RIGHTS OF THE HOLDER OF A BILL AGAINST THE DRAWEE AND OTHERS†

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Prior to the Uniform Negotiable Instruments Law (the "N.I.L."), it was commonly held that the payee or later holder of a bill of exchange or check, the most common form of bill, had no cause of action against the drawee who failed or refused to pay the instrument on presentment. This was true despite the fact that the drawee was indebted to the drawer in an amount that warranted the drawer in issuing the bill. Such failure or refusal might be the basis of an action against the drawee *by the drawer* but not by the holder. There was, as frequently stated, no privity beween the drawee and the holder.

In a number of states, however, such holder was, before the N.I.L., deemed to have a cause of action against such drawee. This result was based on the ground that by issuing the bill the drawer had assigned, to the extent of the bill, his claim against his debtor, the drawee.

The N.I.L., in the interest of uniformity, provides in two sections that the issuance of the bill (or check) does not "of itself" amount to an assignment of any part of the drawer's claim against the drawee.

Section 127 of the N.I.L. deals with bills of exchange in general. It declares that

> A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same.

Note the words: "the drawee is not liable on the bill," etc.

Section 189 deals specifically with checks, which of course are bills of exchange. It states that

> A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check.

Here the declaration is not as in section 127 that the drawee is not liable "on the bill" unless, etc., but that the drawee, the bank, is not liable "to the holder." Why was section 189 put into the statute if it was not intended that the rule as to checks should be different from a bill of exchange not a check? The language used in section 127 pro-

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* See Contributors' Section, p. 87, for biographical data.

hibits a *type of action* — one "on the bill." By contrast, section 189 seems to prohibit an action against the drawee, the bank, by a *person,* namely, the "holder."

An interesting pair of cases bearing on this situation are *Elyria Sav. & Banking Co. v. Walker Bin Co.* in Ohio[1] and *State v. First Nat'l Bank,* in New Mexico.[2] Each of these cases involved checks on which a trusted employee indorsed, without authority, the name of his employer,[3] the payee, which checks were ultimately paid by the drawee bank and charged to the account of the drawer. In each case the payee sued the drawee bank which had paid without any acceptance or certification.

Relying on section 189, quoted above, the Ohio Supreme Court in the first case ruled against the plaintiff saying that this section was

> . . . intended to cover the liability of a bank to the holder of a check, and he can recover from the bank only when he brings himself within the provisions of this statute. If the check is neither accepted nor certified, there is no liability on the part of the bank to the holder.[4]

In the New Mexico case the court, reversing the lower court, sustained the action, despite the reliance by the bank on section 189. The defendant, in relying on the section, cited cases headed by *First Nat'l Bank v. Whitman,*[5] which were claimed to declare the effect of the principle stated in the section. The court observed that

> . . . these cases deny a recovery upon the check because of a want of privity between the payee and the drawee. With this principle and its application in the cases cited, we have no quarrel. But here the action is not sought to be sustained as one *ex contractu,* but rather *ex delicto* for the conversion.[6]

It thus appears that the New Mexico court reads section 189 as if its terms were the same as those used in section 127.

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[1] 92 Ohio St. 406, 111 N.E. 147, L.R.A. 1916, 433, ANN. CAS. 1917 D, 1055 (1915). A recent decision, Elwert v. Pacific Sav. & Loan Ass'n., 138 F. Supp. 395 (1956) seems to agree with the Ohio court.

[2] 38 N. Mex. 225, 30 P.2d 728 (1934).

[3] In the Ohio case the employer-employee relationship was clear. In the New Mexico situation there was a question as to whether the unauthorized endorsement was made by one who really was the payee's representative. See *infra.*

[4] Elyria Sav. & Banking Co. v. Walker Bin Co., *supra* note 1, 111 N.E. at 148.

[5] 94 U.S. 343 (1877).

[6] State v. First Nat'l Bank, *supra* note 2, 30 P.2d at 729.

"In the Whitman Case," the court said, "the action was upon the draft itself. Certainly the bank had breached no contract with the payee. It sustained no contractual relations toward her. The holding in that case does not support a denial of liability for the bank's intermeddling with the property of the payee, nor was recovery sought on that theory." *Ibid.*

In R. Mars, Contract Co. v. Massanutten Bank of Strasburg, 285 F.2d 158 (1960), the court allowed recovery by a holder against the drawee bank without any reference to the N.I.L. and without any reference to the theory on which the recovery rested other than that the primary responsibility to determine the validity of an indorsement rests on the drawee bank.

The nature of the action in the Ohio case would have warranted a recovery *ex delicto* if the court had thought section 189 permitted it. Nothing in its opinion gives any indication that the court even thought of the possibility of a judgment on that basis. If counsel had argued that point, or if the court had thought of it, would the result have been as in New Mexico? The answer is, of course, purely speculative. The court's clearcut observation that a drawee bank is not liable "to the holder" unless there was a certification warrants the speculation that it would have rejected the position taken in the New Mexico case.

If the action by the holder had been not against the drawee bank but against a person, perhaps another bank that had cashed the check after the forged or unauthoized indorsement and which had then presented the check to the drawee, the question clearly would not have involved section 189. In such action the law of conversion would seem clearly to warrant recovery *ex delicto* or probably a recovery in assumpsit, the tort being waived.[7] If section 189 were not a part of the law, the position of the drawee that pays to one not entitled to the instrument on which payment is made, might well be considered the same, so far as the conversion element is concerned, as that of the intermediate bank or other person.

Needless to say, if one is to succeed in the conversion action, no matter who may be the alleged converter, he must have such interest in the chattel that he may maintain that action.[8]

The Ohio case referred to at the beginning of this article grew out of the following facts: One Smalley was indebted to the Bin Co. He drew a check on the Elyria Bank to cover that debt, the check being made payable to the order of McKain, the company's manager. He delivered he check to Sutherin, a salesman who worked under McKain. Instead of turning the check over to the latter, Sutherin indorsed the check in McKain's name, a forgery, and got it cashed by X Bank which, through customary channels, presented it to the drawee bank by which it was paid and charged to Smalley's account.[9] The Bin Co. then sued the drawee bank with the result stated above.

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[7] In 38 HARV. L. REV. 857, 858 (1925), the present writer discussed the question rather fully with reference to many decisions.

[8] See *infra*, p. 18.

[9] In the report of the *Elyria Sav. Bank* case it is stated that after the checks that Smalley put into the hands of Sutherin had been paid by the drawee bank and charged to Smalley's account, an action was brought by the Bin Company against Smalley to recover the amount of the checks, the theory, of course, being that Smalley still owed the company that amount. The trial court decided against the Bin Company, it being pointed out that Sutherin had authority to receive the checks and that the delivery of them to him canceled Smalley's obligation to the amount of the checks.

That action against Smalley seems never to have gone to a higher court. The question is an intriguing one, and there are authorities each way. In an interesting case, Strickland Transp. Co. v. First State Bank of Memphis, 147 Tex. 193, 214 S.W.2d 934 (1948), the conclusion was the same as that of the Ohio trial court, It probably was a fact that while Sutherin had no authority to sign McKain's name as indorser, he did have authority to receive the check on behalf of McKain. In other words, the check was effectively delivered to McKain. So far as the Bin Company's action against the drawee bank, viewed as one for conversion, is concerned, the company was entitled to judgment. The Ohio court, however, ruled that as a "holder" the plaintiff could not prevail, because of the sweeping language of section 189.[10]

In the New Mexico case the wrongdoer (Sutherin in the Ohio case) was a collector of delinquent taxes. Two checks, one payable on its face to the order of the county treasurer, the other indorsed to him, came into the hands of the collector who then indorsed them in the name of the treasurer, but without authority, and collected the money they called for from the drawee bank. The action against that bank was the same sort as that by the Bin Co. in the Ohio case.[11] As pointed out above, the New Mexico court sustained the action as one in tort for conversion. The court pointed out that the conversion thus charged to the defendant drawee was not in respect to any misappropriation of any moneys or funds belonging to the payee (or indorsee) but in its dealing with the check, the "payee's property." The court added:

> Surely an action in conversion by the true owner of a check against one other than the drawee upon facts concededly amounting to conversion would not for a moment be questioned.[12] The mere coincidence that the wrongdoer chances to be the bank upon which the check is drawn does not absolve it from liability. Nor do we think it was either the purpose or thought of the Negotiable Instruments Law in declaring the relationship, or want of it, of the payee of a check toward the drawee contractually, to license a wrong by the latter upon the former's property rights in a check.[13]

No doubt there is force in what the court said. But the question remains, why did the framers of the law and the legislatures that enacted it sharply differentiate between bills generally in section 127, where it is declared that a drawee who has not accepted "is not liable on the bill," and checks in section 189, where it is stated that in the absence of acceptance (certification) the drawee is "not liable to the

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but five of the eleven judges vigorously dissented. In the opinions in that case will be found references to many of the cases dealing with the problem. See 27 TEX. L. REV. 713 (1949).

[10] See *infra*, note 14.

[11] In neither case was it necessary for the plaintiff to label his action. So far as the pleadings were concerned, the judgment could go for the plaintiff if on the facts pleaded a cause of action was stated.

[12] *Supra* note 7.

[13] State v. First Nat'l Bank, *supra* note 2, 30 P.2d 732.

holder?"[14] Since checks are bills of exchange, the statutory provisions regarding the latter apply to the former except as checks were deemed properly subject to different rules. The N.I.L. contains only a few sections dealing specially with checks (sections 184-189) and section 189 is one of those.

Of course it is a question of statutory construction. If one centers his attention on section 189, the only thing about it that tends to limit the specific declaration of nonliability to the holder is the fact that the section starts out with the statement that the check "of itself" does not amount to an assignment, thus rejecting those authorities that had allowed actions against the drawee as a debtor. If that is all the section was intended to do, again one may ask, why the shift in language from the companion section, 127?[15]

The New Mexico case came to a head on a demurrer by defendant bank on two grounds. The first was the one involving section 189. The other, viewing the complaint as attempting to state a case in conversion, was that the actiton should fail "because the county treasurer was never vested with title to the checks," the idea being that until the checks were delivered to the treasurer and accepted by him, he had not acquired the proprietary interest in them that is essential for such claim.[16]

In his excellent treatise on Torts, Dean Prosser points out that "The fundamental idea underlying the tort [conversion] is that of interference with the dominion or control over the chattel incident to some general or special ownership, rather than with the physical condition of the chattel itself."[17] The New Mexico court found it unnecessary to determine whether the collector of delinquent taxes acquired pos-

[14] In the law of negotiable instruments the word "holder" has technical significance. It must be remembered that such instruments must be payable to "order" or to "bearer." As to the former, the word means the payee or endorsee in possession; as to the latter, it means the bearer. See the definition in section 191 N.I.L. Since Sutherin in the Ohio case, though an agent, had authority to accept possession of Smalley's checks payable in effect to the order of the Bin Company, it was a "holder."

[15] If the Ohio Court meant what its broad language seems to mean, that the person named as drawee cannot be liable to the person who is a holder, perhaps it got itself out on a limb. If such person, though a holder, were suing the person named as drawee as an assignee of the drawer, or as a cestui in a trust or as a third party beneficiary of the contract between the drawee and drawer, it is a fair speculation that the Ohio court would not find section 189 a bar. If so, then why should it be a bar to recovery as for a conversion? It is true that the N.I.L. clearly declares that neither a bill nor a check "of itself" amounts to an assignment, but with other facts an assignment may be found. In such situations the holder is suing as a creditor-assignee and the defendant is sought to be charged not in his character of drawee but as a debtor.

Perhaps we are faced with the conclusion that the N.I.L. was not drawn up with sufficient care.

[16] State v. First Nat'l Bank, *supra* note 2, 30 P.2d at 729.

[17] PROSSER, TORTS 66 (2nd ed. 1955).

session of the checks as agent of the treasurer in which case his possession would have amounted to that necessary "dominion or control," or whether he held them as agent of the taxpayer, in which case the treasurer would not have had that "dominion or control." The court found an answer unnecessary, for it considered the state and county to have ratified the receipt of the checks by instituting the action.

This brings us to an interesting case recently decided in Colorado which involves several of the points adverted to above.[18] The case arose out of these facts: Phipps, indebted to A Company, drew his check on the drawee bank payable to the order of A Company. The envelope containing the check was, however, erroneously addressed to B Company, a concern in the same business as was A Company. Through the mails the check then got into the hands of B Company. By it the check was indorsed in the name of the payee and X Bank paid the check to B Company. Through the clearing process the check was then presented to the drawee bank which paid the X Bank the amount called for. That payment was then charged to the account of Phipps. When A Company learned what had happened, it instituted suit, in several counts, against (a) the drawee bank, (b) X Bank, (c) Phipps, and (d) B Company.

Any possible liability of the drawee bank to A Company quickly disappeared from the case, the court saying that the

> dismissal of the claims against First National Bank [the drawee] in the original complaint was probably based on the principle that the giving of a check does not assign present funds on deposit and does not create drawee liability to the payee unless and until it is accepted by the drawee. . . .[19]

Thus, there being no decision on the point, the case is not authority either way on the problem of the Ohio and New Mexico cases.

The precise question before the Colorado court was whether the lower court had properly dismissed certain claims against Phipps. That action was affirmed with the exception of a potential claim for damages that might result from the alleged negligence of Phipps. In arriving at this conclusion the court pointed out that A Company had had a choice of two courses.

One alternative, the court said, was for the plaintiff, the named payee in the check issued by its debtor, to sue the drawer-debtor for the amount of the debt which the diverted check was designed to pay.[20]

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[18] Denver Elec. & Neon Serv. Corp. v. Phipps, 354 P.2d 618 (Col. 1960).

[19] *Id.*, 354 P.2d at 623.

[20] The denial of recovery from the debtor under somewhat similar circumstances, as pointed out above in connection with the *Elyria Sav. Bank* case, *supra* note 9, would not be in conflict since in the decisions denying recovery, the dishonest party was an employee or agent of the creditor, while in the Colorado case he was a total stranger. See Morrison v. Chapman, 155 App. Div. 509, 140 N.Y.S. 700 (1913), as to where the loss occasioned by the "rascality" of an agent should fall.

The debtor would not be paying his debt twice for he could require the drawee bank to restore to his account the amount which had been improperly charged to it.[21] The drawee would be reimbursed by the collecting bank — X Bank — because the amount of the check had been paid to the latter by mistake.[22] Whether this series of potential lawsuits could be shortcircuited by the plaintiff suing X Bank directly seems more than doubtful, for the money received by that bank from the drawee was not plaintiff's; it was the drawee's money.

The Colorado court, however, in setting forth the alternate course open to the plaintiff says flatly: "He can sue the collecting bank directly."[23] Pausing abruptly at that point, one might jump to the conclusion that the court was thinking of a liability of the collecting bank for conversion. That plaintiff's claim could be grounded on the conversion theory seems out of the question, for, as said by the New Mexico court, A Company "was never vested with title to the checks;"[24] it had never had even that minimal proprietary interest, possession! In the Ohio case, the delivery of the check by the drawer to Sutherin, though the latter turned out to be dishonest, was nevertheless a delivery to his employer. In the New Mexico case, the delivery to the delinquent tax collector may or may not have been, legally speaking, a delivery to the county treasurer; the court concluded that it did not need to decide that question, since, as it said, the treasurer and the state had effectively ratified the delivery.

Though the court does not expressly reject the conversion approach, it distinctly states its basis for its conclusion as to liability of X Bank to the plaintiff as "adoption and ratification." It states that the legal effect of the suit by plaintiff against X Bank was "adoption and ratification of the collection and payment of the check (notwithstanding that it was not endorsed)."[25] For this view the court relied on *United States Portland Cement Co. v. United States Nat'l Bank*, an earlier Colorado decision.[26]

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[21] Drawee banks, as is well known, may, in general, charge to their customers' accounts only those payments made in strict accordance with the genuine orders of those customers. In the Colorado case the only basis on which the drawee might have contested the demand that the credit be restored would be that the drawer of the check had breached his duty to his bank in mailing the check carelessly.

[22] The authorities, headed by the leading case of Canal Bank v. Bank of Albany, 5 Hill (N.Y.) 287 (1843), are clear on this point.

The same principle would, in theory at least, support an action then by X Bank against B Company. The net result then would be that the guilty party would be required to disgorge the money it had gotten through its dishonesty. As a matter of practicality, however, the chances of getting reimbursement from B Company would probably have been slim.

[23] Denver Elec. & Neon Serv. Corp. v. Phipps, *supra* note 18, 354 P.2d at 623.

[24] State v. First Nat'l Bank, *supra* note 2, 30 P.2d at 729.

[25] Denver Elec. & Neon Serv. Corp. v. Phipps, *supra* note 18, 354 P.2d at 623.

[26] 61 Colo. 334, 157 Pac. 202 (1916), L.R.A. 1917 A, 145.

That A Company might have an effective remedy against B Company for the

The court in the New Mexico case found a ratification by the payee, but there it was of an act that, as stated above, might or might not have been that of an agent. That court thus was able to find in the payee a sufficient proprietary interest (possession) to enable him to maintain a conversion action. In the Colorado case[27] there was no possible agency relation, factually speaking, as between A Company and B Company; the action was not, and seemingly could not, have been based on the theory that X Bank being liable in tort, the former could waive the tort and sue in assumpsit. The "adoption and ratification" in this case was, as the Colorado court said, of the "collection and payment of the check" as a result of which, the court further pointed out, was payment of Phipp's debt to A Company.[28] The "adoption and ratitfication" was effected not by something that had happened *before* the action by A Company, but by the very action it brought against X Bank. The court's way of expressing it was: "It can be said, therefore, that plaintiff renounced any claim predicated on the continued existence of the debt or on the non-discharge of the checks."[29]

In the *Portland*[30] case the drawee bank had paid checks to the presenting bank, the payee's indorsement having been forged by a fraudulent agent of the payee. It was there held that the payee could ratify the payment by the drawee and then maintain an action against the collecting bank on the theory that it had collected and misappropriated the proceeds of the checks and was thereby accountable to the plaintiff, payee, for the proceeds.

It will be noted that in the *Portland* case there was an agency element as there was in the New Mexico case, and the resort to the ratification factor was not surprising in either instance. But in the *Colorado* case,[31] it is clear that the forging or unauthorized indorser was in no sense an agent or other representative of the payee, nor did he ever purport to act as such.

What was the nature of the action which the court declared was an "alternative remedy" against X Bank? Surely it was not in conversion or, waiving the tort, a quasi contractual action. If it is suggested that the basis of such action was money had and received by X Bank to the use of A Company, is it not an effective answer that

money the latter collected on the Phipps check, on the basis of B Company being a constructive trustee, is indicated by the American Law Institute Restatement of Restitution, sections 165 and 126. Whether X Bank, which dealt with B Company, could likewise be held to the same trust would, it seems, depend upon facts not disclosed by the report.

27 *Supra* note 18.

28 *Supra* note 23.

29 *Supra* note 23, 354 P.2d at 624.

30 United States Portland Cement Co. v. United States Nat'l Bank, *supra* note 26.

31 Denver Elec. & Neon Serv. Corp. v. Phipps, *supra* note 18.

the money thus received was the drawee's money? The "ratification" and "adoption" thus appear to rest on pretty unsubstantial basis, the *Portland* case presenting facts quite different.

If Phipps instead of trying to pay his debt to A Company by check, had made up a package of money and then had sent the package by careless mistake to B Company which then deposited the money in X Bank, it would probably not be seriously urged that A Company had no action against Phipps for the recovery of the debt; and any claim by A Company against X Bank, for instance to impress a trust on the deposited fund, would probably be summarily dismissed, even though X Bank knew how B Company got the money. In short, A Company never had a claim to *that money*.