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The Effect of the Adoption of the Proposed Uniform Commercial Code on the Negotiable Instruments Law of Louisiana - The Doctrine of Price v. Neal

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The Effect of the Adoption of the Proposed Uniform Commercial Code on the Negotiable Instruments Law of Louisiana—The Doctrine of Price v. Neal

Under quasi-contract principles, money paid in error in reliance upon a supposed right or duty is recoverable.[1] An exception to this broad rule is the doctrine expounded in the case of *Price v. Neal*.[2] There, a drawee who had paid an accepted bill and a non-accepted bill, each of which bore the forged signature of the drawer, was denied the right to recover the money paid on either bill from the endorsee who received payment. This doctrinal rule denying a drawee who has paid a forged instrument restitution from a bona fide purchaser has been accepted by courts throughout the United States, including Louisiana. The purpose of this Comment is to examine the situations in which the doctrine may be applied and to determine the possible effects which the adoption of the proposed Uniform Commercial Code would have on the subject in Louisiana.[3]

Forgery of the Drawer's Signature

The doctrine of *Price v. Neal* finds general application in the situation where the drawer's signature is forged. As a rule, a drawee of a bill who has paid an instrument bearing the forged signature of the drawer will be denied the right to recover the money from a bona fide purchaser of the instrument to whom payment has been made. The reason given by the courts for this rule is that the drawee is bound to know the signature of his customer.[4] The doctrine of *Price v. Neal* as it existed under the law merchant is now contained in section 62 of the Negotiable Instruments Law.[5] It states:

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1. BRITTON, BILLS AND NOTES 613 (1943).

2. 3 Burr. 1354, 97 Eng. Rep. 871 (K.B. 1762).

3. The right of a drawee bank to debit the account of the drawer for the amount of a check negligently drawn is covered in the comment dealing with the doctrine of Young v. Grote, 4 Bing. 253, 130 Eng. Rep. 764 (C.P. 1827), *The Effect of the Adoption of the Proposed Uniform Commercial Code on the Negotiable Instruments Law of Louisiana — The Doctrine of Young v. Grote*, 16 LOUISIANA LAW REVIEW 134 (1955).

4. WOODWORD, THE LAW OF QUASI-CONTRACTS 137 (1913): "The true reason for the rule, it is beleived, is one of policy — the policy of maintaining confidence in the security of negotiable paper by making the time and place of acceptance or payment the time and place for the final settlement, as between drawee and holder, of the question of the genuineness of the drawer's signature."

5. BRITTON, BILLS AND NOTES 621 (1943).

"The acceptor by accepting the instrument engages that he will pay it according to the tenor of his acceptance, and admits:

"(1) The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument; and

"(2) The existence of the payee and his then capacity to endorse."[6]

The doctrine of *Price v. Neal* was not recognized by the Louisiana courts prior to the adoption of the NIL in 1904,[7] and not until 1940 in *Security State Bank and Trust Co. v. First National Bank*[8] did a Louisiana court hold squarely that section 62 of the NIL includes the doctrine of *Price v. Neal.* Although the word "accepting" and not the word "paying" is employed in the Louisiana statute, the court held that the section includes payment as well as acceptance.[9]

Section 3-418 of the Uniform Commercial Code completely restates section 62 of the NIL:

"Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section,[10] payment or acceptance of any instrument is final in favor of a holder in due course."

The Code's provision accepts the principle recognized under the NIL that the drawee will be denied the right to recover money paid on an instrument bearing the forged signature of

6. LA. R.S. 7:62 (1950).

7. Note, 15 TUL. L. REV. 468, 470 (1941): "Hence, Louisiana courts, prior to the adoption of the Negotiable Instruments Law, had taken the minority position contrary to Price v. Neal. McCall v. Corning, 3 La. Ann. 409, 48 Am. Dec. 454 (1848); McKleroy & Bradford v. Southern Bank of Ky., 14 La. Ann. 458, 74 Am. Dec. 438 (1859); La. State Bank v. Hibernia Bank and Germania Nat. Bank, 26 La. Ann. 399 (1874)." *But see* Howard & Preston v. The Mississippi Valley Bank, 28 La. Ann. 727, 728, 26 Am. Rep. 105 (1876). In that case the drawees who had paid forged drafts drawn upon them were denied recovery from the holder. The court stated: "The drawee of a bill is presumed to have a better knowledge of the signature of the drawer than the holder."

8. 199 So. 472 (La. App. 1940).

9. *Id.* at 480; see LA. R.S. 7:62 (1950).

10. Section 3-418 is subject to certain exceptions which are set out in section 3-417, SUPPLEMENT NO. 1 TO 1952 OFFICIAL DRAFT OF THE UNIFORM COMMERCIAL CODE, at 21, UCC 3-417 (1955). No change in substance is made in the 1955 amendments except the elimination of the warranty of no knowledge of a stop payment order. *Id.* at 31. See Vergari, *Amending the Uniform Commercial Code — In re Articles 3, 4 and 5*, 28 TEMPLE L.Q. 529, 537 (1955).

the drawer. Further, there can no longer be any question whether or not payment is to be included, for the section specifically provides that "payment or acceptance of any instrument is final in favor of a holder in due course." It should also be noted that the application of this section is not limited to drawees, for it applies to the maker of a note or to any person who pays an instrument. Under section 3-417(1) any person who obtains payment or acceptance makes certain warranties to a person who pays or accepts in good faith.[11] Except for liabilities for breach of these warranties, payment or acceptance of any instrument is final in favor of a holder in due course. Thus, under sections 3-417(1) and 3-418 the drawee's right to recover is no longer based upon quasi-contract principles but upon the basis of warranty.

Forgery of the Payee's Endorsement

At common law a bona fide purchaser taking under a forged endorsement could not retain as against the drawee the benefits of a payment.[12] A Louisiana decision prior to the adoption of the NIL seems to support this view.[13] In that case the court stated that an "acceptance is not an admission of the payee's signature" and "an acceptance, without knowledge by the acceptor of the fictitious character of the bill, would, it seems, give no remedy and be completely void."[14] Although the NIL does not expressly cover this situation, many American jurisdictions have reached the same result.[15]

The "finality rule" of section 3-418 that "payment or acceptance of any instrument is final in favor of a holder in due course" would not apply to payments made on drafts or notes bearing forged endorsements. This is because section 3-417-(1)(a) provides that the person who obtains payment or acceptance warrants that "he has good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title." However, if an instrument bearing a

11. *Ibid.*

12. BRITTON, BILLS AND NOTES 641 (1943): "In accordance with the accepted quasi-contract rule permitting recovery of money paid out under mutual mistake of material fact a drawee of a bill or check may recover money paid out on a genuine instrument under a forged indorsement of the payee or of a special indorsee."

13. McCall v. Corning, 3 La. Ann. 409, 48 Am. Dec. 454 (1848).

14. *Id.* at 414, 48 Am. Dec. at 458.

15. Cases cited in BRITTON, BILLS AND NOTES 642, n. 2 (1943).

forged endorsement is accepted by the drawee and then comes into the hands of a holder in due course, subsequent knowledge of the forgery by the holder in due course would not affect his rights. This is because under section 3-418 the acceptance would be final in favor of the holder in due course.

Materially Altered Instruments

At common law the drawee of a materially altered bill was allowed to recover the money paid on it. Such a case was deemed to fall within the rule which permitted the recovery of money paid under mistake of fact. The analogy to the rule of *Price v. Neal* was held inapplicable.[16] In a pre-NIL decision the Louisiana Supreme Court reached a result contrary to the majority rule in other jurisditcions.[17] The case involved a suit by the drawee to recover the amount paid on a check which had been fraudulently raised prior to certification. In denying recovery the court rejected the plaintiff's contention that he who pays in error is entitled to recover the money paid and that the only exception is when the signature of the drawer is forged. The decision seems to be in accord with the view later expressed by Professor Ames that "if a holder has in good faith purchased a bill, of which the amount has been raised, and the drawee has in like good faith paid it, the payment, it would seem, should have the same effect in favor of the holder, as the payment of a bill on which the drawer's name is forged."[18] Under NIL section 62 there is conflict of authority as to whether the common law rule continues, but most cases assume that it does.[19] Whether or not the Louisiana court in interpreting the NIL will follow the majority of common law jurisdictions on this point has not been decided. However, if the rule is to be adopted that the drawee bank is the place of final settlement as regards materially altered instruments it ought to rest on more solid foundations than that provided by the language of section 62 of the NIL.

16. *Id.* at 650-51. Negligence on the part of the drawee in not discovering the alteration did not bar his recovery. National Bank of Commerce v. National Mechanics' Banking Association, 55 N.Y. 211, 14 Am. Rep. 232 (1873).

17. Louisiana National Bank v. Citizens' Bank, 28 La. Ann. 189, 26 Am. Rep. 92 (1876).

18. Ames, *The Doctrine of Price v. Neal*, 4 HARV. L. REV. 297, 306 (1891).

19. See Interstate Trust Co. v. United States Nat. Bank, 67 Colo. 6, 185 Pac. 260, 100 A.L.R. 705 (1919); McClendon v. Bank of Advance, 188 Mo. App. 417, 174 S.W. 203 (1915). For cases holding that NIL § 62 has changed the common law, see Wells Fargo Bank v. Bank of Italy, 292 Pac. 281 (Cal. App. 1930), *aff'd*, 214 Cal. 156, 4 P.2d 781 (1931); National City Bank v. National Bank of Republic, 300 Ill. 103, 132 N.E. 832, 22 A.L.R. 1153 (1921).

Under the Code the drawee who accepts or pays a materially altered instrument would be protected on the theory of warranty. Section 3-417(1)(c) provides that the person who obtains payment or acceptance warrants that "the instrument has not been materially altered." Although a party who obtains payment or acceptance warrants that the instrument has not been materially altered, under section 3-417(1)(c)(iii) such warranties are not given by a holder in due course who has taken a draft drawn on and accepted by a bank after such alteration. The Code would change the majority rule under the NIL in this respect.[20]

Insufficient Funds

The rule of *Price v. Neal* has been extended to apply to the situation where the accepting or paying bank is mistaken as to the amount of the drawer's account. Cases decided in American jurisdictions before[21] and under the NIL[22] support the view that a drawee who accepts or pays an overdraft is liable. Louisiana cases are in accord.[23] Once a check is accepted from a good faith holder and is deposited to his credit with the drawee bank, the bank may not later change the amount back to the depositor's account on discovering that the check is an overdraft.[24] A leading English case held that notwithstanding the fact that the mistake was discovered while the holder was at the bank counter, a demand for the return of the money came too late.[25]

Under section 3-418 of the Code, the drawee who accepts or pays would not be allowed to refuse payment nor to recover any amount paid. This provision should always be read in connection with section 3-417 to ascertain whether the drawee would have a remedy for breach of warranty.[26]

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20. Comment, *The Effect of the Adoption of the Proposed Uniform Commercial Code on the Negotiable Instruments Law of Louisiana — Certification*, 16 LOUISIANA LAW REVIEW 141 (1955); Wells Fargo Bank v. Bank of Italy, 292 Pac. 281 (Cal. App. 1930), *aff'd*, 214 Cal. 156, 4 P.2d 781 (1931); National City Bank v. National Bank of the Republic, 300 Ill. 103, 132 N.E. 832, 22 A.L.R. 1153 (1921).

21. The two leading American cases supporting this view are First Nat. Bank v. Burkhardt, 100 U.S. 686 (1879) and City Nat. Bank v. Burns, 68 Ala. 267, 44 Am. Rep. 138 (1880).

22. Cohen v. First Nat. Bank, 22 Ariz. 394, 198 Pac. 122, 15 A.L.R. 701 (1921); First Nat. Bank v. Mammoth Blue Gem Coal Co., 194 Ky. 580, 240 S.W. 78 (1922).

23. Sowers Co. v. First National Bank, 6 La. App. 721 (1927); Schutte v. Citizens' Bank, 3 La. App. 547 (1926).

24. BIGELOW, THE LAW OF BILLS, NOTES AND CHECKS 139 (1928).

25. Chambers v. Miller, 13 C.B. (N.S.) 128, 143 Eng. Rep. 50 (C.P. 1862).

26. See note 10 *supra*.

The Negligent and the Bad Faith Purchaser

Under the law merchant and the NIL most courts followed the view that negligence on the part of a purchaser of an instrument would free the drawee from the *Price v. Neal* rule.[27] Another line of authority follows the view that, since there is nothing in section 62 of the NIL which forces a contrary result, negligence on the part of the purchaser in failing to discover the forgery does not enable the drawee to recover the money so paid.[28] The Louisiana court has accepted the negligence test in conformity with the majority of American jurisdictions.[29]

At common law and under the NIL a drawee can recover from the forger himself, from a bad faith purchaser possessing knowledge of the forgery at the time he purchased, and presumably, from an innocent purchaser who had knowledge of the forgery at the time he received payment.[30] But if a drawee has once accepted a bill from a holder in due course, discovery of fraud afterwards would in no case relieve the drawee.[31]

Since section 3-418 of the Code adopts the "finality rule" in favor of a holder in due course, it apparently rejects the negligence doctrine. But this result could be avoided by the courts by construing negligence to amount to a lack of good faith, thus denying the holder the status of a holder in due course.[32] UCC 3-417(1) would cover the situation in which an innocent purchaser learns of the forgery after he obtains the instrument and later receives payment. It states in part that "unless otherwise agreed any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts . . . (e) that the instrument has not been materially altered . . . ."

Conclusion

It is submitted that the adoption of the provisions of the Uniform Commercial Code which relate to *Price v. Neal* situa-

27. BRITTON, BILLS AND NOTES 626-27 (1943).
28. *Id.* at 631.
29. Security State Bank and Trust Co. v. First National Bank, 199 So. 472, 478 (La. App. 1940). The court stated: "Certainly, there is nothing in the law that would excuse negligence, and therefore if negligence is proven and the drawee is free from fault, the plaintiff should recover judgment." *But see* Howard and Preston v. Mississippi Valley Bank, 28 La. Ann. 727, 26 Am. Rep. 105 (1876).
30. BRITTON, BILLS AND NOTES 626 (1943).
31. BIGELOW, BILLS, NOTES, AND CHECKS 128 (1928).
32. See discussion in STEFFEN, CASES ON COMMERCIAL AND INVESTMENT PAPER 459 (2d ed. 1954).

tions would not alter the present law to great extent. With regard to situations involving forgery of the drawer's signature[33] or insufficient funds in the drawer's account,[34] the Code is in accord with the Louisiana cases which deny protection to the drawee. As to material alterations the Code would bring Louisiana in line with the jurisdictions which allow the drawee to recover money paid. However, as to a holder in due course who takes a draft accepted or certified by the drawee after such alteration, the Code would change the majority rule by denying the drawee recovery. In the case of a forgery of the payee's endorsement, the Code is in accord with a pre-NIL Louisiana decision which protected the drawee.[35] On the other hand, the negligence test which has won approval in Louisiana[36] would be abandoned if the Code is accepted. Louisiana courts have not had opportunity to examine all of the questions that might arise under the doctrine of *Price v. Neal.* Adoption of the Uniform Commercial Code would solve many of those unanswered questions and provide certainty in this area of the law.

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The Effect of the Adoption of the Proposed Uniform Commercial Code on the Negotiable Instruments Law of Louisiana—The Doctrine of Young v. Grote

Under the law merchant, the alteration of a negotiable instrument rendered it void, even if the hands of a holder in due course,[1] although a few jurisdictions allowed recovery on the instrument as originally written.[2] The effect of negligent execution which facilitates alteration of a negotiable instrument was

33. Security State Bank and Trust Co. v. First National Bank, 199 So. 472 (La. App. 1940).

34. Sowers Co. v. First National Bank, 6 La. App. 721 (1927); Schutte v. Citizens Bank, 3 La. App. 547 (1926).

35. McCall v. Corning, 3 La. Ann. 409, 48 Am. Dec. 454 (1848).

36. Security State Bank and Trust Co. v. First Nat. Bank, 199 So. 472 (La. App. 1940).

1. Fordyce v. Kosminski, 49 Ark. 40, 3 S.W. 892 (1886); Knoxville National Bank v. Clark, 51 Iowa 264, 1 N.W. 491 (1879); Bank of Herington v. Wangerin, 65 Kan. 423, 70 Pac. 330 (1902); Greenfield Savings Bank v. Stowell, 123 Mass. 196, 25 Am. Rep. 67 (1877); see Steinheimer, *Impact of the Commercial Code on Liability of Parties to Negotiable Instruments in Michigan*, 53 MICH. L. REV. 179 (1954).

2. Dunbar v. Armor, 5 Rob. 1 (La. 1843); Burrows v. Klunk, 70 Md. 451, 14 Am. St. Rep. 371 (1889); Worrall v. Gheen, 39 Pa. 388 (1861).