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DEVELOPMENTS IN THE LAW, 1986-1987

A Faculty Symposium

BANKING LAW

*Ronald L. Hersbergen**

BANKS AND THE LOUISIANA UNFAIR TRADE PRACTICES ACT

Section 1405 of the Louisiana Unfair Trade Practices and Consumer Protection Law[1] declares "unfair or deceptive acts or practices in the conduct of any trade or commerce" to be unlawful; however, section 1406(1) of the law exempts from that prohibition "[a]ctions or transactions subject to the jurisdiction of . . . the state bank commissioner . . . and any bank chartered by or under the authority of the United States acting under statutory authority of this state or the United States to regulate unfair or deceptive trade practices."[2] Because the quoted language falls short of clarity, state banks have asserted exempt status under the Unfair Trade Practices Act in at least four reported cases.

In a case discussed in a prior symposium article,[3] the Bank of New Orleans asserted section 1406 in defense to the claim of one of its credit cardholders that the bank's knowing act of filing collection suits in a venue inconvenient to the cardholder-debtor was "unfair" within the meaning of the Unfair Trade Practices Act.[4] The fourth circuit court

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1. La. R.S. 51:1401-1418 (1987).

2. La. R.S. 51:1405 (1987). The "state banking commissioner" is now known as the commissioner of financial institutions. La. R.S. 6:2(4), 101 (1986).

3. Hersbergen, Developments in the Law, 1981-1982—Banking Law, 43 La. L. Rev. 309, 321-25 (1982).

4. The United States Court of Appeals for the Seventh Circuit held in 1976 that

held that section 1406 of the Unfair Trade Practices Act did not exempt the bank under the particular facts involved, but did so on unconvincing grounds.[5]

In two recent Louisiana Fifth Circuit Court of Appeal decisions, the applicability to banks of section 1406 has been considered. In *State Bank of Commerce v. Demco of Louisiana*,[6] the defendant-debtor asserted in reconvention that a bank officer's letter to a third party (who owed an account to defendant) had violated section 1405, damaging defendant's business and trade reputation. Reasoning that monitoring and collecting a loan are powers "incidental to the power to loan money" under section 242 of Title 6 of the Louisiana Revised Statutes, the fifth circuit held that under section 1406, the State Bank of Commerce was exempt from the Unfair Trade Practices Act. The court's reasoning was essentially the same as that of the fourth circuit in the earlier *Bank of New Orleans* case, to wit, if the act or practice in question was the exercise of "banking" activities, no cause of action can be thereon premised under the Unfair Trade Practices Act. Such reasoning is flawed. The language of section 1406, while not without ambiguity, seems obviously to seek non-duplication of regulation of banking activities, so that if the commissioner of financial institutions has, and exercises, the power to regulate unfair or deceptive practices by banks, such banks are to be exempt from an action under section 1405.

In a subsequent decision, *First Financial Bank v. Butler*,[7] the fifth circuit has applied the "non-duplication" view of section 1406, rather than the "banking activities" view, in determining the applicability of section 1406 to a federally chartered savings and loan institution.[8] Such

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the Federal Trade Commission could enjoin consumer-debt collection suits brought in inconvenient forums against out-of-state consumers. Spiegel, Inc. v. Federal Trade Comm'n, 540 F.2d 287 (7th Cir. 1976). Because an act violative of the FTC Act of 1914 is presumptively violative of the Louisiana Unfair Trade Practices Act, see Guste v. Demars, 330 So. 2d 123 (La. App. 1st Cir. 1976); Moore v. Goodyear Tire & Rubber Co., 364 So. 2d 630 (La. App. 2d Cir. 1978), the crucial issue in the *Bank of New Orleans* case was the applicability of the Unfair Trade Practices Act to a bank.

5. Bank of New Orleans & Trust Co. v. Phillips, 415 So. 2d 973 (La. App. 4th Cir. 1982), criticized by Hersbergen, supra note 3, at 321-23.

6. 483 So. 2d 1119 (La. App. 5th Cir. 1986).

7. 492 So. 2d 503 (La. App. 5th Cir. 1986).

8. The United States Court of Appeals for the Fifth Circuit took a similar view of section 1406 in Lamarque v. Massachusetts Indem. & Life Ins. Co., 794 F.2d 197 (5th Cir. 1986), in holding that an unfair trade practice claim against an insurer was not excluded because the insurance commissioner's regulatory power is not distinct from section 1405. But see Comeaux v. Pennsylvania Gen. Ins. Co., 490 So. 2d 1191 (La. App. 3d Cir. 1986) (the failure of an insurer to pay uninsured motorist proceeds was held exempt as an "action or transaction" subject to the jurisdiction of the insurance commissioner).

institutions are under the regulatory authority of the Federal Home Loan Bank Board, which agency has and exercises the authority to issue rules prohibiting unfair or deceptive acts or practices by institutions within its jurisdiction.[9]

The Louisiana Supreme Court has now taken the perfunctory "banking activities" view of section 1406. The decision on point, *Scott v. Bank of Coushatta*,[10] neither cites to nor discusses the "non-duplication" view of the *Butler* case. Thus, unless the Commissioner of Financial Institutions exercises his jurisdiction to regulate deceptive and unfair acts or practices by banks, such acts or practices will be unregulated. The supreme court should reconsider what the legislature intended by section 1406; for its part, the legislature should restate that intent with clarity. Virtually every state has some form of deceptive practices act, most of which contain an exemption provision similar to section 1406. The relatively few decisions from the other jurisdictions on the issue tend to support the non-duplication view.[11]

The Bank-Customer Relationship

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

The ability of banks to contractually vary the effect of the provisions of Title 10 of the Louisiana Revised Statutes (the "Commercial Laws") has been noted in a prior issue of this publication.[12] Although not without limits, there is considerable latitude afforded by Louisiana Revised Statutes 10:1-102(3) and 4-103(1) for variation by agreement. One obvious provision that a payor bank may wish to vary is Louisiana Revised Statutes 10:4-302(a), under which a payor bank is "accountable"

9. 15 U.S.C. § 57a(f) (1982). See also NCNB Nat'l Bank v. Tiller, 814 F.2d 931 (4th Cir. 1987).

10. 512 So. 2d 356 (La. 1987).

11. NCNB Nat'l Bank v. Tiller, 814 F.2d 931 (4th Cir. 1987); Matanuska Maid, Inc. v. State, 620 P.2d 182 (Alaska 1980); State v. O'Neill Investigations, 609 P.2d 520 (Alaska 1980); In re Real Estate Brokerage Antitrust Litig., 95 Wash. 2d 297, 622 P.2d 1185 (1980); State v. Reader's Digest Ass'n, 81 Wash. 2d 259, 501 P.2d 290 (1972); State v. Sterling Theatres Co., 64 Wash. 2d 761, 394 P.2d 226 (1964); Tokarz v. Frontier Fed. Sav. & Loan Ass'n, 33 Wash. App. 456, 656 P.2d 1089 (1983). The Washington Consumer Protection Act does not apply to "actions or transactions otherwise . . . regulated under laws administered by the insurance commissioner . . . or . . . any other regulatory body. . . ." Wash. Rev. Code Ann. § 19.86.170 (1978). The Alaska Unfair Trade Practices and Consumer Protection Act exempts an "act or transaction regulated under laws administered by the state, by a regulatory board or commission . . ., unless the law regulating the act or transaction does not prohibit the practices declared unlawful [by the Consumer Protection Act]." Alaska Stat. 45.50.481 (1986).

12. See Hersbergen, supra note 3, at 309-14. See generally Hersbergen, The Bank-Customer Relationship Under the Louisiana Commercial Laws, 36 La. L. Rev. 29 (1975).

for the face amount of any demand item (other than a documentary draft), whether properly payable or not, retained beyond the midnight deadline.[13] The liability of a payor bank under section 4-302 is virtually absolute.[14] Such a variance agreement may take the form of a clearing house agreement providing for an extended midnight deadline on all items presented through the clearing house,[15] or a simple agreement between the depositor-holder and the drawee-payor bank by which a particular item can be held beyond the midnight deadline without accountability,[16] or, as in *Springhill Bank & Trust Co. v. Citizens Bank*

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13. The accountability of a payor bank under La. R.S. 10:4-302(a) has been discussed in two prior symposium articles. See generally Hersbergen, Developments in the Law, 1982-1983—Banking Law, 44 La. L. Rev. 247, 253-61 (1983); Hersbergen, Developments in the Law, 1979-1980—Banking Law, 41 La. L. Rev. 313, 323-30 (1981).

14. A collecting bank (La. R.S. 10:4-105 (1983)) which fails to abide by its midnight deadline faces liability in the nature of a negligence action, see La. R.S. 10:4-202 (1983); a payor bank holding an item beyond its midnight deadline is *accountable* under La. R.S. 10:4-302 (1983). The difference can be seen in Marcoux v. Van Wyk, 572 F.2d 651 (8th Cir. 1978), in which a collecting bank did hold sight drafts beyond its midnight deadline, but in circumstances clearly suggesting that the drawer-creditors were dealing with an insolvent drawee; thus, even had the collecting bank observed its midnight deadline and timely returned the drafts, the drawer-creditors' loss would not have been thereby avoided. Had those creditors deposited demand checks of the debtor, which were held beyond the midnight deadline by the drawee-payor bank, the fact of the drawer-debtor's insolvency would have been irrelevant. See, e.g., Bank Leumi Trust Co. v. Bank of Mid-Jersey, 499 F. Supp. 1022 (D.N.J. 1980), aff'd, 659 F.2d 1065 (3d Cir. 1981); Whalen & Sons Grain Co. v. Missouri Delta Bank, 496 F. Supp. 211 (E.D. Mo. 1980); Blake v. Woodford Bank & Trust Co., 555 S.W.2d 589 (Ky. Ct. App. 1977). There are a limited number of valid "excusing" circumstances by which the midnight deadline can be expanded. See La. R.S. 10:4-106 to 4-108 (1983).

15. See West Side Bank v. Marine Nat'l Exchange Bank, 37 Wis. 2d 661, 155 N.W.2d 587 (1968).

16. See Western Air & Refrig., Inc. v. Metro Bank, 599 F.2d 83 (5th Cir. 1979); Marfa Nat'l Bank v. Powell, 512 S.W.2d 356 (Tex. Civ. App. 1974). The depositor will typically so agree upon being informed of a current lack of sufficient funds in the drawer's account with which to pay the presented item. There is, however, a limitation on all such agreements: the object of the agreement cannot be to disclaim a bank's responsibility for failure to exercise due care. La. R.S. 10:4-103(1) (1983). Thus, where the object of the agreement is to extend the midnight deadline in an effort to obtain payment from funds or credits coming into the drawer's account during the extended period, the agreement is valid, as in the *Powell* case. Where, however, the variance agreement extends the time within which a depositary bank may "charge back" to the depositor's account an item that has been returned unpaid by the drawee-payor bank, such an agreement may be viewed as an invalid attempt to disclaim the depositary bank's responsibility to exercise due care in returning the item or sending notice of dishonor under La. R.S. 10:4-202(1)(b) (1983). See Sunshine v. Bankers Trust Co., 34 N.Y.2d 404, 314 N.E. 2d 860 (1974).

The depositing-holder or the depositary bank may also send to a drawee-payor bank an item "for collection" as opposed to "for payment," making an agreement, in essence, that the payor bank will act as a collecting bank and not be liable for failure to return an item within the midnight deadline. See Corsica Livestock Sales, Inc. v. Sumitomo

& Trust Co.,[17] an agreement between two or more banks that unpaid items may be returned on the third banking day rather than within the applicable midnight deadline.

Variance agreements are not without problems, however, as the *Springhill Bank* case reveals. For instance, the trial court found the agreement was "to the effect that either bank could return unpaid items on the third working day rather than giving notice before its midnight deadline."[18] If the two banks customarily, but for the "three day" agreement, would have merely given notice of dishonor as to unpaid items—as opposed to returning such items—prior to the midnight deadline, then the "three day" agreement was a good idea indeed, because accountability for late return of unpaid items is only avoided by the giving of notice of dishonor when the unpaid item is held for protest or otherwise unavailable for return.[19] In other words, a dishonoring payor bank does *not* have the option of returning the item, or giving notice of dishonor, prior to the midnight deadline—it must return the item whenever the item is available for return.[20]

The *Springhill Bank* case also demonstrates another (and obvious) problem of variance agreements: what items were covered by the agreement. The plaintiff collecting bank asserted that only items not paid due to insufficient funds, missing endorsements, closed accounts, or

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Bank, 726 F.2d 374 (S.D. Cal. 1983); Idaho Forest Indus. v. Minden Exch. Bank & Trust Co., 212 Neb. 820, 326 N.W.2d 176 (1982); David Graubart, Inc. v. Bank Leumi Trust Co., 48 N.Y.2d 554, 399 N.E.2d 930, 423 N.Y.S.2d 899 (1979).

17. 505 So. 2d 867 (La. App. 2d Cir. 1987).

18. Id. at 868.

19. La. R.S. 10:4-301(1) (1983).

20. A reading of La. R.S. 10:4-302 (1983) by itself does suggest the availability of such an option, for that section states that a payor bank "is accountable for the amount of . . . a demand item . . . if the bank . . . does not pay or return the item *or send notice of dishonor* until after its midnight deadline" (emphasis added). But, La. R.S. 10:4-301(1) (1983) only permits a payor bank to have the deferred posting period of a midnight deadline if it *settles* for the item before midnight of the banking day of receipt; if it does so, the payor bank may revoke that settlement, upon deciding to dishonor the item, if it has not made final payment, and if "before its midnight deadline it returns the item; or sends written notice of dishonor *if* the item is held for protest or is otherwise unavailable for return." A payor bank sending a notice of dishonor before its midnight deadline, but retaining after the midnight deadline an item "available for return" is accountable under La. R.S. 10:4-302 (1983). See United States v. Loskocinski, 403 F. Supp. 75 (E.D.N.Y. 1975); Blake v. Woodford Bank & Trust Co., 555 S.W.2d 589 (Ky. Ct. App. 1977).

A payor bank operating under a Federal Reserve Operating Circular requiring a "wire advice" of dishonor for items over a stipulated amount must do so, of course, but unless such Operating Circular itself is the equivalent of an agreement varying La. R.S. 10:4-302, such a bank would also have to return the item prior to its midnight deadline to avoid accountability under section 4-302. See La. R.S. 10:4-103(2) (1983); U.C.C. § 4-103, comment 2.

timely stop payment orders were intended to be covered, while the defendant payor bank argued that items returned for virtually any reason were within the intent of the agreement. The item in question had apparently been subjected to a stop payment order prior to completion of the payor bank's usual process of posting. Unless the variance agreement is tightly drawn, however, such a payor bank could do as the payor bank in *West Side Bank v. Marine National Exchange Bank*:[21] Make a decision to pay the item, as evidenced by the stamping of "paid" on the item, file the item in the drawer-customer's account file, then honor a stop order arriving prior to the (extended) midnight deadline, and return the item to the depository bank as an "unpaid" item. In that sense, an agreement between banks in variance of the midnight deadline should carefully distinguish between the timely return of an item as "unpaid" (for enumerated reasons) and items which although returned as "unpaid" may in fact be *deemed* paid under Louisiana Revised Statutes 10:4-213 and 4-302. Moreover, parties to such agreements should specify the procedure for handling of stop payment orders which arrive at the payor bank after all of the usual posting steps have been taken. Under the reasoning of *West Side Bank*, a payor bank can, in effect, "unpay" and return such items within its midnight deadline—a degree of payor bank power that neither party may desire the other to have.

Bank Liability For Cashier's Checks

The Louisiana Fifth Circuit Court of Appeal addressed in *First Financial v. First American Bank*[22] a commercially familiar transaction: First American issued its cashier's check[23] to First Financial in exchange for a personal check held by First Financial and drawn by a First American checking account customer. Prior to the issuance of the cashier's check, the drawer of the personal check issued—presumably not in sufficient time to be acted upon—a written stop payment order on

21. 37 Wis. 2d 661, 155 N.W.2d 507 (1968), discussed in Hersbergen, Developments in the Law, 1982-1983—Banking Law, 44 La. L. Rev. 247, 253-61 (1983).

22. 489 So. 2d 388 (La. App. 5th Cir. 1986).

23. A "cashier's check" is referred to, but not defined in La. R.S. 10:4-211(1)(b) (1983); however, it has been judicially defined as a draft drawn by a bank, as drawer, on itself as drawee. Laurel Bank & Trust Co. v. City Nat'l Bank, 33 Conn. Supp. 641, 365 A.2d 1222 (1976). By contrast, drafts drawn by one financial institution on another financial institution are referred to as "bank drafts" or "teller's checks." See Banco Ganadero y Agricola v. Society Nat'l Bank, 418 F. Supp. 520 (N.D. Ohio 1976); Malphrus v. Home Sav. Bank, 44 Misc. 2d 705, 254 N.Y.S.2d 980 (Albany County Ct. 1965).

the personal check.[24] Because the drawer's stop payment order was arguably binding under Louisiana Revised Statutes 10:4-403 and 4-303, First American found itself in a conundrum: unable to charge its customer's checking account[25] for the $1800 amount of the personal check,

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24. The drawer of the personal check informed a First American employee (presumably by telephone) on the day of issuance, Friday, May 3, that she wished to stop payment on the check, but was advised that the request to stop payment would have to be placed in writing. It is not clear from the report of the case whether the drawer would have had time that day to place her stop payment request in writing, but, for whatever reason, the drawer appeared at First American on Monday, May 6, at 9:00 a.m. and executed the written request. The written stop payment order, however, did not afford First American a reasonable opportunity to act on it prior to the exchange of the personal check for the cashier's check. See Thompson v. Lake County Nat'l Bank, 47 Ohio App. 2d 249, 353 N.E.2d 895 (1975); La. R.S. 10:4-403(1). Section 4-403(1), however, validates oral stop payment orders; thus, unless there was a valid variance agreement, the drawer's attempted oral stop order should have been deemed received on Friday, May 3—giving First American a reasonable opportunity to act on it—and the drawer's attempted oral stop order should not have been thwarted. Even if a contractual stipulation for written stop orders did exist, such a requirement can be subject to the notion of waiver by the bank. See Thomas v. Bank of Springfield, 631 S.W.2d 346 (Mo. Ct. App. 1982) (the *Thomas* case does not validate such a stipulation; the court was not required to reach that issue, in view of the evidence of waiver by the bank).

25. A timely and otherwise valid stop order renders an item "not properly payable" under La. R.S. 10:4-401 (1983). However, La. R.S. 10:4-403(1) (1983) requires that the stop order be received by the drawee-payor bank in such manner as "to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in R.S. 10:4-303." Exchanging the item for the bank's own cashier's check, however, is not necessarily an "action by the bank . . . described in R.S. 10:4-303." Had the bank certified the personal check, paid it in cash, irrevocably settled for it, completed the process of posting it, or become accountable for the amount of it under La. R.S. 10:4-213(d) or 4-302, clearly the drawer's stop payment order would have been untimely under section 4-303. Section 4-303(1)(d) does contain one "action" category that the drawee-payor bank could have plausibly asserted in refusing to honor its customer's stop order: "or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item." UCC comment 3 to section 4-303 does not preclude the argument that the issuance of a cashier's check in exchange for a personal check *is* an "action" which makes a subsequent stop order on the personal check "come too late" under subsection (1)(d), giving priority, over that stop order, to the bank's right to charge the customer's account:

> The sixth event conferring priority is stated by the language "or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item." This general "omnibus" language is necessary to pick up other possible types of action impossible to specify particularly but where the bank has examined the account to see if there are sufficient funds and has taken some action indicating an intention to pay. An example is what has sometimes been called "sight posting" where the bookkeeper examines the account and makes a decision to pay but postpones posting. The clause should be interpreted in the light of Nineteenth Ward Bank v. First Nat. Bank of South Weymouth, 184 Mass. 49, 67 N.E. 670 (1903). It is not intended to refer to various preliminary acts in no way close to a true decision of the bank to

and facing liability on an issued cashier's check in that amount. In such circumstances, First American notified First Financial of its intent not to honor the cashier's check—in essence, an anticipatory breach of its engagement on the cashier's check.[26]

Casting the case as one of first impression in Louisiana and characterizing the issue as one of a bank's ability to "stop payment" on a cashier's check, the fifth circuit affirmed the trial court's judgment in favor of the holder of the cashier's check, First Financial. While that outcome is no doubt satisfactory,[27] the opinion of the fifth circuit contains sufficient potential for misleading the reader to warrant comment.

In the first place, a bank issuing a cashier's check has no right to stop payment in the sense of section 4-403(1). That section provides that a *customer* has the right to stop, or countermand, payment of any item payable for his account. A bank issuing a cashier's check is not a "customer" within the meaning of 10:4-403,[28] and there is no other stop payment provision in Title 10. In the second place, while the fifth circuit correctly notes that the majority of the decisions across the country parrot the view of *Kaufman v. Chase Manhattan Bank, National Association*[29] that the issuance of a cashier's check constitutes an immediate *acceptance* of the check, thereby constituting a primary obligation of the issuer and foreclosing a stop order under section 4-303, such a view is merely a corollary of the basic error in analysis that

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pay the item, such as receipt of the item over the counter for deposit, entry of a provisional credit in a passbook, or the making of a provisional settlement for the item through the clearing house, by entries in accounts, remittance or otherwise. All actions of this type are provisional and none of them evidences the bank's decision to pay the item.

26. The effect of a "stop payment order" from the issuer of a cashier's check to the holder of the item would simply be to excuse any requirement that the holder thereafter present the item to the issuer, or that the holder give any notice of dishonor. See La. R.S. 10:3-511(2)(b) and (3)(b) (1983).

27. See infra text accompanying notes 33-37.

28. La. R.S. 10:4-104(e) (1983) defines "customer" so as to include a bank carrying an account with another bank, but a bank issuing a draft on itself would not come within the definition. Moreover, the issuing bank's customer likewise has no section 4-403 right to stop payment on a cashier's check, since the item is not one payable from his account. Wood v. Central Bank of the South, 435 So. 2d 1287 (Ala. App. 1982).

29. 370 F. Supp. 276 (S.D.N.Y. 1973). The *First Financial* opinion cites numerous decisions following *Kaufman*.

The *Kaufman* rationale has also been used by various courts to prevent stop payment orders on personal money orders, bank money orders and teller's checks, but there has developed a contrary line of authority on this issue. See First Nat'l Bank v. Duncan Sav. & Loan Ass'n, 656 F. Supp. 358 (W.D. Okla. 1987), and cases cited therein.

cashier's checks can be subjected to a stop order, which view is at best misleading and at worst, plainly wrong.[30]

In fact, the issuance of a cashier's check in the form set out in Louisiana Revised Statutes 10:3-104 is simply the issuance of a negotiable draft or check by a drawer, drawn on itself as drawee.[31] The issuing bank has no greater liability on the instrument than does any drawer or maker.[32] It is true, as the fifth circuit also observes, that cashier's checks are viewed by the courts and the public as substitutes for cash, but that perception is one premised not on statutory authority but rather on the solvency and honesty of banking institutions. No doubt, the Pope's personal check would enjoy a similar perception.

In most cases it matters little, however, whether a cashier's check is viewed as accepted in advance upon issuance or not, subject to stop payment or not, or a "cash equivalent" or not. Whenever an issuing bank decides to refuse payment on a cashier's check, it usually will be the loser. But this is so for the normal reasons inherent in the issuance of negotiable instruments, not because the cashier's check is some kind of mutant-hybrid instrument. If the issuing bank refuses to pay the cashier's check because its customer wishes to undo the underlying transaction,[33] that customer either has a defense against the holder of the cashier's check, or has no such defense; if the latter, there is no way for the bank to avoid payment to the holder, and if the former, there is no way the bank can assert its customer's defenses against the holder, if the holder is a holder in due course.[34]

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30. Under La. R.S. 10:4-303 (1983), acceptance of an item cuts off the drawer's right to stop payment of that item. But an "acceptance" is defined by La. R.S. 10:3-410 (1983) as the drawee's signed engagement to honor the draft as presented, and although that engagement may consist of the drawee's signature alone, as U.C.C. comment 4 to section 3-410 points out, the drawee's signature on a draft (issued by another) is sufficient for an acceptance because the drawee has no reason to sign for any other purpose. But in the issuance of a cashier's check, there is another purpose for the bank's signature— to properly execute the *order* on itself as drawer. Thus, in the absence of a *second* signature by the issuing bank, there can be no "acceptance" upon issuance of a cashier's check.

31. La. R.S. 10:3-104(2) (1983). A draft drawn on the drawer is *effective as* a note. La. R.S. 10:3-118(a) (1983).

32. See La. R.S. 10:3-413 (1983).

33. It is inferable from the customer's request that the issuing bank dishonor the cashier's check, or from the customer's stop order on the personal check exchanged for the cashier's check.

34. Under La. R.S. 10:3-306 (1983), a person without the rights of a holder in due course "takes the instrument subject to . . . all defenses of any party . . . ." Thus, an endorser may raise, as against a holder-not-in-due course, any defense the maker or drawer might have raised against the payee, including defenses "personal" to the maker or drawer. See Bush Constr. Co. v. Carr, 486 So. 2d 183 (La. App. 1st Cir. 1986); City Bank & Trust Co. v. White, 434 So. 2d 1299 (La. App. 3d Cir. 1983); Guaranty Bank

If, as in *First Financial*, the issuing bank decides for reasons of its own to refuse to pay the cashier's check, the outcome of the case will depend upon the status of the holder of the check as a holder in due course; if the holder is in due course, or has those rights from a prior transferee,[35] the bank's defense will usually be unassertable.[36] Thus, in *First Financial* the issuing bank, presumably having a failure of consideration defense or the defense of mistake, would ultimately have to pay the holder of the cashier's check, if a holder in due course. Unfortunately for issuing banks, those who take a cashier's check will typically be holders in due course.[37]

In summation, the issue raised in cases such as *First Financial* is: does either the issuing bank or its customer[38] have a right to stop payment on a cashier's check? The answer is "no" in both cases, at least in the sense of a section 4-403 stop order.[39] The issuing bank can, however, refuse to pay the cashier's check, just as a maker or acceptor may so refuse. If it does refuse, the case will be decided, as are most negotiable instruments cases, by a determination of the holder's due course status under sections 3-104, 3-202, 3-302 and either section 3-305 or 3-306.[40] To avoid such problems, the issuing bank should treat a cashier's check as a functional equivalent of a certified check, making an immediate debit to the customer's account, or treat the cashier's check as a functional equivalent of a payment in cash,[41] memorializing

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& Trust Co. v. Carter, 394 So. 2d 701 (La. App. 3d Cir.), writ denied, 399 So. 2d 599 (1981).

35. La. R.S. 10:3-201 (1983).

36. La. R.S. 10:3-305 (1983).

37. When the cashier's check has been issued to the bank's customer and thereafter transferred to a retailer or creditor, that transferee, if in good faith, will almost certainly be a holder in due course. On the other hand, where (as in *First Financial*) the cashier's check is issued directly to the merchant or creditor, the transferee's status as a holder in due course may, or may not, cut off the bank's defenses, dependent on the meaning in La. R.S. 10:3-305(2) (1983) of the language "a holder in due course . . . takes . . . free from . . . all defenses of any party to the instrument *with whom the holder has not dealt*" (emphasis added). It would seem that such a transferee as in *First Financial* has, in fact, "dealt with" the issuing bank. The decision in Travi Constr. Corp. v. First Bristol County Nat'l Bank, 405 N.E.2d 666 (Mass. App. Ct. 1980), on facts identical to those of *First Financial*, so holds.

38. The term refers, in this instance, both to a person purchasing a cashier's check by issuing his own personal check to the bank therefor, and to the bank's checking account customer who, as in *First Financial*, may be adversely affected by the act of the bank in issuing a cashier's check to the payee of the customer's personal check. By "adversely affected" is meant the possibility that such issuance may cut off the right of the customer to stop payment on his own personal check, as suggested at supra note 25.

39. See supra text accompanying notes 28-30.

40. La. R.S. 10:3-104, 3-202, 3-302, 3-305, 3-306 (1983).

41. If the personal check in *First Financial* was not postdated, there was seemingly

the right to so treat the cashier's check in the bank-customer agreement. In that way, issuance of the cashier's check would trigger the provisions of section 4-303(1)(a) or (b), thereby rendering untimely a subsequent customer stop order on the exchanged personal check. Without such an agreement, the bank is left to argue that the issuance of the cashier's check constitutes a "decision to pay" under section 4-303(1)(d).[42]

ITEMS IN THE BANK COLLECTION PROCESS

Handling and Payment of Items Not Properly Indorsed

Adoption of portions of the Uniform Commercial Code ("UCC") in 1974 did not, in general, bring substantial change to the law of negotiable instruments in Louisiana.[43] One change of substance, however, was brought about by adoption of section 3-419 of the UCC in Title 10 of the Louisiana Revised Statutes.[44] Under this section, payment of an instrument bearing a forged indorsement now makes the payor liable to the true owner.[45] The new cause of action created by section 3-419 also created a number of questions not previously addressed by Louisiana courts, including: 1) the liability, if any, of collecting banks which handle, but do not, in the normal sense of the word, "pay" forged indorsement instruments; 2) the scope of section 3-419(1)'s "true owner" label; 3) the extent of the payor's liability; 4) the defenses assertable by the payor-defendant; and 5) whether a *missing* indorsement is to be

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no reason for First Financial to exchange it for a cashier's check, as opposed to demanding a cash payment for it; therefore, one suspects the check was postdated, and if so, a certification of the check would have protected First American under section 4-303(1)(a). Alternatively, if the check was not postdated, then the issuance of the cashier's check should be viewed as a *purchase* by First Financial with the cash due to it as the holder demanding, and due, payment. So viewed, the issuance of the cashier's check would be a form of payment in cash under §4-303(1)(a).

42. See supra note 25. A UCC draftsman has written of the language "otherwise evidenced by action its decision to pay the item" that "this action must be closely related to the decision of the appropriate [bank] employee that there are sufficient funds to pay the item, not mere receipting for the item in a passbook or other preliminary acts in no way related to a true decision to pay" (emphasis omitted). Malcolm, Article 4—A Battle With Complexity, 1952 Wis. L. Rev. 265, 294. It is at least a plausible argument that the issuance of a cashier's check in exchange for a personal check would only follow such a decision to pay.

43. Louisiana adopted the Uniform Negotiable Instruments Law ("NIL") in 1904.

44. La. R.S. 10:3-419 (1983).

45. Under the rule of M. Feitel House Wrecking Co. v. Citizens Bank & Trust Co., 159 La. 752, 106 So. 292 (1925), a drawee-payor bank was liable for payment of a forged indorsement instrument only to its drawer-customer, not to the payee or other true owner whose signature had been forged. See Hersbergen, The Work of the Louisiana Appellate Courts for the 1972-73 Term—Commercial Paper, 34 La. L. Rev. 293-96 (1974).

treated as a "forged" indorsement under section 3-419(1). Satisfactory answers to these questions have emerged from decisions of the various courts of the country, which decisions Louisiana courts may find persuasive.[46] Recent Louisiana decisions have addressed some of the abovementioned questions of statutory construction.

The Louisiana First Circuit Court of Appeal addressed the meaning of "true owner" under section 3-419(1) in *Patterson v. Livingston Bank*,[47] in which the plaintiff-payee had apparently never actually possessed the check in question, although it had been mailed to him.[48] Of course, when a payee in possession of an unindorsed check loses it or it is stolen from him, he is clearly the "true owner" having a cause of action under section 3-419(1). But in the case of the payee-addressee who never received the check, or in the case of the co-payee who is neither the addressee nor the one to whom the check is delivered by the drawer, applicability of the "true owner" label is less clear. By utilizing the notion of *constructive delivery* so as to make the payee in *Patterson* the true owner of an undelivered check, the first circuit decision also suggests that a co-payee to whom a check is not delivered is likewise a true owner by constructive possession.[49] The plaintiff cannot merely allege true owner status, however; he must plead facts which show either actual or constructive possession.[50]

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46. See Hersbergen, Developments in the Law, 1980-1981—Banking Law, 42 La. L. Rev. 330-31 (1982). The decisions of other jurisdictions under a uniform 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, 87 S. Ct. 855 (1967).

47. 509 So. 2d 6 (La. App. 1st Cir. 1987). Cf. Lincoln Nat'l Bank & Trust Co. v. Bank of Commerce, 764 F.2d 392 (5th Cir. 1985) (payee whose name was placed on checks as part of a third party's fraudulent scheme was not a "true owner" where the checks were not mailed to the named payee).

48. See Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 184 N.E.2d 358 (1962).

49. Most of the decisions nation-wide permit such a co-payee to sue as a true owner. See Harry H. White Lumber Co. v. Crocker-Citizens Nat'l Bank, 253 Cal. App. 2d 368, 61 Cal. Rptr. 381 (Cal. Ct. App. 1967); Barnett Bank v. Lipp, 364 So. 2d 28 (Fla. Dist. Ct. App. 1978); Trust Co. v. Refrigeration Supplier, Inc., 241 Ga. 406, 246 S.E.2d 282 (1978); contra Burritt Mut. Sav. Bank v. Transamerica Ins. Co., 180 Conn. 71, 428 A.2d 333 (1980); Humberto Decorators, Inc. v. Plaza Nat'l Bank, 180 N.J. Super. 170, 434 A.2d 618 (N.J. Super. Ct. App. Div. 1981). Absent contrary proof, such a co-payee would be entitled to one-half of the face amount of the check. Stapleton v. First Sec. Bank, 675 P.2d 83 (Mont. 1983). Cf. Lund v. Chem. Bank, 665 F. Supp. 218 (S.D.N.Y. 1987) (signature by one co-payee where both were partners).

50. Sunbelt Factors, Inc. v. Bank of Gonzales, 481 So. 2d 648 (La. App. 1st Cir. 1985). Cf. *Lund*.

A most significant issue not expressly addressed by section 3-419(1) is whether the true owner's cause of action is prescribed by one year, as a delictual action under Louisiana Civil Code article 3492, or by five years, as an action on a negotiable instrument, under Louisiana Civil Code article 3498.[51] UCC comment 2 to section 3-419(1)—and conventional commercial law wisdom—views the section 3-419(1) action as *not* one "on" the instrument, but rather as an action in tort.[52]

In the recent past, Louisiana decisions have failed to recognize the importance of distinguishing between actions on an instrument[53] and those actions only involving an instrument.[54] In *Strother v. National American Bank*,[55] for instance, Civil Code article 3498's precursor, article 3540, was held applicable to the act of a collecting bank cashing checks contrary to a restrictive indorsement in violation of what is now Louisiana Revised Statutes 10:3-419(1). Although *Strother* was not a Louisiana Commercial Laws-Title 10 decision, it was relied on by the fifth circuit court in a Commercial Laws case, *Johnny Turcich, Jr., Inc. v. First National Bank*,[56] holding that a bank customer's complaint regarding improper payment of a stale check was within the "actions on instruments" language of what is now article 3498.[57] In 1984, relying on *Strother* and *Turcich*, the third circuit court held in *Top Crop Seed & Supply Co. v. Bank of Southwest Louisiana*[58] that the five-year limitation of article 3540, rather than the one-year period of article 3536, applied to a section 3-419(1) cause of action. The reliance

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51. The issue presents a good example of the effect of La. R.S. 10:1-103 (1983): "Unless displaced by the particular provisions of this Title, the other laws of Louisiana shall apply." Nothing in Title 10 addresses the applicable prescriptive period, although La. R.S. 10:3-122 (1983) does address the issue of the *accrual* of the cause of action.

52. The comment recognizes that the true owner's action in section 3-419(1) is an adoption of the common law *conversion* action, and that "[t]he action is not on the instrument, but in tort for its conversion."

53. That is, actions relating to an engagement of a party reflected by that party's signature, such as actions founded upon drawer, maker or acceptor engagements pursuant to section 3-413, or indorser engagements pursuant to section 3-414, and those of accommodation parties and guarantors pursuant to sections 3-415 and 3-416.

54. The transfer or presentment of an instrument is an act having liability consequences, but which does not give rise to a cause of action "on" the transferred instrument. See La. R.S. 10:3-417(1) & (2), 4-207(1) & (2) (1983). The same may be said for the cause of action under section 3-419.

55. 384 So. 2d 592 (La. App. 4th Cir. 1980).

56. 427 So. 2d 602 (La. App. 5th Cir. 1983).

57. The *Strother* and *Turcich* decisions are discussed in Hersbergen, supra note 21, at 262-64. More or less the identical issue to that in *Strother* has been decided similar in Alaska, Oregon, Missouri and California. In those states, the shorter tort action prescriptive periods have been held inapplicable to "conversion" actions. See Vest v. First Nat'l Bank, 659 P.2d 1233 (Alaska 1983), and cases cited therein.

58. 457 So. 2d 273 (La. App. 3d Cir. 1984).

was misplaced. Even if *Strother* is viewed as a defensible pre-UCC decision, it clearly would be incorrect under the Louisiana Commercial Laws enactment of the UCC; *Turcich* is likewise a questionable decision, for a failure to pay properly-payable items, or a failure to dishonor not-properly-payable items, simply creates an action for breach of the bank-customer agreement,[59] rather than an action "on an instrument." The Louisiana Supreme Court has now expressly disagreed with the *Top Crop* decision, and implicitly undermined *Strother* and *Turcich*, in *Daube v. Bruno*.[60]

Before the court in *Daube* was the same issue as in *Top Crop*: whether the section 3-419(1) action is prescribed as an article 3492 delictual action, or as an article 3498 action "on a negotiable instrument." The court not only held that section 3-419(1) authorizes a delictual action, prescriptible by one year (and that the section does not additionally authorize an action "on" the instrument), it further held that in both the fifth circuit court's decision in *Daube* and the third circuit's decision in *Top Crop*, the *concept* of an action "on a negotiable instrument" had been misunderstood. "An action on a negotiable or non-negotiable instrument, as envisioned by Civil Code art. 3498," the court explained, "is one by the holder of a note [or draft] against a defendant whose name is on the note [or draft] as maker, indorser, or in some other capacity."[61] Thus, the prescriptive period of article 3498 "applies only to actions *on* the instrument itself, those actions for the breach of the contract which the note [or draft] represents, for the payment of the note [or draft] according to its terms."[62]

The Louisiana Supreme Court has clearly and correctly distinguished between actions based on an engagement represented by a signature on an instrument and those based on ancillary claims arising in the context of an instrument, but which are not premised on some engagement reflected on the face of the instrument.[63] Although the *Daube* decision distinguishes the *Turcich* case,[64] it is clear from the court's discussion of the concept of an action on an instrument that breaches of the bank-customer contract by a drawee-payor bank appropriately fall under the ten-year prescriptive period of article 3499. The cause of action for payment over a timely stop order would be affected by the *Daube* decision, but payment of an item that bears a forgery or an alteration

59. See generally Hersbergen, supra note 12. A telling point on this issue is that the bank-customer agreement can be breached by improper handling of a *non*-negotiable instrument.

60. 493 So. 2d 606 (La. 1986). The court in *Daube* expressly overruled *Top Crop*.

61. Id. at 610.

62. Id.

63. See supra notes 53-54.

64. 493 So. 2d at 610, n.1.

is subject to the three-year prescriptive period of Louisiana Revised Statutes 10:4-406(4), and the action for wrongful dishonor has long been held in Louisiana to be delictual in nature and subject therefore to a one-year prescriptive period.[65] Bank lawyers should perhaps consider a bank-customer contractual stipulation limiting the viability of actions based on payments over valid stop orders to considerably less than ten years.[66]

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65. See Galloway v. Vivian State Bank, 168 La. 691, 123 So. 126 (1929) (allowing damages for humiliation in a wrongful dishonor case); Spearing v. Whitney-Central Nat'l Bank, 129 La. 607, 56 So. 548 (1911) (characterizing the wrongful dishonor action as one governed by La. Civ. Code art. 2315).

66. Since Title 10 does not contain a section 4-403 prescriptive provision, the use of La. R.S. 10:4-103 to "vary" the prescriptive period is problematic. UCC comment 1 to section 4-103, however, clearly favors the concept of abbreviated time limitations in general: "In view of the technical complexities of the field of bank collections, the enormous number of items handled by banks, [and] the . . . certainty of changing conditions . . ., it would be unwise to freeze present methods of operation by mandatory statutory rules." UCC section 4-406 (La. R.S. 10:4-406 (1983)) does contain a prescriptive period, in subsection four, limiting to one year the time within which a customer may sue a bank for improper payment of altered checks and checks bearing forged signatures, and limiting to three years actions involving indorsements. In New York Credit Men's Adjustment Bureau, Inc. v. Mfrs. Hanover Trust Co., 41 A.D.2d 912, 343 N.Y.S.2d 538 (App. Div. 1973), an agreement between bank and customer, limiting the time within which the customer must notify the bank of forgeries of his own name and of indorsers' names to thirty days, and six months, respectively, was upheld as "in the nature of an abbreviated period of limitations." Id. at 914, 343 N.Y.S.2d at 540. The negative implication of Civil Code article 3471 would permit a contractual shortening of a prescriptive period, particularly in view of the comments thereto. See Lester Minerals, Inc. v. California Co., 241 La. 915, 132 So. 2d 845 (1961); Note, Insurance—Validity of Contractual Limitation of Prescriptive Period—Article 3460, Louisiana Civil Code of 1870, 16 Tul. L. Rev. 625 (1942).