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relationship continue to exist to the point that the wife can share in his estate, although the personal relationship was terminated by an *ex parte* divorce? Of course, if the wife can prove the invalidity of the *ex parte* divorce then she remains his wife and will take her share as his widow.⁷⁹ But assume the husband had left his wife in New York and had gone to Nevada, where he got a valid *ex parte* divorce and then died. Assume also that the wife has not sought support but now seeks an indefeasible share in the estate. If New York grants it to her, is it denying full faith and credit to the Nevada divorce? If New York does not give it to her, it is failing to give effect to the policy and rationale of divisible divorce?

Thus, since the first *Williams* case, the Supreme Court apparently has been attempting to realign divorce law with the desires of society. Such an undertaking, as has been indicated, gives rise to new and complex problems, which must, in turn, someday be resolved by that Court.

HARVEY COUCH, III

The Scope of the Depositor's Duty To Prevent and Discover Alterations and Forgeries of His Checks

With billions of dollars worth of commercial paper changing hands daily, the business world cannot afford uncertainty as to the duties of the various parties to the paper, for uncertainty hinders negotiability. This is especially true in the case of the relationship between the drawer-depositor of a check and the drawee bank. Clearly the drawee may not normally debit the drawer's account when it pays a forged or materially altered instrument. However, when the drawer carelessly executes a check or does not bother to examine his checks when they are cancelled and returned to him, different considerations arise, altering the general rule. Does the business world know what these considerations are? Do drawers know what degree of care is required of them when they launch checks onto the seas of commerce? Perhaps not, and thus the reason for this note—to point out the problems in this area, note the solutions produced by the case law and statutes, and suggest change where change perhaps is needed.

79. *Rice v. Rice*, 336 U.S. 674 (1949).

I. DRAWER'S CONDUCT AFFECTING HIS RIGHT TO RECOVER ON A MATERIALLY ALTERED INSTRUMENT

As a general rule the drawee bank which cashes a materially altered check is absolutely liable to the drawer-depositor for the unauthorized amount of the instrument, *i.e.*, the amount the check was raised.¹ This is so because the bank is under a contractual duty, express or implied, to pay only the amount authorized by the depositor.² However, an early English case, *Young v. Grote*,³ held that this rule is not without exception and that an innocent drawee bank may properly debit the account of its depositor for the full amount of a check which is so negligently drawn as to facilitate its subsequent alteration.⁴ The precise nature of the decision, as well as the scope of the drawer's duty to take care to prevent alterations, has been the subject of much dispute.⁵

Most interpretations have placed denial of recovery by the drawer on the basis of estoppel. Thus the drawer is "estopped" to set up the material alteration as a defense against the bank.⁶ This interpretation is objectionable, however, because misrepresentation, an element of true estoppel, is lacking.⁷ In reality the legal responsibility of the drawer is based essentially on his negligent conduct.⁸ But since the suit by the drawer-depositor to recover funds paid out on a materially altered (or forged) instrument is based on the contract of deposit, the courts are reluctant to talk about negligence, even though they realize that it is the depositor's negligence which provides the drawee bank a

1. BRITTON, *BILLS AND NOTES* § 132, at 363 (2d ed. 1961) [hereinafter cited as BRITTON]. The bank may of course debit the account of the depositor for the amount of the check prior to the alteration. *Smith v. State Bank*, 54 Misc. 550, 104 N.Y.S. 750 (1907).

2. *Ibid.*

3. 4 Bing. 253, 130 Eng. Rep. 764 (1827).

4. *Accord*: *Goldsmith v. Atlantic Nat'l Bank*, 55 So. 2d 804 (Fla. 1952); *Timbel v. Garfield Nat'l Bank*, 121 App. Div. 870, 106 N.Y.S. 497 (1907); *Foutch v. Alexandria Bank & Trust Co.*, 177 Tenn. 348, 149 S.W.2d 76 (1941). For a general discussion of the doctrine see BRADY, *BANK CHECKS* § 14.6 (Bailey ed. 1962).

5. It has been stated that negligence did not enter into the case at all, that the depositor by signing a blank check had given authority to any person in whose hands it fell to fill it for any amount. This view is criticized in Note, 31 HARV. L. REV. 779, 780 (1918). Britton points out that Best, C. J., who decided the case, was most concerned about the wisdom of entrusting a blank check to a female. Best concluded that this conduct was certainly negligent. BRITTON § 282.

6. "The grounds for the decision in *Young v. Grote* . . . rests primarily on the doctrine of estoppel . . . "Preclusion from assertion of rights is estoppel." Ewart on Estoppel, 45." *Foutch v. Alexandria Bank & Trust Co.*, 177 Tenn. 348, 360, 149 S.W.2d 76, 80-81 (1941) (negligent drawer "estopped" to deny authority of drawee to honor raised check). See also *Goldsmith v. Atlantic Nat'l Bank*, *supra* note 4 (negligent drawer "estopped" to set up defense of material alteration); BRITTON § 282.

7. McCLEINTOCK, *EQUITY* § 31 (2d ed. 1948).

8. Note, 31 HARV. L. REV. 779, 784-785 (1918). To say that negligence creates the estoppel is to mean that negligence creates the liability. *But see* note 6 *supra*.

defense, and not the bank's "justified reliance to its detriment" on some misrepresentation of the depositor. Apparently the courts are creating a new breed of estoppel based on negligent conduct rather than misrepresentation. Unfortunately, such indiscriminate use of the term leads to confusion.

In an effort to skirt the confusion resulting from this imprecise use of the doctrine of estoppel, the Uniform Negotiable Instrument Law [hereinafter cited as N.I.L.]⁹ and the Uniform Commercial Code [hereinafter cited as U.C.C. or the Code]¹⁰ substitute "preclude" for "estop." If the distinction between the terms were recognized by the courts, much confusion would vanish. But courts continue to insist that "preclude" and "estop" are synonymous,¹¹ and judges continue to base decisions on the ground that the depositor's negligence estops him from asserting the material alteration or forgery.

The principle of the *Young* case has been accepted by most American courts. However, Texas repudiated it¹² on the theory that raising the amount of a completed check constitutes a material alteration as defined by N.I.L. section 125, which makes the rights of the parties determinable by section 124, which in turn discharges the drawer to the extent the check has been raised.¹³ Since section 124 does not expressly recognize the *Young* doctrine, it has been interpreted as indicative of an intent to abolish it. This position has been rejected by the text writers¹⁴ and the U.C.C.¹⁵ It has been correctly pointed

9. "When a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative . . . unless the party, against whom it is sought to enforce [the instrument] is precluded from setting up the forgery for want of authority." N.I.L. § 23. Section 124 dealing with material alterations speaks in terms of "authorization" and "assent" rather than preclusion.

10. "Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority . . ." U.C.C. § 3-406.

11. *Union Trust Co. v. Soble*, 192 Md. 427, 64 A.2d 744, 746 (1949); *Coffin v. Fidelity-Philadelphia Trust Co.*, 374 Pa. 378, 392, 97 A.2d 857, 864 (1953).

12. *Glasscock v. First Nat'l Bank*, 114 Tex. 207, 266 S.W. 393 (1924). Here a check drawn in pencil by the depositor's son-in-law was altered from five to five hundred dollars by the insertion of additional words in the spaces left in the check. The court held that the depositor, even if he were negligent, could recover the unauthorized amount from the bank. The court refused to hold the depositor responsible for the intervening criminal act of a third party. The intervening criminal act was treated as the cause of the loss. Although the N.I.L. was not in effect in Texas at the time this case was decided, the court expressed the opinion that the result would be the same under the N.I.L. It viewed the *Young* doctrine as being incompatible with § 124.

13. N.I.L. § 125 provides that: "Any alteration which changes . . . the sum payable . . . is a material alteration." N.I.L. § 124 states: "Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized, or assented to the alteration . . ."

14. "The view that the N.I.L. makes inapplicable the principle of estoppel by negligence to actions on bills and notes cannot be supported, for all courts, which have had occasion to pass upon it, have held in some types of cases that the principle is just as applicable to cases under the act as before. . . . All courts agree that negligence

out that the depositor's suit is not brought upon the check; rather it is brought upon the contract of deposit between the bank and the depositor.¹⁶ The N.I.L. is inapplicable in cases merely determining rights and duties arising out of the contract of deposit.¹⁷

Recognition of the rule of the *Young* case furthers the policy of negotiability of commercial paper since it allows the bank, which must determine the validity of large numbers of checks in a relatively short period of time, cashing or dishonoring them at its peril,¹⁸ the assurance that the depositor by his negligence may not substantially increase the risks involved without suffering the consequences. On the other hand, no onerous burden is placed on the drawer. All that is required of him is the exercise of some care during a period when his checks are peculiarly within his control and responsibility. Perhaps most important is that the proposition for which *Young* stands is in accord with the understanding of the business world. This is illustrated by the express adoption of the doctrine in the U.C.C.¹⁹

The drawer's negligence will not automatically relieve the bank of its liability, however. In order to avail itself of the defense of preclusion based on the drawer's negligence, the bank must show that it was not negligent itself in failing to detect the alteration.²⁰ When both parties are guilty of negligent conduct it may be said either that the drawer's negligence is not a cause in fact, or that the bank's negligence in failing to detect the alteration at the time the check was cashed is the proximate cause of the loss. Another explanation is afforded by a re-examination of the positions of the bank and the depositor. Initially the bank is under an absolute duty to pay only the amount authorized by the depositor.²¹ Where the depositor's negligence is the proximate cause of the loss, equities arise in favor of the bank which justify shifting the loss to the drawer. Where the depositor and the bank are both negligent, however, the bank is in no better position than the drawer; thus there is no compelling reason either to

by a drawer of a check in the examination of his canceled checks may result in the loss of his right against the drawee bank In so far as the recognition of the [*Young*] principle is concerned, there is no difference between negligent conduct prior to or contemporaneous with the issuance of an instrument and negligence by the drawer subsequent to issuance" BRITTON § 282, at 668-669.

15. U.C.C. § 3-406.

16. BRANNAN, NEGOTIABLE INSTRUMENTS LAW § 124, at 1192 (7th ed. Beutel 1948).

17. "The great interstate circulation of negotiable paper presents a good reason for uniformity in the law of *negotiable instruments* but there is no such compelling reason presented for uniformity in the law governing banker and depositor." Note, 23 MICH. L. REV. 775, 778 (1925).

18. See 17 TENN. L. REV. 395 (1942).

19. U.C.C. § 3-406, comment 1.

20. BRITTON § 132, at 374.

21. *Id.* at 363.

shift the loss or to make exception to the general rule that the bank is liable.

Accepting the prevailing view that the depositor owes a duty to his bank to exercise care in the execution of his checks, to what standard of care must he conform to discharge this duty? The frequent characterization of the drawer as one of two innocent parties who made the loss possible and therefore must bear it is not very helpful in determining the precise nature of the drawer's duty.²² Just as meaningless is language which indicates that the drawer's conduct must "invite" alteration rather than merely facilitate it.²³ This terminology may imply that something less than ordinary care will satisfy the drawer's duty, and that only "gross negligence" will result in his preclusion. This language is probably intended to emphasize the causal connection which must exist between the drawer's negligence and the method of alteration rather than to define the requisite degree of care. One writer suggests that the drawer will be precluded only when he is "exceptionally careless."²⁴ Obviously this conclusion depends upon the meaning of "exceptionally careless." The suggestion is that while "exceptional carelessness" will defeat a drawer, the "ordinary careless" drawing habits of most people should not call for a court to invoke the *Young* rule.²⁵

The key to the problem is this: these "ordinary careless" drawing habits simply do not amount to negligence. To speak in terms of exceptional carelessness is to run the risk of injecting the concept of gross negligence into the controversy. This need not be. The standard imposed on the drawer should be that of reasonable care under the circumstances—the rule for determining the standard of care in any negligence case. Since the question of negligence will almost always be for the jury, whose natural sympathy will be with the drawer, few drawers will be held to a very high degree of care in this situation, and "ordinary careless" drawing habits will pass as reasonable. This approach is better than trying to couch the depositor's duty in terms of "slight care," a breach of which renders him liable because he has been "grossly negligent."

22. *Goldsmith v. Atlantic Nat'l Bank*, *supra* note 4; *Weiner v. Pennsylvania Coal Co.*, 160 Pa. Super. 320, 51 A.2d 385 (1947); *Foutch v. Alexandria Bank & Trust Co.*, *supra* note 4.

23. *Critten v. Chemical Nat'l Bank*, 171 N.Y. 219, 63 N.E. 969 (1902); *Foutch v. Alexandria Bank & Trust Co.*, *supra* note 4.

24. "Even where the *Young v. Grote* rule is applied courts have narrowly limited its scope to instances where blank spaces are unreasonably left on the lines where the amount in words and figures is written and where the alteration consists of insertions raising the amount. Thus the squeezing in of an insertion, as where the letter 'y' is added after 'eight' so as to change 'eight' to 'eighty,' has been held not within the rule." BRADY, *BANK CHECKS* § 14.6, at 454 (Bailey ed. 1962).

25. *Id.* at 458.

The question of what conduct will constitute negligence on the drawer's part is not easily answered. In the *Young* case the conduct declared negligent was the entrusting by a depositor of signed, blank checks to a person unskilled in business in order that she might carry on the drawer's business in his absence.²⁶ Courts have held that an employer who entrusted signed blank checks to his employee, who subsequently filled in the blanks for more than the authorized amount, was negligent.²⁷ Leaving spaces in the instrument which can easily be filled by an unscrupulous payee or a thief is the most common form of negligence.²⁸ Also, a depositor who could neither read nor write, but who could distinguish figures, was precluded from asserting an alteration when it was shown that he had entrusted the writing of a check to the payee who filled the check out for the correct amount in figures, but for a larger amount in writing, and who subsequently raised the figures to correspond to the writing.²⁹ Finally, a depositor was held negligent for writing on a check in pencil a condition which was erased by the holder and cashed prior to the happening of the condition.³⁰ This case has been criticized, however, for no other court has held a drawer negligent simply because he wrote a check in pencil.³¹ Neither have the courts required the use of sensitized paper,³² indelible ink,³³ or some sort of check writing machine or "protectograph."³⁴ The U.C.C. refuses to extend the drawer's duty any further in this direction.³⁵

Not infrequently it has been suggested that the standard of care required of the drawer should include a duty not to draw checks in pencil.³⁶ A superficial objection to this is that the law recognizes the validity of checks written in pencil just as it recognizes the validity of those written in ink.³⁷ However, the law also recognizes the validity

26. *Young v. Grote*, *supra* note 3.

27. See, e.g., *Pacific Coast Cheese, Inc. v. Security First Nat'l Bank*, 273 P.2d 547 (Cal. App. 1954), *rev'd for bank's failure to show prejudice resulting from drawer's negligence*, 45 Cal. 2d 75, 286 P.2d 353 (1955).

28. See, e.g., *Goldsmith v. Atlantic Nat'l Bank*, *supra* note 4; *Reiter v. Western State Bank*, 240 Minn. 484, 62 N.W.2d 344 (1953) and cases cited therein; *Foutch v. Alexandria Bank & Trust Co.*, *supra* note 4.

29. *Weiner v. Chase Nat'l Bank*, 142 Misc. 124, 253 N.Y. Supp. 203 (1931).

30. *Harvey v. Smith*, 55 Ill. 224 (1870).

31. *Broad St. Bank v. Nat'l Bank*, 183 N.C. 463, 112 S.E. 11 (1922); *Lanier v. Clarke*, 63 Tex. Civ. App. 266, 113 S.W. 1093 (1910).

32. *Savings Bank v. National Bank*, 3 F.2d 970 (4th Cir. 1925).

33. *Broad St. Bank v. National Bank*, *supra* note 31. In both this and the *Savings Bank* case, cited in note 32, the duty of taking the additional precautionary measures was sought to be imposed on a bank. Obviously if courts will not hold banks to this higher degree of care, they will not hold the average drawer to it.

34. *Ibid.*

35. U.C.C. § 3-406, comment 3.

36. See, e.g., *Farmers' Bank v. Bank of Abbeville*, 29 Ga. App. 472, 116 S.E. 204 (1923); *Commercial Bank v. Arden*, 177 Ky. 520, 197 S.W. 951 (1917).

37. *Farmers' Bank v. Bank of Abbeville*, *supra* note 36.

of a check in which the most obvious spaces are left, but it imposes a duty on the drawer not to leave such spaces in his checks, and requires him to bear the resulting loss if his checks are altered.

A more serious objection is that of commercial inconvenience and the possible extension of the rule to require more onerous precautionary measures.³⁸ It is difficult to make a distinction between a check written in pencil and one written in washable ink. A skillful alterer could probably erase one as easily as the other, avoiding detection in either case; and once the duty to use ink is established, it is not much of an extension to require indelible ink; from there to sensitized paper, and so on. The answer to the suggestion is this: Writing checks in pencil is not negligence, for there is no pressing need to discourage such practices. Witness thereto the facts that no bankers' organization is clamoring for legislation or court action on the subject, and that banks are not incorporating in their signature cards provisions to the effect that they will not be responsible for losses resulting from the alteration of checks written in pencil. The degree of care currently required of the drawer seems to satisfy drawers, drawees, and courts alike.

II. DRAWER-DEPOSITOR'S CONDUCT PRIOR TO AND DURING EXECUTION OF THE CHECK RESULTING IN HIS PRECLUSION TO ASSERT THE DEFENSE OF FORGERY

Just as it is possible for the drawer-depositor to preclude himself from being able to assert the defense of material alteration to the drawee bank's attempt to debit his account on an altered instrument, it is possible for his carelessness prior to and at the time of execution of the instrument to preclude him from claiming the defense of forgery.³⁹ Evidently the courts are less likely to find a depositor negligent in the case of forgery than they are in the case of material alteration. Nevertheless, the depositor does owe a duty to the drawee bank to exercise some care to insure against both forged signatures and forged endorsements.

One line of cases where the depositor's conduct precluded him from

38. Consider the position adopted by the drafters of the Uniform Commercial Code: "No attempt is made to define negligence which will contribute to an alteration. The question is left to the court or the jury upon the circumstances of the particular cases. . . . No unusual precautions are required and the section is not intended to change decisions holding that the drawer of a bill is under no duty to use sensitized paper, indelible ink, or a protectograph." U.C.C. § 3-406, comment 3. Although the Code does not adopt a higher degree of care as a rule of law, it leaves within the discretion of judges and juries the power to raise the requirement whenever a need is felt.

39. BRITTON § 132. Forgery is used in the sense of any unauthorized signature.

asserting a forgery is exemplified in *Phillips v. A. W. Joy Co.*⁴⁰ There the depositor left signed blank checks with his salesgirl for her to use during the business day. The checks were stolen when they were left out in the open while the depositor's office was vacant. Although N.I.L. section 15 states that an incompleting instrument which has not been delivered will not become valid if subsequently completed and negotiated without authority, the court precluded the depositor from asserting the forgery and negotiation of an undelivered, incomplete instrument because of the agent's negligence in leaving the signed checks out in the open. Since the U.C.C. reverses the rule of N.I.L. section 15,⁴¹ the depositor will be liable in states operating under the Code also, but the grounds for liability will not be his negligence or that of his agent.

Another line of cases precluding the depositor from asserting forgery arises out of the situation where, because of inadequate safety precautions in the depositor's business arrangement, a dishonest employee can make out checks to non-existent employees or in payment of non-existent accounts, have the depositor or some other authorized person sign the checks and return them to the forger, and by forging the payees' names, cash them for his own use.⁴² This situation is not covered by the "fictitious payee" rule of N.I.L. section 9(3), but it is covered by the amendment to that section proposed by the American Bankers' Association and adopted in twenty-four states. It is also covered by the U.C.C.⁴³ Under the fictitious payee rule, an instrument is deemed payable to bearer, requiring no endorsement to negotiate, if the named payee is intended to have no interest in it and the drawer knows this. The A.B.A. amendment and the Code broaden the scope of this rule to include an instrument made payable to a person not intended to have any interest in it if this is known by the drawer, his employee, or other agent. Thus the rule discussed in the above line of cases will be applicable only in a state having neither the A.B.A. amendment to section 9(3) nor the Uniform Commercial Code, though the result will be the same.

To reach the decision that the depositor is precluded from asserting the forgery of his employee, the court must conclude either (1) that the depositor was negligent in relying implicitly on the honesty and faithfulness of an employee whom he had no reason to suspect of dis-

40. 114 Me. 403, 96 Atl. 727 (1916).

41. U.C.C. § 3-407(3): "A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed."

42. *Defiance Lumber Co. v. Bank of California*, 180 Wash. 533, 41 P.2d 135 (1935); see also *Young v. Gretna Trust & Sav. Bank*, 184 La. 872, 168 So. 85 (1936).

43. U.C.C. § 3-405. A number of states which adopted the Bankers' Association amendment to N.I.L. § 9(3) have since adopted the Code.

honesty, or (2) that the depositor was negligent in not setting up business procedures with sufficient safety precautions to detect this particular type of employee defalcation. The courts have specifically rejected (1) as a grounds for negligence.⁴⁴ The duty imposed on the depositor is, therefore, to make some effort to verify the payee and amounts of checks written at the request of his employees.⁴⁵

Two courts have precluded the depositor from asserting the defense of forgery where the drawer mailed the check to a person other than the payee, who had the same name as the payee and who forged the endorsement knowing that he was not intended to have any interest in the check. Although some courts confuse this problem with those involving fictitious payees and delivery to imposters,⁴⁶ the correct basis for denying the depositor the right to resist the debiting of his account is that he, through his negligence in not ascertaining the correct address of the payee, greatly facilitated the forgery and made it practically impossible to detect.⁴⁷ Thus a drawer who mailed a check to one Max Roth in Cleveland, thinking he was mailing it to a gentleman of the same name in New York City, was precluded from asserting the forgery when the Roth from Cleveland cashed in on his windfall.⁴⁸ Similarly a drawer who drew a check payable to one Joe Cunningham but mailed it to a different Joe Cunningham was made to suffer the resulting loss.⁴⁹

Finally, a minority of courts have precluded the depositor from asserting the forgeries of his bookkeeper when the depositor retained the bookkeeper in a position of confidence after he had become aware that the bookkeeper had a record of unfaithfulness on prior jobs.⁵⁰ The duty breached by the depositor was a duty not to keep an un-

44. See, *e.g.*, *Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank*, 252 Mich. 163, 233 N.W. 185 (1930).

45. *Gutfreud v. East River Nat'l Bank*, 251 N.Y. 58, 167 N.E. 171 (1929). Here the depositor's bookkeeper presented for signature checks to "Swift" (rather than "Swift & Co.") attached to previously paid bills from Swift & Co. The depositor, thinking the checks were in payment of the attached bills, would sign and return them to the dishonest employee. The employee, whose duty it was to deliver the checks to the payees, would add an initial to the payees' names so that the checks would read "G. Swift," or "B. Swift," etc., forge the appropriate endorsements and cash the checks for himself. The bank was allowed to debit the depositor's account for the full amount of the checks on the grounds that the depositor was negligent in not setting up a procedure to check on employees entrusted with check-paying duties of this magnitude.

46. *United States v. Union Trust Co.*, 139 F. Supp. 819 (D.C. Md. 1956). This case is complicated by the fact that the United States was both drawer and drawee of the instrument but was suing on the guarantee of endorsements.

47. *Weisberger Co. v. Barberson Sav. Bank*, 84 Ohio St. 21, 95 N.E. 379 (1911).

48. *Ibid.*

49. *Citizens' Union Nat'l Bank v. Terrell*, 244 Ky. 16, 50 S.W.2d 60 (1932).

50. *Hillside Dairy Co. v. Cleveland Trust Co.*, 142 Ohio St. 507, 53 N.E.2d 499 (1944). *But see* note 52 *infra*.

trustworthy employee in a position of trust.

In a host of other cases, however, the depositor has not been held negligent in spite of his less than careful conduct. It has been held, and appears to be the majority rule, that an employer who retains a bookkeeper after having acquired knowledge of his activities as a forger is not negligent in retaining the bookkeeper in a position of trust.⁵¹ Likewise when a brother-in-law who was a convicted forger living with the depositor used the opportunity to forge a number of checks on the depositor's account, the drawee bank was not allowed to debit the account on the ground that the depositor had no duty to keep his blank checks under lock and key in deference to his brother-in-law's record.⁵² These cases, however, appear clearly wrong.

The courts have also held that the mere practice of signing checks with a rubber stamp is not negligence; but the depositor may be under some duty to use care in keeping the rubber stamp out of improper hands.⁵³ Presumably if the depositor locks the stamp in his safe only to have it stolen and a batch of bogus checks thereby forged, the bank would suffer the loss since the depositor had taken precautions to keep the stamp in his possession. This type of case seems subject to the same arguments that have been used against pencil-written checks. That is, if the depositor wants the convenience of a rubber stamp, he should be willing to suffer the loss which occurs when a forger avails himself of the stamp to forge the depositor's signature. Banks could protect themselves, however, by requiring a depositor who wishes to use a signature stamp to agree to hold them harmless in the event the stamp gets out of his possession.

Remembering the three exceptions mentioned above, it is safe to say that the depositor will not be held negligent for failing to anticipate dishonesty on the part of his employees or other persons such as friends and relatives who have regular opportunities to forge his paper. Apparently the courts have adopted this position because they have felt bound by the traditional agency rules concerning ratification and estoppel. Unfortunately, strict adherence to these rules has in many cases resulted in casting the loss caused by careless conduct of the depositor onto a bank which acted diligently.

51. See, *e.g.*, *Home Indem. Co. v. State Bank*, 23 Iowa 103, 8 N.W.2d 757 (1943); *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938); *Fitzgibbons Boiler Co. v. National City Bank*, 287 N.Y. 326, 39 N.E.2d 897 (1942).

52. *Arnold v. State Bank & Trust Co.*, 218 N.C. 433, 11 S.E.2d 307 (1940).

53. *First Nat'l Bank v. Albright*, 111 Pa. Super. 394, 170 Atl. 370 (1934) (dictum).

III. DEPOSITOR'S DUTY TO INSPECT FOR FORGED SIGNATURES AND MATERIAL ALTERATIONS

We have seen that a depositor may be precluded from setting up the defense of forgery, material alteration, or want of authority because of his negligent conduct prior to execution of the check. We shall also see that he may be precluded for failing to discharge certain duties after the cancelled checks are returned to him. What duty does the depositor owe the drawee bank with regard to cancelled checks? Basically it is the duty to examine them for forged signatures and material alterations within a reasonable time after he receives them,⁵⁴ to compare them with his check stubs,⁵⁵ and to report any discrepancies to the bank.⁵⁶ This duty may be said to arise as an implied term of the contract of deposit to which the depositor assented when he signed the signature card.⁵⁷ It is justified because the depositor is in a position to discover forged or altered checks and his prompt report to the bank might enable the bank to recover the money from the wrongdoer, or at least perfect its claim against a prior transferor, when recovery might otherwise be impossible.⁵⁸ The breach of this duty either (1) creates an estoppel if the bank has relied on the fact that the depositor would examine his accounts and report discrepancies, and has been harmed by his failure to do so,⁵⁹ or (2) gives rise to a defense of breach of contract based on the depositor's implied promise to use reasonable care in discovering and reporting forgeries and alterations.⁶⁰ Since it is necessary that the bank be harmed by the depositor's failure to inspect and notify, in the event the bank is negligent in failing to detect an obviously forged or altered instrument when one is presented to it for payment, it will not be able

54. *Leather Mfrs. Bank v. Morgan*, 117 U.S. 96 (1886).

55. *Ibid.*

56. *First Nat'l Bank v. Allen*, 100 Ala. 476, 14 So. 335 (1893). But the depositor is under no duty to call for his cancelled checks and if the bank is harmed because the depositor did not receive his vouchers for a long period of time, it has no grounds for complaint. *McCarty v. First Nat'l Bank*, 204 Ala. 42, 85 So. 754 (1920).

57. *Matteson v. Bank of Italy*, 97 Cal. App. 643, 275 Pac. 998 (1929).

58. Remember that the rule of *Price v. Neal*, 3 Burr. 1354, 97 Eng. Rep. 871 (1762), prevents the drawee bank from recovering money paid out on a forged signature unless the person the bank paid was the forger or a bad faith purchaser from him.

59. *Deer Island Fish & Oyster Co. v. First Nat'l Bank*, 166 Miss. 162, 146 So. 116 (1933). It should be noted that in this type of case a real estoppel in pais is created. The depositor represents to the bank that everything is satisfactory when he reports nothing to the contrary within a reasonable time after he has received his statement. The bank relies on this representation when it makes no effort to recover money paid out on checks covered by the statement, or continues to cash checks presented by the wrongdoer or holders from him bearing forgeries or alterations which are not obvious. The bank is harmed as a result of its reliance when it loses an opportunity to recover these funds from the forger or continues to honor forged or altered paper.

60. *Critten v. Chemical Nat'l Bank*, 171 N.Y. 219, 63 N.E. 969 (1902).

to claim either estoppel or negligence against the depositor.⁶¹ The reasoning is that the bank could not have been harmed by the depositor's breach of duty because it should never have honored an obviously faulty instrument in the first place.

Since negligent conduct creates the estoppel against the depositor, the two defenses, estoppel and negligent breach of contract, are almost coextensive. The defense based on estoppel is, however, available only for those forged or altered checks which are honored after previously forged or altered checks have been returned to the depositor for verification. If the depositor fails to inspect the cancellations within a reasonable time, and the bank subsequently honors more checks by the same wrongdoer, the estoppel is created against the depositor. But even though no estoppel can arise on the first forged or altered checks which the bank honors, the depositor may still be precluded from asserting his defense as to these checks because of his negligent conduct resulting in the breach of his implied contract that he will use care in executing his checks. As a practical matter, however, proof of injury in such a situation will be exceedingly difficult. The Code makes both of these defenses available to the bank.⁶²

*Critten v. Chemical National Bank*⁶³ exemplifies the interplay of considerations occurring whenever a bank tries to charge its depositor with a forged or altered check. Critten employed one Davis whose duty it was to draw checks on the company in payment of the company's bills, and enter the amounts and payees on the stubs of the checkbook. Davis would present these with the bills for which they were written to Critten to be signed. He was then supposed to mail these checks to the proper payees. Over a two year period, however, Davis purloined twenty-four of these checks, obliterated the names of the payees and the amounts payable, raised the checks by about one hundred dollars each, made them payable to cash, and cashed them. He did not, however, change the amounts or the payees on the check stubs. These checks were charged to Critten's account; the account was balanced every two months; and the vouchers were returned to Critten. But Davis himself was entrusted with the job of verifying the bank balance. As a result, the scheme was not discovered for two years.

The issue litigated when Critten sued to have his balance credited by the amounts paid on the raised checks was that of Critten's negligence in not checking his cancellations. The court held Critten chargeable with the information which would have been acquired by an honest agent entrusted with the duty of inspecting the stubs. Cer-

61. *Ibid.*

62. U.C.C. § 4-406(2).

63. *Supra* note 60.

tainly the same result would have been reached had Critten himself checked the vouchers and reported nothing to the bank, or simply neglected to check the cancellations at all. Nevertheless, the bank was allowed to debit Critten's account for only the third, fourth, and fifth checks for these reasons: (1) As to the first two checks, Critten's failure to report the alteration did not create an estoppel against him because they were honored before Critten had an opportunity to inspect. Neither could the bank prevail on a negligence theory because it could not show that it would have been able to recover from the alterer if Critten had been more prompt in notifying the bank of the alteration. (2) The sixth check presented for payment by Davis was obviously altered; therefore the bank itself was negligent in paying it without question. Had it refused to pay and called the depositor's attention to the alteration, the scheme would have been uncovered then and the remaining eighteen checks would never have been passed. Only as to the third, fourth, and fifth checks was the bank injured by Critten's negligence in failing to report the first two alterations. Therefore, for these checks alone was Critten precluded from asserting the alterations.

How much of an examination does the depositor have to make to satisfy his duty to the bank? It is of little help to say he must examine the vouchers in a way consistent with prevailing business standards. What these are is for the jury to say. Of course his duty will necessitate an examination of the drawer's signature.⁶⁴ It should also include a comparison of the amounts of the checks and the names of the payees with those listed on the stubs.⁶⁵ One court held that the depositor fulfills his duty by examining only the cancellations if he has no stubs to check them by and the forgery is too skillful to be detected without an examination of stubs.⁶⁶ In short, the depositor probably has no duty to stub his checks, but if he does, he must include an examination of the stubs in his search for forgeries and alterations. As was shown above, the depositor does not have to make this examination himself. He may delegate the duty to an employee, but he will be charged with knowledge of what an honest employee would have discovered if the employee making the examination does not report the wrongdoing.⁶⁷

IV. DEPOSITOR'S DUTY TO INSPECT FOR FORGED ENDORSEMENTS

It is universally recognized that the depositor has no duty to inspect

64. *Morgan v. United Mortgage & Trust Co.*, 208 N.Y. 218, 101 N.E. 871 (1913).

65. *Union Tool Co. v. Farmers' & Merchants Nat'l Bank*, 192 Cal. 40, 218 Pac. 424 (1923). The bank had to bear the loss, however, because it had been negligent in not discovering the forgery upon presentment of the check for payment.

66. *Deer Island Fish & Oyster Co. v. First Nat'l Bank*, *supra* note 59.

67. *Critten v. Chemical Nat'l Bank*, *supra* note 60.

his cancelled checks for forged endorsements.⁶⁸ This is a recognition of the probability that the depositor will not be familiar with the payee's signature. For example, if the check is stolen by an agent of the payee and cashed by forging the payee's endorsement, there is only an infinitesimally small chance that the drawer could detect this by examining the endorsements. But suppose the check is purloined by an agent of the drawer. There is at least a possibility, because he might be familiar with his agent's signature, that diligent inspection of the endorsements would lead to a discovery of the agent's defalcation. For this reason Professor Britton suggests that the depositor should be under a duty to inspect for forged endorsements made by his own agents.⁶⁹ This rationale could certainly be extended to create a duty for the depositor to inspect for forgeries by his wife, his children, his business associates, or for that matter, anyone with whose signature he should be familiar.

Notwithstanding the absence of a duty to investigate for forged endorsements, if the depositor should happen to discover that a check charged to him bears a forged endorsement, he is under a duty to report this to the bank within a reasonable time.⁷⁰ Failure to do so will result in his being precluded from asserting the forgery as a defense if the bank is harmed by such failure.⁷¹ Here again, if the bank was negligent itself in paying an obviously forged instrument, or if the bank was not prejudiced by the depositor's failure to discover the forgery, it will not be aided by the defense of negligence.

V. EFFECT OF PROVISION IN SIGNATURE CARD OR STATUTE ON DRAWER'S DUTY TO GIVE NOTICE OF FORGED SIGNATURES, ENDORSEMENTS, AND ALTERATIONS

Suppose there is a provision in the signature card that the depositor will report all errors to the bank within a specified time—for example, ten days—after receiving the cancellations. One case held this would bind the depositor if it were called to his attention and he assented to it.⁷² Most courts have struck these provisions down, however, on a

68. See, e.g., *Jordan Marsh Co. v. National Shawmut Bank*, 201 Mass. 397, 87 N.E. 740 (1909); *New York Cas. Co. v. Sazenski*, 240 Minn. 202, 60 N.W.2d 368 (1953); *Sprague v. West Hudson County Trust Co.*, 92 N.J. Eq. 639, 114 Atl. 344 (1921).

69. BRITTON § 143. This is quite similar to the problem talked about in the discussion dealing with depositor's negligence resulting in his employee's forging his paper. There the duty imposed on the depositor was to discover defalcations before the checks were negotiated; here the duty would be to discover employee forgeries after the cancellations are returned to the depositor.

70. *National Sur. Co. v. President & Directors of Manhattan Co.*, 252 N.Y. 247, 169 N.E. 372 (1929).

71. *Ibid.*

72. *Brunswick Corp. v. Northwestern Nat'l Bank & Trust Co.*, 214 Minn. 370, 8 N.W.2d 333 (1943).

number of grounds. Primary among these are: (1) that the time for discovery is too short to be fair to the depositor,⁷³ and (2) that the provision was not called to the depositor's attention.⁷⁴

At least forty states have statutory time limits within which notice must be given if the depositor is to be able to assert the forgery or alteration in his defense.⁷⁵ The U.C.C.'s provision is more or less representative of other statutes although there is substantial variation in them.⁷⁶ The Code's provisions may be broken down thusly:

1. The depositor has a duty to use reasonable care in inspecting the statement of account sent him by the bank for forgeries of his signature and alterations, and must notify the bank promptly upon discovering any error in the statement.⁷⁷

2. If the bank establishes that the depositor failed in this duty and it suffered loss thereby, the depositor is precluded from asserting the forgery or alteration unless he can show the bank failed to use reasonable care in paying the item.⁷⁸

3. Without regard to care or lack of care by either the depositor or the bank, a depositor who does not notify the bank of an alteration or forged signature within one year, or of a forged endorsement within three years, of the time he receives his vouchers, is precluded from asserting the forgery or alteration against the bank.⁷⁹

It should be apparent that the statutes imposing an absolute time limit on giving notice do not free the depositor of his duty to make a prompt inspection when he receives his cancellations.⁸⁰ The statutory time limit simply establishes a cutoff point beyond which a drawer cannot for any reason recover from the bank. It neither sets a standard of reasonable care nor states what is a reasonable time for giving notice. Thus if a forgery or alteration could have been discovered by a reasonable inspection and wasn't, or if a defect

73. *Frankini v. Bank of America Nat'l Trust & Sav. Ass'n*, 86 P.2d 686 (Cal. App. 1939), subsequent opinion reported in 31 Cal. App. 2d 666, 88 P.2d 790 (1939).

74. *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 182 Pac. 293 (1919); *First Nat'l Bank v. American Sur. Co.*, 77 Ga. App. 112, 30 S.E.2d 402 (1944); *Detroit Piston Ring Co. v. Wayne County Home Sav. Bank*, *supra* note 46.

75. U.C.C. §4-406, comment 1.

76. U.C.C. § 4-406.

77. U.C.C. § 4-406(1).

78. U.C.C. §§ 4-406(2)-(3).

79. U.C.C. § 4-406(4). The section has another provision prohibiting the payor bank from asserting a claim against a collecting bank or other prior party to the paper if it has a valid defense against the depositor's claim and fails to assert it.

80. For cases construing state statutes on the same point see, *e.g.*, *McCormick v. Rapid City Nat'l Bank*, 67 S.D. 444, 293 N.W. 819, *modified on rehearing on other grounds*, 67 S.D. 586, 297 N.W. 39 (1940); *Denbigh v. First Nat'l Bank*, 102 Wash. 546, 174 Pac. 475 (1918).

was discovered but this fact was not related to the bank within a reasonable time, the depositor will still suffer the loss if the bank was prejudiced thereby, even though the depositor may have given notice prior to the expiration of the statutory time limit.⁸¹

VI. CONCLUSION

In redefining or expanding the duty of the drawer in light of contemporary changes in the concept of commercial due care, and in interpreting the various statutes in this area, courts will do well to remember that the basic consideration in their decisions must be the promotion of certainty. For as was said in the opening paragraph, uncertainty hinders negotiability, and in a nation dependent upon the unlimited use of commercial paper to sustain its business activities, the acceptance of this paper by those who are parties thereon, as well as by those who are not, is imperative.

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81. Conceivably an argument could be made in states not having the Code that the legislature by statute has stated that a "reasonable" time is six months or one year, or whatever time is stated in the statute as being the time for giving notice; therefore, any notice given within that time is reasonable even though the depositor may have discovered the wrongdoing much earlier.