Commerical Law - Negotiable Instruments - Uniform Commerical Code Section 3-419(3) Unavailable to a Collecting or Payor Bank as a Defense to an Action in Conversion by the True Owner for Paying Out the Face Value of the Instrument on a Forged Indorsement. Cooper v. Union Bank, 9 Cal. 3d 123, 507 P.2d 609, 107 Cal. Rptr. 1 (1973)

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Several sections of articles three and four of the Uniform Commercial Code deal with the allocation of losses sustained when a check is altered or when the signature or a required indorsement on the check is forged. In Cooper v. Union Bank, a case dealing with the liability for loss in a check forgery when it is compounded by the negligence of the bank or the payee, the California Supreme Court interpreted Uniform Commercial Code sections 3-419(3) and 3-404.

For over a year and a half, plaintiff's secretary-bookkeeper had been forging her employer's indorsement on checks received at his office and either cashing the checks or depositing them into her own account. After discovering the forgeries, plaintiff attorney sued the payor and collecting banks to recover his losses.

On the basis of testimony that a layman would not be able to detect the forgery, the trial court found that the bookkeeper was an ex-
The trial court also found that defendant banks were unaware of the forged character of the indorsements and "thus acted in good faith in dealing with the checks." On the issue of the payee's negligence, the trial court held that the plaintiff was negligent in not discovering the forgeries within six months of their commencement. The court said that this negligence "substantially contributed to the making of the unauthorized endorsements on each of the said checks that were accepted and paid after April 1, 1966 . . . ." Finding that the banks involved had acted in good faith and in accordance with reasonable commercial standards, and factoring in plaintiff's negligence, the trial court ruled that both payor and collecting banks were exonerated from liability. The trial court based its conclusions on Code sections 3-406 and 3-419(3) and made its decision despite the fact that a prima facie case of conversion had been made out against the banks under another section of the Code.

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8. *Id.* This finding is one factor that probably contributed to the trial court's holding that the banks employed "reasonable commercial standards." Had the forgeries been obvious, the bank might have been held to have violated the "reasonable commercial standards" requirement.

9. *Id.*

10. *Id.* at 614.

11. *Id.*

12. *Id.* at 613.

13. **Uniform Commercial Code** § 3-406 provides:

   Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawer or another payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawer's or payor's business.

**UCC** § 3-419(3) provides:

   Subject to the provisions of this Act concerning restrictive indorsements a representative, including a depository 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.

The **California Commercial Code** replaces "Act" with "code" in the first line of § 3-419(3).

14. The Supreme Court stated: "It is clear . . . that defendant collecting banks are liable for conversion . . . ." 9 Cal. 3d at 128, 507 P.2d at 613, 107 Cal. Rptr. at 5. It is unclear from the opinion upon which UCC section such liability is based.

**UCC** § 3-419(1)(c) provides: "An instrument is converted when . . . it is paid on a forged indorsement." There is the question of whether "paid" in the statute restricts the action in conversion to payor banks or whether "paid" is being used here in the more general sense of "gave value for." One view is represented in Stone & Webster Eng'r Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 184 N.E.2d 358 (1962). There the drawer brought an action against a collecting bank for cashing
The Supreme Court of California reversed in part, holding unanimously that good faith on the part of the payor or collecting bank in honoring a check with a forged indorsement is no defense to an action by the true owner in conversion under Code section 3-419(3). The court also held that plaintiff's negligence would bar his recovery on all checks cashed or deposited later than six months after the forgeries began. The California court based this holding on Uniform Commercial Code section 3-404, a novel approach to payee negligence in California under the Code.

**SECTION 3-419(3)**

In an effort to determine collecting bank liability under section 3-419(3), the court seized upon the clause "beyond the amount of any proceeds remaining in [the bank's] hands." To determine if the collecting bank has "any proceeds remaining in [its] hands," began the checks on forged indorsements, an action previously disallowed under Massachusetts law. The court held that § 3-419(1)(c) referred to a payor bank as defined in § 4-105 of the UCC and then used its own pre-Code law to preclude drawer recovery from the collecting bank. 345 Mass. at 5-6, 184 N.E.2d at 361. The Cooper court relied on the view in Harry H. White Lumber Co. v. Crocker-Citizens Nat'l Bank, 61 Cal. Rptr. 381 (Ct. App. 1967). In that case a joint payee of a check sued the collecting bank in conversion after the other payee forged the former's indorsement. While not confronting the § 3-419(1)(c) language directly, the court noted that there was no language in the comments to the section to indicate that prior California law had been changed. Prior California law allowed such an action under its former statute which was the same as § 23 of the Negotiable Instruments Law, and the court reasoned that UCC § 3-419(1)(c) had not extinguished such an action.

"Paid", then, is narrowly construed to refer to "payor bank" when a plaintiff attempts to use the section to create a new cause of action against a collecting bank. It will not be used, however, to exclude actions in conversion against collecting banks which were formerly allowed under a state's pre-Code law. The conversion liability was probably based here on § 3-404 for the collecting banks and on § 3-419(1)(c) for payor banks.

15. 9 Cal. 3d at 128, 507 P.2d at 613, 107 Cal. Rptr. at 5. It is interesting to note regarding the court's analysis of § 3-419(3) that "none of the reasons or issues therein set forth were, at any stage of the appeal, argued to the Court either orally or in written briefs." Letter from L. P. McElhaney of Cosgrove, Cramer, Rindge & Barnum, attorneys for respondents, to William J. Woodward, Jr., June 29, 1973, on file with the Rutgers-Camden Law Journal.

16. 9 Cal. 3d at 135, 507 P.2d at 618, 107 Cal. Rptr. at 10.

17. Neither of the courts below used § 3-404 to deal with the negligence issue. Both relied on § 3-406. 103 Cal. Rptr. 610, 613, 617 (Ct. App. 1972).

18. This reasoning was used, although not as extensively, in Ervin v. Dauphin Deposit Trust Company, 38 D. & C. 2d 473, 3 UCC Rep. 311 (Pa. C. P. 1965). For an excellent criticism of this case and an attempt to make it consonant with UCC § 3-419 (3), see Advanced ABA Course of Study on Banking and Secured Transactions Under the Uniform Commercial Code 54-57 (1968) (dialogue between Prof. E. Allan Farnsworth and Fairfax Leary, Jr.).
court, one must make a bifurcated inquiry. One must first ask if the bank received any "proceeds," and then one must determine if the bank has disbursed any "proceeds." Using a "general theory of bank collection," the court noted that a collecting bank receives the proceeds of the check if the payee brings suit against it, since such a suit makes the payment of the check by the payor bank and the debiting of the drawer’s account by that bank legitimate acts. The payor bank and the drawer no longer have the "proceeds" of the check at this point; the "proceeds" rest in the hands of the collecting bank. In order for the collecting bank to dispose of the "proceeds," it likewise must make a legitimate disbursal. The court indicated that a legitimate disbursal could not be made to the forger under any circumstances. When cashing a check, the collecting bank has not collected the "proceeds" from the payor bank at the time of payment to the forger and, thus, such payment is not a disbursal of the "proceeds." Likewise, if the forger deposits the check and then, after the collecting bank collects from the payor bank, the forger withdraws all of his funds, the collecting bank will still retain the proceeds because of the law of constructive trusts. The collecting bank thus will have no defense under section 3-419(3) because it still will have all of the "proceeds remaining in [its] hands."

19. The court emphasized and read *Ervin* as saying that there is no distinction between cashing and accepting for deposit for the purposes of this definition of "proceeds." 9 Cal. 3d at 131, n.12, 507 P.2d at 616, n.12, 107 Cal. Rptr. at 8, n.12. Professor Farnsworth and Mr. Leary felt that such a distinction would enable *Ervin* to fit within § 3-419(3) because a bank *cashing* checks was not a representative of the forger. *ADVANCED ALI-ABA COURSE OF STUDY ON BANKING AND SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* 56 (1968). That bank merely bought a worthless instrument out of its own funds. On the other hand, a bank *accepting* a check for deposit is an agent (representative) for collection of the proceeds. Presumably if, after deposit of the check and collection by the collecting bank of funds from the payor bank, the forger closed out his account, the collecting bank under this analysis would be protected by § 3-419(3) in a direct suit by the true owner. The *Cooper* court’s use of a constructive trust analysis at this point destroys such a defense for a collecting bank under these circumstances.

20. A survey of the authorities cited in the court’s footnote five reveals no definition of "proceeds" but, rather, lends support to the court’s "general theory of bank collection." *Jennings v. United States Fidelity & Guaranty Co.*, 294 U.S. 216 (1935), cited by the court and discussed in the opinion, also lends support to the bank collection theory rather than to a substantive definition of "proceeds."

21. 9 Cal. 3d at 131, 507 P.2d at 615-16, 107 Cal. Rptr. at 7-8.

22. The court’s theory of "proceeds" would even extend to payor banks. If sued, the payor bank will be deemed to have made an illegitimate disbursal to the collecting bank by paying the check on the forged indorsement. Thus the payor bank will still retain the proceeds and § 3-419(3) will be of no avail to the payor bank. Rather than rely on this analysis, the court apparently chose to rely on the language in the statute and the opinions of numerous commentaries which suggested that the section was not
Thus the first and major part of the Cooper opinion is devoted to determining when a collecting bank is in possession of the "proceeds" of the instrument. But, by the end of this part of the opinion, the statute which is apparently clear on its face has been turned around and interpreted nearly opposite to what it appears to say. The reason the analysis alters what the statute appears to say is that "proceeds" is being used by the Cooper court in a way different from its common usage or use under pre-Code law.

"Proceeds" is commonly used to denote what is received for that which is given in exchange. The pre-Code ratification cases in negotiable instruments, although confused, frequently seem to reflect this definition and in many cases equate "proceeds" to "face value" of the instrument when negotiated.

The Cooper court implies, however, that what the forger received from the collecting bank when either cashing or depositing the instrument is something other than the "proceeds" of the instrument. Al-
though the forger ultimately may have received the face value of the instrument, he received no "proceeds."\textsuperscript{26} The "proceeds" were in the possession of some other party to the transaction at any given time following the forger's cashing or depositing of the check. Those proceeds materialize under the court's analysis of the ratification theory when suit is brought by the true owner. Proceeds are what the party who is liable—be he the collecting bank or the payor bank—must turn over to the true owner.

The ratification theory posits that the suit by the true owner against the collecting bank "ratifies" the payor bank's payment of the check and that bank's debiting its customer, the drawer. Such a ratification makes the acts, for which the payor bank previously would have been liable, actions which will no longer result in liability to either the true owner or the drawer. That is, in ordinary cases, such a suit estops the true owner from seeking recovery against either the payor bank or the drawer in a later suit. This process leads to the Cooper court's view that when ratification occurs, the "proceeds," previously evanescent, locate themselves. They reside with the party who is sued—assuming that this party is liable—and with no one else. The Cooper court has taken pre-Code law, which would have held a collecting bank liable to the true owner for either cashing or taking a check for deposit, and has identified the pre-Code liability with possession of the proceeds. The court's analysis seems to argue that in ordinary check forgery litigation, if the party would have been liable under pre-Code law, he will have the proceeds. And under section 3-419(3), if he has the proceeds, he will be liable. Liability under this statute is, for the court, completely determined by pre-Code law.

Viewed in this way, the court's analysis of the collecting bank's possession of the proceeds really flows from the assumption that section 3-419(3) is consistent with pre-Code law.\textsuperscript{27} The court has taken

\textsuperscript{26}3 S.W. 1038 (Mo. Ct. App. 1924). In these cases, a distinction with respect to "proceeds" seems to be drawn between cashing a check and accepting a check for deposit although there is liability in both cases for the collecting bank. The Cooper court breaks down this distinction with its constructive trust analysis. By maintaining such a distinction, the court might have had a basis for arguing that the drafters intended to use "proceeds" as it was used in these cases.

\textsuperscript{27}This analysis assumes that suit is not brought against the forger himself. Under the court's analysis, such a suit would appear to put the "proceeds" in the hands of the forger.

\textsuperscript{27}Many pre-Code cases support the rule that a collecting bank is liable to the true owner for paying out the amount of the check on a forged indorsement. Indeed, the decisions are nearly unanimously in support of the proposition. See, e.g., Hoffman v. First Nat'l Bank, 299 Ill. App. 290, 20 N.E.2d 121 (1939); National Union
the pre-Code law and fashioned a novel definition of "proceeds" which, when used in Code section 3-419(3), will fix the same liabilities as would pre-Code law. 28 But there is nothing in the first part of the


In stating its reason for allowing a direct suit, an enlightened court in National Union Bank v. Miller Rubber Co., 148 Md. 449, 129 A. 688 (1925), reacted against a rule which would force true owners to sue the drawer of the check. The court indicated that the end result of a direct suit would be the same, and "in reaching that end it avoids a useless multiplication of litigation. For under that rule [exempting the collecting bank in a direct suit] the collecting bank would be liable to the drawer; the drawer would still be liable to the drawer, the drawer to the payee, and the forger to the collecting bank." Id. at 456, 129 A. at 690 (1925).

28. The court might have employed its technique in a less subtle but analogous way by concentrating on the "reasonable commercial standards" language in § 3-419(3). Since prevailing pre-Code law established liability for honoring a check on a forged indorsement, when the true owner brings an action against the collecting bank, one should infer that honoring a check on a forged indorsement is never acting within "reasonable commercial standards." Under such an analysis, of course, the exception to the rule swallows up the rule.

The court's "proceeds" analysis also seems to produce an exception which swallows up the statute. For the statute to act as a defense, there should be some type of case in which, were it not for the statute, there would be liability under either another section of the UCC or some other rule of law. The statute must be a "defense" to some determination of liability. Under the same reasoning, it follows that there are some cases wherein defendant would have been liable in spite of the fact that he had no proceeds remaining in his hands. Examples of this are to be found in the pre-Code law where the forger had deposited the forged check and subsequently had withdrawn all of this money. These courts intimated that the bank had no proceeds—yet they held the banks liable. See note 25 supra. There are also cases in which the defendant bank was liable and retained the proceeds, e.g., where the collecting bank had cashed the checks rather than accepted them for deposit. In other words, we might assume that there are two groups of potentially liable defendants who will argue that § 3-419 (3) is a defense: those defendants who the court will eventually find in possession of the proceeds, and those who the court will eventually find have disposed of them.

Thus the relevant question is: of the potentially liable defendants, which defendants are in possession of the proceeds and which are not. The fact that a party would have been liable under some other rule of law can have no bearing on this discrimination because in all cases this fact is present. When one deals with a defense statute, its only application can be to parties who are liable under another rule of law. Yet the court indicates that defendant was formerly liable under the law of constructive trusts; thus he is said to have the "proceeds" of the instrument. But what else is the law of constructive trusts but another determination of liability over which § 3-419 (3) is arguably to provide a defense? Using this field of the law to add content to the word "proceeds" in § 3-419(3) eliminates a relevant issue in the application of the statute: whether or not the statute affects liability which has been determined by the law of constructive trusts. By eliminating such an inquiry, we are left with an assumption or an assertion that the statute is consistent with the law of constructive trusts, and that the statute does not apply in this case because the result would be inconsistent with the prior law.
court's opinion which would serve to justify the assumption that this section is consistent with the pre-Code law in the area. Any support for such an assumption must be sought in the remainder of the opinion.

To support its analysis, the court in its next argument, a "clearer drafting argument," deals with the intent of the drafters. This theory maintains that the drafters would have employed clearer language if they had intended to reverse pre-Code law and exempt from liability a collecting bank which had negotiated a check on a forged indorsement. Far from being unclear, the statute appears on its face to be very clear. It expressly includes the words "including a depository or collecting bank . . . ." The Cooper court had some trouble explaining these words. Of the few courts dealing with the statute, however, none except the court in Ervin v. Dauphin Deposit Trust Co. has had any difficulty with the meaning of the word "proceeds." Nor has any commentator been found who suggested prior to Ervin that "proceeds" might be used as a tool to change so drastically what the statute appears to say.

Next the court advanced the stronger argument that had the drafters intended to change the pre-Code law as much as this plaintiff's interpretation of the statute would advocate, the drafters would have been more explicit in their comment to the section. As has been previously noted, and as the court pointed out, the pre-Code law in California as well as in other jurisdictions was inconsistent in the area of check forgery with a literal reading of this Code section. Nonetheless, those enacting the Uniform Commercial Code could not have been unaware

This argument might stand on its own if it were read to imply that the framers and adopters of the UCC had in mind the Cooper court's definition of "proceeds" when they were drafting and enacting the Code. If this is what the court is really saying in the first part of its opinion, there is little in the cases which would support such an argument. Any consistently used pre-Code definition of "proceeds" would have allowed defenses to collecting banks under the statute in more cases than the Cooper court is willing to allow. See notes 24 and 25 supra.

29. 9 Cal. 3d at 132, 507 P.2d at 616, 107 Cal. Rptr. at 8.
30. The court implied that these words applied to a "true agency" relationship which is rarely found in a bank's normal check negotiating business. Id. at 134, 507 P.2d at 618, 107 Cal. Rptr. at 9-10. A more persuasive interpretation, however, is that the words "including a depository or collecting bank" were expressly meant to apply § 3-419(3) to the situation before the court.
32. Cooper v. Union Bank, 9 Cal. 3d at 134, 507 P.2d at 617, 107 Cal. Rptr. at 9-10. As has been previously noted, in note 24 supra, a reversal of prevailing pre-Code law was necessary if § 3-419(3) were to protect the collecting banks.
33. 9 Cal. 3d at 132, n.13, 507 P.2d at 616, n.13, 107 Cal. Rptr. at 8, n.13.
of the apparent discrepancy between this section and the prevailing law in this area, since attention was called to this problematic section as early as 1953.84

Uniform Comment five to Code section 3-419(3) and the California Comment five to the section are perhaps as difficult to interpret as the Code section they are intended to clarify. The Uniform Comment85 makes reference to a "rule of decisions" and the California court, aided again by Ervin,86 believed these cases to be those dealing with a more restrictive type of "representative" than is found in a typical banking situation.87 It is difficult to reconcile this part of the court's analysis with the fact that section 3-419(3) purportedly deals with ordinary banking transactions rather than with the unusual situation to which the court refers. On the other hand, the only other "rule of decisions" alluded to in Uniform Comment five is that represented by Soderlin v. Marquette National Bank,88 a decision clearly out of the


35. UCC § 3-419(c), Comment 5, provides:
   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 (3) are, however, subject to the provisions of this Act concerning restrictive indorsements (Sections 3-205, 3-206 and related sections).


37. 9 Cal. 3d at 134, 507 P.2d at 618, 107 Cal. Rptr. at 10. First Nat'l Bank v. Goldberg, 340 Pa. 337, 17 A.2d 377 (1941), was one of the cases the court thought to be the basis for its interpretation of "representative." There, an attorney, acting for his client, assisted in the sale of negotiable securities through a bank. The court found that the attorney had no knowledge of the stolen nature of the securities and had turned over all of the proceeds to his client. The court held that since the attorney had acted in good faith and had delivered all of the proceeds to his client, he would not be held liable to the true owner of the securities from whom they were stolen. Id. at 343, 17 A.2d at 380.

The California court distinguished the Goldberg situation from Cooper since the former involved a "true agency" relationship, whereas in the latter a debtor-creditor relationship emerged between the depositor and the bank upon collection of the proceeds by the collecting bank. 9 Cal. 3d at 134, 507 P.2d at 618, 107 Cal. Rptr. at 10. The court indicates that by mutual agreement, a "true agency" relationship might be set up between the customer and the bank. Id. at 131, 507 P.2d at 615, 107 Cal. Rptr. at 7.

38. 214 Minn. 408, 8 N.W.2d 331 (1943). The facts were somewhat similar to those in Cooper, but the forger had cashed all of the checks. The court's reasoning was that since the collecting bank had paid out to the forger all that it had received from the payor bank, the former had not been unjustly enriched. Id. at 412, 8 N.W.2d at 332-33. The action, however, had been in indebitatus assumpsit for money had and received rather than in conversion. The reasoning in this decision has been
mainstream of the prevalent law in the check forgery area. The California Comment five to the section is equally cryptic and appears to demonstrate either an unawareness of the weight of contrary authority on ordinary banking transactions or a conscious ignoring of such authority.

Other courts that have dealt with the statute have done so in a manner more faithful to its actual wording, perhaps better preserving the judicial flexibility in its application. Those courts have based their reasoning on the "reasonable commercial standards" language in section 3-419(3) and have developed a small body of law around this flexible term. Under this approach, cases can be adjudicated on an

criticized in Comment, 27 MINN. L. REV. 583 (1943). The author of this comment believes that First Nat'l Bank v. Goldberg, 340 Pa. 337, 17 A.2d 377 (1941), stood for the proposition that a defendant collecting bank would be relieved of liability for conversion if the forger had not cashed the checks, but instead had deposited them and subsequently had withdrawn the amount of the instruments (providing, of course, that the bank had acted in good faith). 27 MINN. L. REV. 583, 585 (1943). This case has never been cited by another court.

39. One commentator believes that this decision was the basis for UCC § 3-419(3) but cites no other cases which embody the "rule of decisions" referred to in the comment to that section. H. Bailey, THE LAW OF BANK CHECKS 498-99 (4th ed. 1969).

40. Comment 5 to California's version of UCC § 3-419 provides:
Subdivision (3) is new statutory law. Its basic premise that a person dealing in good faith with the property of another is not liable for conversion is consistent with prior California law on the tort of conversion.

41. The implications of Uniform Comment 6 to § 3-419(3) are, however, a good deal clearer. This comment provides:
The provisions of this section are not intended to eliminate any liability on warranties of presentment and transfer (Section 3-417). Thus a collecting bank might be liable to a drawee bank which had been subject to liability under this section, even though the collecting bank might not be liable directly to the owner of the instrument. This comment thus appears to foresee exactly the situation which the court fears: the circuity of a suit by the true owner against the payor bank who would then recover from the collecting bank on that bank's warranty of presentment and transfer. See Cooper v. Union Bank, 9 Cal. 3d at 133-34, 507 P.2d at 617, 107 Cal. Rptr. at 9. If, as the court indicates, § 3-419(3) applies to a representative as in Goldberg, note 37 supra, this Uniform Comment appears to make no sense, for the policy represented in that case would demand a complete exoneration from liability for the "representatives." This comment indicates that liability might be merely postponed. The court, however, does not deal with this comment in its interpretation of the section.


43. In Salsman v. Nat'l Community Bank, 102 N.J. Super. 482, 246 A.2d 162 (Law Div. 1968), for example, the court said that UCC § 3-419(3) "clearly implies the liability of a depository or collecting bank in conversion when it deals with an instrument or its proceeds on behalf of one who is not the true owner, where the bank does not
individual basis, an approach which generally renders the section 3-419(3) defense inapplicable because "reasonable commercial standards" have not been met. But, unlike the approach used in Cooper, this approach does not preclude use of the defense in the special or unusual case which might warrant its application. But even assuming that the California court had wanted to preserve its options for the future, the bank's lack of "reasonable commercial standards" could not easily have been used to negate the section 3-419(3) defense. The court would have been confronted with the trial court's finding (affirmed by the intermediate court) that the collecting bank had employed "reasonable commercial standards."

If a dominant aim of the Uniform Commercial Code is to simplify the existing law, it is arguable that all negotiable instruments conversion actions brought against a collecting bank or against any other "representative" of the true owner should be governed by one rule. The California court, on the contrary, opted for preserving both of the pre-Code rules relating to conversion of negotiable instruments by making section 3-419(3) inapplicable to ordinary banking transactions.

The California Supreme Court appears to have taken a definitive policy stand in Cooper and has gone to some length to justify its decision. As the court notes, this decision avoids circuity of action by placing the loss due to the forgery directly on the collecting bank which dealt with the forger. With the current emphasis in the federal courts and in most state courts on economy of trials, the decision is well within sound, firmly established judicial policy. In most cases, the col-

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44. Cooper v. Union Bank, 103 Cal. Rptr. 610, 613 (Ct. App. 1972).
45. Id. at 616, 617.
46. UCC § 1-102(2) declares in part that, "Underlying purposes and policies of this Act are (a) to simplify, clarify and modernize the law governing commercial transactions . . . ."
47. Cooper v. Union Bank, 9 Cal. 3d at 133, 507 P.2d at 617, 107 Cal. Rptr. at 9.
48. See note 27 supra. But cf. FED. R. CIV. P. 14. Arguably the liberal joinder rules could make it possible for the plaintiff true owner to satisfy his claim in but one action while offering no injustices to the collecting bank in requiring that bank to pay a claim which should fall on the drawer. See notes 51-53 and accompanying text infra. Thus UCC § 3-419(3) could be applied as a defense for the collecting bank in many cases without requiring the plaintiff true owner to retry his case to satisfy his claim. But, assuming it would not cost the true owner much more in litigation costs, the legal
lecting bank would ultimately be liable. Therefore, it seems to be a waste of both a plaintiff's and a court's energy to prosecute the collecting bank by way of the payor bank. And, as the court points out, fairness to the plaintiff dictates its holding since, in a typical situation, most of the checks are cashed at one local bank, a relatively available defendant.

With so many reasons for the prevailing pre-Code view which the court has adopted, one must ask why section 3-419(3) appears to state an opposite rule. The answer may lie in the section of the Code dealing with the duty of the drawer of the check to report forgeries. Uniform Commercial Code section 4-406(4) sets up a defense for the payor bank in an action by the drawer against that bank when it has paid the drawer's checks on forged indorsements. The statutory scheme "precludes" the drawer from bringing such an action if he has failed to report the forged indorsements to the bank within the statutory time limits. By virtue of section 4-406(5), it appears that this duty of the

costs to the banking system as a whole might well increase. Payor banks as well as collecting banks would be involved in many check forgery actions. In terms of costs to the banking system and to the public, it might be better policy to allow the system to pick up the occasional loss belonging to the drawer. The alternative is to require the system to bear heavier litigation costs in all cases in an effort to ferret out the guilty drawer in a small number of cases.

49. The court indicated one exception—lack of timely action on the part of the payor bank—which would preclude its recovery under § 4-207(4). 9 Cal. 3d at 133 n.14, 507 P.2d at 617 n.14, 107 Cal. Rptr. at 9 n.14.

50. Id. at 133-34, 507 P.2d at 617, 107 Cal. Rptr. at 9. The court states:

Even though the collecting banks would be ultimately liable after initial suits were brought in all the various fora, the expense and difficulty of bringing such suits would have the actual effect of freeing the collecting banks from any responsibility. Id. at 134, 507 P.2d at 617, 107 Cal. Rptr. at 9.

If in Cooper, for example, the secretary-bookkeeper had forged the indorsement on one check of low value drawn on a bank in Kansas, it is highly unlikely that the plaintiff would undergo the expense of litigation to recover that amount if required to sue the payor bank. The plaintiff would in most cases sustain the loss which legitimately belongs to the collecting bank.

The discussion ignores, as does the court, the possibility of bringing action against the drawer of the check. The determinants of liability in such actions are beyond the present scope of discussion. But, even assuming there would be liability of the drawer to the true owner, there would still be the problem of numerous and diverse defendants. And added to this, there would be, in many cases, the natural reluctance of the true owner to harm an ongoing business relationship by suing his customer and forcing on him the costs of recovering against the payor bank.

51. UCC § 4-406(4) provides:

Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subsection (1)) discovers and reports his unauthorized signature or any alteration on the face or back of the item or does not within 3 years from that time discover and report any unauthorized
drawer to report forgeries can become an issue in some cases in which a payor bank is attempting to recover from a collecting bank for the latter's accepting a check on a forged indorsement.\textsuperscript{53} If the drawer breached his duty to report forgeries, such a breach could well preclude a recovery by the payor bank from the collecting bank. In that case, the payor bank may be compelled by section 4-406(5) to look to the drawer to make good its loss on the instrument.

Taken at its face value, Code section 3-419(3) may be a part of this same scheme. By allowing a collecting bank a ready defense when sued by the true owner, the statute would serve to direct actions against the payor banks. The true owner could recover directly from the payor bank using section 3-419(1)(c). When the payor bank attempts to recoup the loss it has sustained in the true owner action by

\begin{quote}
indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.
\end{quote}

\textbf{California Commercial Code \textsection\ 4406(4) reads:}

Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subdivision (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or any unauthorized indorsement, and if the bank so requests exhibit the item to the bank for inspection, is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration. The burden of establishing the fact of such unauthorized signature or indorsement or such alteration is on the customer.

The California version appears to reflect a legislative intent that the customer be as vigilant in searching for unauthorized indorsements as he is in detecting forgeries of his signature or alterations to the instrument. Instead of giving the customer three years to detect an unauthorized indorsement, California allows him only one year. California would appear to preclude the drawer from bringing his action against the bank for paying on the forged indorsement in a significantly larger number of cases than in other jurisdictions with the uniform language. California Comment 8 indicates that this change was made in order to equate the statute of limitations in this section of the UCC with that of the \textit{California Code of Civil Procedure}. The comment indicates that the one year statute has been satisfactory in the past. \textit{Id.}

\textbf{52. UCC \textsection\ 4-406(5) provides:}

If under this section a payor bank has a valid defense against a claim of a customer upon or resulting from payment of an item and waives or fails upon request to assert the defense the bank may not assert against any collecting bank or other prior party presenting or transferring the item a claim based upon the unauthorized signature or alteration giving rise to the customer's claim.

\textbf{53. A somewhat analogous situation was presented in Canadian Imperial Bank of Com. v. Federal Reserve Bank, 64 Misc. 2d 959, 316 N.Y.S.2d 507 (1970).} There the court refused a summary judgment in favor of the payor bank against a collecting bank. The collecting bank had honored an altered check and was sued under its warrant of presentment. The court reasoned that \$ 4-406(5) made the negligence of the drawer a triable issue of fact in this case and indicated that further inquiry regarding such negligence was appropriate. \textit{Id.} at 960-61, 316 N.Y.S.2d at 509-10. The court clearly implied that drawer negligence could preclude a recovery from the collecting bank. \textit{Id.}
bringing an action against the collecting bank, the statutory duty of the
drawer to report forgeries can be placed in issue. Directing suits at the
payor bank would force that bank to evaluate the drawer's possible
breach of section 4-406(4). The payor bank is, of course, in a better
position to make such an evaluation than is the collecting bank.

Allowing a direct action against a collecting bank is attractive from
a policy standpoint. But under the present Uniform Commercial Code,
the drawer's breach of his duty to detect forgeries will not be at issue
in such an action. Thus the possibility arises that some losses legiti-
mately belonging to a drawer will fall on a collecting bank merely by
virtue of the plaintiff true owner's choice of the collecting bank as a de-
fendant. There is no indication that the court considered this possible
ramification of its opinion. Even if it had, the court might well have
determined that the injustice inherent in a circuitous action is greater
than that involved in having a collecting bank shoulder some losses that
legitimately belong to a negligent drawer.

However much the mechanics of reaching the decision on section
3-419(3) might be criticized, the result reached in Cooper appears to
be sound. The arguments against such an interpretation pale when
compared with the injustices to the true owner inherent in an opposite
conclusion. And whatever the merits of the reasoning, in view of the
prestige of the California Supreme Court and the unanimity of its deci-
sion, the Cooper holding may well become a firm precedent.

54. Courts, of course, could somehow introduce the drawer's breach of statutory
duty into the direct suit between the payee and the collecting bank. But it is highly
doubtful that a collecting bank will undergo the expense of investigating check recon-
ciliation methods of customers of other banks. Collecting banks are not in the same
position as the payor bank to evaluate the drawer's conduct. The Cooper court's
interpretation of § 3-419(3) could well have the effect of making § 4-406(4) into a
paper tiger. This would seem to be against the legislative policy evidenced in Cal-
ifornia's change of the statute of limitations governing discovery of forged indorse-
ments from three years to one year.

55. See the court's discussion of relative injustice. Cooper v. Union Bank, 9 Cal. 3d at 133 n.14, 507 P.2d at 617 n.14, 107 Cal. Rptr. at 9 n.14.

56. It might be argued that the Cooper decision precipitates a split of authority
on § 3-419(3). Some cases prior to Cooper hinted that given proper facts and parties,
UCC § 3-419(3) would provide a defense to a collecting bank. One can infer from
the language in these cases that the courts were reading and would apply the statute
on its face, that is, opposite to the Cooper application. See, e.g., Stone & Webster
Eng'r. Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 6, 184 N.E.2d 358, 361
(1962); Forman v. First Nat'l Bank, 66 Misc. 2d 433, 434, 320 N.Y.S.2d 648, 649
(1971). But an attorney faced with the dilemma of relying on clear holdings in
other states (Cooper and Ervin) or on dicta in his own state's decisions is reminded
of the other decisions in the various fora which deal with UCC § 3-419(3). Courts
have consistently avoided allowing this defense in ordinary forgery litigation. See
Cooper is widely followed, however, new Uniform Commercial Code methods to ensure vigilance on the part of drawers in detecting forgeries of their signatures or required indorsements will probably be needed.

SECTION 3-404

In another part of the Cooper opinion, the court allowed the issue of the payee's negligence to be raised under Uniform Commercial Code section 3-404. This is a novel use of this provision. Neither in California nor elsewhere have cases been found which allow this construction of section 3-404.

Article twenty-three of the Uniform Negotiable Instruments Law was the predecessor of Code section 3-404. The few cases decided under that statute which dealt with payee negligence were more lenient toward payee negligence than Cooper. Many of these cases established the principle that a payee's negligence must be in the nature of an inducement by the payee to have the bank honor his check on a forged indorsement. The plaintiffs, however, did not "dispute the trial court's

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57. 9 Cal. 3d at 135, 507 P.2d at 618-19, 107 Cal. Rptr. at 10-11.
58. Uniform Negotiable Instruments Law § 23 (1943) provided:
   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.
59. Uniform Commercial Code § 3-404, Official Comment.
61. For example, in R. Mars, Contract Co. v. Massanutten Bank, 285 F.2d 158 (4th Cir. 1960), the court stated that the "negligence of the payee effective to bar recovery must be such as directly and proximately affects the conduct of the bank, contributing to and inducing its acceptance of the forged endorsement itself." Id. at 161. The court went on to say that "The unbusinesslike conduct of the Company's affairs and the lack of careful supervision of its employees were factors too remote from the Bank's acceptance of forged endorsements to be the proximate cause of loss resulting from such endorsements." Id.

In Hensley-Johnson Motors v. Citizens Nat'l Bank, 122 Cal. App. 2d 22, 264 P.2d 973 (1953), the facts were similar to those in Cooper except that the forgeries occurred over a period of only four months. Since there was, however, no evidence that the payee's negligence had contributed to the bank's acceptance of the checks, it is immediately distinguishable from Cooper. But the Hensley-Johnson court perhaps reveals a
finding that their negligence substantially contributed to the conversion of these instruments . . . .”62 It is thus difficult to determine whether the case is consistent with prior cases on the negligence issue.63 The fact that the court went to some length to reiterate the content of plaintiff's negligence, even though such content was not at issue, indicates the court's desire to inject some content into the concept of payee negligence for purposes of precedent.

It is unclear why this court used section 3-404 rather than section 3-406 in dealing with the negligence issue. Possibly the court viewed section 3-406 as being directed solely at drawer negligence,64 The Oregon Supreme Court examined section 3-406 and payee negligence with a bifurcated inquiry. That court asked if the payee's negligence “substantially contributed” to the forgery, and whether the party honoring the check had employed “reasonable commercial standards.”65 Both of these conditions must be met, the Oregon court intimated, before the defense of section 3-406 may be invoked by the party honoring the check.66

California had the same rule in its pre-Code law with respect to drawer negligence.67 In Cooper, however, the court may be signalling by way of dicta68 an approach to payee negligence which is different from the approach to drawer negligence. The court states:

different attitude toward the negligence issue. The court stated that,

Mere negligence in the conduct of the customer's business is not a sufficient defense where it does not contribute to the payment of the check, since the obligation of seeing whether there is a forged endorsement rests primarily on the bank.

Id. at 25, 264 P.2d at 976 (1953).


64. There is some support for such an interpretation. Uniform Comments to § 3-406 all deal with the maker of a note rather than with the payee. Courts have, however, used § 3-406 to deal with payee negligence. See, e.g., Gresham State Bank v. O & K Constr. Co., 231 Ore. 106, 370 P.2d 726 (1962).

65. Id. at 119, 370 P.2d at 732.

66. Id. But the court hedges on whether any negligence on the part of the negotiator of the check would preclude him from asserting the § 3-406 defense. Id. at 126, 370 P.2d at 735-36.


68. Since the trial and appellate courts had foreclosed the issue of negligence and since the finding was not challenged by plaintiffs, such statements can only have the weight of dicta.
[The banks] acted entirely in good faith, and, though their conduct with respect to certain of the instruments may have fallen somewhat below reasonable commercial standards, it was not sufficiently egregious to shift the balance of the scales in plaintiffs' favor.69

The court's use of section 3-404 as a tool to force a check forgery loss onto a negligent payee and its dicta regarding "reasonable commercial standards" may thus be an indication that a different approach—something analogous to comparative negligence—is about to be applied in California when both a payee's negligence and the bank's negligence are at issue.

CONCLUSION

By manipulating the terms of Uniform Commercial Code section 3-419(3), the Supreme Court of California has completely eliminated that statute as a defense for a collecting or payor bank in ordinary check forgery litigation. In so doing, the court has eliminated a significant injustice to the payee. Section 3-419(3) can no longer be used by a collecting bank to require the payee to bring his actions against potentially numerous and distant banks. This interpretation may, however, allow a drawer who has not detected forgeries within the statutory time limits to escape liability merely because the payee decided to bring his action against a collecting bank. The court may also have signalled the onset of a new approach in California in cases wherein both the payee and the collecting bank are negligent.

69. 9 Cal. 3d at 135-36, 507 P.2d at 619, 107 Cal. Rptr. at 11 (emphasis added).