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COMMERCIAL PAPER AND BANK DEPOSITS AND COLLECTIONS

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THE RELATIONSHIP BETWEEN THE COMMERCIAL LAWS AND THE LOUISIANA CIVIL CODE

During the eighty years in which the Uniform Negotiable Instruments Law (NIL) was applicable to negotiable instruments in Louisiana, Revised Statutes 7:195 permitted the law merchant[1] to govern "any case not provided for" in the NIL. Section 195, which was not often utilized,[2] does not reappear in Chapter 3 of the Commercial Laws;[3] instead, section 1-103 simply says that "[u]nless displaced by the particular provisions of this title, the other laws of Louisiana shall apply."[4] In many instances, the Commercial Laws' provisions explicitly do not displace the other laws of Louisiana; thus, when the party who has signed a negotiable instrument claims that he lacked *capacity* at the time of signing, section 3-305(2)(b) permits that fact to be asserted defensively against a holder in due course

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1. LA. R.S. 7:915 (1950), *repealed by* 1974 La. Acts, No. 92, provides: "In any case not provided for in this chapter the rules of the law merchant shall govern." Law merchant means, essentially, the customs and usages of business. *See, e.g.*, White v. Jones, 14 La. Ann. 681 (1859) (recognizing a then-existing mercantile custom between planters and factors).

2. The NIL itself was an attempt to codify the law merchant. *See* Marinoni v. Levy, 9 Orl. App. 253 (1912). In *J. I. Case Threshing Machine Co. v. Bridger*, 133 La. 754, 63 So. 319 (1913), the court, finding no explanation of the language in section 119 of the NIL, which read, in part, "the act which will discharge a simple contract for the payment of money," held, through resort to the law merchant, that the provisions of the Louisiana Civil Code applied on the issue of discharge of one solidary obligor as discharging all.

3. LA. R.S. 10:1-101 through 8-501 (Supp. 1974 & 1978). Section 1-101 provides that title 10 of the Revised Statutes shall be known as the "Commercial Laws." These provisions represent the enactment of articles 3, 4, 5, 7 and 8 of the Uniform Commercial Code (U.C.C.), with minor revisions where necessary to conform with the general scheme of Louisiana law. Hereinafter, any reference to the U.C.C., where different from Louisiana law, will be noted. Otherwise, any reference to "Commercial Laws" will be to title 10.

4. LA. R.S. 10:1-103 (Supp. 1974). The section adopts the sense, but not the text, of U.C.C. § 1-103.

only if "such . . . incapacity . . . renders the obligation an absolute nullity."[5] As demonstrated in *First National Bank of Shreveport v. Williams*,[6] the answer to the "absolute nullity" language of section 3-305 is found in Civil Code articles 1788 and 1789. Other sections of the Commercial Laws also rely on the "other laws of Louisiana," including sections 3-207 and 3-123(b); the references in section 3-305(2) to minority, duress, and illegality; various references in the statute to negligence,[7] agreement,[8] claims,[9] or contract defenses;[10] and numerous definitions.[11]

In several instances, however, the Commercial Laws' particular provisions obviously do displace any inconsistent provisions found elsewhere in the laws of Louisiana. For example, the issues of negotiable form,[12] acquisition of and rights attendant to holder in due course status,[13] liability of signatories and transferors,[14] and the liability of those who pay an instrument on a forged indorsement[15] are displaced by the provisions of the Commercial Laws pertaining thereto. In still other situations, the silence of the Commercial Laws triggers section 1-103; included in this category are the effect on the underlying obligation of the giving of a negotiable instrument[16] and the matter of lost instruments.[17]

The recent decision of the First Circuit in *Houston v. McCoy*[18] portends judicial difficulty with the meaning of sec-

5. LA. R.S. 10:3-305(2)(b) (Supp. 1974).

6. 346 So. 2d 257 (La. App. 3d Cir. 1977).

7. LA. R.S. 10:3-406, 10:4-406 (Supp. 1974). *See also* St. James Bank & Trust Co. v. Board of Comm'rs, 354 So. 2d 233 (La. App. 4th Cir. 1978).

8. LA. R.S. 10:1-102(3), 10:4-103(1) (Supp. 1974).

9. LA. R.S. 10:3-305(1), 10:3-306(a) (Supp. 1974).

10. LA. R.S. 10:3-601(2) (Supp. 1974).

11. LA. R.S. 10:1-201, 10:3-102, 10:4-104, 10:4-105 (Supp. 1974).

12. LA. R.S. 10:3-104-19 (Supp. 1974).

13. LA. R.S. 10:3-302, 10:3-305 (Supp. 1974).

14. LA. R.S. 10:3-401-06, 3-410-16 (Supp. 1974) (signatories); LA. R.S. 10:3-417(2) (Supp. 1974) (transferors).

15. LA. R.S. 10:3-419(1) (Supp. 1974).

16. *Cf.* U.C.C. § 3-802 (1972 revision) (not adopted in Louisiana); Housing Auth. of Lake Charles v. Minor, 355 So. 2d 271 (La. App. 3d Cir. 1977), discussed in text accompanying notes 35-44, *infra*.

17. *Cf.* U.C.C. § 3-804 (1972 revision) (not adopted in Louisiana).

18. 351 So. 2d 829 (La. App. 1st Cir. 1977).

tion 1-103, for the decision, if correct as a matter of the NIL,[19] would certainly be incorrect under the Commercial Laws. The facts were these: a bearer note[20] was acquired by Myrtle Houston from James McCoy in part payment of the sale price of certain of Mrs. Houston's separate properties. Six months prior to her death, Mrs. Houston made a manual donation of the note to William Houston, her husband. Mrs. Houston died intestate and, because no authentic act attended the donation, a claim of ownership was created in favor of some of Mrs. Houston's relatives. McCoy subsequently refused to pay the note; Mr. Houston sued him, only to lose the case upon the lower court's ruling that the delivery of the note to Mr. Houston had not been a "negotiation" and therefore had not bestowed title or holder status upon him—in short, that the transfer was a nullity. The decision was affirmed by the First Circuit Court of Appeal.

Although the ultimate outcome would not change, there is reason to believe that the decision is incorrect as a matter of the NIL[21] as well as an incorrect application of the Commercial Laws in force today. When Mrs. Houston voluntarily delivered a bearer note to Mr. Houston, a "negotiation" took place within the meaning of section 3-202, *i.e.*, it *was* a "transfer . . . in such form that the transferee becomes a holder," because section 3-202's *sole* requirement for a negotiation of bearer paper is *delivery*.[22] It matters not that for other purposes an authentic act was required; what constitutes a valid "negotiation" is a matter clearly displaced by the specific provisions of section 3-202.[23] Thus, when Mr. Houston presented the note to McCoy (who presumably knew at that time of the

19. The case arose prior to January 1, 1975, the effective date of title 10.

20. The note was issued by James McCoy, payable to the order of "myself" and indorsed in blank. *See* First Nat'l Bank of Lafayette v. Gaddis, 250 So. 2d 504 (La. App. 3d Cir. 1971).

21. *See Continental Bank & Trust Co. v. Sacks*, 92 So. 747 (La. 1922), holding that the matter of indorsement without recourse *was* a "case provided for" by the NIL, and, accordingly, the law merchant was not applicable.

22. Defined in § 1-201 as a "voluntary transfer of possession . . . from one person to another." LA. R.S. 10:1-201 (Supp. 1974).

23. The same result arguably obtained under NIL § 30, upon which section U.C.C. § 3-202 is based. *See also* J. I. Case Threshing Machine Co. v. Bridger, 63 So. 319 (La. 1913).

claim of Mrs. Houston's heirs), current law would not allow McCoy to defend his non-payment on the basis of such a claim, unless the heirs themselves defended the action for him.[24] In fact, McCoy under the present laws could proceed to pay Mr. Houston and obtain a *discharge* of his obligation, in spite of knowledge of the claim of the heirs, unless prior to such payment the claimants had either supplied indemnity deemed adequate by McCoy or enjoined payment by an order of a court in an action in which the claimants and Mr. Houston were parties.[25]

The decision in *Houston v. McCoy* is not itself dramatic, since Mr. Houston, apparently not a holder in due course,[26] is quite likely to lose to the heirs in the final analysis.[27] But to deny a good faith transferee title and holder status to a bearer note voluntarily delivered to him, on the basis of invalid negotiation, is to blithely undo a commercial principle extant for two hundred and twenty years—namely, the doctrine of *Miller v. Race*,[28] the very foundation of negotiable instruments law.

Similar trauma to the concept of negotiability was avoided

24. *See* LA. R.S. 10:3-306(d) (Supp. 1974). A maker could, however, personally raise against a non-holder in due course the defense of "acquisition by theft," without the third-party's intervention.

25. *See* LA. R.S. 10:3-603(1) (Supp. 1974). The only situations in which a maker may not proceed to pay the party in possession of the instrument and thereby obtain a discharge are when: (a) the possessor is not the holder due to a prior forged indorsement; (b) the maker pays the possessor in bad faith because of his knowledge that the possessor acquired the bearer paper by theft; or (c) the maker pays the possessor despite the indemnity supplied by the claimant, or despite a court order enjoining payment.

The donation presently could be considered "rescindable" by the heirs under LA. R.S. 10:3-207 (Supp. 1974), but that section and its U.C.C. commentary still deem the transfer a negotiation and the transferee a holder until such time as the transfer is judicially undone.

26. *See* LA. R.S. 10:3-302(1)(a), 10:3-303 (Supp. 1974). Section 3-201 presumably does not aid Mr. Houston unless Mrs. Houston was herself a holder in due course.

27. Section 3-306 recites that "[u]nless he has the rights of a holder in due course any person takes the instrument subject to (a) all valid claims to it on the part of any person . . . ."

28. 1 Burr. 452, 97 Eng. Rep. 398 (K.B. 1758). In *Miller*, Finney, possessor of a Bank of England note payable to bearer, on demand, sent it by mail to Odenharty. The mail was robbed and the bearer note ultimately came into the possession of an innkeeper named Miller, a good faith taker for valuable consideration. Finney, realizing that the note had been lost, requested that the Bank of England refuse or "stop"

by the Fourth Circuit Court of Appeal in *St. James Bank and Trust Co. v. Board of Commissioners, Ponchartrain Levee District.*[29] The Board had issued a warrant[30] directed to the State Comptroller and payable to a construction company, but prior to receipt thereof by the Comptroller, the Board had ordered payment stopped. The plaintiff-bank, which had advanced funds against the warrant, sued the Board, claiming holder in due course status.[31] Finding that the warrant was in negotiable form[32] under sections 3-104 and 3-105(1)(g), the

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payment on the note. When Miller presented the note to the bank for payment, Race, the bank's clerk, refused to either pay or return the note. By ruling in favor of Miller, Lord Mansfield created the concept of a protected third party taker, or, holder in due course, by equating the bearer note with money:

> Tis pity that reporters sometimes catch at quaint expressions that may happen to be dropped at the Bar or Bench; and mistake their meaning. It has been quaintly said, "that the reason why money cannot be followed is, because it has no ear-mark:" but this is not true. The true reason is, upon account of the currency of it: it cannot be recovered after it has passed in currency. So, in case of money stolen, the true owner cannot recover it, after it has been paid away fairly and honestly upon a valuable and bona fide consideration: but before money has passed in currency, an action may be brought for the money itself . . . .
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> Apply this to the case of a bank-note. An action may lie against the finder, it is true; (and it is not all denied:) but not after it has been paid away in currency.

29. 354 So. 2d 233 (La. App. 4th Cir. 1978).

30. Historically, warrants have not been deemed negotiable. *See, e.g.*, Boxwell v. Dep't of Highways, 203 La. 760, 14 So. 2d 627 (La. 1943); Logan County Bank v. Farmers' Nat'l Bank, 155 Pac. 561 (Okla. 1916); Adams v. McGill, 146 S.W.2d 332 (Tex. Civ. App. 1940). The court held the warrant in the principal case to be negotiable under LA. R.S. 10:3-104, 10:3-105(1)(g) (Supp. 1974). See note 32, *infra*. That being so, it technically must be referred to as a "draft" under LA. R.S. 10:3-104(2) (Supp. 1974), the label "warrant" being a colloquialism or customary term. Warrants for corporate stock are "investment securities" within the meaning of LA. R.S. 10:8-102 (Supp. 1978). *See* E. F. Hutton & Co. v. Manufacturers Nat'l Bank of Detroit, 259 F. Supp. 513 (E.D. Mich. 1966). Instruments within the newly-enacted Chapter 8 of the Commercial Laws are not subject to the provisions of Chapter 3 thereof. 1978 La. Acts, No. 165. *See* LA. R.S. 10:3-103(1) (Supp. 1974).

31. The plaintiff-bank was probably a depositary-collecting bank under LA. R.S. 10:4-105(a), (d) (Supp. 1974) which gave value and had possession of the instrument after dishonor. *See* LA. R.S. 10:4-208(1)(c), 10:4-209, 10:3-302 (Supp. 1974).

32. Warrants are typically drawn against what the NIL and law merchant considered a "particular fund" and were for that reason generally classified as non-negotiable. See note 30, *supra*. Under the Commercial Laws, as pointed out by the court, such instruments are negotiable under LA. R.S. 10:3-104, 11:3-105(1)(g) (Supp. 1974). *See also* United States v. Swan's Estate, 441 F.2d 1082 (5th Cir. 1971).

Fourth Circuit affirmed the lower court's judgment for the bank. The Board asserted that funds should not have been advanced by a bank against a "collection" item,[33] but the court, while agreeing that such a practice is not to be recommended,[34] found no distinction in the statute between "collection" items and "payment" items as negotiable instruments.

The Third Circuit Court of Appeal decision in *Housing Authority of Lake Charles v. Minor*[35] raises an issue of commercial paper law in an area in which there is currently little certainty. A tenant transferred his paycheck by indorsement to his lessor in (late) payment of rent due, and the lessor sought eviction.[36] It appears well-settled in Louisiana jurisprudence[37]

33. There is no definition in the Commercial Laws of "collection" items or "payment" or "cash" items. The term "item" itself is defined in LA. R.S. 10:4-104(1)(g) (Supp. 1974) as "any instrument for the payment of money even though it is not negotiable but does not include money." Banking usage provides working definitions of "collection" and "cash" items. Typically, banks deal with checks as "cash" items on the assumption that the overwhelming majority of them will be honored ("paid") by the drawee, and banks willingly give provisional credits immediately for a check at all stages of the collection process. Such credits automatically become final without further action when the drawee pays. *See* LA. R.S. 10:4-213(2) (Supp. 1974). But not all items handled by banks carry the assumption, enjoyed by checks, that payment will be virtually automatic; such items are handled as "collection" items and the bank's function is viewed as a conduit for movement of the item in the bank collection process. No credits—not even provisional—are usually given, and no funds are usually advanced against collection items. Ultimately, the collection item reaches the intended bank, which itself will present the item to—rather than pay it out of the account of—the payor. Documentary drafts provide an example, as do instruments payable "at" or "through" a named bank. *See* LA. R.S. 10:4-104(1)(f), 10:3-120, 10:3-121 (Supp. 1974). *See generally* Farnsworth, *Documentary Drafts Under the Uniform Commercial Code*, 22 BUS. L. J. 479, 482-84 (1967); *see also The Work of the Louisiana Appellate Courts for the 1972-1973 Term—Commercial Paper*, 34 LA. L. REV. 293, 296-99 (1974).

34. The defendant-Board alleged, but failed to prove, that the bank had been negligent in advancing funds on the warrant. Ordinary care is required of collecting banks in various of their specific activities (*see* LA. R.S. 10:4-202 (Supp. 1974)) and in the general handling of an item (*see* LA. R.S. 10:4-103(5) (Supp. 1974)), but it is difficult to see how that duty would be owed to the drawer or to anyone other than the collecting bank's own customer or transferor. *See also* Davis v. Miller Builders & Dev'rs, Inc., 340 So. 2d 409 (La. App. 2d Cir. 1976); *The Work of the Louisiana Appellate Courts for the 1976-1977 Term—Commercial Paper*, 38 LA. L. REV. 384-90 (1978).

35. 355 So. 2d 271 (La. App. 3d Cir. 1977).

36. The decision was in favor of the tenant, on equitable grounds. *See* U.C.C. § 1-103 (1972 revision).

that the giving of a check is generally presumed to be intended as conditional payment only, and that the underlying obligation (such as rent) is not discharged until the check is paid by the drawee[38] or negotiated to another by the creditor.[39] The parties are presumed to understand and intend that the underlying obligation is in suspension and that the creditor can not bring an action on that obligation until presentment is made and the check is dishonored—in which case he may sue either on the underlying obligation or on the check.[40] Many NIL jurisdictions entertained an exception to this presumed intent: where a third-party's instrument is given by the debtor to the creditor concurrently with the creation of the obligation, the creditor-holder takes the instrument in unconditional *payment* of the obligation,[41] retaining rights only as to the instrument; if he cannot collect it, he has no other rights on the obligation. Thus, if the instrument is an unindorsed bearer instrument, or indorsed "without recourse," or if the creditor-holder fails to seasonably initiate collection proceedings on the check indorsed by the debtor, he will have lost all rights against the debtor.[42]

It is unclear whether Louisiana jurisprudence has incorporated the "third-party instrument" exception;[43] likewise there

37. U.C.C. § 3-802, which would govern the effect of the instrument on the underlying obligation, was not adopted in Louisiana, making the "other laws" language in section 1-103 applicable.

38. *See, e.g.*, Oxner v. Union Nat'l Life Ins. Co., 289 So. 2d 229 (La. App. 1st Cir. 1973), *cert. denied*, 292 So. 2d 243 (La. 1974); Work Clothes Rental Service Co. v. DuPont Mfrs., Inc., 262 So. 2d 807 (La. App. 3d Cir. 1972); Seliga v. American Mutual Liability Ins. Co., 174 So. 2d 878 (La. App. 4th Cir. 1965). The same is true with respect to a draft. *See* Bank of Napoleonville v. Knobloch & Rainold, 144 La. 100, 80 So. 214 (1918).

39. Yarbrough v. Marks, 168 La. 57, 121 So. 301 (1929). The parties can, of course, agree that the taking of an instrument *is* payment. *See* Abat v. Nolte, 6 Mart. (N.S.) 636 (La. 1828).

40. LA. R.S. 10:3-413(2) (Supp. 1974).

41. U.C.C. § 3-802(1) narrows this exception to cases in which the third-party is a bank, *i.e.*, a teller's check, cashier's check, or similar bank instrument. *See generally* Rothschild, *The Uniform Commercial Code's Undoing of an Obligation*, 7 BOS. C.L. REV. 63 (1965).

42. *See* LA. R.S. 10:3-503(2)(b) (Supp. 1974). A discharge on the instrument is a pro tanto discharge of the underlying obligation. *See also* U.C.C. § 3-802(1)(b) (1972 revision).

43. *Compare* Waldrip Tire & Supply Co. v. Campbell Constr. Co., 158 So. 2d

is a lack of clarity as to the effect on the underlying obligation of a discharge on the instrument,[44] at least to the extent a novation[45] has not resulted.

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464 (La. App. 2d Cir. 1963) (a contractor's check accepted by a supplier of materials to a sub-contractor was said to have paid the sub-contractor's obligation) *with* Nielsen v. Planter's Trust & Savings Bank of Opelousas, 164 So. 613 (La. 1935) (the Louisiana Supreme Court ruled that "the indorsement and delivery of a check is not payment but an order for payment." *Id.* at 615). The proposition in *Nielsen* is peculiar since the *indorsement* of a check would, by definition, be the giving of a third-party's check, which normally was held to be the equivalent of payment prior to the U.C.C.'s § 3-802. What is more peculiar, the check in question was a cashier's check drawn by the defendant bank on itself—the very type of instrument that U.C.C. § 3-802(1)(a) describes. *See also* Ocean Tow Boat Co. v. Ship Ophelia, 11 La. Ann. 28 (1856).

44. In the *Minor* case, for example, the landlord held the indorsed check from May 9 to at least May 16, arguably a discharging circumstance. See note 42, *supra*.

45. The taking of a third-party's instrument has been held in a few cases to be a novation under LA. CIV. CODE art. 2189, but the case law clearly indicates that a novation is not easily proven by mere acts. The vendor's act of taking a third-party's note, indorsed in blank by the payee, but not indorsed by the vendee, had the effect of discharging the vendee pro tanto in *Bates-Crumley Chevrolet Co. v. Brown*, 141 So. 436 (La. App. 2d Cir. 1932). The vendor had sued both the maker and the payee-indorser and that fact contributed to the court's analysis of the vendor's intent regarding novation (discharge). It is unclear how important to the decision was the fact that the vendee (as a bearer of the note) was not required by the vendor to indorse the note.

The *Bates-Crumley* opinion, however, does discuss the difference between a check and a promissory note:

> A check . . . is merely the . . . means of delivery of the money. Whereas, a note is a written engagement or promise to pay a certain sum of money at a time specified. It is the evidence of an obligation to pay . . . .
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> When [vendees] delivered to [vendor] . . . the note, it was a giving of the obligation of [maker], not theirs, unless they had indorsed the note.

Id. at 439. One can well take issue with the conclusion drawn by the court as to the absence of a vendee's indorsement; one also has to doubt the significance of the distinction implicit in *Bates-Crumley* between the giving of a third-party's note and the giving of a third-party's check, which also represents an engagement or obligation of the issuing party. *See* LA. R.S. 10:3-413(2) (Supp. 1974); NIL § 61.

The case of *Barron v. How*, 2 Mart. (N.S.) 144 (La. 1824) also involved the discharge of an obligation by acceptance of the note of a third-party.