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THE BANK—CUSTOMER RELATIONSHIP

Contractual Stipulations That Vary the Effect of the U.C.C.

The checking account contract between a bank and its customer obligates the bank to pay sums out of the customer's account only to the extent that the bank follows the "order" of the customer to pay, embodied in the checks he issues. Section 4-401 of the Commercial Laws of Louisiana[1] indicates that a bank may charge against the customer's account a "properly payable" item,[2] and the negative implication is that any order not the act or responsibility of the customer is not properly payable and therefore may not be charged to the customer's account. The principle of section 4-401 is traceable to the ancient case of *Hall v. Fuller*,[3] in which the drawer's order to pay three pounds was altered so as to read "two hundred pounds" and paid in the altered amount. The drawee was required to repay the drawer one hundred and ninety-seven pounds. Because the rule of *Hall v. Fuller* and section 4-401 rests upon a contractual basis[4] rather than a "reasonably prudent banker" basis, the drawee bank today may not charge the customer's account even on items in which the not properly payable status is impossible to detect. Unauthorized drawer signatures, unauthorized holder indorsements, and skillful alterations are examples of such items.

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1. LA. R.S. 10:4-401 (Supp. 1974).

2. "Item" 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." Personal checks, bank drafts, cashier's checks, notes, and even nonnegotiable instruments are "items."

3. 5 B. & C. 750, 108 Eng. Rep. 279 (K.B. 1826).

4. In holding that the bank could only charge three pounds against the drawer's account, the court stated,

> The banker, as the depository of the customer's money, is bound to pay from time to time such sums as the latter may order. If, unfortunately, he pays money belonging to the customer upon an order which is not genuine, he must suffer, and to justify the payment, he must show that the order is genuine, not in signature only, but in every respect. This was not a genuine order, for the customer never ordered the payment of the money mentioned in the check.

5 B. & C. at 757, 108 Eng. Rep. at 282.

The apparently unforgiving nature of the rule of *Hall v. Fuller* is tempered somewhat by sections 1-102(3) and 4-103(1) of the Commercial Laws,[5] by which the effect of the Commercial Laws may be varied by agreement.[6] The freedom of contract inherent in sections 1-102(3) and 4-103(1) is limited only by the following exceptions: (1) no variation is permitted whenever the Commercial Laws otherwise provide;[7] (2) the obligations prescribed by the Commercial Laws pertaining to good faith,[8] diligence,[9] reasonableness,[10] and care[11] may not be disclaimed;[12] (3) no agreement can disclaim a bank's general responsibility for its lack of good faith[13] or failure to exercise ordinary care;[14] and (4) no agreement can limit the measure of damages for any such lack or failure.[15] Within such limits, and of course within the limits of the Civil Code applicable to all contracts,[16] the bank and its customers may determine by agreement the standards by which good

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5. LA. R.S. 10:1-102(3) (Supp. 1974) provides:

The effect of provisions of this Title may be varied by agreement, except as otherwise provided in this Title and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Title may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

La. R.S. 10:4-103(1) (Supp. 1974) provides:

The effect of the provisions of this Chapter may be varied by agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

6. *See generally* Hersbergen, *The Bank—Customer Relationship Under the Louisiana Commercial Laws*, 36 LA. L. REV. 29 (1975).

7. LA. R.S. 10:1-102(3) (Supp. 1974). Given the adoption in Louisiana of only articles 1, 3, 4 and 5 of the U.C.C., the exception in question is of little present relevance, since the only examples of an "otherwise provided" exception occur in LA. R.S. 10:4-103(1) (Supp. 1974) itself, and impliedly in LA. R.S. 10:1-203 (Supp. 1974). The exception, however, has greater relevance to provisions of the U.C.C. not adopted in Louisiana, such as U.C.C. §§ 2-719, 9-501(3). U.C.C. § 1-102, comment 3 does point out that as a matter of drafting style, the absence of words such as "unless they otherwise agreed," occurring, for example, in LA. R.S. 10:3-201(3) (Supp. 1974) and LA. R.S. 10:3-414(2) (Supp. 1974) has no negative implication vis-a-vis § 1-102(3).

8. *See* LA. R.S. 10:1-203, 1-208, 4-108(1), 4-401(2), 4-404 (Supp. 1974).

9. *See* LA. R.S. 10:4-202, 4-301(2) (Supp. 1974).

10. *See* LA. R.S. 10:4-202(2), 4-204(1), 4-403(1), 4-406(1) (Supp. 1974).

11. *See* LA. R.S. 10:4-103(5), 4-202(1), 4-406(3) (Supp. 1974).

12. LA. R.S. 10:1-102(3) (Supp. 1974).

13. *See* LA. CIV. CODE art. 1901; LA. R.S. 10:1-203, 1-208, 4-103(1), 4-108(1), 4-401(2), 4-404 (Supp. 1974).

14. LA. R.S. 10:4-103(1). *See* statutes cited in notes 10 & 11, *supra*.

15. LA. R.S. 10:4-103(1) (Supp. 1974).

16. U.C.C. § 1-103 states: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative

faith and the exercise of ordinary care are to be measured, provided that the standards are not "manifestly unreasonable."[17]

An obvious candidate for an agreement in variance of section 4-401 is the facsimile signature produced by machine or handstamp. The facsimile signature is a convenience for the corporate officer or employee to whose lot falls the signing of numerous checks, but it does add to the bank's "properly payable" items headache.[18] In the hands of the authorized but faithless officer or employee, or of the unauthorized person, the facsimile signature can create bogus checks that are identical to authorized and properly payable ones.[19] Sections 3-405, 3-406, and 4-406 do provide protection for the bank in such situations, but a carefully drafted facsimile signature agreement may be the more prudent approach. Such an agreement was upheld in *Perini Corp. v. First National Bank of Habersham County*,[20] but a similar

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to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." The Commercial Laws deleted this section due to its reference to "concepts and terms either unknown to Louisiana or having different meaning." LA. R.S. 10:1-103, La. St. L. Inst. Comment. LA. R.S. 10:1-103 (Supp. 1974) states instead: "Unless displaced by the particular provisions of this Title, the other laws of Louisiana shall apply."

The Commercial Laws do not adopt the U.C.C. definition of "agreement," but U.C.C. § 1-205 was adopted. Obviously an "agreement" within the meaning of LA. R.S. 10:4-103 must, under LA. R.S. 10:1-103, be a valid and enforceable agreement under Louisiana law, though a course of dealing between the parties or a usage of trade may "give particular meaning to and supplement or qualify" the terms of an agreement between them. LA. R.S. 10:1-205. Comment 2 to § 4-103 reveals that within the intent of the drafters of the U.C.C., the agreement "may be direct, as between the customer and the depositary bank," or "indirect, as where the customer authorizes a particular type of procedure and any bank in the collection chain acts pursuant to such authorization," it "may be with respect to a single item," or "to all items handled for a particular customer," as for example, a "general agreement between the depositary bank and the customer at the time a deposit account is opened." Legends on deposit tickets, collection letters, and acknowledgments of items, "coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are 'agreements,'" in the U.C.C. sense of § 4-103, if they meet the tests of the definition of 'agreement.'"

17. LA. R.S. 10:4-103(1) (Supp. 1974).

18. To be within § 4-401, a check would not have to be negotiable, § 4-104(1)(g), but whether or not negotiable, it would have to be signed. Under § 1-201, "signed" includes "any symbol executed or adopted by a party with present intention to authenticate a writing."

19. Although the end product is identical, the facsimile signature will have been produced by either an authorized act or an unauthorized act; the latter situation falls within the § 3-404(1) provision that "any unauthorized signature is wholly inoperative as that of the person whose name is signed . . . ." Naturally, a signature may be made by an authorized agent. § 3-403. These provisions of chapter 3 of the Commercial Laws apply to chapter 4 bank-customer situations via § 4-102(1).

20. 553 F.2d 398 (5th Cir. 1977).

agreement did not stand up in *Cumis Insurance Society v. Girard Bank*.[21]

The Perini Corporation had adopted (presumably at the insistence of the drawee banks) a corporate resolution authorizing four banks to honor and charge Perini's account on all checks drawn in the name of the company:

> when bearing or purporting to bear the single facsimile signature of R. A. Munroe. . . . regardless of by whom or by what means the actual or purported facsimile signature thereon may have been affixed thereto, if such facsimile signature resembled the facsimile specimen from time to time filed with said banks . . . .[22]

An unknown party obtained preprinted Perini checks and either gained access to Perini's facsimile signature machine or perhaps perfected a likeness of the signature produced by the machine. Ultimately, drawee banks paid out of Perini's accounts over $1 million on seventeen checks bearing unauthorized facsimile signatures of R. A. Munroe. The Fifth Circuit ruled that Perini Corporation had no recourse against the drawee on the unauthorized signatures, in light of the facsimile signature resolution.

In *Cumis*, the bank required a corporate resolution from the drawer similar to that in *Perini*, by which Cumis Insurance Society's insured authorized Girard Bank to honor checks "bearing or purporting to bear the facsimile signature or any signature or signatures resembling the facsimile specimens . . . with the same effect as if the signature or signatures were manual signatures. . . ."[23] The Pennsylvania federal court decision provides a lesson for lawyers: the "with the same effect as if . . . manual signatures" language created an ambiguity not present in the *Perini* resolution, and it was construed favorably to the drawer, thus undermining the agreement. On the one hand, the "bearing or purporting to bear" language seemed to suggest, as in *Perini*, that the drawee was authorized to honor items produced *either* by the unauthorized use of the drawer's actual facsimile signature stamp or by a bogus facsimile signature stamp. The intent of the parties in this regard was made uncertain by the "manual signatures" language that followed, for if the facsimile signature was simply to be treated as a manual signature, the legal consequences attendant thereto would require that the drawee bear the loss caused by bogus facsimile signatures, because of section 3-404(1). Alternatively, the intent may have been to protect the bank from liability where the facsimile signature was produced by the real stamp or

21. 522 F. Supp. 414 (E.D. Pa. 1981).
22. 553 F.2d at 400.
23. 522 F. Supp. at 416.

machine but not where a bogus stamp or machine produced the facsimile signature. That construction, the more favorable of the two from the drawer's point of view, was adopted by the court, with the result that the drawee remained liable for the wrongful payment of items bearing unauthorized drawer signatures which, while "strikingly similar" to authentic facsimile signatures, were not shown to have been produced by the authentic facsimile stamp.

It seems clear from *Perini* and *Cumis* that banks can validly protect themselves from unauthorized checks produced by the authentic facsimile signature stamp or machine. The ability of a bank to gain broader protection by bringing into the agreement the nonauthentic facsimile signature item is not so clear. The *Cumis* court seemed to take the view that such an agreement, free of ambiguity, could be enforceable, but the court did not reach the issue. The Fifth Circuit's *Perini* decision likewise did not reach that issue. But having denied the drawee's protection in that regard due to the ambiguous nature of the contractual language, the *Cumis* court went on record as doubting that an agreement could validly authorize payment on *any* facsimile signature regardless of origin.[24]

Sections 4-103(1) and 1-102(3) do not sanction agreements that disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care, and an agreement which permits the honoring of items bearing any signature that "purports" to be or "resembles" the genuine facsimile signature may be viewed as an impermissible attempt by the bank to exculpate itself from the conse-

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24. *Id.* at 417. In Mercantile Stores Co. v. Idaho First Nat'l Bank, 641 P.2d 1007 (Idaho App. 1982), a former employee of the drawer obtained a quantity of unnumbered blank checks on which he traced a likeness of the drawer's facsimile signature by using carbon paper and the authentic facsimile signature from a dividend check he had received from the drawer. Ultimately the drawee honored fourteen of the bogus checks, and refused to recredit the drawer's account therefor, on the basis of an agreement by which the bank

> shall be entitled to honor and charge the drawer's account for any such checks. . . regardless of by whom or by what manner the facsimile signature thereon may have been affixed thereto if such facsimile signature resembles the facsimile specimen impressed on this resolution and the corporation signature card furnished the depository bank.

The drawer was not found to have been negligent either as a matter of § 3-406 or § 4-406. The court held that the facsimile signature agreement did not apply to the checks in litigation since the act of tracing the signature on the checks did not constitute the placement thereon of a "facsimile signature." The fact that the traced signature in fact "resembled" the facsimile specimen produced by the company's signature machine did not help the bank's case, for, while the agreements did create a standard of performance for the bank under some circumstances, it would be manifestly unreasonable to apply that standard to the facts of the *Mercantile* case. *See* § 4-103(1).

quences of its own negligence. Although it is difficult to see how a drawee could be negligent in paying checks bearing authentic but unauthorized signatures, or bearing nonauthentic signatures "strikingly similar" to the authentic facsimile signatures, the *Cumis* court makes a valid point. For example, suppose the rascal in *Cumis* had presented one of the bogus checks directly to the drawee, and in the style of the rascal in *Perini*, he had an obviously fake mustache attached to his upper lip by visible tape.[25] Despite such suspicious circumstances, the *Cumis* and *Perini* agreements would theoretically protect the bank if the check was paid. The *Cumis* court is not ready to sanction such a broadly written agreement.

There is another potential pitfall for the *Cumis* and *Perini* agreements: sections 1-102(3) and 4-103(1) permit agreements that vary the effect of the provisions of the Commercial Laws; however, the bank may not simply rewrite the legislative will. In context, the statutory norm of the Commercial Laws dictates that the risks of unauthorized drawer signatures are on the drawee, but the risks are balanced by the protection of sections 3-405, 3-406, 4-406, and the implied warranties of section 4-207(1). Banks cannot simply shift these risks to the customer in an adhesion contract. To the *Cumis* court, such a shifting of risks was precisely what the agreement sought to do. The *effect* of provisions of the law, however, can be varied by an agreement that defines standards. For instance, section 4-406 requires the customer to exercise reasonable care and promptness to examine his returned items and statement of account to discover alterations and forgeries of his name, but the standard of care and promptness is not prescribed. Accordingly, the bank, by agreement, may require that the customer notify the bank of any such forgeries or alterations within a certain period—six months, for example—and thereafter the statement of account shall be deemed accurate.[26] From this point of view, the lawyer should not place undue faith in the *Perini* decision because the agreement in question, by equating the mere use of facsimile signatures with all risks incident thereto, may be invalid.

ITEMS IN THE BANK COLLECTION PROCESS

The Payor Bank's Warranty Protection

A justification of the *Cumis* view of bank-customer agreements in variance with the U.C.C. is the broad protection of payor banks

25. 553 F.2d at 402.

26. *See* New York Credit Men's Adjustment Bureau, Inc. v. Manufacturers Hanover Trust Co., 41 A.D.2d 912, 343 N.Y.S.2d 538 (App. Div. 1973). Giving the customer a very short period in which to meet his § 4-406 obligations may be viewed not as an attempt to define the standard of care but as an impermissible attempt to shift the

therein. When a payor bank has paid an item that is not properly chargeable to the customer's account, the U.C.C. (and the Commercial Laws as a faithful adoption of it) affords the bank three defensive postures. First, the three most common examples of improperly payable items—unauthorized drawer signatures, unauthorized indorsements, and material alterations—are subject to the prescriptive, or limitation of action, period in section 4-406(4).[27] Second, the customer can be precluded under section 4-406 from asserting his unauthorized signature or an alteration if he fails to exercise reasonable care and promptness in examining the periodic statement of account and returned items and in discovering and notifying the bank of such unauthorized signatures or alterations.[28] Third, the payor bank may seek the protection of sections 3-405, 3-406, or 3-407; the first section cures what otherwise would be an unauthorized indorsement on "fictitious payee" and "impostor" checks,[29] while the latter sections preclude the assertion of unauthorized signatures and material alterations by the drawer or any person "who by his negligence substantially contributes" to the alteration or to the making of the unauthorized signature.

Whenever the payor bank successfully assumes one of the three defensive postures, the drawer's demand for a recrediting of his account for the improperly payable item is avoided and the loss is

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entire risk to the customer, while in effect exculpating the bank from the consequences of its own negligence. *See* State *ex rel.* Gabalac v. Firestone Bank, 46 Ohio App. 2d 124, 346 N.E.2d 326 (1975).

27. 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 discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.

LA. R.S. 10:4-406(4) (Supp. 1974).

28. *See* § 4-406(1), (2). The customer is not required by § 4-406 to exercise reasonable care to discover unauthorized indorsements. *See* Hersbergen, *Developments in the Law, 1979-1980—Banking Law*, 41 LA. L. REV. 313, 332-34 (1981).

29. (1) An indorsement by any person in the name of a named payee is effective if
(a) an impostor by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee; or
(b) a person signing as or on behalf of a maker or drawer intends the payee to have no interest in the instrument; or
(c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.
Nothing in this Section shall affect the criminal or civil liability of the person so indorsing.

LA. R.S. 10:3-405 (Supp. 1974).

shifted to the drawer-where it may very well come to rest.[30] However, an alternative to these defensive postures is provided by the Commercial Laws. Under section 4-207, the payor bank that pays an item is protected by the implied warranties of the collecting bank that it has good title to the item, that it has no knowledge that the drawer's signature is unauthorized, and that the item has not been materially altered. As a reflection of the ancient rule of *Price v. Neal*[31] that the drawee is in the better position to know when the signature of the drawer is unauthorized, the warranty of "no knowledge" on the part of a collecting bank is virtually meaningless. The warranties with respect to title and alterations, by contrast, are potent protections for the drawee-payor bank. Still, there are some pitfalls to be avoided by a payor bank: section 4-207(1) protects only a "good faith"[32] payor who claims his warranty protection within a reasonable time after he learns of the breach[33] and who is willing to assert his defensive postures against the drawer-customer.[34] The question of what constitutues a "reasonable time" within which to claim a section 4-207 warranty involves the same basic considerations that determine the reasonableness of the time of presentment of demand instruments.[35] Thus, quite lengthy delays in claiming the warranty protection will not necessarily defeat the payor's claim, and certainly that is so if

30. The drawer has been permitted to sue a collecting bank for negligence and for breach of warranty, but the collecting bank should in such an action be permitted to assume the same basic defensive postures afforded the drawee. *See* Perini Corp. v. First Nat'l Bank of Habersham County, 553 F.2d 398 (5th Cir. 1977); Sun 'N Sand, Inc. v. United California Bank, 21 Cal. 3d 671, 582 P.2d 920 (1978). Louisiana courts have not as yet ruled on the viability of the drawer's warranty actions. In Koerner & Lambert v. Allstate Ins. Co., 374 So. 2d 179 (La. App. 4th Cir. 1979) (permitting a negligence action against the drawer), the drawer alleged in defense of a claim against it that the claimant had breached the warranty of good title under LA. R.S. 10:3-417(1), but the drawer's own negligence precluded it under LA. R.S. 10:3-406 from raising the unauthorized payee signature essential to the warranty of title allegation. The case is discussed in Hersbergen, *supra* note 28, at 334-38. Under *Sun 'N Sand*, the court would be required to hold that the drawer is either an "other payor who . . . pays . . . the item" under § 4-207(1) or "a person who . . . pays" under § 3-417(1). Because LA. R.S. 10:4-202(1) requires that a collecting bank use ordinary care in handling an item, a negligence action by the drawer seems a distinct possibility; Louisiana courts have not as yet faced this issue.

31. 3 Burr. 1354, 97 Eng. Rep. 871 (1762).

32. The meaning of good faith under § 4-207(1) has not been tested in the courts, but presumably the definition under LA. R.S. 10:1-201 of "honesty in fact in the conduct or transaction" would translate in the § 4-207(1) context as "no actual knowledge" of an unauthorized signature or material alteration. *Cf.* Aetna Cas. & Sur. Co. v. Traders Nat'l Bank & Trust Co., 514 S.W.2d 860 (Mo. App. 1974) (issue pretermitted by a stipulation between the payor and the collecting bank).

33. LA. R.S. 10:4-207(4) (Supp. 1974).

34. LA. R.S. 10:4-406(5) (Supp. 1974).

35. LA. R.S. 10:3-503(2) (Supp. 1974).

no damage has resulted from the delay. An example of unreasonable delay under section 4-207(4) is found in *Home Indemnity Co. v. First National Bank.*[36] Home Indemnity, an insurance company, issued its claim payment drafts "payable through"[37] Hartford National Bank. One such draft was issued on July 19, 1977, in the amount of $18,000, payable jointly[38] to Mary Taylor and Howard Lidov, her lawyer. On July 23, 1977, one Will Loyd deposited the draft for collection in his account at First National Bank, having apparently forged the signatures of both Taylor and Lidov. First National accepted the draft for deposit on the condition that no withdrawals be made therefrom for two weeks. On July 26, Hartford National Bank received the draft from First National and forwarded it to Home Indemnity. On the same day, Lidov advised Home Indemnity of nonreceipt and the decision was made to issue a "stop payment order."[39]

On August 2, the stop order was issued by Home Indemnity's Chicago claims office, but, inexplicably, it was not received by the principal office in New York until August 8. On August 11, the New York office determined that payment could be stopped; this was a mistake, as the draft had been paid on or shortly after July 26. Taylor had informed Home Indemnity on August 29 that her signature was forged, and Home Indemnity contacted First National about the forgery on September 9. On September 26, Home Indemnity obtained from Taylor an affidavit of forgery and formally presented it to First National. Loyd had withdrawn the entire $18,000 on August 8 and 9.

Through the series of delays that began on July 26, First National was kept in the dark for six weeks. "In the light of modern methods of communication with the availability of immediate electronic and telephonic transmission of information," said the Seventh Circuit, "the district court was warranted in finding the delay unreasonable *as a matter of law.*"[40]

Although some decisions have implied that a payor has no duty to inform the warrantor of a probable forgery until an affidavit of forgery is obtained,[41] the Seventh Circuit rejected that notion as un-

36. 659 F.2d 796 (7th Cir. 1981).

37. *See* LA. R.S. 10:3-120 (Supp. 1974).

38. *See* LA. R.S. 10:3-116 (Supp. 1974).

39. Technically, Home Indemnity could not issue a stop order on a "payable through" draft since Hartford National Bank, under § 3-120, could not have paid it without consultation with Home Indemnity; stated otherwise, the payable through draft was not an "item payable for" Home Indemnity's account under § 4-403. In the nontechnical sense, the message to Hartford would no doubt have been clear and obeyed.

40. 659 F.2d at 799 (emphasis added).

41. *See* Twellman v. Lindell Trust Co., 534 S.W.2d 83, 99 (Mo. App. 1976).

founded in the U.C.C. and likely to defeat the purpose of section 4-207 to encourage prompt notification of forgeries. According to the Seventh Circuit, a payor's notification duty can be based on an agent's knowledge that the instrument has been paid, although not ever received by the payee. Whether or not Home Indemnity's duty was violated as early as July 26, when it first obtained knowledge of the fraud, to the Seventh Circuit, the duty certainly was violated when Home Indemnity failed to notify First National by August 8.

In *Clarkson v. Selected Risks Insurance Co.*,[42] the payor learned of a probable forged payee signature on December 21, 1977, and immediately notified the drawer, Selected Risks, but did not notify the collecting bank until February 24, 1978. Requesting verification prior to taking action was not unreasonable, said the court, but delaying that request for more than a month was unreasonable. However, the account in question at the collecting bank had contained only insignificant funds after September of 1977, and in any event the rascal was a lawyer, hence the account funds were held by him in trust and thus beyond the collecting bank's right of set-off. That being so, the delay caused no loss to the collecting bank.

A delay of seventy-seven days in notifying the collecting bank of a material alteration was held to be unreasonable in *First National Bank of St. Paul v. Trust Co. of Cobb County*,[43] but the court concluded that the delay had no effect on the collecting bank, as a notification within ten days (which the court said would have been "well within the boundaries of reasonable notice") would have found the accounts in question with only negligible funds.

The defensive postures of sections 3-406, 3-407, and 4-406 are not necessarily seen by payor banks as alternatives to the section 4-207 warranty action against the collecting bank. When it is the "good" customer who would absorb a loss caused by rascality, the payor bank would no doubt agonize a bit before asserting sections 3-405, 3-407, and 4-406.[44] In recognition of this fact of commercial life, section 4-406(5) declares that "[i]f 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 that claim or fails upon request (of the collecting

42. 170 N.J. Super. 373, 406 A.2d 494 (Law Div. 1979).

43. 510 F. Supp. 651 (N.D. Ga. 1981).

44. A payor bank is more likely to assert § 3-405 against the good customer because if it does not, the collecting bank can avoid the warranty of title breach by asserting that section itself. *See* Perini Corp. v. First Nat'l Bank of Habersham County, 553 F.2d 398 (5th Cir. 1977); Girard Bank v. Mount Holly State Bank, 474 F. Supp. 1225 (D.N.J. 1979). The facsimile signature agreement and similar exculpatory agreements are asserted for the same reason: there is no meaningful warranty from the collecting banks beyond those of good title and material alterations.

bank, presumably) to assert the defense, the payor bank may not assert against any collecting bank or other prior party a claim based upon the unauthorized signature or alteration which gives rise to the customer's claim. Obviously affected by section 4-406(5) is the section 4-207(1) warranty claim, but presumably the payor bank's section 4-407 subrogation rights[45] are also affected.

In view of the similarity of the underlying facts, it is not totally clear why the section 4-406 defensive posture may not be waived by the payor bank, while the sections 3-406 and 3-407 defensive postures apparently may be waived, without prejudice to the payor bank's warranty claim. Comment 7 to section 4-406 admits that, "[a]lthough the principle of subsection (5) might well be applied to other types of claims of customers against banks and defenses to these claims," the rule itself is limited to defenses of a payor bank under this section and "no present need is known to give the rule wider effect."

Just as it is surely tempting for a payor to waive defenses against the good customer and assert instead a warranty claim against the collecting bank, it occasionally has tempted a court to let section 4-406(5)'s principle apply to defenses the payor bank may have against the drawer that do not arise "under this section." Most courts have not succumbed to this temptation,[46] including the federal district court in the 1979 case of *Girard Bank v. Mount Holly State Bank.*[47] In

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45. If a payor bank has paid an item over the stop payment order of the drawer or maker or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank shall be subrogated to the rights

(a) of any holder in due course on the item against the drawer or maker; and

(b) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(c) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

LA. R.S. 10:4-407 (Supp. 1974).

46. Mellon Nat'l Bank & Trust Co. v. Merchants Bank of New York, 15 U.C.C. Rep. Serv. (Callaghan) 691 (S.D.N.Y. 1972), Clarkson v. Selected Risks Ins. Co., 170 N.J. Super. 373, 406 A.2d 494 (Law Div. 1979), and East Gadsden Bank v. First City Nat'l Bank of Gadsden, 50 Ala. App. 576, 281 So. 2d 431 (Civ. App. 1973), view subsection 4-406(5) as limited to the defenses arising under that section. Taking a contrary view is Canadian Imperial Bank of Commerce v. Federal Reserve Bank of New York, 64 Misc. 2d 959, 316 N.Y.S.2d 507 (Sup. Ct. 1970). Other courts have implied that §§ 3-406 and 3-407 should be incorporated into § 4-406(5). *See* Stone & Webster Eng'r Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 184 N.E.2d 358 (1962); Society Nat'l Bank v. Capital Nat'l Bank, 30 Ohio App. 2d 1, 281 N.E.2d 563 (1972). *See also* Whaley, *Negligence and Negotiable Instruments*, 53 N.C.L. REV. 1, 21 (1974).

47. 474 F. Supp. 1225 (D.N.J. 1979).

deference to comment 7 to section 4-406,[48] *Girard* seems a correct decision; yet, a caveat must be mentioned: one may doubt that a payor bank waiving what it knew to be, or objectively seemed to be, a "valid defense" could be in good faith.[49] Moreover, subsection 4-406(5) and comment 7 thereto could be viewed as evidencing a legislative intent to merely insure that the section 4-406 defenses cannot be waived without prejudice to warranty claims, rather than an intent that a section 3-406 defense can be waived. In short, nothing in section 4-207 suggests, in the style of section 4-406(5), that the payor can waive the section 3-406 or section 3-407 defense without prejudice to its warranty claim. Under Louisiana Revised Statutes 10:1-103 & 10:1-106,[50] a Louisiana court might be willing to fill the gap.[51]

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48. Important to the decisions in *Mellon* and *Girard* was the history of U.C.C. sections 4-406 and 4-207. In an early draft of the U.C.C., a provision similar to that now comprising subsection 4-406(5) was included in § 4-207, so that the warranty action could not have been maintained if the payor waived defenses it had against the drawer based on delay in reporting unauthorized signatures and alterations (§ 4-406) and negligence in preparing and issuing checks (§§ 3-406, 3-407). As adopted, however, the official draft of the U.C.C. moved that provision from § 4-207 to its final resting place in § 4-406(5) and the phrase was added limiting it to § 4-406. *See Girard*, 474 F. Supp. at 1237.

49. Section 4-207(1) only requires that the payor bank *pay* in "good faith," but LA. R.S. 10:1-203 imposes a broad duty of good faith in enforcing contracts or duties. *Cf.* Seinfeld v. Commercial Bank & Trust Co., 405 So. 2d 1039 (Fla. App. 1981) (good faith in a commercial setting); C-K Enter., Inc. v. Depositors Trust Co., 438 A.2d 262 (Me. 1981) (bank cannot arbitrarily close an account).

50. Under § 1-106, the remedies provided by title 10 "shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." In the § 4-406(5) situation, the aggrieved party is the payor bank and the remedy is § 4-207(1). While the *Girard* approach to § 4-406(5) complies with the "letter" of § 1-106, it arguably offends the spirit of that section by allowing the drawer, the party at fault, to avoid a loss that he could have prevented but that the collecting bank could not have prevented. Of course, to the extent the collecting bank is at fault, § 3-406 will not aid it anyway, since the section itself requires a collecting bank seeking its protection to have observed reasonable commercial standards.

51. It can be argued that, while the relationship between the § 4-406 defenses and the § 4-207(1) warranties is a matter "displaced by the particular provisions of this Title" under § 1-103, so that the "other laws of Louisiana" do not apply, the same is not true of the relationship between the § 3-406 and § 3-407 defenses and the payor's warranty protection, thus permitting the other laws of Louisiana to apply. The case of Koerner & Lambert v. Allstate Ins. Co., 374 So. 2d 179 (La. App. 4th Cir. 1979), for example, permitted a party in the position of a collecting bank to sue a drawer on the theory that the check had been issued negligently, causing the plaintiff loss (the debiting of plaintiff's account by the depositary bank, presumably by virtue of warranties made by plaintiff as a customer-depositor). The court did not characterize the action as a § 1-103 matter and erroneously referred to § 3-406.

Another feature of Louisiana law that might bear on a *Girard* case is unjust enrich-

THE REGULATION OF "BANKING ACTIVITIES"

Banking is a business of delineated powers. Title 6 of the Louisiana Revised Statutes, section 237, declares that "banking associations have the following powers, those incidental to the exercise of these powers, *and no others*." There then follows a listing of banking powers such as receipt of deposits, the making of loans, the accepting of drafts drawn by customers, and the discounting of commercial paper. Chapters 3 and 4 of title 10 (the Louisiana U.C.C.) and chapter 2 of title 9 (the Louisiana Consumer Credit Law) of the Revised Statutes add certain rights and responsibilities to those delineated powers without actually adding any new powers. Banking activities within the meaning of section 237 are subject to the supervision and regulation of the Commissioner of Financial Institutions.[52] The Commissioner's bailiwick is significant for at least this issue: the provisions of the Louisiana Unfair Trade Practices and Consumer Protection Law[53] do not apply to "actions or transactions subject to the jurisdiction [of the Commissioner of Financial Institutions]." This exemption presumably means that allegations of unfair practices cannot be made under the trade practices act when the action or transaction in question comes within section 237 of title 6, or when the action or transaction comes within the Louisiana Consumer Credit Law,[54] over which the commissioner also has jurisdiction.[55]

The relationship between the commissioner's jurisdiction and the Unfair Trade Practices Act was before the fourth circuit in *Bank of New Orleans & Trust Co. v. Phillips*.[56] The bank arguably utilized the unfair practice of intentionally filing suits, to collect amounts owing by its VISA credit card holders, in the wrong (and presumably inconvenient) venue. The *Phillips* decision ruled that the unfair practices action could be maintained by the cardholder, since bank credit card transactions are not within the jurisdiction of the Commissioner of Financial Institutions because: 1) the repeal of Louisiana Revised Statutes 6:965-969 by Act 466 of 1974 removed bank credit card transactions from the jurisdiction of the Commissioner of Financial Institutions, and 2) in any event, in conducting credit card transactions a

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ment, LA. CIVIL CODE art. 1965, for clearly the drawer is enriched at the expense of the collecting bank in a *Girard* situation. The scope of article 1965 is discussed in Edmonston v. A-Second Mortgage Co. of Slidell, 289 So. 2d 116 (La. 1974).

52. *See* LA. R.S. 6:1 (Supp. 1972), 6:151 (Supp. 1976), & 6:168 (Supp. 1977).

53. LA. R.S. 51:1401-1418 (Supp. 1972).

54. LA. R.S. 9:3510-3571 (Supp. 1972).

55. LA. R.S. 9:3554-3555 (Supp. 1972).

56. 415 So. 2d 973 (La. App. 4th Cir. 1982).

bank is not acting as a bank but rather as a commercial credit card company.[57] The fourth circuit is wrong on both counts. In the first place, the provisions of Louisiana Revised Statutes 6:965-969 were added to title 6 by section 15 of Act 454 of 1972 (the Consumer Credit Law), as parallel provisions to certain provisions of title 9 simultaneously enacted and designated as Louisiana Revised Statutes 9:3532, 9:3533, & 9:3534. By these parallel provisions, certain limits were placed on negotiability, negotiation, and holder in due course status regarding retail installment contracts, notes, instruments or other evidences of indebtedness executed by a consumer. Neither sections 3532-3534 of title 9, nor sections 965-969 of title 6 concerned bank credit card transactions. When Act 466 of 1974 repealed sections 965-969 of title 6, the legislature thus said nothing helpful to the court's opinion in *Phillips*.

As a matter of fact, the true legislative history of bank credit cards unquestionably places such transactions within the jurisdiction of the commissioner. By Act 24 of the 1968 extra session, the legislature added to title 6 certain provisions regulating bank credit card transactions and providing for interest and other allowable charges.[58] These provisions were also repealed as part of the enactment of the Consumer Credit Law, under Act 454 of 1972.[59] But, far from removing bank credit card transactions from the commissioner's jurisdiction, Act 454 places such transactions within the commissioner's jurisdiction, to the extent that the card transaction is a "consumer credit transaction."[60]

The court also seems to believe that credit card transactions are not within the realm of "banking." A credit card transaction, however, is simply a preconceived tripartite method of financing purchases which contemplates the making of loans on an open-end or revolving

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57. In the words of the court:

> While banks are generally regulated by the State Banking Commissioner, this particular transaction is not. In the instant case, BNO is not acting as a bank, but rather as a commercial credit card company. This fact was recognized by the legislature in 1974. Prior to that time, R.S. 6:965-969, dealing with revolving loan plans and retail installment contracts, were placed in Chapter 6 of the Revised Statutes and placed under the jurisdiction of the State Banking Commissioner. Those provisions were repealed by Acts 1974, No. 466 § 3. Thus, bank credit card transactions are no longer within the jurisdiction of the State Banking Commissioner. Accordingly, the exception contained in R.S. 51:1406 does not apply and the Unfair and Deceptive Trade Practices Act does apply.

415 So. 2d at 975.

58. Act 24 was designated as LA. R.S. 6:1081-1084 & 6:1101-1102.

59. 1972 La. Acts, No. 454, § 4.

60. *See* LA. R.S. 9:3516(7), (11), (13), (18), 9:3524, 9:3554, 9:3555 (Supp. 1972).

basis. The making of loans fits rather nicely into Louisiana Revised Statutes 6:237.

Does the flawed nature of the *Phillips* opinion undermine the result reached by the court? It does not. The exemption of Louisiana Revised Statutes 51:1406 does not give a bank carte blanche to commit unfair trade practices. A bank cannot employ "bait and switch" schemes or other unfair or deceptive advertising methods and then hide behind section 1406; neither can it utilize unfair collection techniques with impunity. When a bank employs such unfair trade practices it is an advertiser and creditor which happens incidentally to be a bank.[61] All that is meant by section 1406 is that an unfair trade practices action cannot be premised upon a bank's consumer loan charges or its methods of computing those charges or rebates of those charges, for such matters are within the jurisdiction of the Commissioner of Financial Institutions, in his role as administrator of the Consumer Credit Law. The same may be said of the bank's contacts to various persons in its collection efforts; section 3562 regulates such contacts, and therefore such may not form the premise of an unfair trade practices suit.

The relationship between the banking powers as outlined in title 6, section 237, and the powers of a creditor under the Louisiana Consumer Credit Law was a determining factor in *Bank of Winnfield & Trust Co. v. United States*.[62] The Bank of Winnfield had, during the 1973 and 1974 tax years, made credit life insurance available to its customers through an affiliated corporation,[63] and had not treated as its own the income derived therefrom.[64] Federal law prohibits a national bank from selling insurance and that fact had influenced the 1972 decision of the United States Supreme Court in *Commissioner v. First Security Bank of Utah*[65] (a case involving facts virtually iden-

61. In Gerasta v. Hibernia Nat'l Bank, 411 F. Supp. 176 (E.D. La. 1975), the federal court ruled on an alleged violation of the Louisiana Unfair Trade Practices and Consumer Protection Act by a bank, giving no indication of the possible relevancy of LA. R.S. 51:1406.

62. 540 F. Supp. 219 (W.D. La. 1982).

63. Premiums paid by those customers choosing to purchase credit life insurance would be deposited by bank officials into a checking account maintained at the bank by Black Cat Corporation, the four sole-shareholders of which were also the controlling shareholders of the bank.

64. Black Cat Corporation would transfer 40% of the premium deposited to the insurer, paying the remainder to the four shareholders of Black Cat, who reported the premium income on their individual tax returns (Black Cat having elected Subchapter S status under the Internal Revenue Code).

65. 405 U.S. 394 (1972).

tical to those in *Bank of Winnfield*) that such income was not properly to be allocated to the bank. If Louisiana law similarly prohibited a state bank from engaging in the sale of insurance or the receipt of insurance commissions, the bank could expect a result similar to that of the *First Security Bank* case. The sale of insurance (or the receipt of commissions therefrom) is not among the banking powers of Louisiana Revised Statutes 6:237, but the Louisiana Consumer Credit Law permits an extender of credit[66] under that law to sell credit insurance.[67] The federal court, however, was not willing to let that legislation add *sub silentio* to the expressly limited powers of Louisiana Revised Statutes 6:237.[68]

Banks and other extenders of credit making loans which do not meet the definition of a "consumer loan" under the Louisiana Consumer Credit Law,[69] or which are excluded from the application of that law,[70] are permitted to stipulate that the transaction is subject to the provisions of the Consumer Credit Law.[71] One reason to so stipulate is to gain a higher permissible rate of charge for certain categories of loans. The finance company lender in *Caffey v. People Mortgage & Loan of Shreveport, Inc.*[72] had not so stipulated—at least in specific and express language—but had contracted for an interest rate which, while higher than that permitted by Louisiana Revised Statutes 9:3503,[73] was apparently within the permissible bounds of the Consumer Credit Law. The lender unsuccessfully argued that the stipulation necessary to bring the credit law to bear on loans not within the credit law need not be expressly written into the transaction, but could in effect form a part of the contract based on the borrower's knowledge that the lender was a finance company governed by the credit law and the expectation the borrower therefore must have had that he would be charged rates permitted by the credit law. Such a ruling, of course, would blow a large-size hole in usury laws such

66. LA. R.S. 9:3516(16) (Supp. 1972).

67. LA. R.S. 9:3542-3550 (Supp. 1972 & 1980). Subsection 3550(c) does require that an insurance premium financer obtain a license from the commissioner.

68. The opinion observes that in the *First Security Bank* case, the United States Supreme Court had distinguished between "selling" insurance and "making available" insurance. 540 F. Supp. at 221 n.6. *See also First Security Bank*, 405 U.S. at 402 n.16.

69. LA. R.S. 9:3516(11), (13).

70. LA. R.S. 9:3512.

71. LA. R.S. 9:3514.

72. 408 So. 2d 1153 (La. App. 2d Cir. 1981).

73. Before Act 205 of 1979, LA. R.S. 9:3503 stated that "the amount of simple conventional interest on obligations bearing interest from date and secured . . . by a mortgage on immovable property shall not exceed ten per cent per annum."

as Louisiana Revised Statutes 9:3501,[74] and that fact was well understood by the second circuit. The summary judgment ordering forfeiture under section 3501 was affirmed.[75]

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74. "Any contract for the payment of interest in excess of that authorized by law shall result in the forfeiture of the entire interest so contracted." LA. R.S. 9:3501 (1950).

75. *See also* Bamburg v. Lavigne, 403 So. 2d 827 (La. App. 2d Cir. 1981).