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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

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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).

determined in 1825 in the leading English case of *Young v. Grote*.[3] In that case, Young drew checks on defendant Grote, blank as to amount and date. Young left them with his wife for the upkeep of his business and a clerk filled out one of the checks and left spaces on the instrument which permitted subsequent alteration. After the wife approved the amount of the check, it was fraudulently altered by the clerk who inserted figures in the spaces. Because the alteration was not apparent, the drawee paid the check. In the suit instituted by Young against the drawee, the court held that where an instrument is so negligently drawn as to invite or facilitate alteration by the insertion of words or figures,[4] and such alteration is not apparent, the drawee has the right to charge the drawer's account for the amount of the check as altered.

The doctrine of *Young v. Grote* is founded on the idea that it is the drawer's duty to prevent or at least discourage alteration by drawing checks in a careful manner and that such duty is an implied condition of his contract of deposit with the bank.[5] Aside from the purpose of making the drawer bear the cost of his negligence, justification for the doctrine may also be found in the fact that it extricates the drawee bank from an apparent dilemma. A bank may risk loss if it dishonors a check as well as if it honors it. If it wrongfully dishonors a check, it is liable in damages to the depositor for injury to his credit standing.[6] If it honors an altered check, and the alteration is apparent, it may not charge the drawer's account for the raised amount of the check.[7] Thus, it seems only fair that banks, faced with this determination, be protected against loss resulting from a drawer's negligence.

One author[8] has grouped the cases dealing with the effect of negligent execution of completed negotiable instruments[9] into

3. 4 Bing. 253, 130 Eng. Rep. 764 (C.P. 1827).

4. In *Young v. Grote* the court upheld the finding of the lower court that Young had been guilty "of gross carelessness by causing his draft to be delivered to the clerk in such a state that the latter . . . did, by the insertion of other words, make it appear to be the draft of Young for a larger sum, and that as he . . . had caused the bankers to pay the larger sum, he [Young] was bound to make good to them the loss."

5. BRITTON, BILLS AND NOTES 1072 (1943).

6. Valley Nat. Bank v. Witter, 58 Ariz. 491, 121 P.2d 414 (1942); Browning v. Bank of Vernal, 60 Utah 197, 207 Pac. 462 (1922).

7. First National Bank v. Ketchum, 68 Okla. 104, 172 Pac. 81 (1918).

8. BRITTON, BILLS AND NOTES 1065 (1943).

9. The entire problem of the effect of negligence on liability presupposes that the instrument be complete in essential material, and that a material alteration

three fact categories: (1) where the instrument has been executed in such a manner that alteration is possible through the insertion of words and figures; (2) where it is completed with no blank spaces provided for qualifying clauses and such a clause is subsequently added to the instrument; (3) where its execution is attended by careless acts other than leaving spaces on the instrument — such as the failure to use a "protectograph" machine.

The doctrine of *Young v. Grote* has been applied most frequently in the first situation, dealing with the alteration of a negotiable instrument by the insertion of words and figures. The majority of jurisdictions in this country have adopted the English view that a bank may lawfully charge the drawer's account for the full amount of the instrument as altered, where the loss can be attributed to the negligence of the drawer.[10] Conversely, where the alteration is apparent, a bank which honors such an instrument may not raise the defense of negligent execution inasmuch as the loss was occasioned by its own negligence, and not by the fault of the depositor.[11]

The second fact situation, wherein a negotiable instrument having no blank space provided for qualifying clauses is altered by the addition of such clause, has created no serious difficulty for the courts. The decisions clearly indicate that the maker or drawer is not liable on the instrument, for the reason that it is impossible to fill in every space on the paper to prevent alteration.[12]

In the third group of cases, negligence has been alleged because of the maker's failure to use some special device to prevent alteration, such as a "protectograph" machine.[13] Generally, the courts have been reluctant to extend the doctrine of *Young v. Grote* this far,[14] probably because of the unreasonable burden it would impose on the use of negotiable instruments. Thus, in one decision the North Carolina court remarked: "[I]t would well-

has been facilitated through the drawer's negligence. Where the instrument is not complete, the holder has "prima facie authority to complete it by filling up the blanks." NIL § 14. When such an incomplete instrument is so filled up, the filling does not constitute a material alteration. See BRITTON, BILLS AND NOTES 1070 (1943).

10. BRITTON, BILLS AND NOTES 1068 (1943).
11. First National Bank v. Ketchum, 68 Okla. 104, 172 Pac. 81 (1918).
12 BRITTON, BILLS AND NOTES 1069, 1070 (1943).
13. Broad Street Bank v. National Bank, 183 N.C. 463, 112 N.E. 11 (1922).
14. BRITTON, BILLS AND NOTES 1074 (1943).

nigh withdraw these instruments from ordinary use if any and every one who issued them without these precautionary devices would incur the risk of liability insisted on by plaintiff."[15] Nevertheless, an Illinois court has held that a drawer who executed a negotiable instrument partly in pencil was "guilty of gross carelessness" and consequently was liable to a holder in due course when the instrument was altered by erasures.[16] While this group of cases implies that a high standard of care is not required when it places an unreasonable burden on the use of negotiable instruments, it is equally clear that a drawer will not be relieved of liability when he could have prevented the alteration with little or no effort.

Some decisions[17] have limited the doctrine of *Young v. Grote* to the banker-depositor relation, while others,[18] including those of the Louisiana courts,[19] have allowed recovery by a holder in due course in suits brought against the negligent party. The latter ruling, which extends protection of the doctrine of *Young v. Grote* to a holder in due course, is difficult to defend since there is no contract between the holder in due course and the maker to warrant imposition of the duty of reasonable care. But the courts which have extended the doctrine apparently have not been favorably impressed with this argument. Thus, the Louisiana court in *Isnard v. Torres*,[20] citing *Young v. Grote* as authority for allowing a holder in due course to recover from the maker of a negligently drawn instrument, stated: "We think the solution of the question is readily found by a recurrence to the familiar principle, that where one of two parties, neither of whom has acted dishonestly, must suffer, he shall suffer who by his own act occasioned the confidence, and consequent injury

15. Broad Street Bank v. National Bank, 183 N.C. 463, 473, 112 N.E. 11, 16 (1922).

16. Harvey v. Smith, 55 Ill. 224, 226 (1870).

17. Knoxville National Bank v. Clark, 51 Iowa 264, 1 N.W. 491 (1879); Bank of Herrington v. Wangerin, 65 Kan. 423, 70 Pac. 330 (1902); Burrows v. Klunk, 70 Md. 451, 14 Am. St. Rep. 371 (1889); Greenfield Savings Bank v. Stowell, 123 Mass. 196, 25 Am. Rep. 67 (1877); Goodman v. Eastman, 4 N.H. 455 (1828); National Exchange Bank v. Lester, 194 N.Y. 461, 87 N.E. 779 (1909).

18. Yocum v. Smith, 63 Ill. 321, 14 Am. Rep. 120 (1871); Hackett v. First National Bank, 114 Ky. 193, 70 S.W. 664 (1902); Scotland County National Bank v. O'Connel, 23 Mo. App. 165 (1886); National Bank v. Nolting, 94 Va. 263, 26 S.E. 826 (1897).

19. Helwege v. Hibernia National Bank, 28 La. Ann. 520 (1876); Godchaux v. Union National Bank, 28 La. Ann. 516 (1876); Isnard v. Torres, 10 La. Ann. 103 (1885).

20. 10 La. Ann. 103 (1885).

of the others."[21] Similarly, it has been held that a bank which certifies a check containing spaces and which fails to draw lines through those spaces to prevent alteration is liable to a holder in due course of the instrument as altered when the maker fraudulently alters the check subsequent to the certification and negotiates it to the holder.[22]

The conflict existing among courts regarding the scope of the doctrine of *Young v. Grote* was not substantially affected by the adoption of the Negotiable Instruments Law.[23] Although the NIL allows a holder in due course of a materially altered instrument to recover on the instrument according to its original tenor,[24] it makes no specific mention of what effect negligence should have upon the liability of the parties. Therefore, under section 196 of the NIL, the law merchant still governs.[25]

The Uniform Commercial Code

> UCC section 3-406 states: "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 drawee or other payor who pays the instrument in good faith."[26]

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21. *Id.* at 104. Prior to the adoption of the NIL the Louisiana court had found privity of contract between the holder of a check and the drawee bank, despite common law decisions denying such right on the basis that a chose in action is not assignable. See Gordon & Gomila v. Muchler, 34 La. Ann. 604 (1882), *overruling* Case v. Henderson, 23 La. Ann. 49, 8 Am. Rep. 590 (1871), which had accepted the common law rule. This was in accord with civilian principles. See LA. CIVIL CODE art. 2642 *et seq.* (1870). However, this ruling was changed in M. Feitel House Wrecking Co. v. Citizens' Bank & Trust Co., 2 La. App. 118, 120-21 (1925), *affirmed*, 159 La. 752, 106 So. 292 (1925), where the court held that adoption of NIL § 189 overruled this line of cases and established the common law rule requiring acceptance or certification. The question of contract did not arise in *Isnard v. Torres*, but the ruling is in accord with the pre-NIL principle, although differing to the extent that in the *Young v. Grote* situation there is acceptance.

22. Helwege v. Hibernia National Bank, 28 La. Ann. 520 (1876); Godchaux v. Union National Bank, 28 La. Ann. 516 (1876).

23. LA. R.S. 7:1-195 (1950).

24. NIL § 124; Arnold v. Wood, 127 Ark. 234, 191 S.W. 960 (1917); Commercial Bank v. Arden, 177 Ky. 520, 197 S.W. 951 (1917).

25. BRANNAN, NEGOTIABLE INSTRUMENTS LAW 1190 (Beutel ed. 1948).

26. UCC as amended by SUPPLEMENT NO. 1 TO THE 1952 OFFICIAL DRAFT OF TEXT AND COMMENTS ON THE UNIFORM COMMERCIAL CODE, PART I, at 21, UCC 3-406 (1955). The amendment consisted of deleting the concluding phrase "and in accordance with the reasonable commercial standards of the drawee's or payor's business" from the 1952 draft of the section. A similar deletion was made in UCC section 3-302. The reason offered for the change is that it "is intended to make clear that the doctrine of an objective standard of good faith, exempli

This section of the Uniform Commercial Code recognizes the doctrine of *Young v. Grote,* thereby dealing specifically with a problem on which the NIL was notably silent.[27] In addition, it enlarges the sphere of the application of the doctrine to include a holder in due course or a payer who technically might not be considered a drawee.[28] In states whose courts have already included a holder in due course within the ambit of the doctrine,[29] this section would create no substantial change in the law. However, in jurisdictions where the doctrine has not been recognized,[30] or where it has been sharply limited to the drawer-drawee relation,[31] the adoption of the Code would broaden the liability of the parties to a negotiable instrument. The section repudiates the view that the liability of a drawer of a negligently executed negotiable instrument may flow only from a contract of deposit with a bank. On the contrary, the section adopts the view that "the maker or drawer voluntarily enters into a relation with later holders which justifies his responsibility"[32] and is liable on the instrument as altered.

Under UCC 3-406 negligence is immaterial unless it "substantially contributes" to the alteration. Since the section provides no test to determine when negligence "substantially contributes" to the alteration, the issue of negligence in each case is a question of fact.[33] Although the negligence "must afford an opportunity of which advantage is in fact taken,"[34] the section does not impose an unusual standard of care on the maker or drawer. Section 3-406 was not intended to change decisions holding that there is no duty to use a protectograph machine, indelible inks, or similar devices to prevent alteration.[35] Even if the negligence is not substantial, the holder in due course still has protection under the Code. Section 3-407 permits recovery

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fied by the case of Gill v. Cubbitt, 3 B. & C. 466 [107 Eng. Rep. 807 (K.B. 1824)], is not intended to be incorporated in Article 3." *Id.* at 18.

27. BRANNAN, NEGOTIABLE INSTRUMENTS LAW 1190 (Beutel ed. 1948).

28. UCC 3-406, comment.

29. See notes 18 and 19 *supra.*

30. Annot., 22 A.L.R. 1139 (1923).

31. See note 17 *supra.*

32. UCC 3-406, comment.

33. *Ibid.* That the issue of a drawer's negligence is a jury question, and not a question of law, was decided in the case of Timbel v. Garfield National Bank, 106 N.Y. Supp. 497, 121 App. Div. 870 (Sup. Ct. 1907).

34. UCC 3-406, comment.

35. *Ibid.*

by a holder in due course on an altered instrument according to its original tenor, thus preserving his rights under the NIL.[36]

Aside from negligence which contributes to a material alteration, a person is liable under the Code on a negotiable instrument if his negligence substantially contributes to "the making of an unauthorized signature."[37] Thus, a person using a signature stamp would be liable on a negotiable instrument if his negligent manner of keeping the stamp contributed substantially to the making of an unauthorized signature on the instrument.[38] Similarly, the section is equally applicable to instances where a person's negligence contributes to the making of a forged or other unauthorized signature of another. Typical instances of this might occur where a check is negligently mailed to a person having the same name as the payee,[39] where the drawer's negligence consists in his failure to discover and prevent the issuance of fraudulently executed instruments bearing forged endorsements,[40] or where the drawer negligently surrenders possession of checks to a forger who had the means of misleading others as to his right to endorse.[41]

In conclusion, it would seem that the effect of the Uniform Commercial Code on the doctrine of *Young v. Grote* can be measured only by the degree of change its adoption would cause in the law of each individual jurisdiction. Since Louisiana is in accord with those jurisdictions that have extended the doctrine to include the holder in due course within its protection, adoption of the Code in this state would constitute statutory recognition of an accepted rule. In addition, doing so would undoubtedly lend a degree of clarity to an area of the law where conflict existed previously under the law merchant and the Negotiable Instruments Law.

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36. See note 24 *supra*.

37. UCC 3-406, comment; see Steinheimer, *Impact of the Commercial Code Liability of Parties to Negotiable Instruments in Michigan*, 53 MICH. L. REV. 170, 182 (1954).

38. See note 37 *supra*.

39. UCC 3-406, comment.

40. Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank, 252 Mich. 163, 233 N.W. 185 (1930); see Steinheimer, *Impact of the Commercial Code on Liability of Parties to Negotiable Instruments in Michigan*, 53 MICH. L. REV. 170, 182 (1954).

41. Peninsular State Bank v. First National Bank, 245 Mich. 179, 222 N.W. 157 (1928); see Seinheimer, *Impact of the Commercial Code on Liability of Parties to Negotiable Instruments in Michigan*, 53 MICH. L. REV. 170, 182 (1954).