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BANKING LAW

Ronald L. Hersbergen*

ITEMS IN THE BANK COLLECTION PROCESS

Handling Items Not Properly Indorsed

The enactment of section 3-419(1) of Title 10 of the Louisiana Revised Statutes brought to Louisiana the common law notion of conversion in the act of improperly paying an instrument. By that section, "when a person pays an instrument on a forged indorsement, he is liable to the true owner." In addition to changing prior law,¹ section 3-419(1) raised several questions of interest to Louisiana commercial lawyers: 1) Are collecting banks to be considered under section 3-419(1) as persons who "pay" an instrument? 2) Is a drawer or maker to be considered as the "true owner" of the instrument? 3) For how much is the paying party to be liable? 4) What defenses may the paying party raise? 5) Is a party liable under section 3-419(1) if he pays an instrument, not on a forged indorsement, but on a *missing* indorsement? In the fifteen or so years since the Uniform Commercial Code gained wide adoption by the states, satisfactory answers to the first four questions surrounding section 3-419(1) have emerged from the various courts of the country.² Loui-

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1. The prior Louisiana law is discussed in Hersbergen, *The Work of the Louisiana Appellate Courts for the 1972-1973 Term—Commercial Paper*, 34 LA. L. REV. 293 (1974).

2. Most of the decisions addressing the issue have held that the drawer is not the "true owner" and has no right to sue under section 3-419(1). *National Sur. Corp. v. Citizens State Bank*, 41 Colo. App. 580, 593 P.2d 362 (1978); *Stone & Webster Eng'r Corp. v. First Nat'l Bank & Trust Co.*, 345 Mass. 1, 184 N.E.2d 358 (1962); *Twellman v. Lindell Trust Co.*, 534 S.W.2d 83 (Mo. App. 1976); *Life Ins. Co. of Va. v. Snyder*, 141 N.J. Super. 539, 358 A.2d 859 (1976). In some states, prior law permitted the drawer to sue one who had paid his item on a forged indorsement. In two cases, this law was found to have been unaffected by adoption of the Uniform Commercial Code. *Justus Co. v. Gary Wheaton Bank*, 509 F. Supp. 103 (N.D. Ill. 1981); *International Indus. Inc. v. Island State Bank*, 348 F. Supp. 886 (S.D. Tex. 1971). See generally Comment, *Commercial Paper: Depository Bank Liable to Drawer for Payment Over Forged Indorsement*, 45 MO. L. REV. 511 (1980). Drawers have succeeded in direct actions against collecting banks on the theory that a drawer, while not the true owner of the improperly paid instrument, is the recipient of implied warranties from the collecting bank under section 3-417(1) or section 4-207(1), as a "payor who in good faith pays" the instrument. See *Sun 'N Sand, Inc. v. United Cal. Bank*, 148 Cal. Rptr. 329, 582 P.2d 920 (1978).

Collecting banks have been unsuccessful, for the most part, in arguing that they

siana courts may find these answers persuasive.³ In recent years a split of authority has developed as to the liability under section 3-419(1) of a person who pays an instrument that is missing a necessary indorsement, but which bears no forged indorsement. The recent decision in *Top Crop Seed & Supply Co. v. Bank of Southwest Louisiana*⁴ suggests that the Third Circuit Court of Appeal would take the view that section 3-419(1) does not apply to the missing indorsement case. Such a ruling would place the court in the minority view on that issue.⁵

are not parties "who pay" within the meaning of U.C.C. section 3-419(1). *Federal Deposit Ins. Corp. v. Marine Nat'l Bank of Jacksonville*, 431 F.2d 341 (5th Cir. 1970); *Cooper v. Union Bank*, 107 Cal. Rptr. 1, 507 P.2d 609 (1973); *Underpinning & Foundations Constructors, Inc. v. Chase Manhattan Bank, N.A.*, 414 N.Y.S.2d 298, 386 N.E.2d 1319 (1979). See *Top Crop Seed & Supply Co. v. Bank of Southwest La.*, 392 So. 2d 738 (La. App. 3d Cir. 1980).

Section 3-419(2) states that the drawee's liability for payment on a forged indorsement instrument is the face amount of the instrument but that the liability of other persons is *presumed* to be the face amount of the instrument. A collecting bank thus could reduce the true owner's recovery by showing, for example, that the underlying obligation for which the check was issued has been satisfied. *Tette v. Marine Midland Bank*, 435 N.Y.S.2d 413 (Supp. Ct., App. Div. 1981). On the other hand, a drawee might be liable to a payee whose indorsement had been forged, even though the payee mistakenly had been named as such, and had no interest in the check. See *Montgomery v. First Nat'l Bank*, 265 Or. 55, 508 P.2d 428 (1973).

The negligence of the true owner may prevent him from establishing that his signature is unauthorized. LA. R.S. 10:3-406 (Supp. 1974). The true owner's negligence can, therefore, be raised in defense of liability by a drawee. *Cooper v. Union Bank*, 107 Cal. Rptr. 1, 507 P.2d 609 (1973). Section 3-406 does not clearly permit a collecting bank to raise negligence as a preclusionary bar in an unauthorized indorsement situation, but logically a collecting bank should be considered an "other payor" under section 3-406 if it is considered to have "paid" the item for purposes of section 3-419(1). In *Cooper, supra*, the California Supreme Court side-stepped that issue by allowing the collecting bank to invoke what the court considered to be the broader equitable estoppel principle inherent in the preclusion language of section 3-404(1). Subsequently, the California court held in *Sun 'N Sand, Inc. v. United California Bank, supra*, that a collecting bank is, in fact, an "other payor" for purposes of section 3-406.

3. The decisions of other jurisdictions under a "borrowed" or common statute have traditionally been accepted in Louisiana as persuasive on questions of interpretation. See, e.g., *State v. Macaluso*, 235 La. 1019, 106 So. 2d 455 (1958); *Standard Oil Co. v. Collector of Revenue*, 210 La. 428, 27 So. 2d 268 (1946); *Broussard v. State Farm Mut. Auto Ins. Co.*, 188 So. 2d 111 (La. App. 3d Cir.), *cert. denied*, 249 La. 713, 190 So. 2d 233 (1966), *cert. denied*, 386 U.S. 909 (1967).

4. 392 So. 2d 738 (La. App. 3d Cir. 1980).

5. Most of the decisions either hold that section 3-419(1) does apply to the missing indorsement situation by *analogy*, or that section 3-419(1) was not intended to displace the underlying common law conversion liability of a person who pays such an instrument. The following cases hold that the payment of an instrument on which a necessary indorsement is missing constitutes conversion: *FDIC v. Marine Nat'l Bank of Jacksonville*, 431 F.2d 341 (5th Cir. 1970); *State Nat'l Bank v. Sumco Eng'r, Inc.*, 46 Ala. App. 244, 240 So. 2d 366, *cert. denied*, 286 Ala. 740, 240 So. 2d 369 (1970); *Wilton*

The act of signing a negotiable instrument by a person in a non-representative capacity obligates the person signing to pay the instrument, according to its tenor, as either a primarily or secondarily liable party.⁶ Unless the instrument itself clearly indicates that a signature⁷ thereon is made in some other capacity⁸ it is deemed to be an "indorsement."⁹ An indorsement can be qualified, in which case no liability, on the instrument, is created as to the person who signs.¹⁰ When the holder of an instrument *payable to order*¹¹ indorses it, his act of indorsing not only creates the normal indorsement engagement,¹² but also constitutes a necessary step in the passing of title to the instrument and in the establishing of holder status by the transferee. Stated otherwise, an indorsement by the holder of an instrument payable to order is necessary for a *negotiation* of the instrument, for only by a negotiation may a third party

Manors Nat'l Bank v. Adobe Brick & Supply Co., 232 So. 2d 29 (Fla. App. 1970); *Trust Co. of Columbus v. Refrigeration Supplies, Inc.*, 241 Ga. 406, 246 S.E.2d 282 (1978); *Refrigeration Supplies, Inc. v. Bartley*, 144 Ga. App. 141, 240 S.E.2d 566 (1977); *Insurance Co. of N. America v. Atlas Supply Co.*, 121 Ga. App. 1, 172 S.E.2d 632 (1970); *Peoples Nat'l Bank v. American Fed. Fire Ins. Co.*, 39 Md. App. 614, 386 A.2d 1254 (1978); *Beyer v. First Nat'l Bank of Dillon*, 612 P.2d 1285 (Mont. 1980); *Capital Dist. Tel. Employees Fed. Credit Union v. Berthiaume*, 105 Misc. 2d 529, 432 N.Y.S.2d 435 (Sup. Ct. Sp. Term 1980); *Edwards Co. v. Long Island Trust Co.*, 347 N.Y.S.2d 898 (Sup. Ct. Sp. Term 1973); *Berkheimers, Inc. v. Citizens Valley Bank*, 270 Or. 807, 529 P.2d 903 (1974); *Pacific Metals Co. v. Tracy-Collins Bank*, 21 Utah 2d 400, 446 P.2d 303 (1968).

Drug House, Inc. v. Keystone Bank, 414 A.2d 704 (Pa. Super. 1979) holds that section 3-419(1) does not apply to the missing indorsement situation. See generally Annot., 47 A.L.R.3d 537 (1973). Many of the cited cases involved joint payee checks. Historically, banks have not successfully avoided conversion liability by arguing that the non-indorsing payee, having never been in actual possession of the check, had no "true owner" rights therein. See *Indiana Plumbing Supply Co. v. Bank of America Nat'l Trust & Sav. Ass'n*, 63 Cal. Rptr. 658, 255 Cal. App. 2d 910 (1967); *Hoffman v. First Nat'l Bank*, 299 Ill. App. 290, 20 N.E.2d 121 (1939); *House-Evans Co. v. Mattoon Transfer & Storage Co.*, 275 P.2d 268 (Okla. 1954).

6. LA. R.S. 10:3-401, 3-403, 3-413, 3-414, 3-415 (Supp. 1974). "Liable," in this context, means only that the party has taken on an engagement to pay.

7. A "signature" on an instrument is made by the use of any name, or by any word or mark used in lieu of a written signature. LA. R.S. 10:3-401(2) (Supp. 1974). In a broad sense, "signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing. LA. R.S. 10:1-201 (Supp. 1974). A signature by an authorized representative obligates the party whose name is signed. LA. R.S. 10:3-403(1) (Supp. 1974).

8. The "other capacity" would include a signing by a maker, drawer, or acceptor. LA. R.S. 10:3-413 (Supp. 1974).

9. The term "indorsement" is not a defined one in the Commercial Laws, but in view of LA. R.S. 10:3-401(1) and 3-402 (Supp. 1974), an indorsement is simply a signature that is not that of a drawer, maker, or acceptor.

10. LA. R.S. 10:3-414(1) (Supp. 1974).

11. LA. R.S. 10:3-110 (Supp. 1974).

12. LA. R.S. 10:3-414(1) (Supp. 1974).

become a holder of the instrument.¹³ Without an indorsement by the holder, the transferee of an instrument payable to order cannot himself achieve holder status, and ordinarily it matters not whether the indorsement is forged or otherwise made in an unauthorized manner¹⁴ or simply is missing.¹⁵ If the instrument happened to be a check, the drawee-payor bank could not properly debit the indicated amount to the drawer's account unless all necessary indorsements appeared on the instrument, for without them, the check would not be properly payable.

To the would-be holder and to the drawee-payor bank, there ordinarily is no significant difference between the instrument that bears a forged or otherwise unauthorized necessary indorsement, and one that is simply missing a necessary indorsement. It is not the presence of an unauthorized signature on the instrument that is significant to the transferee or to the payor bank; rather, it is the absence of the signature of the holder that defeats a negotiation of the instrument and renders it not properly payable. Similarly, it is not significant to the implied warranties of parties obtaining payment or acceptance whether a necessary indorsement is missing or unauthorized. The implied warranty of title¹⁶ would be breached in either case. To the transferor of an instrument, an unauthorized necessary indorsement would mean that two implied warranties have been breached; in contrast, a missing necessary indorsement would result in only a breach of the warranty of title.¹⁷

A holding that section 3-419(1) has no application to the missing necessary indorsement case would recognize a distinction between missing indorsements and unauthorized indorsements, and would be a minority view.¹⁸ Arguably, it would be the correct view. Although

13. LA. R.S. 10:3-201, 3-202 (Supp. 1974). An indorsement also expands the extent of warranties that are implied from the act of *transfer* of an instrument. LA. R.S. 10:3-417(2) (Supp. 1974).

14. The term "unauthorized indorsement" includes both the "forgery" and the signature by one exceeding his authority. LA. R.S. 10:1-201 (Supp. 1974).

15. The mere failure of the transferring holder to indorse as he intended to do would create in the transferee the right to have the intended indorsement. LA. R.S. 10:3-201(3) (Supp. 1974). Once the indorsement was acquired, the transferee would become a holder. The transferee under a forged or otherwise unauthorized indorsement does not have the right to compel the proper indorsement.

16. LA. R.S. 10:3-417(1)(a), 4-207(1)(a) (Supp. 1974).

17. An unauthorized necessary indorsement would breach both implied transfer warranties of title and genuine signatures. LA. R.S. 10:3-417(2)(a) & (b), 4-207(2)(a) & (b) (Supp. 1974). An unauthorized but unnecessary indorsement would not breach the warranty of title, but would breach the warranty as to genuine signatures.

18. See note 5, *supra*. On the less vexing issue of payment of an instrument bearing not a forged indorsement, but an indorsement by one who exceeded some existing authority in so indorsing, virtually all decisions hold that section 3-419(1) does apply,

the effect of the missing indorsement and the forged or otherwise unauthorized indorsement is often the same in that there is an unauthorized transfer or presentment in either case, the U.C.C. does not equate the two situations.¹⁹ More importantly, section 3-419(1) is unambiguously limited to the forged indorsement case. An incorrect ruling that section 3-419(1) applies to the missing indorsement case does not necessarily constitute reversible error in the other U.C.C. jurisdictions, in view of the underlying common law liability for conversion. The common law, which arguably is not displaced by U.C.C. section 3-419(1),²⁰ would provide that the act of paying an instrument that is missing a necessary indorsement is "an exercise of dominion and control over the instrument inconsistent with the rights of the owner, thus resulting in liability for conversion."²¹ This liability for conversion was not the underlying pre-U.C.C. law of Louisiana; rather it seems that a true owner to whom Louisiana Revised Statutes 10:3-419(1) is unavailable must sue his own transferor (or the drawer or maker, if the owner is the payee) on the unsatisfied underlying obligation.²² Typically, however, the collecting bank will ultimately have to answer to the drawee-payor bank for breach of the implied warranty of title.²³ This litigation mode is not only circuitous, but also it may produce an anomaly in that while the successful true owner ordinarily would not be awarded attorney's fees in a section 3-419(1) case,²⁴ such fees are arguably available in an implied warranty action against a collecting bank.²⁵

despite the technical difference between "forged" indorsements and other varieties of unauthorized indorsements discernible in section 1-201's definition of "unauthorized." *Equipment Distribs., Inc. v. Charter Oak Bank & Trust Co.*, 34 Conn. Sup. 606, 379 A.2d 682 (1977); *Hartford Acc. & Indem. Co. v. South Windson Bank & Trust Co.*, 171 Conn. 63, 368 A.2d 76 (1976); *Smith v. General Cas. Co. of Wis.*, 75 Ill. App. 3d 971, 394 N.E.2d 804 (1979); *Salsman v. National Comm. Bank of Rutherford*, 102 N.J. Super. 482, 246 A.2d 162 (1968).

19. There is no suggestion in section 1-201's definition of "unauthorized" that the missing indorsement situation is even an analogous one. Sections 3-201 and 3-202 clearly draw a distinction between unauthorized and missing indorsements. A payroll-padded or fictitious payee check not indorsed "in the name of the named payee" does not, for example, trigger the protection of section 3-405.

20. See U.C.C. § 1-103 (1970 version).

21. U.C.C. § 3-419, Comment 3 (1970 version).

22. See *M. Feitel House Wrecking Co. v. Citizens Bank & Trust Co.*, 159 La. 752, 106 So. 292 (1925); Hersbergen, *The Work of the Louisiana Appellate Courts for the 1972-1973 Term—Commercial Paper*, 34 LA. L. REV. 293 (1974). The underlying obligation is typically discharged by payment to the holder; in the absence of the necessary indorsement there is no holder. LA. R.S. 10:3-201, 3-202 (Supp. 1974).

23. LA. R.S. 10:4-207(1)(a) (Supp. 1974).

24. See *Perkins State Bank v. Connolly*, 632 F.2d 1306 (5th Cir. 1980); *Puckett v. Southeast Plaza Bank*, 620 P.2d 461 (Okla. App. 1980). If the instrument's "face amount" included a stipulation for attorney's fees, section 3-419(2) arguably provides the basis for awarding such fees.

25. Section 4-207(3) indicates that damages for breach of the implied warranties in-

Misencoding and Misrouting of Items

Computerized handling of checks in the bank collection process is made possible by the Magnetic Ink Character Recognition (MICR) system. The typical check is pre-encoded with magnetic numerals and characters representing the drawee's identification number and the drawer's account number, which bank computers are programmed to "read." Upon deposit by the holder, the amount of the check is also encoded by the depository bank. The depository bank's computer reads the drawee's identification number and automatically sorts and routes the check to the drawee. Upon arrival at the drawee bank, a computer is programmed to debit the drawer's account or to "kick out" the check if it was either drawn against insufficient funds, or has been subjected to a stop payment order, or if the drawer's account otherwise requires special handling.²⁶ Both over-encoding and under-encoding by the depository bank of the amount payable create liability potential for both the depository and the drawee bank.²⁷ As *Morris v. Deluxe Check Printers, Inc.*²⁸ reveals, the printer of the checks has contractual liability for damage to the drawer's credit reputation caused by the dishonor resulting from erroneous routing symbols printed on the drawer's checks.

Magnetic encoding and computerized handling of checks are banker's conveniences, but banks are not immune from liability if they rely on erroneous encoding. In *Morris*, for example, the drawee bank's name correctly appeared on the drawer's checks,²⁹ so that the

clude finance charges and "expenses related to the item, if any." LA. R.S. 10:4-207(3) (Supp. 1974). U.C.C. Comment 5 to section 4-207 states that the "expenses" referred to "may be ordinary collection expenses and in appropriate cases could also include such expenses as attorneys fees." The comment does not suggest what are "appropriate" cases.

26. See generally B. CLARK & A. SQUILLANTE, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* 213-18 (1970).

27. Payment of the over-encoded amount would possibly result in the wrongful dishonor of subsequently presented items; but to dishonor the item as an overdraft on the basis of the over-encoded amount would be a wrongful dishonor if the actual amount ordered paid by the drawer could have been paid. Payment of an under-encoded amount would not be in accordance with the order of the drawer. See cases at note 31, *infra*. The collecting bank presumably would be subject to a negligence claim. Cf. *Exchange Bank of St. Augustine v. Florida Nat'l Bank*, 292 So. 2d 361 (Fla. 1974) (mis-encoding of drawee's identification number by collecting bank); *Citizens State Bank v. Martin*, 609 P.2d 670 (Kan. 1980) (raising the issue of drawee negligence); *State ex rel. Gabalac v. Firestone Bank*, 46 Ohio App. 2d 124, 346 N.E.2d 326 (1975) (payment by drawee of an over-encoded check). See also *First Nat'l Bank & Trust Co. of Augusta v. Georgia R.R. Bank & Trust Co.*, 238 Ga. 693, 235 S.E.2d 1 (1977).

28. 395 So. 2d 927 (La. App. 2d Cir. 1981).

29. See LA. R.S. 10:3-104(2)(b) (Supp. 1974). That the drawee's name will appear on a check seems to be assumed by the U.C.C. because N.I.L. section 1(5), which required

collecting banks had mis-routed the checks by following only the magnetically encoded drawee identification number.³⁰ Likewise, a drawee that overpays or underpays a check on the basis of an amount erroneously encoded by the depository bank has failed to follow the order of its customer.³¹

THE RIGHTS OF THE HOLDER

The Liability of the Nonaccepting Drawee

The holder of a dishonored check or draft has rights against the drawer and any prior indorsers,³² but he has no rights on the instrument against the non-accepting drawee.³³ Because rights against a drawer who resides elsewhere are of little practical benefit to the merchant, he often contacts the drawee to determine whether the check, if taken by him in lieu of cash or another payment method, will be honored. However, bankers tend to be coy in handling such inquiries³⁴ and a contract to accept or pay the check will not often be found. It is even less likely that actionable representations by the drawee as to the drawer's account will be made.³⁵ A statement by the banker that the drawer's draft or check "will be honored," however, did result in an obligation to honor in *Carrol v. Twin City*

that the drawee's name be indicated with reasonable certainty, was omitted by the U.C.C.

30. LA. R.S. 10:4-202(a) (Supp. 1974). Under LA. R.S. 10:3-118(c) (Supp. 1974), words control figures, unless the words themselves are ambiguous. If MICR characters are likened to "figures" the name of the drawee would control the issue of proper routing. See *St. Paul Fire & Marine Ins. Co. v. State Bank of Salem*, 412 N.E. 2d 103 (Ind. App. 1980). Section 1-102(3) does permit the collecting bank to vary a provision such as section 3-118(c) by contract so long as the variance does not amount to an exculpation of negligence. See Hersbergen, *The Bank Customer Relationship Under the Louisiana Commercial Laws*, 36 LA. L. REV. 29, 43-55 (1975).

31. See LA. R.S. 10:3-118(c), 4-401 (Supp. 1974); *First Nat'l Bank & Trust Co. of Augusta v. Georgia R.R. Bank & Trust Co.*, 238 Ga. 693, 235 S.E.2d 1 (1977); *State ex rel. Gabalac v. Firestone Bank*, 46 Ohio App. 2d 124, 346 N.E.2d 326 (1975).

32. LA. R.S. 10:3-413(2), 3-414 (Supp. 1974). Depending on the reason for dishonor, the holder may also have implied warranty rights. LA. R.S. 10:3-417(2) (Supp. 1974).

33. LA. R.S. 10:3-409 (Supp. 1974). *But see* LA. R.S. 10:3-418, 4-213(1), 4-302 (Supp. 1974). By section 3-409 a check or draft "does not of itself operate as an assignment of any funds in the hands of the drawee." Though it is rare, holders have succeeded in showing special fact situations which permit a court to find an assignment. See *Mid-Continent Cas. Co. v. Jenkins*, 410 P.2d 521 (Okla. 1965). See also *Fortier v. Delgado & Co.*, 122 F. 604 (5th Cir. 1903) (applying Louisiana law).

34. An excellent example of the care with which such inquiries are handled by bankers is seen in *Night & Day Bank of St. Louis v. First Nat'l Bank of Shreveport*, 150 La. 954, 91 So. 405 (1922).

35. See *Sabin Meyer Reg. Sales Corp. v. Citizens Bank*, 502 F. Supp. 557 (N.D. Ga. 1980); *C & S Nat'l Bank v. Levitz Furn. of Eastern Region, Inc.*, 147 Ga. 295, 248 S.E.2d 556 (Ga. App. 1978).

*Pontiac Used Cars, Inc.*³⁶ This case demonstrates the meaning of the statement in section 3-409(2) that: "Nothing in this Section shall affect any liability in contract, tort, or otherwise arising from any . . . obligation or representation which is not an acceptance."³⁷

DEFENSES TO PAYMENT

Discharge by Impairment of Collateral

Among the various defenses which can be asserted against a holder are the discharge defenses.³⁸ By their nature, discharge defenses can frequently be asserted against even a holder in due course.³⁹ A frequent example of the defense of discharge is provided by cases in which the holder unjustifiably impairs the collateral given by or on behalf of a party against whom the holder has recourse.⁴⁰ The term "unjustifiably impairs" was held inapplicable in *American Discount Corp. v. Glover*,⁴¹ where the holder knew that the obligor was moving out of state, but did not prevent the obligor from loading the collateral on a truck, apparently believing the obligor's representation that the collateral would remain in St. Martin Parish.⁴² When the holder was subsequently unable to locate either the obligor or the collateral, it sued the accommodation maker, to whom the unjustifiable impairment of collateral defense was held unavailable. Even assuming that the holder would have had sufficient time to institute legal proceedings to prevent the impairment, the third circuit was not convinced that any duty to do so exists.⁴³

36. 397 So. 2d 42 (La. App. 2d Cir. 1981).

37. A negligently made (and erroneous) statement as to a customer's account resulted in liability in *Bank of Nevada v. Butler Aviation-O'Hare, Inc.*, 616 P.2d 398 (Nev. 1980). Cf. *First Nat'l Bank of Denver v. Ulibarri*, 557 P.2d 1221 (Colo. App. 1976) (bank may be estopped under section 1-103 to deny the truth of its representation that the check in question was "finally settled").

38. LA. R.S. 10:3-601(1) (Supp. 1974).

39. In general, if the holder has notice of any defense against the instrument on the part of any person, he cannot acquire holder in due course status on his own. LA. R.S. 10:3-302(1)(c) (Supp. 1974). If the holder's transferor had the rights of a holder in due course, however, the holder is entitled to assert such rights as his own. LA. R.S. 10:3-201 (Supp. 1974). Notice of discharge does not, of itself, constitute notice of a defense, unless the holder has notice that all parties to the instrument have been discharged. LA. R.S. 10:3-304(1)(b) (Supp. 1974). Thus, one may become a holder in due course despite knowledge or notice of a discharge, but the party discharged may raise his defense against the holder in due course. LA. R.S. 10:3-602 (Supp. 1974).

40. LA. R.S. 10:3-606(1)(b) (Supp. 1974).

41. 391 So. 2d 853 (La. App. 3d Cir. 1980).

42. The obligor was not delinquent in payments on the note at the time. 391 So. 2d at 854.

43. The opinion observes that a different case is presented where the holder consents to removal of collateral from the state. See *Glass v. McLendon*, 66 So. 2d 369 (La. App. 2d Cir. 1953).

ELECTRONIC FUND TRANSFER SYSTEMS

Customer Liability for Unauthorized Transfers

Congress acted in 1978 to protect those bank customers who utilize the electronic fund transfer system (EFTS) offered by virtually all banks. In theory the customer's risks are slight, since an unauthorized withdrawal from the customer's account can only be effectuated by one who not only has the customer's EFTS card but also knows the customer's "personal identification code" (PIC). In imposing limits on customer liability for unauthorized electronic transfers,⁴⁴ Congress was apparently concerned that very human (but very negligent) acts, such as keeping the EFTS card and the PIC in the same wallet, purse, briefcase or drawer would permit one's life savings to evaporate at the hands of a rascal. If *Judd v. Citibank*⁴⁵ is a reliable indication of unauthorized electronic fund transfer litigation, the concern was unnecessary. According to the customer's version of the facts, no one was authorized by her to use her card, nor was her PIC either revealed to anyone or ever written down. Furthermore, the customer produced evidence that she had not been at the bank on the occasions during which the disputed withdrawals had been made. According to the bank's evidence, only someone possessing both her card and her PIC could have made the withdrawals; and the bank's employees were shown to have no retrieval access to the computer and could not have obtained the PIC for her account. It would be difficult to imagine a better example of human-versus-machine credibility. The court in the *Judd* case sided with the human, awarding her the amount of the disputed withdrawals.⁴⁶

The *Judd* opinion placed on the bank the burden of proof that the transfer was authorized, consistent with, but without express reliance on, 12 U.S.C. § 1693g(b).⁴⁷ Once a transfer is classified as "unauthorized" Congress has mandated that the liability of a consumer:⁴⁸

In no event . . . shall . . . exceed the lesser of (1) \$50; or (2) the amount of money . . . obtained in such unauthorized electronic fund transfer prior to the time the financial institution is

44. 15 U.S.C. § 1693g (Supp. 1978).

45. 435 N.Y.S.2d 210 (N.Y. City Civ. Ct. 1980).

46. The opinion stresses that the bank's own witness testified to various physical malfunctions in the bank's system. 435 N.Y.S.2d at 212.

47. The cited section places the burden of proof on the financial institution to show that the transfer was authorized.

48. For purposes of section 1693g, a consumer means a natural person. 15 U.S.C. § 1693a(5) (Supp. 1978).

notified of, or otherwise becomes aware of, circumstances which lead to the reasonable belief that an unauthorized electronic fund transfer involving the consumer's account has been or may be effected.⁴⁹

The success of banks in cases such as *Judd* depends on proof that the disputed transfer was authorized; and the *Judd* case makes the possibility of such success somewhat remote.

49. 15 U.S.C. § 1693g(a) (Supp. 1978). Cf. 15 U.S.C. § 1643(a)(1) (Supp. 1970) (liability of credit card holder for unauthorized use).