument is payable to multiple payees, the interest of one of the payees may be less than the amount of an instrument. Therefore, in a matter of various payees, subsection 3-110(b) states that the payment of an instrument is void unless all payees join in the action of cashing the instrument. Thus, if one of the payees has a limited interest in an instrument, the last clause in § 3-420(b) prevents him or her from receiving unworthy payment.[193] For instance, a New York Law Firm forged the signature of an Estate's administrator on a settlement check payable to the Law Firm and the Estate jointly.[194] The Law Firm cashed the check and deposited the funds in the Law Firm's account at the defendant bank, then filed bankruptcy. The Estate filed a claim with the client protection fund and received indemnity in the amount of two-thirds of the value of the settlement check, which was equal to the amount of the check minus the contingency fee the Law Firm would have received. As part of the compensation agreement, the Estate assigned its rights to the fund, which then sued the defendant bank for conversion. The question was whether the plaintiff could recover the entire amount of the settlement check from the bank or only the net after deduction of the legal fee. The court stated that the plain language of old § 3-419(2)[195] provides that the remedy for conversion is the face amount of the instrument. The Estate never received any of the funds, and its assignee could not be in any worse position than the assignor. Therefore, the critical inquiry for the court to find was whether the plaintiff indeed received a possible benefit from the forger, to be able to justify the forger's claim to the contingency fee.[196]

The depositary bank could deduct from the remedy to the owner any amount that the owner of an instrument received from the forger. The appeals court of Georgia disagreed with the defendant bank that paid a negotiable instrument over a forged indorsement when the bank claims that check issued by the drawer upon a fraudulent application and not based upon any obligation. The court said that the check is a negotiable instrument which names *Thornton* as a payee and the plaintiff is a legitimate holder.[197] However, the court did limit the liability of the defendant bank to the amount not returned to the drawer by the forger.[198] The court said it is the party whose name forged that usually suffers the loss, and if the defendant bank's argument were adopted no one whose name forged on an instrument could seek recovery for conversion. However, the court noted that the measure of the defendant bank's liability for the conversion is assumed to be the face amount of the instrument under § 3-419(2). Thus, the defendant bank is liable for the whole amount of the check unless evidence raised which would support a finding of otherwise. While *Thornton's* suit is for the full-face amount of the instrument, the evidence

---

192 - § 3-420(b) The measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument. Also, under § 3-419(2), the measure of liability in action against a drawee was stated to be the face amount of the instrument. *See* also, 2 James J. White et al., *Uniform Commercial Code* § 19:9 (Thomson Reuters. eds.,6th ed. 2013).

193 - § 3-420 Official Comment. 2.

194 - *Lawyers' Fund for Client Protection* v. *Bank Leumi Trust Co*., 94 N.Y.2d 398, 706 N.Y.S.2d 66, 727 N.E.2d 563 (2000).

195 - Current § 3-420(b).

196 - *Lawyers' Fund for Client Protection,* 94 N.Y.2d at 406.

197 - *Thornton & Co.* v. *Gwinnett Bank & Tr. Co.,*151 Ga. App. 641, 260 S.E.2d 765 (1979).

198 - *Thornton & Co.,* 151 Ga. App. at 646.

shows that the forger has in fact repaid the drawer a serious part of the proceeds the forger received from cashing the converted check and *Thornton* has repaid the balance by the drawer. Since the only loss sustained by *Thornton* comes from its having to repay the drawer the amount represented by the fraudulent premium financing applications, which has no right to retain the proceeds of the check itself, any amount that the forger has refunded reduces *Thornton's* loss and thus the defendant bank's liability. Therefore, Thornton's is entitled to recover, at most, the amount it has refunded to the drawer and the defendant bank is entitled to a set-off for any amounts the forger has repaid to the drawer.[199]

The rationale behind allowing depositary banks the right to reduce the interest of the plaintiff's interest in the instrument stated by the appeals court of Washington.[200] The court said that the doctrine of election of remedies, designed to prevent double recovery for a single loss, provides that if two or more inconsistent remedies exist, a party choosing one will be bound to the one remedy and precluded from asserting the others. Also, the court added that losses should not be placed upon negligent banks only because it is a convenient solution to do so or when such action will grant an unwarranted and unearned benefit upon another. The situation must consider in the light of general principles of law and equity which supplement the provisions of the Uniform Commercial Code. In *Lawyers' Fund for Client Prot*,[201] the court stated that the reason for allowing such setoff is that defendant bank cannot be said to have engaged in conversion "an unauthorized exercise of the rights of ownership" where the plaintiff has control of the funds.[202] Besides allowing the defendant bank to set-off prevents unjust enrichment.[203]

3. Drawer's status under Section 3-420

The drawer after the delivery of the instrument sustains two conditions. First, the underlying debt suspended, so the payee cannot sue on the underlying debt when the location of the instrument is known. Second, the drawer is not entitled to sue a depositary bank conversion under 3-420 because s/he after delivery is no longer the owner of the instrument.

The payee cannot sue on the underlying debt when the location of the instrument is known. For instance, after the payee of stolen check sued the defendant for negligence because of damages suffered in a car accident, the defendant denied negligence and claimed that the defendant's insurer had already paid the payee. The facts show that the defendant's insurance carrier had mailed a check to the plaintiff's post office box. Thus, the court held that the plaintiff payee received delivery within the meaning of 3-420 when the check delivered to the post office box. Someone else had taken the check from the post office box, forged the indorsement, and transferred it to a bank. While the plaintiff had a cause of action for conversion against the depositary bank and the person who stole the check, the plaintiff had no cause of action against the defendant because the defendant's underlying obligation still suspended and the defendant's insurer had already satisfied the claim by issuing and delivering the check to the plaintiff.[204]

---

199 - *Id*.

200 - *Bank of the W.* v. *Wes-Con Dev. Co.,* 15 Wash. App. 238, 548 P.2d 563 (1976); *S. Cal. Permanente Med. Grp.* v. *Bozinovski,* 148 Cal. App. 3d 503, 196 Cal. Rptr. 150 (1983).

201 - *Lawyers' Fund for Client Prot.,* 94 N.Y.2d at 406.

202 - *Mouradian* v. *Astoria Fed. Sav. & Loan*, 91 N.Y.2d 124, 667 N.Y.S.2d 340, 689 N.E.2d 1385 (1997).

203 - *Tonelli* v. *Chase Manhattan Bank, N. A.,* 41 N.Y.2d 667, 394 N.Y.S.2d 858, 363 N.E.2d 564 (1977).

204 - *Bumgarner* v. *Wood*, 149 N.C.App. 974, 563 S.E.2d 309, 47 UCC Rep. Serv. 2d 1099 (2002).

Also, the payee as a bearer or named on an instrument cannot sue a depositary bank for conversion unless s/he received the instrument before the conversion; until receipt, the payee has no property interest in the instrument.[205] Thus, Western District Court of Tennessee denied the action for conversion because the plaintiff cannot sue for conversion for checks he had never received.[206] The remedy in these circumstances is to sue on the underlying obligation under 3-310[207] as the underlying debt remains until the instrument received by the payee.[208]

Also, the California appeals court of stated that § 3-420(a) does not give the drawer of the check after delivery to the payee any right to sue a depositary bank in conversion because the check went to the ownership of a different person. In *Barrett Business Services, Inc.*,[209] the payee sued the drawer after the drawer mailed the check to a wrong address and someone negotiated and cashed the check with a forged indorsement. The California appeals court held that the drawer was liable to the payee for the amount of the check because the underlying obligation had not been suspended or paid, under sections 3-310, 3-601, and 3-602. The California appeals court noted that the drawer of the check has no conversion remedy against a depositary bank, except the remedy the drawer would have against the drawee bank for charging his account under section 4-401. Then, the drawee bank could assert a claim for breach of warranty under subsection 3-417(a)(1) or subsection 4-208(a)(1) against the depositary bank., The loss eventually will fall on the person who gave value to the thief for the check.[210]

Moreover, a drawer of an instrument is not able to sue a depositary bank for conversion because of the delivery of the instrument to the payee. For instance, after an authorized employee issued a check on the company's account and indorsed the check to himself and deposited it into his personal account in the defendant bank, the company sued the defendant bank for conversion. The court rejected the company's claim, as the company was the drawer and once the check issued and delivered, the drawer was not the owner and could not sue for conversion. At that point, a check remains a debt of the drawer, not his or her property.[211]

Also, the indorser has no right to sue for conversion after the indorsement and delivery. Section 3-405 would preclude the transferee of an instrument from asserting a forged indorsement against a depositary bank if the forger of the check was an employee of the drawer with responsibility.[212] Therefore, the court allowed the defendant bank "*Citibank*" to assert the defense of section 3-406 against an action for conversion. The court accepted the defense

---

205 - 3-420 Official Comment. 1: "under the last sentence of § 3-420(a), the payee has no conversion action because the check was never delivered to the payee. Until delivery, the payee does not have any interest in the check."

206 - *Notredan, LLC* v. *Old Republic Exchange Facilitator Co.*, 875 F. Supp. 2d 780 (W.D. Tenn. 2012).

207 - § 3-310(b) "if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken."

208 - *Barrett Business Services, Inc.* v. *Workers' Comp. Appeals Bd.*, 204 Cal. App. 4th 597, 139 Cal. Rptr. 3d 109, 77 UCC Rep. Serv. 2d 194 (2d Dist. 2012).

209 - *Barrett Business Services, Inc.,* 204 Cal. App at 602.

210 - *Barrett Business Services, Inc.,* 204 Cal. App at 603.

211 - *300 Broadway Healthcare Center, L.L.C.* v. *Wachovia Bank,* N.A., 425 N.J. Super. 33, 39 A.3d 248, 77 UCC Rep. Serv. 2d 248 (App. Div. 2012); *Buchanan* v. *Helfrich*, Civil No. 88-439-FR, 1989 U.S. Dist. LEXIS 523 (D. Or. Jan. 13, 1989).

212 - *Lee Newman, M.D., Inc.* v. *Wells Fargo Bank*, 87 Cal. App. 4th 73, 104 Cal. Rptr. 2d 310, 43 UCC Rep. Serv. 2d 912 (2d Dist. 2001).

because the employee of the plaintiff stole checks payable to the company, added a fictitious payee, indorsed in the name of the fictitious payee, and deposited the checks to his account at the defendant bank "*Citibank*."[213]

However, there is no conversion if a check payable to two spouses was deposited into a joint account of the payees when an estranged spouse deposited a check payable to the other spouse into their joint account without the indorsement of the other spouse and cashed the check. The Louisiana appeals court found the payor bank's arguments persuasive. The payor bank argued that *FNBC* was a party entitled to enforce the check and that its payment of the cashier's check to *FNBC* discharged its liability. The payer bank pointed out as the trial court held that the base of *FNBC's* right to impose the check is on the language of *Mr. Marshall's* depositor's agreement with *FNBC*. The depositor's agreement appointed *FNBC* as *Mr. Marshall's* mandatory such that it could supply his missing indorsement on any check deposited into his joint checking account provided the item be payable to either of the two joint account holders. Thus, it was legally bound to pay *FNBC*. Furthermore, the payor bank argued that if it had not paid *FNBC*, then *FNBC* could have brought an action against it as a holder in due course of the item protected under section 4-205,[214]and the drawee bank would have been entitled to seek indemnity from *Mr. Marshall* under the terms of the Indemnity Agreement.[215]

4. Depositary Bank's Defenses

The depositary bank who cashed or accepted for deposit an instrument over an unauthorized or forged indorsement may avoid the liability for conversion in two events. The first is where, notwithstanding the unauthorized signature, the proceeds of the instrument goes to the hands of the intended party. The second event is where a forger's indorsement may be legally irrelevant contains instances involving an imposter, a fictitious payee, and a padded payroll, and the case where a responsible employee forges the employer's indorsement. However, the depositary bank may lose the defense if it acted in bad faith or failed to exercise reasonable commercial care.

a. The Proceeds of Instrument went to the Intended Party

Subsection 3-404(b) covers cases in which an instrument is payable to a fictitious or non-existing person and to cases in which a payee is a real person, but the drawer or the maker does not intend the payee to have any interest in the instrument. Also, subsection 3-404(b) applies to any instrument, but its essential value is concerning checks drawing by corporations, other organizations, and all other forged check cases.[216]

---

[213] - *National Accident Ins. Underwriters, Inc.* v. *Citibank, FSB*, 333 F. Supp. 2d 720, 727 (N.D. Ill. 2004).

[214] - Section 4-205. "If a customer delivers an item to a depositary bank for collection:

(1) the depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether the customer indorses the item, and, if the bank satisfies the other requirements of Section 3-302, it is a holder in due course; and

(2) the depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account."

[215] - *Marshall* v. *First Bank & Trust*, 848 So. 2d 660(La. Ct. App. 4th Cir. 2003).

[216] - Section 3-404. Official Comment. 2.

However, the defense of subsection 3-404(b) does not apply where a faithless employee stole check payable to an intended payee and, indorsed it in the name of the payee. Subsection 3-404(b) applies only on cases the authorized employee was the person who issues the instrument. For instance,[217] a faithless employee intercepted specific insurance premium checks that one of the plaintiff's client's had made payable to the plaintiff. The faithless employee was not involved in any scene of plaintiff's business that gave him authority to indorse or negotiate the checks. The faithless employee took the checks and altered them by adding a "slash" and extra payees, such as "*Sherman*" and "*Sherman Imports, Inc.*" The alterations were made either in a different typewritten font or different handwriting than that used on the original checks. The faithless employee maintained a checking account (*Sherman Account*) in the name of the altered payees with the defendant bank. He indorsed and deposited the checks in the Sherman account; the defendant bank accepted the checks and credited the account. The defendant bank then presented the checks for payment to various drawee banks. The plaintiff sued the defendant bank for conversion. The defendant bank contended that fictitious payee rules in subsection 3-404(b) apply to this case. However, Northern District Court of Illinois disagreed with the defendant bank the statutory fictitious payee rule covers situations where a bank honors a check bearing the forged indorsement of a fictional payee. However, subsection 3-404(b) covers issues where an employee with signing authority signs a check intending that the named payee receive it but later changes his mind and steals the check, indorsing it in the name of the payee. There is nothing in the rule, its history, or cases analyzing it, to suggest the rule applies to situations--such as the one here--between payees and drawee banks. All the example cited in the comments to the U.C.C. involve fraud or forgery occurring in the drawing or issuance of checks; courts have even held that if the intent to commit forgery arises after the check issuance, subsection 3-404(b) is not applicable.[218]

The same verdict accrued when a cattle trading company signed checks by the company's owner with the payee and amount lines left blank. The checks delivered to an employee, with instructions to fill in the amounts and payee names as needed to purchase cattle. Instead, the employee used the checks to embezzle from the employer. The faithless employee deposited 17 unauthorized checks at the depositary bank; some had forged indorsements; others had no indorsements, and some indorsed in a name other than the payee. The cattle company sued the depositary bank for negligence and conversion. Southern District Court of West Virginia, rejecting the discovery rule, held that some of the claims barred by the statute of limitations under section 3-118. Also, the other claims failed as well because a drawer cannot sue for conversion under section 3-420 once the checks have been delivered to a new owner and on the grounds of the intended payee rule.[219]

The drawer of an instrument cannot recover from the depositary bank for conversion in the event the named payee on the instrument is not the intended to have any interest.[220] For

---

217 - *Nat'l Accident Ins. Underwriters, Inc*. v. *Citibank, F.S.B.,* 243 F. Supp. 2d 763, 764. (N.D. Ill. 2002).

218 - *Nat'l Accident Ins. Underwriters Inc.,* F.S.B., 243 F. Supp. 2d. at 766.

219 - *Willier, Inc*. v. *Hurt,* 64 UCC Rep. Serv. 2d 759 (S.D. W. Va. 2007).

220 - § 3-404(b) Official Comment. 2. Case #2. Same facts as Case #1 except that Supplier Co. is an actual company that does business with Corporation. If Treasurer intended to steal the check when the check was drawn, the result in Case #2 is the same as the result in Case #1. Subsection (b) applies because Treasurer did not intend Supplier Co. to have any interest in the check. It does not make any difference whether Supplier Co. was or was not a creditor of Corporation when the check was drawn.

instance,[221] where a check is evidencing a loan was issued to both the husband and the wife, but only the husband had in fact applied for the loan, the wife's unauthorized indorsement was held to be immaterial. The plaintiff (Issuing Bank) issued two cashier's checks payable to husband and wife. These checks were for loans made by the plaintiff bank. After wife's indorsement on the checks forged, the husband deposited them to the account of his company in *First National Bank*. After that, *First National Bank* indorsed the checks and processed them for payment. The plaintiff bank promptly paid on each check. After many renewals of the loans and after several payments against the principal, the loans were in default. The plaintiff bank sued the *First National Bank* on its statutory warranty under section 4-207 alleging that *First National Bank* cashed checks bearing the wife's forged indorsement. The trial court gave issuing bank judgment against the husband; however, denied judgment against wife and cashing bank. The trial court found that the Issuing Bank drew the cashier's checks with the intention that wife has no interest in them. Thus, by operation of § 3-405(1)(b), the forged indorsement of the wife was immaterial, and therefore the depositary bank is not liable for conversion. The Missouri appeals court affirmed.[222]

b. Deception by Employee or Someone communicating with Drawer

Under Article 3, an indorsement by any person in the name of a named payee on the face of the instrument is effective. Such when (1) An imposter induced a drawer to issue an instrument payable to him.[223] (2) A representative signing on behalf of a drawer intending the named payee to have no interest in the instrument.[224] (3) A representative of a drawer supplied the drawer with the name of the payee intending the named payee to have no interest.[225] (4) An employee forges the indorsement of a check payable to his employer.[226] However, the employer is not responsible if the employee has an authority that merely allows the latter to have access to instruments or blank or incomplete instrument forms which are being stored or transported or are part of incoming or outgoing mails, or similar access.[227]

These provisions reflect the public policy that a drawer should bear the loss resulting from undiscovered impersonation and that an employer issuer or payee should bear the loss from a dishonest employee as a risk of the business. The rules govern employer's responsibility located under the general rule of section 3-406 which tells that a person whose lack of ordinary care substantially contributes to a forgery precluded from asserting that forgery against an individual who, in good faith, pays the instrument or takes it for value or collection. In leverage, the drawer or payee in these circumstances is typically in a better position to prevent the forgeries.[228] Consequently, a forged indorsement is efficient, assuming that the employee dealing with the instrument has not acted according to the direction of the employer drawing the instrument. Thus, there is no cause of action in conversion against a person who in good faith

[221] - *Am. Nat ' l Bank* v. *Seidel*, 622 S.W.2d 19 (Mo. Ct. App. 1981).

[222] - *Am. Nat'l Bank*, 622 S.W.2d. at 21.

[223] - Section 3-404.

[224] - § 3-405 (2).

[225] - § 3-405 (3).

[226] - § 3-405 (3).

[227] - *Id.*

[228] - Section 3-405 imposes liability on the employer for forged indorsements by an employee (subject to a contributory negligence defense), where the employee has "responsibility" for the instrument.

pays or takes it for value, and the drawer or payee must recover directly or indirectly from the forger or bear the loss.

i. Imposter

According to subsection 3-404(a), an imposter[229] is a person by using the mails or otherwise, induced a drawer to issue a check to him or her, or his or her integrated into the name of the payee.[230] The official comment to section 3-404[231] indicates that under old Article 3, the former subsection 3-405(1)(a) governed the impostor cases while subsection 3-405(1)(b) governed the fictitious payee cases. However, current section 3-404 replaces former subsection 3-405(1)(a) and (b) and modifies the previous law in some respects. Former section 3-405 was read by some courts to require that the indorsement is in the exact name of the named payee but, amended Article 3 rejects this outcome. Currently, in § 3-404(c), the only requirement is that the indorsement must be made in a name substantially identical to that of the named payee. Also, subsection (c) recognizes the fact that the deposit of checks may occur without indorsement.

Moreover, subsection 3-404(a) changes former section 3-405 in a case where the impostor is impersonating an agent. Under former subsection 3-405(1)(a), if an impostor impersonated *Sam* and induced the drawer to draw a check to the order of *Sam*, the impostor could negotiate the check. However, if the impostor impersonated *Sam*, the president of *Smith Co.*, and the check was payable to the order of *Sam Co.*, the section is not applicable. In current Article 3, under subsection 3-404(a) the impostor's negotiation of the check is legitimate in both cases.[232]

The defense of imposter was rejected in the absence of false identity.[233] The plaintiff, *Advocate Health & Hospitals Co.,* issued a check to an attorney as a settlement in a malpractice action after the attorney falsely represented that he was authorized to settle the claim and tendered a notarized covenant not to sue bearing his client's forged signature. The settlement subsequently vacated, and the medical malpractice claim against *Advocate Health & Hospitals Co.* went forward. *Advocate Health & Hospitals Co.* then sought recoupment of the check amount, alleging that due to the client's forged indorsement the defendant bank's payment of the check was not correct under section 4-401. The defendant bank asserted the imposter defense. The court rejected, holding that none of the evidence presented by the defendant bank, including the notarized covenant, established that the attorney had ever represented himself as the client and did not prove that the assumption of identity is what induced *Advocate Health & Hospitals Co.* to issue the settlement check.[234] The statements indicate that the attorney indeed misrepresented his authority to settle, yet misrepresentation of authority is not an imposture and has never been enough to trigger the defense. Thus, no imposture had taken place; and material

[229] - "Imposter" under old Article 3 referred to impersonation and did not extend to a false representation that the party was the authorized agent of the payee. Current § 3-404(a) eliminates this qualification. *See* § 3-404 Official Comment. 1.
[230] - Current § 3-404(a); old § 3-405(1)(a). *See* also, 2 Thomas D. Crandall et al., *Uniform Commercial Code* § 17.12.2 (Aspen. eds., 1995).

[231] - Section 3-404. Official Comment. 1.
[232] - *Id.*
[233] - *Advocate Health & Hosps. Corp.* v. *Bank One, N.A.*, 348 Ill. App. 3d 755, 284 Ill. Dec. 710, 810 N.E.2d 500 (2004).
[234] - *Advocate Health & Hosps. Corp.*, 348 Ill. App. 3d at 765.

questions of fact remained as to what transpired before the issuance of the settlement check. Therefore, the defendant bank could not contend that there is no set of facts would entitle *Advocate Health & Hospitals Co.* to recover for conversion.

However, the imposter defense is effective even when the communication with the imposter occurred through representations by a third party. For instance,[235] where the imposter the wife came to the office of contractors accompanied by a guy whom she introduced to the contractors as her husband. She wanted a mortgage on a real estate owned by both the real husband and herself. The real husband does not know his ex-wife's attempt. The drawer, *Philadelphia Title Ins. Co.* did not deal directly with the imposter. However, the drawer accepted the word of the contractors that the deed and mortgage signed by the real husband. The Pennsylvania supreme court stated that both § 3-405(1)(a) and its official comment leave no doubt that the impostor can induce the drawer to issue him or his confederate a check within the meaning of the section, even when the impostor did not carry out his impersonation before the very eyes of the drawer. Subsection 3-405(1) (a)[236] says the inducement might occur by "the mails or otherwise," which was broad enough to cover the case.[237]

In different facts,[238] *American General Financial Services, Inc*., was contacted on the telephone by a man, later revealed to be an imposter. The imposter sought a loan from *American General* Based on the information provided by him over the telephone, *American General* ran a credit check on the real name, finding his credit to be excellent. *American General Officers* informed the imposter that they would need personal tax returns for the prior two years and questioned him what he intended to do with the proceeds of the desired loan. The imposter sent by electronic facsimile to *American General* the requested tax returns of the real person and explained that he wanted the loan to renovate a property he owned. *American General Officers* approved the loan. The imposter appeared at *American General's* office. He proffered an apparent Maryland driver's license bearing the real individual's personal information and the imposter's photograph. After the imposter signed all the loan documents, *American General* issued to the imposter a loan check payable to the real person "*Ronald E. Wilder*." Later that afternoon, the imposter presented the check to *State Security Check Cashing, Inc.*, a check cashing business. At the time the imposter appeared in *State Security's* office, only one employee was on duty, who considered the same driver's license that the imposter presented to *American General officers*, then reviewed the *American General* loan documents regarding the check. The employee compared the check to other checks issued by *American General* which had been cashed previously by *State Security*. Considering the amount of the check relatively large, the employee called a higher officer, to confirm that the proper steps in verifying the check were correct. Upon the higher officer approval, the employee cashed the check, on behalf of *State Security*, for the imposter. Five days later, the real person "*Ronald E. Wilder*" appeared at the offices of *American General* indicating that the *U.S. Secret Service* notified him that a person applied for a loan in his name.

Maryland appeals court stated that the trial court's ruling in favor of *American General* is contrary to the position emphasized in official comment 3 of 3-404. If a depositary bank cashed

---

[235] - *Philadelphia Title Insurance Co*. v. *Fidelity-Philadelphia Trust Co*.,419 Pa. 78, 212 A.2d 222 (Pa. 1965).

[236] - § 3-404(a).

[237] - *Philadelphia Title Insurance Co*., 419 Pa. 78, 225.

[238] - *State Sec. Check Cashing, Inc.* v. *Am. Gen. Fin. Servs. (DE),* 409 Md. 81, 972 A.2d 882 (2009).

or deposited a check payable to an impostor, the effect of subsections 3-404(a) and (b) is to place the loss on the drawer of the check rather than on a depositary bank.[239] Putting the loss on the drawer or the owner is due to the estimate that the drawer is in the best position to avoid the fraudulence. Maryland appeals court found no evidence to suggest the application of this default rule would be inappropriate. *American General* had the best means available by which to protect itself against the fraud, the least of which included contacting the personal references the imposter listed on the credit application, which may have helped protect *American General* against the fraud. Maryland appeals court rejected *American General*'s attempt to shift the burden of the loss to *State Security* on such a weak basis as *State Security's* failure to ask the imposter for his thumbprint before cashing the check. While *State Security* did examine the same driver's license and the loan documents *American General* created and found satisfactory in issuing the check.[240]

ii. Faithless Employee

In the case where a responsible employee forges the indorsement on an instrument payable to his employer, the latter will bear the loss.[241] For instance,[242] an employee of the charity opened a bank account in a name identical to that of the charity, then stole donation checks payable to the charity, indorsed them, and deposited them in the account. The charity sued the depositary bank for conversion under section 3-420. Also, the charity argued that the defendant bank was not acting in good faith when the defendant bank deposited the checks in the accounts having a name similar to the named payee. District Court of New Jersey concluded that the three-year statute of limitation at section 3-118 barred recovery as to checks stolen outside that limit-the "discovery rule" did not apply because there was no fraudulent concealment by the bank. The court rejected the conversion claim because under section 3-405 the indorsements were not forged. The court stated that a bank ordinarily would bear the loss when it makes or obtains payment on a fraudulently indorsed check. However, subsection 3-405(b) provides that the burden of loss shifts to the named payee when a bank acted in good faith and the person who indorsed the check is an employee of the payee entrusted with responsibility for the check. Also, District Court of New Jersey rejected the charity's common law negligence claim that the depositary bank did not exercise ordinary care because banks do not owe a general duty of care to non-customers in the absence of a special relationship.

In another example,[243] District Court for the District of Nevada defined the meaning of the term "responsibility" in this context. A company's employee opened a bank account in the company's name, then deposited fraudulently indorsed checks stolen from the company. The company sued the bank for negligence and conversion under section 3-420, arguing the depositary bank was negligent in opening the account because the Articles of Incorporation submitted to the bank did not authorize the employee to open the account. The bank contended that the company entrusted the employee with "responsibility" for the checks under section 3-405. The case required the court to examine what that term means. The court concluded that this

---

[239] - Section 3-404. Official Comment. 3.

[240] - *State Sec. Check Cashing, Inc.*, 409 Md. at 119,120.

[241] - § 3-405(b) comment. 3.

[242] - *Armenian Missionary Ass'n of Am., Inc.* v. *TD Bank, N.A.*, Civil Action No. 15-cv-03328-SDW-SCM (D.N.J. Sep. 11, 2015).

[243] - *24-7 Group of Companies, Inc.* v. *Roberts*, 82 Rep. Serv. 2d 407 (D. Nev. 2014).

standard requires the bank to demonstrate that the company had authorized the employee to indorse, prepare or receive checks like those in question. The court rejected the bank's 3-405 defense because the employee was hired as an independent contractor to perform duties not related to processing the checks, and therefore was not entrusted with responsibility as to the subject checks.

iii. Fictitious payee

The employer will bear the loss when his employee signs on behalf of employer intended the payee to have no interest. For instance,[244] a plaintiff drawer of the checks made them payable to dealers for bookkeeping purposes, intending the payees to have no interest in the checks. Instead of voiding the checks, his employee forged the payees' indorsements and submitted the checks to the defendant in payment of her credit card debt. New York appeals court placed liability for the forged instruments with the drawer under the fictitious payee rule subsection 3-405(1)(b) since nothing in the U.C.C. prevented the rule from extending to non-bank depositories where the drawer was in the best position to avoid the losses. Further, the bad faith exception to section 3-405 did not apply since there was no evidence showing that the defendant participated in the fraud.[245]

Similarly, the employer will bear the loss, and the indorsement will be effective if an employee of a drawer has supplied him with the name of the payee intending the named payee to have no such interest.[246] For instance,[247] over a period of 10 years, ending in 1989, *Jerome Rutberg*, an insurance broker working for the *Baer Insurance Agency*, committed a fraudulent scheme by which he obtained checks from the plaintiff "*Guardian Life Insurance Company of America*." *Jerome Rutberg* represented policy loans and dividends withdrawals made payable to *Guardian Policyholders* who had purchased life insurance through *Baer Insurance* and gained the proceeds by forging the payees' indorsements. *Guardian* sued *Chemical Bank* on all the checks, for damages of over $253,000, the 131 checks obtained by *Rutberg*.

A disputed question was whether *Rutberg* was an agent of *Guardian Life Insurance*. Judge *Levine* concluded that *Rutberg* was an agent. Also, according to the court, *Guardian,* was in the best position to prevent the loss. Judge *Levine* explained: "*Guardian* could have required authorization from the Policyholders before issuing the checks, could have sent the checks straight to the policyholders or could have given them contemporaneous notification that it had issued checks made payable to them."

Also, an employer will bear the loss if his agent or employee signing as or on behalf of him[248] intended the payee to have on interest in the instrument. The result is the same whether

---

244 - *Getty Petroleum Corp.* v. *Am. Express Travel Related Servs. Co.,* 90 N.Y.2d 322, 660 N.Y.S.2d 689, 683 N.E.2d 311 (1997).

245 - Samuel J. M. Donnelly & Mary Ann Donnelly, *Commercial Law*, 51 Syracuse L. Rev. 279 (2001) at 336.

246 - Section 3-405(1)(c).

247 - *Guardian Life Ins. Co. of Am.* v. *Chem. Bank,* 94 N.Y.2d 418, 705 N.Y.S.2d 553, 727 N.E.2d 111 (2000).

248 - "an unknown person forged checks payable to non-existent payees and indorsed them. The court held the indorsements were effective because whoever drew the checks intended the named payees to have no interest in them. The case involved an expansive reading of old § 3-405(1)(b), given the policy behind it discussed below. Nonetheless, it makes sense and current Article 3 carries it forward." *Perini Corp.* v. *First Nat'l Bank*, 553 F.2d 398 (5th Cir.1977).

agent employs a fictitious payee or a real payee. The agent's intent to give nothing to the named payee is the determined point.[249]

A significant issue concerning the unintended or fictitious payee provision seems to be whether the employee whose intent defines to whom the instrument is payable under 3-110, intended the named payee to have an interest.[250] The result is same as an unauthorized signature was held to be irrelevant when a husband who applied for a loan and the wife also signed the application and the check for the loan proceeds paid out to both. However, the husband without authority of his wife, indorsed for both. The court concluded that the unauthorized signature does not shift the liability away from the drawer here, as the drawer never intended the other spouse to have an interest and required that person's obligation on loan only to avoid any later collection issues.[251]

Lastly, the padded payroll provision makes an employer responsible for his employee's forgery of his indorsement on instruments.[252] The official comment 3, case 7 illustrates the padded payroll provision by an example; Bursar signs checks on behalf of the corporation as a drawer. An Officer's duties include the preparation of checks for payment to the cooperation's creditors. The Officer prepares a check payable to the order of *Supplier Co*. for a Bursar's signature. The Officer fraudulently informs Bursar that the check is needed to pay a due debt owed to *Supplier Co,* a company that does business with the corporation. In fact, *Supplier Co.* is not a creditor, and the Officer intends to steal the check. The Bursar signed it and sent it to the Officer for mailing. The Officer does not indorse the check but deposits it into an account in Depositary Bank that the Officer opened in the name "*Supplier Co*." Eventually, the drawee bank honored the check. In this case, § 3-404(b)(i) does not apply because the Officer, under § 3-110(a), is not the person whose intent locates to whom the check is payable. However, section 3-405 does apply, and it deems the indorsement and deposit by the Officer an effective because the Officer is an authorized employee with responsibility concerning the check. Similarly, If *Supplier Co.* is a fictitious person, subsection 3-404(b)(ii) applies and the result is the same. The Officer's deposit is deemed as a valid indorsement of the check regardless that *Supplier Co.* is a fictitious payee or a real person, or whether the debt was or was not owing to *Supplier Co.* The drawee bank may debit the account of the corporation and no breach of warranty by Depositary Bank under subsection 3-417(1)(a).[253]

iv. The Need of Proper Indorsement, Reasonable Care, Good Faith to hold Employer Responsible

A depositary bank will not be able to allege the defense against an employer on the last occasions unless the instrument presents a typical appearance. Also, the indorsement must be in a name substantially like the name of the person to whom the instrument is payable or deposited to an account in a name substantially like the name of the payee. However, the bank might bear the loss even with the defenses of sections 3-404, 3-405, and 3-406 if the bank did not exercise customary care or acted in bad faith.

---

[249] - *Perini Corp.*, 553 F.2d at 404.

[250] - § 3-404(b).

[251] - *Gordon* v. *State Street Bank & Trust Co.,*361 Mass. 258, 280 N.E.2d 152 (Mass. 1972).

[252] - § 3-405(b).

[253] - § 3-405. Official Comment. 3. Case #7.

Regarding the standard for evaluating whether the indorsement is correct under section 3-404, section 3-204[254] indicates a liberal standard recognized for a long time in the U.C.C. For instance, regarding an issue of misspelled indorsement,[255] Tenth Circuit appeals court held that an indorsement that misspelled "*Greater*" as "*Grater*" in the name of the payee was not conclusive. The standard that the court used to scale the indorsement was whether the instrument presented a normal appearance. In contrary, when the payee's name was as "*Longview Fibre Co*." and the stamped indorsement read "*Longview Fibre Products*," the court held that the argument of the bank using old section 3-405 as a defense against the plaintiff employer is not persuasive.[256]

However, courts may reject the defense of negligent on the side of the employer, holding the depositary bank liable for the loss if the depositary bank failed to exercise ordinary care or acted in bad faith. Subsections 3-404(c) and 3-405(c) protect a depositary bank in case the indorsement is in a name substantially like the name of the person to whom the instrument is payable, or the instrument deposited to an account in a name substantially like the name of the payee. However, the depositary bank who is cashing or accepting an instrument for deposit is liable under § 3-405(d) and § 3-405(b) if the depositary bank failed to exercise ordinary care or acted in bad faith, and the depositary bank's failure substantially contributed to the forfeiture resulting from the payment of the instrument.

For instance,[257] when a drawer purchased a vehicle from a seller who did not own it, but who represented that the car owned by him and his wife, who did not exist, the plaintiff wrote a check made payable to the two parties. The seller cashed the check at the defendant bank, signing both his name and that of his supposed wife. The drawer obtained a judgment against the defendant bank for negligently cashing the check over a forged indorsement. On appeal, the court affirmed, holding that the defendant bank was negligent in failing to require a proper indorsement under 3-405. The appeals court rejected the defendant bank's argument that it was absolved from liability under 3-406 because the drawer's negligence substantially contributed to the making of the unauthorized signature since he failed to investigate the ownership of the vehicle. The appeals court held that the bank had a duty to its depositor resting on an implied contract, and that appellee drawer did not induce the bank officer to cash a forged instrument.

Furthermore, the bank might lose the defense against an employer if the bank failed to exercise ordinary care in taking the instrument for value. For instance,[258] a Corporate executive embezzled $20 million in Corporate funds by sending wire transfers to herself and creating Corporate checks to pay off her credit card and other personal expenses. The Credit Card Company discovered the fraud but did not report this to the victimized Corporation for more than

---

[254] - Section 3-204. Official Comment. 3. "Subsection (d) is a restatement of former Section 3-203. Subsection 3-110(a) states that an instrument is payable to the person intended by the person signing as or in the name or behalf of the issuer even if that person is identified by a name that is not the true name of the person. In some cases, the name used in the instrument is a misspelling of the correct name and in some cases the two names may be entirely different. The payee may indorse in the name used in the instrument, in the payee's correct name, or in both. In each case the indorsement is effective."

[255] - *Western Casualty & Surety Co.* v. *Citizens Bank,* 676 F.2d 1344 (10th Cir.1982).

[256] - *First Nat'l Bank* v. *Security Nat'l Bank*, 32 UCC Rep. Serv. 926 (D.Mass.1981).

[257] - *Dykstra* v. *Nat'l Bank*, 328 N.W.2d 862 (S.D. 1983).

[258] - *Koss Corp.* v. *American Exp. Co*., 233 Ariz. 74, 309 P.3d 898 (Ct. App. 2013).

a year. The Corporation then sued the Credit Card Company for negligence, conversion, breach of fiduciary duty, and aiding - abetting fraud. The trial court dismissed the claims; on appeal, South Dakota supreme court affirmed the dismissal of the negligence claim reasoning that the defendant bank does not owe a duty to report suspicious activities to third parties. However, South Dakota supreme court reversed the dismissal of the conversion, breach of fiduciary duty, and aiding - abetting claims. South Dakota supreme court held that the common law claims were not barred by Article 4A because they did not arise out of a wire transfer and thus the conversion claims based on negotiation and payment of the fraudulent checks were permitted by section 3-420. Therefore, the case remanded for consideration of the conversion and common law claims.

v. Standards of Reasonable Commercial Practices

Banks must follow reasonable commercial practices to avoid the liability under an action for conversion or negligence for cashing or accepting an instrument for deposit over a forged or an unauthorized indorsement. Massachusetts appeals court of [259] defined the standards of "reasonable commercial practices" that a bank must follow to prevent the swap of liability for conversion. *Govoni* is an owner or small company. He is the treasurer as well. *Govoni* employed *Maddalena* as an accountant. *Govoni* placed their trust in *Maddalena*. Allowed him to keep the financial records, reconcile the checkbooks, and prepare the taxes. When *Maddalena* requested tax checks from the treasurer, *Govoni* simply signed checks in the requested amounts and gave them back to *Maddalena*. *Govoni* did not supervise, question or audit him, nor did he request receipts or review bank statements or tax returns. *Govoni*, guided by falsely inflated tax returns prepared by *Maddalena*, drew numerous checks for taxes. However, *Maddalena* deposited the checks into his account which was also at Mechanics Bank.[260]

Maddalena at the defendant bank's branch was known as a regular client. When the branch was busy, he buried the unindorsed checks in multiple item deposits of checks payable to *Maddalena*. Many deposits had at least eight items, and some had as many as sixty-one. The bank's practice on multi-item deposits was for its tellers to quickly flip through the checks, scanning the back sides for missing indorsements and returning unindorsed checks to the presenter. However, the tellers were not required to inspect the face of a check to ensure the named payee indorsed it. Further, depending on the level of activity at the branch, the number of clients waiting in line, and familiarity with the depositor, a teller could entirely dispense with fanning. The trial court deduced that because *Maddalena* was a regular client presenting multi-item deposits during busy times, the tellers did not flip through for indorsements and were thus unaware that *Maddalena* had inserted the *Govoni's* unindorsed checks into the multi-item stacks.[261]

After *Maddalena* presented a stack of checks, the tellers then credited *Maddalena's* account for the total amount which *Maddalena* wrote on the deposit slip. Then, the checks went to a central processing center for "proofing," a process of checking the amount indicated on each deposit slip against a manual totaling of the individual checks accompanying each deposit slip.

[259] - *Govoni & Sons Constr. Co.*, 742 N.E.2d 1094.

[260] - *Govoni & Sons Constr. Co.*, 742 N.E.2d at 1097.

[261] - *Govoni & Sons Constr. Co.*, 742 N.E.2d at 1098.

Proofing did not include the verification of signatures or indorsements. After proofing, each check stamped with a *Mechanics Bank* processing stamp.[262]

After that, the defendant bank sent the checks through an automated sorter. For checks such as these, drawn on one account at the bank and deposited to a different account at the bank, the sorting process resulted in debiting the drawer's account and the depositor's account receiving final credit.

So, the defendant bank contended that the drawer's negligence in failing to supervise the accountant preclude him from asserting the bank's wrongdoing in the first instance. The court answered that even if the *Govoni* was negligent, the bank's contention lacks merit under both the code's provisions. The court stated that 3-406 is inapplicable to the bank.[263]

The court concluded that the payment of the checks violated "reasonable commercial standards," which deprives the defendant bank of the ability to invoke the provision 3-406 even if it was relevant. There is ample authority finding a failure to comply with "reasonable commercial standards" in these circumstances. There are certain conducts which considered so unjustified as to be commercially unreasonable as a matter of law. The bank involved with unreasonable payment of checks with missing indorse the defense of imposter ments, failure to respect restrictive indorsements, failure to discuss the authority to sign of one pretending to be an agent, and allowing deposit of a check indorsed by a corporate payee into a personal account."[264] Also, the defendant bank apparently committed negligent conduct when it paid checks bearing incorrect indorsements and honored a check bearing an alteration of the name of the real payee.[265] Likewise, the court stated that the payment of a check by a payee bank to an unauthorized third party without inquiry by the bank is commercially unreasonable as a matter of law.[266]

The defendant bank's argument that other banks, following identical procedures, would also have allowed payment of these checks cannot alone make the bank's procedures reasonable in the eye of law. An entire industry may behave unreasonably. Although the defendant bank has established that the procedures it has followed in paying the checks were common among banks, it has failed to show that such procedures were reasonable.[267]

V. Conclusion

Section 23 of NIL afforded the real owner an absolute right to retrieve the proceeds of his instrument from any person received the instruments or its proceeds over a forged or an

---

262 - *Id.*

263 - *Govoni & Sons Constr. Co.*, 742 N.E.2d at 1102.

264 - White & Summers, Uniform Commercial Code § 15-5, at 761-762 (3d ed. 1988).

265 - The court cited *Bullitt County Bank* v. *Publishers Printing Co*., 684 S.W.2d 289, 291-293 (Ky. Ct. App. 1984); *Olean Area Camp Fire Council, Inc*. v. *Olean Dresser Clark Fed. Credit Union*, 142 Misc. 2d 1049, 1062, 538 N.Y.S.2d 905 (N.Y. Sup. Ct. 1989).

266 - *Govoni & Sons Constr. Co.*, 742 N.E.2d at 1102.

267 - *Govoni & Sons Constr. Co.*, 742 N.E.2d at 1103.

unauthorized indorsement. Jurisdictions allowed retrieval under two theories; Conversion or Money had and received.

Both brokers and depositary banks were liable to the real owner. However, courts developed an exception for a broker who dealt with negotiable securities in a bearer form because the real owner of bearer bonds has no outstanding rights against the broker since the bearer bonds move between people such as cash and the title pass by delivery alone.

However, a depositary bank is liable for conversion or money had and received regardless whether the bank has performed in good faith, according to reasonable commercial standards, and has parted with the proceeds. The real owner need only to show that s/he is the owner of the instrument at the time the depositary bank converted it.

Also, a depositary bank is liable for money had and received. The money should not in justice be retained by the depositary bank and which in equity and good conscience the depositary bank should return it to the real owner. The right to recover does not rely upon privity of contract but on the obligation to restore which the law implies "should be returned" where a person is unjustly enriched at another's expense.

The Uniform Commercial Code (1952) under § 3-419(3) altered the preceding rules regarding depositary banks' liability on cashing or accepting for deposit instruments over an unauthorized or a forged indorsement. Former § 3-419(3) provided complete protection to a depositary bank cashing, taking by transfer other than negotiation, obtaining payment, or receiving payment on forged instruments if the bank acted in good faith and according to reasonable commercial standards. However, courts had taken a creative approach to interpreting former § 3-419(3) in a way to find that the depositary bank liable. Courts focused on the terms "representative," "proceeds remaining" and "adherence to reasonable commercials standards."

Courts criticized the defense of § 3-419(3) which was the reason that drove the Legislatures to the latter amendment of the subsection in 1990. Courts recognized that the subsection included depositary banks within its broader concept of "representative," only when the banks are acting as a "representative." The courts justified that a direct suit against the depositary bank avoids circuitous litigation. The direct action would reduce circuitous litigation to single suit and ensure judicial efficiency and will transfer the loss to the party on whom the loss will ultimately lie. Also, Courts stated, in relying on the pre-U.C.C. doctrine of ratification, that when the real payee brought an action against a depositary bank, the action is deemed to have ratified the collection of the proceeds from the payor bank. This ratification conveys the remittance of the funds by the payor bank into an authorized act for which the payor bank may debit the drawer's account. However, ratifying the collection does not constitute ratification for the payment to the forger. The courts held that a depositary bank eventually would bear the loss under the breach of implied warranty because it is the person who communicates with the forger.

The Legislature of § 3-420 drew from the courts' reaction that there is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised article 3, the defense provided by § 3-420(c) is limited to collecting banks other than the depositary bank.

After the amendment of 3-419, the real owner's right to sue a depositary bank for conversion incorporated in § 3-420(c). Also, Article 3 is the applicable law. Thus, once an instrument is indorsed and delivered to a depositary bank, Article 3 is the applicable law. The owner could not sue the drawer or the payor bank if the location of the checks were known. However, when the check is payable to co-payees, the payee who is indorsement forged has the right to sue the drawer. The claim of the drawer discharged by payment of the draft to the all owners; since the co-owner did not indorse the draft, there was no discharge for the drawer under § 3-602.

Also, the real payee must receive the instrument from the drawer. It is only then s/he became the owner of the instrument. Also, if the drawer issued the instrument to the bearer, the holder deemed to be the owner. Moreover, if a co-owner of a company issued an instrument as the company's representative and indorsed the instrument to himself, the other co-owners are not entitled to conversion action. Also, when an instrument in a bearer form, any person is an owner so long as that person possesses the instrument and thus under 3-301, the holder is entitled to enforce it.

After the delivery of the check, the payee as an owner could sue only the depositary bank, not the drawer because the location of the checks was known. The payee could not recover from the drawer on the underlying obligation because the delivery of the check suspended that under 3-310. Cases in which an instrument is payable to two persons and the two persons are not alternative payees, under § 3-110(d) the check can be negotiated or enforced only by both payees. Moreover, the owner has to notice that the three-year limitation period at § 3-118 begins at the time of the conversion when the cause of action accrues, not its later discovery unless the defendant engaged in fraudulent concealment.

Furthermore, the depositary bank is liable only to the amount of an instrument under § 3-420(b) unless proof introduced which would find otherwise. Subsection 3-420(b) allowed depositary banks to provide evidence that may minimize its obligation.

The depositary bank may avoid the liability if the proceeds went to the intended party or if the forger's indorsement is legally irrelevant such as instances involving an imposter, a fictitious payee, and a padded payroll, and the case where a responsible employee forges the employer's indorsement.

Subsection 3-404(b) covers cases in which an instrument is payable to a fictitious or non-existing person and to cases in which a payee is a real person, but the drawer or the maker does not intend the payee to have any interest in the instrument. Also, subsection 3-404(b) applies to any instrument, but its essential value is concerning checks drawing by corporations, other organizations, and all other forged check cases. However, the defense 3-404(b) does not apply where a faithless employee stole check payable to his employer.

Under Article 3, an indorsement by any person in the name of a named payee is effective. Such when: an imposter induced a drawer to issue an instrument, a representative signing on behalf of a drawer intending the named payee to have no interest on the instrument, a representative of a drawer supplied the drawer with the name of the payee intending the named payee to have no interest, and an employee forges the indorsement of a check payable to his employer. These provisions reflect the public policy that a drawer should bear the loss resulting from undiscovered impersonation and that an issuer or a payee should bear the loss from his faithless employee as a risk of the business.

The official comment to section 3-404 indicates that under old Article 3, the former subsection 3-405(1)(a) governed the impostor cases while subsection 3-405(1)(b) governed the fictitious payee cases. However, current section 3-404 replaces former subsection 3-405(1)(a) and (b). Former section 3-405 was read by some courts to require that the indorsement is in the exact name of the named payee. Currently, in § 3-404(c), the only requirement is that the indorsement made in a name substantially identical to that of the named payee.

Moreover, subsection 3-404(a) changes former section 3-405 in a case where the impostor is impersonating an agent. Under former subsection 3-405(1)(a), if an impostor impersonated *Sam* and induced the drawer to draw a check to the order of *Sam*, the impostor's negotiation is effective. However, if the impostor impersonated *Sam*, the president of *Smith Co.*, and the check was payable to the order of *Sam Co.,* the section is not applicable. Under current § 3-404(a) the impostor's negotiation of the check is legitimate in both cases. Also, the imposter defense is effective even when the communication with the imposter occurred through representations by a third party. Subsection 3-405(1) (a) says the inducement might be by "the mails or otherwise." However, the courts rejected the defense of imposter in the absence of false identity. The reason to place the loss on the owner is due to the estimate that the owner is in the best position to avoid the fraudulence.

The employer will bear the loss when his responsible employee forges his indorsement on an instrument payable to him. Also, the employer will bear the loss under when his employee signs on behalf of him intended the payee to have no interest. Similarly, the indorsement will be effective if the employee has supplied his employer with the name of the payee intending the named payee to have no such interest or if the employer's agent signing as or on behalf of him intended the payee to have on interest. The result is the same whether agent employs a fictitious payee or a real payee. The agent's intent to give nothing to the named payee is the determined point.

However, Courts may reject the defense of negligent on the side of the employer, holding the depositary bank liable if the depositary bank failed to exercise ordinary care or acted in bad faith. Subsections 3-404(c) and 3-405(c) protect a depositary bank in case the indorsement is in a name substantially like the name of the person to whom the instrument is payable, or the instrument deposited to an account in a name substantially like the name of the payee. However, the depositary bank who cashed or accepted for deposit a forged instrument is liable under § 3-405(d) and § 3-405(b) if the depositary bank failed to exercise ordinary care or acted in bad faith, and the depositary bank's failure substantially contributed to the forfeiture resulting from the payment of the instrument.

Bibliography

LEGISLATION

The American Law Institute & National Conference of Commissioners on Uniform State Law, *Uniform Commercial Code 1962 Official Text* (The American Law Institute et al eds, 1963).

The American Law Institute, *Uniform Commercial Code Proposed Final Draft 1990* (The American Law Institute et al eds, 1990).

JURISPRUDENCE

300 Broadway Healthcare Center, L.L.C. v. *Wachovia Bank,* N.A., 425 N.J. Super. 33, 39 A.3d 248, 77 UCC Rep. Serv. 2d 248 (App. Div. 2012); *Buchanan* v. *Helfrich*, Civil No. 88-439-FR, 1989 U.S. Dist. LEXIS 523 (D. Or. Jan. 13, 1989).

24-7 Group of Companies, Inc. v. *Roberts*, 82 Rep. Serv. 2d 407 (D. Nev. 2014).

Aetna Casualty & Surety Co. v. Lindell Trust Co., 348 S.W.2d 558 (Mo. Ct. App. 1961).

Allen v. *Mendelsohn*, 207 Ala. 527, 93 So.416 (1922).

Armenian Missionary Ass'n of Am., Inc. v. *TD Bank, N.A.*, Civil Action No. 15-cv-03328-SDW-SCM (D.N.J. Sep. 11, 2015).

Am. Nat ' l Bank v. *Seidel*, 622 S.W.2d 19 (Mo. Ct. App. 1981).

Advocate Health & Hosps. Corp. v. *Bank One, N.A*., 348 Ill. App. 3d 755, 284 Ill. Dec. 710, 810 N.E.2d 500 (2004).

Bank of the W. v. *Wes-Con Dev. Co.,* 15 Wash. App. 238, 548 P.2d 563 (1976).

Barrett Business Services, Inc. v. *Workers' Comp. Appeals Bd.*, 204 Cal. App. 4th 597, 139 Cal. Rptr. 3d 109, 77 UCC Rep. Serv. 2d 194 (2d Dist. 2012).

Bennett v. *Tower Grove Bank & Tr. Co.*, 325 S.W.2d 42 (Mo. Ct. App. 1959).

Bullitt County Bank v. *Publishers Printing Co*., 684 S.W.2d 289, 291-293 (Ky. Ct. App. 1984).

Bumgarner v. *Wood*, 149 N.C.App. 974, 563 S.E.2d 309, 47 UCC Rep. Serv. 2d 1099 (2002).

Chemical Workers Basic Union v. *Arnold Sav. Bank,* 411 S.W.2d 159 (Mo. 1966).

Citizens & Southern Nat'l Bank v. *Davis*, 54 Ga. App. 836, 188 S.E. 589 (1936).

Clients' Sec. Fund of the Bar v. *Allstate Ins. Co.*, 219 N.J. Super. 325, 530 A.2d 357 (Super. Ct. App. Div. 1987).

Continental Airlines, Inc. v. *Boatmen's National Bank of St. Louis*, 13 F.3d 1254, 22 UCC Rep. Serv. 2d 841 (8th Cir.1994).

Coulter Electronics, Inc. v. *Commercial Bank*, 727 F.2d 1078, 38 UCC Rep. Serv. 239 (11th Cir.1984).

Crystaplex Plastics v. *Redevelopment Agency*, 77 Cal. App. 4th 990, 92 Cal. Rptr. 2d 197 (2000).
Denn v. *First State Bank*, 316 N.W.2d 532 (Minn.1982).
Dykstra v. *Nat'l Bank*, 328 N.W.2d 862 (S.D. 1983).
E. Moch Co. v. *Security Bank of New York*, 176 A.D. 842, 163 N.Y.S. 277 (App. Div. 1917).
Fabricon Products v. *United California Bank*, 264 Cal. App. 2d 113, 70 Cal. Rptr. 50 (1968).
Fidelity & Deposit Co. v. *Hamilton Nat'l Bank*, 23 Tenn. App. 20, 126 S.W.2d 359 (1938).
First Nat'l Bank v. *Goldberg*, 340 Pa. 337, 17 A.2d 377 (1941).
First Nat'l Bank v. *Security Nat'l Bank*, 32 UCC Rep. Serv. 926 (D.Mass.1981).
Franklin v. *Safeco Ins. Co.,* 303 Or. 376, 737 P.2d 1231 (1987).
Gerber & Gerber, P.C. v. *Regions Bank,* 266 Ga. App. 8, 266 Ga. App. 8, 11(2), n. 1, 596 S.E.2d 174 (2004).
Getty Petroleum Corp. v. *Am. Express Travel Related Servs. Co.,* 90 N.Y.2d 322, 660 N.Y.S.2d 689, 683 N.E.2d 311 (1997).
G.M.A.C. v. *Citizens Commercial & Savings Bank*, 46 UCC Rep. Serv. 2d 489 (Mich. Ct. App. 2001).
Good Rd. Mach. Co. v. *Broadway Bank*, 267 S.W. 40 (Mo. Ct. App. 1924).
Govoni & Sons Const. Co., Inc. v. *Mechanics Bank*, 51 Mass. App. Ct. 35, 742 N.E.2d 1094, 43 UCC Rep. Serv. 2d 1058 (2001).
Gresham State Bank v. *O & K Constr. Co.*, 231 Or. 106, 370 P.2d 726 (1962).
Gruntal v. *National Surety Co*., 254 N.Y. 468, 173 N.E. 682 (1930).
Gordon v. *State Street Bank & Trust Co.,*361 Mass. 258, 280 N.E.2d 152 (Mass. 1972).
Guardian Life Ins. Co. of Am. v. *Chem. Bank,* 94 N.Y.2d 418, 705 N.Y.S.2d 553, 727 N.E.2d 111 (2000).
Handel v. *Manufacturers Hanover Trust Co*., 16 UCC Rep. Serv. 762 (N.Y.Sup.Ct.1975).
Hawkins v. *Nalick*, 363 Ill. Dec. 767, 975 N.E.2d 793, 78 UCC Rep. Serv. 2d 593 (App. Ct. 5th Dist. 2012).
Hancock Bank v. *Ensenat*, 819 So.2d 3, 46 UCC Rep. Serv. 2d 936 (Miss. App. 2001).
Hart v. *Moore,* 158 So. 490 (Miss. 1935).
Henderson v. *Lincoln Rochester Trust Co*., 303 N.Y. 27, 100 N.E.2d 117 (1951).
Hoffman v. *First Nat'l Bank*, 299 Ill. App. 290, 20 N.E.2d 121 (1939).
Home Indem. Co. v. *State Bank of Fort Dodge,* 233 Iowa 103, 8 N.W.2d 757 (1943).
Independent Oil Men's Ass'n v. *Ft. Dearborn Nat'l Bank,* 311 Ill. 278, 142 N.E. 458 (1924).
International Indus., Inc. v. *Island State Bank*, 348 F. Supp. 886 (S.D. Tex. 1971).
Jennings v. *United States Fidelity & Guaranty Co.,* 294 U.S. 216, 55 S. Ct. 394 (1935).
Jones v. *Bank of America*, 49 Cal. App.2d 115, 121 P.2d 94 (1942).
Jackson Vitrified China Co. v. *People's Am. Nat'l Bank*, 388 So.2d 1059 (Fla.Dist.Ct.App.1980).
Kansas City Casualty Co. v. *Westport Ave. Bank*, 191 Mo. App. 287, 177 S.W. 1092 (1915).
Koss Corp. v. *American Exp. Co.*, 233 Ariz. 74, 309 P.3d 898 (Ct. App. 2013).
Knesz v. *Central Jersey Bank & Trust Co.,* 477 A.2d 806 (N.J.1984).
Kuhn v. *Tumminelli, 366 N.J. Super.* 431, 841 A.2d 496 (Super. Ct. App. Div. 2004).
Larkin General Hospital, Ltd. v. *Bank of Florida*, 464 So. 2d 635 (Fla. Dist. Ct. App. 1985).

Lawyers' Fund for Client Protection v. *Bank Leumi Trust Co*., 94 N.Y.2d 398, 706 N.Y.S.2d 66, 727 N.E.2d 563 (2000).

Lee Newman, M.D., Inc. v. *Wells Fargo Bank*, 87 Cal. App. 4th 73, 104 Cal. Rptr. 2d 310, 43 UCC Rep. Serv. 2d 912 (2d Dist. 2001).

Lopes v. *Mellon Inv'r Servs. LLC*, 2007 U.S. Dist. LEXIS 88910 (S.D.N.Y. Dec. 3, 2007).

Louisville & N. R. Co. v. *Citizens' & Peoples' Nat'l Bank*, 74 Fla. 385, 77 So. 104 (1917).

Marshall v. *First Bank & Trust*, 848 So. 2d 660(La. Ct. App. 4th Cir. 2003).

Mackey-Woodard, Inc. v. *Citizens State Bank*, 197 Kan. 536, 419 P.2d 847 (1966).

Metro. Nat'l Bank v. *Merchants' Nat'l Bank*, 182 Ill. 367, 55 N.E. 360 (1899).

McAllen Hospitals, L.P. v. *State Farm County Mutual Insurance Co.*, 433 S.W.3d 535 (Tex. 2014).

Mouradian v. *Astoria Fed. Sav. & Loan*, 91 N.Y.2d 124, 667 N.Y.S.2d 340, 689 N.E.2d 1385 (1997).

Nat'l Accident Ins. Underwriters, Inc. v. *Citibank, F.S.B.,* 243 F. Supp. 2d 763, 764. (N.D. Ill. 2002).

National Union Bank v. *Miller Rubber* Co., 148 Md. 449, 129 A. 688 (1925).

Notredan, LLC v. *Old Republic Exchange Facilitator Co.*, 875 F. Supp. 2d 780 (W.D. Tenn. 2012).

National Accident Ins. Underwriters, Inc. v. *Citibank, FSB*, 333 F. Supp. 2d 720, 727 (N.D. Ill. 2004).

Olean Area Camp Fire Council, Inc. v. *Olean Dresser Clark Fed. Credit Union*, 142 Misc. 2d 1049, 1062, 538 N.Y.S.2d 905 (N.Y. Sup. Ct. 1989).

Parkway Bank & Trust Co. v. *State Farm Fire & Cas. Co*., 2013 IL App (1st) 122387, 371 Ill. Dec. 824, 990 N.E.2d 1202, 80 UCC Rep. Serv. 2d 920 (App. Ct. 1st Dist. 2013), appeal denied, 374 Ill. Dec. 569, 996 N.E.2d 16 (Ill. 2013).

Pratt v. *Higginson*, 230 Mass. 256, 119 N.E. 661 (1918).

People ex rel. Nelson v. *Kaspar American State Bank*, 364 Ill. 121, 4 N.E.2d 14 (1936).

Parkway Bank and Trust Co. v. *State Farm Fire and Cas. Co.*, 2013 IL App (1st) 122387, 371 Ill. Dec. 824, 990 N.E.2d 1202, 80 UCC Rep. Serv. 2d 920 (App. Ct. 1st Dist. 2013).

Perini Corp. v. *First Nat'l Bank*, 553 F.2d 398 (5th Cir.1977).

Peoples Bank of Biloxi v. *McAdams*, 171 So.3d 505 (Miss. 2015).

Philadelphia Title Insurance Co. v. *Fidelity-Philadelphia Trust Co*.,419 Pa. 78, 212 A.2d 222 (Pa. 1965).

Rodrigues v. *Olin Employees Credit Union*, 406 F.3d 434, 57 UCC Rep. Serv. 2d 392 (7th Cir. 2005).

Reynolds v. *Title Guar. Tr. Co.*, 196 Mo. App. 21, 189 S.W. 33 (1916).

Rabinowitz v. *People's Nat'l Bank,* 235 Mass. 103, 126 N.E. 289 (1920).

Siegel v. *Kovinsky,* 93 Misc. 541, 157 N.Y.S. 340 (App. Term 1916).

Specialized Loan Servicing, LLC v. *January*, 119 So. 3d 582, 80 UCC Rep. Serv. 2d 1225 (La. 2013).

S. Cal. Permanente Med. Grp. v. *Bozinovski,* 148 Cal. App. 3d 503, 196 Cal. Rptr. 150 (1983).

Schaap v. *State Nat'l Bank*, 137 Ark. 251, 208 S.W. 309 (1918).

Southwest Bank v. *Information Support Concepts, Inc.*, 149 S.W.3d 104, 55 UCC Rep. Serv. 2d 116 (Tex. 2004).
State Sec. Check Cashing, Inc. v. *Am. Gen. Fin. Servs. (DE),* 409 Md. 81, 972 A.2d 882 (2009).
State v. *Omaha Nat'l Bank*, 66 Neb. 857, 93 N.W. 319 (1903).
Spooner v. *Holmes*, 102 Mass. 503 (1869).
Tonelli v. *Chase Manhattan Bank, N. A.,* 41 N.Y.2d 667, 394 N.Y.S.2d 858, 363 N.E.2d 564 (1977).
Underpinning & Foundation Constr., Inc. v. *Chase Manhattan Bank*, 46 N.Y.2d 459, 414 N.Y.S.2d 298, 386 N.E.2d 1319 (N.Y. 1979).
United States Portland Cement Co. v. *United States Nat'l Bank*, 61 Colo. 334, 157 P. 202 (1916).
ViewPoint Bank v. *Allied Property and Cas. Ins. Co*., 439 S.W.3d 626, 84 UCC Rep. Serv. 2d 295 (Tex. App. Dallas 2014).
Western Casualty & Surety Co. v. *Citizens Bank,* 676 F.2d 1344 (10th Cir.1982).
West Penn Admin., Inc. v. *Union Nat'l Bank,* 233 Pa. Super. 311, 335 A.2d 725 (1975).
Willier, Inc. v. *Hurt,* 64 UCC Rep. Serv. 2d 759 (S.D. W. Va. 2007).
Wiseman v. *Lyman*, 7 Mass. 286 (1811).

SECONDARY MATERIALS: MONOGRAPHS

4 A. Scott & William Franklin, *The Law of Trusts* (Little Brown & Company. eds., 4d ed. 1989)

2 Barkley Clark & Barbara Clark, *The Law of Bank Deposits, Collections, And Credit Cards* (LexisNexis A.S. Pratt. eds., 3rd ed. 2017).

11 Caryl A. Yzenbaard, *The Law of Trusts & Trustees* (West. ed., 4d ed. 2009)

Frederick Miller & Alvin Harrell, The Law of Modern Payment System (2nd ed. 2017).

2 Henry J Bailey & Richard B. Hagedorn, Brady On Bank Checks (Revised ed. 1998).

Henry J Bailey, *The Law of Bank Checks* (The Banking Law Journal. ed,.3rd ed. 1962).

2 James J. White et al., Uniform Commercial Code (Thomson Reuters. ed.,6th ed. 2013).

1 Ronald A. Anderson, Anderson's *Uniform Commercial Code* 687 (The Lawyers C. eds,.2d ed. 1961)2 Thomas D. Crandall et al., *Uniform Commercial Code* (Aspen. ed., 1995).

SECONDARY MATERIALS: ARTICLES

A Brooke Overby, *Modeling UCC Drafting* Loyola of Los Angeles Law Review, Vol. 29, Issue 2 645 (1996).

Alvin C. Harrell, *Bank Accounts and Payment Transactions - The Law of Deposit Accounts under UCC Articles 3 and 4,* Oklahoma Bar Journal, Vol. 77, Issue 21 2213 (2006).

Barbara Singer, *Uniform Commercial Code Section 3-419 and the Battle to Preserve a Payee's Right to Sue Directly a Depositary or Collecting Bank That Pays on a Forged Indorsement,* Seton Hall Legislative Journal, Vol. 15, Issue 1 39 (1991).

Benton C. Tolley, *Depository Bank Liability under 3-419(3) of the Uniform Commercial Code*, 31 Wash. & Lee L. Rev. 676 (1974).

Donald R. Schmidt, *In Defense of U.C.C. #3-419(3)*, Notre Dame Lawyer, Vol. 53, Issue 5 972 (June 1978).

Donald W. Garland, *A New Law of Negotiable Instruments: Revised Article 3 of the UCC*, Banking Law Journal, Vol. 109, Issue 6 557 (1992).

E. Allan Farnsworth; Fairfax Jr. Leary, *U.C.C. Brief No. 10: Forgery and Alteration of Checks*, 14 Prac. Law. 75, 88 (1968).

Montgomery, *supra* note 82, at p

Eric Wallenbrock, *Forged Indorsements under French Negotiable Instrument Law and the U.S. Uniform Commercial Code: A Comparative Study,* Uniform Commercial Code Law Journal, Vol. 28, Issue 4 (Spring 1996), pp. 393-413.

Frederick J. Jr. Murphy, *Depositary Bank Liability in Conversion under U.C.C. Section 3-419(3)*, Wayne Law Review, Vol. 34, Issue 1 357 (1987).

Fred H. Miller, *The Benefits of New UCC Article 3 and 4,* Uniform Commercial Code Law Journal, Vol. 24, Issue 2 99 (1991).

Irvin M. Weinstein, *Section 3-419(3) of the U.C.C. Does Not Limit the Liability of a Depositary Bank to the True Owner of a Check Paid on a Forged Indorsement*, Columbia Law Review, Vol. 74, No. 1 104 (Jan,1974).

John D. O'Malley*, Common Check Frauds and the Uniform Commercial Code, Rutgers Law Review*, Vol. 23, Issue 2 189 (Winter 1969).

Julian B. McDonnell, Bank Liability for Fraudulent Checks: The Clash of the Utilitarian and Paternalist Creeds under the Uniform Commercial Code, 73 Geo. L. J. 1399 (1985).

Medessa Cook Montgomery, *Conversion Liability of the Depositary Bank under UCC Section 3-419(3)*, 94 Com. L.J. 201 (1989).

Thomas E. McCurnin, *Dishonest Bookkeepers: Protecting the Bank against Forged and Altered Checks,* Banking Law Journal, Vol. 119, Issue 10 891 (2002).

Paula J. Dalley, *A Theory of Agency Law*, University of Pittsburgh Law Review, Vol. 72, Issue 3 495 (2011).