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COMMERCIAL PAPER

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RIGHTS OF PARTIES TO INSTRUMENTS GONE ASTAY

The Second Circuit Court of Appeal held in *Smith v. Louisiana Bank & Trust Co.*,¹ that a co-payee of a check whose indorsement had been forged may sue the drawer *on the check*, despite the fact that the co-payee had never in fact been in possession of the instrument and could not therefore be a holder of it.² The court may have been willing to overlook certain logical imperfections implicit in such a holding³ because the rule of *M. Feitel House Wrecking Co. v. Citizens Bank & Trust Co.*⁴ prevents actions on a check against the drawee bank or a collecting bank by a payee whose indorsement has been forged. Briefly stated, this is the "circuity" rule of *Feitel*: when a collecting bank honors a check bearing a forgery of the payee's indorsement and receives the proceeds thereof from the drawee, there is no valid acceptance by either the drawee or the collecting bank, and hence no funds of the drawer have actually been paid out; therefore, the payee's sole action is against the drawer, since "the check has never in reality been paid."⁵ The drawer then has a cause of action against the drawee since an instrument bearing a forgery of the payee's signature had been "paid," that is, the drawer's account has been debited without authority.⁶ In turn, the drawee is said to have an action against the collecting bank for breach of the latter's "prior indorsements guaranteed" form of indorsement; the collecting bank may then recover against the "cashing" bank which may recover against the forger since payment over the forged necessary indorsement of the payee was not final. The *Feitel* rule has its foundation in the absence of privity of contract as between the payee and the drawee or intermediary collecting banks, and in the absence of a parallel to UCC § 3-419(1)(c).⁷ The overwhelming weight of NIL au-

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1. 255 So. 2d 816 (La. App. 2d Cir. 1971).
3. Id.
4. 159 La. 752, 106 So. 292 (1925).
5. Id. at 761, 106 So. at 295.
6. Such a check no longer represents the drawer's order to the drawee.
7. The section provides that an instrument is converted when it is paid on a forged indorsement, the drawee's liability for which is the face amount of the instrument. *Federal Deposit Insurance Corp. v. Marine National Bank*, 431 F.2d 341 (5th Cir. 1970), and *Harry H. White Lumber Co. v. Crocker-Citizens National Bank*, 61 Cal.
authority from other jurisdictions, however, did allow the true owner of
a check to recover in a direct action against a collecting bank in such
circumstances. On appeal to the Louisiana supreme court, the deci-
sion of the court of appeal permitting the co-payee’s action against
the drawer was reversed on the basis that as between those two par-
ties there was a lack of consideration. Furthermore, the court reaf-
irmed the Feitel rule in dicta over the dissent of Justice Barham. The
majority viewed the issuance of the check in co-payee form as having
been for the “accommodation and convenience” of the plaintiff. Therefore, reasoned the majority, the plaintiff, not being a third
party holder in due course, had no recourse against the drawer who
in fact owed him nothing.

Justice Barham dissented from the holding of the majority that
the co-payee litigant had no claim against the drawer and from the
majority’s reaffirmation of the Feitel jurisprudence. The majority
opinion cites Caskey v. Crawley as supportive of the proposition that
a co-payee, who is owed nothing by the drawer but who has been
made a co-payee by the drawer as an accommodation of or for the
convenience of the creditor co-payee, has no claim against the
drawer. That case, however, involved an action on a note by a payee
against an accommodation indorser who had so indorsed at the re-
quest of the maker and the payee, the court holding that such an
indorser was not liable to the payee. The drawer in Smith was not
an accommodation party. Lack of consideration is, of course, a de-
fense against a holder other than a holder in due course, but that

8. See Annot., 100 A.L.R.2d 670 (1965). A probable majority of jurisdictions hesi-
tated to permit such an action against the drawee if the drawee would, viz-a-viz an
action by the drawer, be exposed to double litigation.

creditor was indebted to plaintiff Smith, and requested the drawer to issue checks in
co-payee style.

10. See Comment, 17 LA. L. Rev. 466 (1957) (discussing the defenses of want and
failure of consideration in negotiable instruments).

11. See Fidelity Nat. Bank v. Vuci, 224 La. 124, 68 So. 2d 781 (1953); Fernon v.
Capital Bank & Trust Co., 190 So. 2d 504 (La. App. 1st Cir. 1966).

12. 16 La. App. 415, 134 So. 711 (1st Cir. 1931).

13. LA. R.S. 7:29 (1950) states: “An accommodation party is one who has signed
the instrument as maker, drawer, acceptor, as indorser, without receiving value there-
for and for the purpose of lending his name to some other person.”

issue is one of proof of fact as to which a party, such as the co-payee litigant in \textit{Smith}, should have an opportunity to prevail. Consideration need not be of the direct, tangible variety and case law can be found which would tend to give the plaintiff in \textit{Smith} a colorable claim of valid consideration. Moreover, resort to sections 24 and 28 leads to the observation that consideration refers to the validity of a negotiable instrument, as a contract, at the time of issuance. Given that one of two co-payees supplied a valuable consideration, it is arguably irrelevant that the other supplied nothing.

The decision of the \textit{Smith} majority on the consideration issue does not, however, appear to be the main thrust of Justice Barham's dissent. Rather, like Justice Tate, who concurred in the majority decision, Justice Barham assumed that certiorari had been granted in \textit{Smith} in order to review the \textit{Feitel} rule as against the background of an overwhelming contrary weight of authority. Justice Barham takes the view that Louisiana should be governed by the majority rule which prevailed in the other states when they operated under the NIL. It was pointed out in the previous symposium issue of the \textit{Review} that a direct action by a drawer against a collecting bank

15. Under LA. R.S. 7:24 (1950) consideration is presumed, but this presumption is a rebuttable one, and if consideration is put in issue by the introduction of evidence which casts doubt on the reality of the consideration, the burden shifts to the plaintiff (holder) to show consideration. Andrews v. Williams, 281 So. 2d 120 (La. 1973); Alexander v. Occhipinti, 251 So. 2d 188 (La. App. 4th Cir. 1971).

16. See, e.g., Dauzat v. Bordelon, 145 So. 2d 41 (La. App. 3d Cir. 1962) (check given to pay a third person’s debt held to be supported by valid consideration); Hale v. Fornea, 79 So. 2d 124 (La. App. 1st Cir. 1955) (son’s check given to pay father’s indebtedness); Reiman Mfg. Co. v. Puccio, 1 La. App. 153 (Orl. Cir. 1924) (same).

17. See, e.g., Bank of American Nat. Trust & Sav. Ass'n v. Superior Court, 4 Cal. App. 3d 435, 84 Cal. Rptr. 421 (1970) (not necessary that anything of value pass from payee to maker); Mason v. Blayton, 119 Ga. App. 203, 166 S.E.2d 601 (1969) (given valid consideration for the promise contained in a check, the promisee has an action against the drawer, notwithstanding that the promisee is a stranger to the consideration); Goldberg v. Rothman, 66 Misc. 2d 981, 322 N.Y.S.2d 931 (1971) (maker’s liability to payee supported by consideration from a third person who was not a party to the note).

18. LA. R.S. 7:24, 28 (1950). R.S. 7:24 states: “Every negotiable instrument is deemed . . . to have been issued for a valuable consideration.” (Emphasis added.)

19. But see Goldberg v. Rothman, 66 Misc. 2d 981, 322 N.Y.S.2d 931 (1971), in which the maker-debtor issued the note payable to the wife of the creditor, and at the creditor's request. The New York court found no problem of consideration despite the fact that the payee-wife was owed nothing by the maker.


might be reasonably disallowed by a court where, for example, the
drawer would thereby avoid defenses assertable by the drawee. This
disturbance of the positioning of the relative equities of the various
parties is perhaps a justification for the refusal of the majority in
Smith to use the case as a vehicle for the breakdown of the Feitel rule.
It is perhaps less inequitable, for instance, to retain Feitel and its
concomitant and seemingly needless involvement of parties in litiga-
tion, than to overturn it in a case in which a collecting or cashing
bank is perhaps thereby made liable with recourse only against a
forger, with respect to a check the payee of which could not, in the
court's view, have enforced as against the drawer.\(^2\) Moreover, the
noncircuitous NIL view would not necessarily permit a direct action
by a payee to whom the check was never delivered,\(^3\) and who, like
the plaintiff in Smith, therefore never received title to it.\(^4\) Such
issues aside, the obvious desire of the majority to retain the Feitel rule
is less defensible.

**Bank-Domiciled Instruments**

Debtors have been making instruments payable "at a bank"
since the early development of commercial banking in England.\(^2\)
Prior to the adoption of section 87\(^2\) of the NIL it was unclear whether
banking practice regarded such instruments as a form of a draft on
an account in the named bank or rather as merely a designation by
the debtor of a convenient place for the parties to make
payment.\(^2\) Under section 87 an instrument made payable "at a bank" is re-
garded as the equivalent of an order to the bank to pay the instru-
ment for the account of the principal debtor. The purpose of the
section was to settle the question of the bank's right, without specific

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\(^2\) See Gregor-Salisbury Metal Prod. v. Whitney Nat. Bank, 160 So. 2d 813 (La.
App. 4th Cir. 1964).

\(^3\) See Jones v. Bank of America Nat. Trust & Sav. Ass'n, 49 Cal. App. 2d 115,
121 P.2d 94 (1942); People ex rel. Nelson v. Kaspar Am. St. Bank, 364 Ill. 121, 4 N.E.2d
14 (1936). Contra, Allen v. M. Mendelsohn & Son, 207 Ala. 527, 93 So. 416 (1922);
Indiana Nat. Bank v. Holtsclaw, 98 Ind. 85 (1884); House-Evans Co. v. Matoon Tran.
and Stor., 275 P.2d 268 (Okla. 1954).

\(^4\) See Foltier v. Schroder & Schreiber, 19 La. Ann. 17 (1887); Estate, Inc. v.
Southern Land Title Corp., 230 So. 2d 341 (La. App. 4th Cir. 1970).


\(^2\) LA. R.S. 7:87 (1950).

\(^2\) Id.
authority, to pay such an instrument and charge the account of the principal debtor.\textsuperscript{25} The section has been generally construed to make the bank the agent of the principal debtor. In Bollitch \textit{v.} Louisiana Bank \& Trust Company,\textsuperscript{29} the issue of first impression for the Third Circuit Court of Appeal was: does section 87 apply to a draft payable "through a bank." The draft in question was drawn by the president of a rice company, on the rice company as drawer and payable to a credit company. The purpose of the draft, which was payable "through" defendant Louisiana Bank \& Trust Company, was payment of certain moneys to the plaintiffs relating to the raising of a rice crop. Plaintiffs received the draft on March 10, 1969, and within one or two days delivered it to the U.S. Department of Agriculture where it then was directed through government channels to the Federal Reserve Bank in New Orleans. The draft was then initially forwarded to defendant Louisiana Bank \& Trust as a "cash item," being received by defendant on March 17, 1969, and returned by defendant that same day to the Federal Reserve Bank with an accompanying telegram to the effect that the draft was not a cash item and should be re-entered as a collection item. Two days later defendant bank again received the draft from the Federal Reserve Bank now marked "for collection," but once again defendant returned the draft, this time with an explanation that it had been presented to the drawer but that defendant had not been able to effectuate collection.

Plaintiffs contended that such delay made defendant bank liable as an acceptor under sections 136, 137,\textsuperscript{30} pursuant to which a drawee must return an item delivered for acceptance within twenty-four hours after delivery. If it does not do so, the instrument will be deemed to have been accepted. Defendant countered with the apparently solid argument that those sections apply to a "drawee" and that the rice company—not defendant—was the drawee on the instrument. The Third Circuit ruled, however, that a draft payable "at" a bank is equivalent to an order to that bank to pay the draft for the account of the drawee within the meaning of section 87 and that the 24-hour rule of sections 136, 137 would apply to such a bank even though it is not the drawee.\textsuperscript{31} Consistent with its handling of the draft,

\textsuperscript{25} Binghamton Phar. \textit{v.} Memphis First Nat. Bank, 131 Tenn. 711, 176 S.W. 1038, (1915).
\textsuperscript{29} 271 So. 2d 274 (La. App. 3d Cir. 1973).
\textsuperscript{30} La. R.S. 7:136, 137 (1950).
however, defendant argued that when an item is payable “through” a bank there is a meaning beyond that which attaches to an item payable “at” a bank—that the “through” items are understood to be sent only for collection and not as cash items. The court disagreed, concluding that no meaningful distinction existed between a draft addressed to a drawee “at” a bank and one addressed “through” a bank. Both terms, said the court, merely designate the bank where the instrument is to be paid, without changing the duties of the bank under sections 136, 137. The court’s ruling that the draft was one payable “at a bank” under section 87 also dispensed with the argument put forth by defendant that since the drawer and the drawee were actually the same, it could under section 130 treat the item as a promissory note and therefore outside of sections 136, 137.

The court’s interpretation of section 87 is significant, but the inquiry does not end there, since compliance with sections 136, 137 remains an issue. Plaintiffs argued that when the Federal Reserve Bank forwarded the draft as a “cash” item, defendant should have either accepted or rejected it under section 137 and that defendant’s act in merely returning it with a suggestion that it be re-entered as a collection item violated sections 136, 137 with the result that the item was deemed to be accepted. Since the draft was clearly neither destroyed nor accepted by defendant at that point, the question became one of return of the draft as non-accepted. Under sections 149 and 150, the court held that the return of the draft constituted a

32. Defendant maintained that under banking procedures a “cash item” is one which the bank may pay without presentment to the drawer or drawee. The ordinary check is an example of such an item, and if presented for acceptance rather than for payment, the 24-hour rule would normally apply. A “collection item” on the other hand, anticipates a collection effort by the bank—presentment—from the drawer or drawee and therefore the 24-hour rule would not normally apply. Most checks, of course, are presented for payment so that sections 136, 137 would not normally apply.

The defendant seems to have been following the Uniform Commercial Code in its practice of handling “through” items—Section 3—120 says that an instrument which states that it is payable “through” a bank designates that bank as a collecting bank to make presentment “but does not of itself authorize the bank to pay the instrument.” See also Uniform Commercial Code § 3-121, and the Comments to both of these sections.

33. R.S. 7:132 states: “The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It must not express that the drawee will perform his promises by any other means than the payment of money.” In addition, the signification must be clear. A drawee’s signature accompanied by the phrase “kiss my foot,” is not, for example, an acceptance. Norton v. Knapp, 64 Iowa 112, 19 N.W. 867 (1884).

34. La. R.S. 7:149, 150 (1950).
dishonor by nonacceptance, and since return occurred within 24 hours of receipt as a cash item, there was no violation of section 137. As to the second receipt of the draft section 137 did not apply since the draft was received “for collection” and the bank thereby allowed a reasonable time for collection. In reaching its conclusion that section 137 was not violated by mere return of the instrument without express dishonor, the court distinguished the case of First National Bank v. Citizens Bank, a 1927 decision labelled by the court as a landmark case under section 137.

The Bollich decision has yet another significant aspect. The rice company had maintained an account with the defendant for several years, during which time the company paid for rice by the use of drafts similar to the one given to plaintiffs. Upon receipt of such drafts, defendant customarily contacted the company president, whereupon a deposit would be immediately made in an amount sufficient to cover the draft or drafts received. The company experienced financial difficulties and began to fall behind in “covering” the drafts as they were received by defendant. At some time during the week preceding March 17, 1969, the company was given a deadline by defendant of March 19, 1969 on which to cover back or “stale” drafts. The deadline was not met, but on March 10, 1969, one of the plaintiffs telephoned defendant’s president to inquire about the draft in question. Plaintiffs alleged that the failure of defendant’s president in that telephone conversation to disclose or warn plaintiffs of the drawee’s financial difficulties breached a duty to plaintiffs. The court disagreed, finding neither the breach of any duty, fiduciary or otherwise, nor any act of defendant which constituted negligence. Since the court’s ruling on the disclosure issue can be viewed as a failure of proof by plaintiffs on the issue of the defendant bank’s duty in that regard, it should be pointed out that within the purview of two relatively recent court decisions, any disclosures by banks of information pertaining to customers’ accounts or deposits invites liability. The Idaho supreme court, and more recently, the District Court of Appeal of Florida, held that implicit in the agreement between a bank and its customer is an obligation that the bank will not divulge to

36. 163 La. 919, 113 So. 147 (1927).
37. 271 So. 2d 274, 278 (La. App. 3d Cir. 1972).
38. Many drafts which were received and which should have been paid as cash items were held for more than 24 hours by the defendant.
third persons, without the customer's consent, express or implied, either the state of the customer's account or of any of his transactions with the bank or any information pertaining to the customer which has been acquired through the keeping of his account, whether the disclosure be made negligently, willfully, intentionally, or maliciously. There is seemingly no reason that might inhibit the adoption of this theory of bank-customer law by the Louisiana courts. The predictability of such adoption is heightened by virtue of the recently enacted Fair Credit Reporting Act, which has caused a re-evaluation by bankers of the entire question of disclosure of customer information to third parties—particularly information which bears on a consumer's credit worthiness.