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Bills and Notes -- Interpretation of "All Prior Endorsements Guaranteed"

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It is submitted that an act based on the above suggestions would go a long way toward meeting the present need for relieving hard pressed debtors without destroying their businesses and without working undue hardships on their creditors; and that such an act might well be enacted by Congress as a system of relief alternate to bankruptcy.

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Bills and Notes—Interpretation of "All Prior Endorsements Guaranteed."

A draft was endorsed without authority by an attorney of the payee and deposited for collection in a bank which forwarded it with "all prior endorsements guaranteed" to the drawee who on the back of the draft had reserved the right to determine the authority of an attorney endorsing it. *Held:* Under these particular facts, the collecting bank by its endorsement guaranteed to the drawee only the genuineness of the prior endorsement and not the authority of the endorser.[1]

Incited by the decision in two cases in which the drawee bank could not recover back the money paid on a forgery, where the collecting bank had used a restrictive endorsement, the New York Clearing House in 1896 adopted a rule requiring its members to send no paper through the exchange which was restrictively endorsed, unless all prior endorsements were guaranteed.[2] Their lead has since been followed by practically every clearing house in the country.

Adequate protection is afforded to an endorsee who is a holder in due course both in the case of forgeries and unauthorized prior

[1] Holloway v. Barbee *et al.*, 203 N. C. 713, 166 S. E. 895 (1932). Inquiry has revealed that this case is regarded by some as holding that "all prior endorsements guaranteed," guarantees to the drawee only the genuineness of prior endorsements and not the authority of the endorser. This is an erroneous view since the court decides no more than that such endorsement guarantees only the genuineness of prior endorsements where the drawee has assumed the risk of the authority.

The bank is designated as a drawee in this comment, since under §87 of the N. I. L., "Where an instrument is made payable at a bank, it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon."

[2] First National Bank of Belmont v. First National Bank of Barnesville, 58 Ohio St. 207, 50 N. E. 723 (1898). Many of the clearing houses no longer use the form "all prior endorsements guaranteed," but the members contract to assume such responsibility. Some of the forms in use are: "endorsements guaranteed," "previous endorsements guaranteed," "absence of endorsements guaranteed," "absent endorsement hereby supplied and guaranteed."

endorsements by the Negotiable Instruments Law.[3] But under that law, the drawee is not a holder in due course.[4] The transaction between the collecting bank and the drawee is one of payment and not of purchase.[5]

Nevertheless where the collecting bank is the owner of the instrument, if the drawee bank pays money on a forged or unauthorized endorsement, it is permitted to recover from the collecting bank on the ground of implied warranty of genuineness,[6] an implied promise to refund money paid under a mistake of fact[7] or negligence.[8] However, where the paper is restrictively endorsed by the collecting bank, it being merely agent and not owner, the absence of either an express or implied warranty necessitates a special guarantee for the protection of the drawee.[9] The situation is now dealt with by the use of the endorsement, "all prior endorsements guaranteed." Such guarantee is meant to give to the drawee the same safeguards which are enjoyed by an endorsee for value under an unrestrictive endorsement. It is addressed to both drawee and subsequent purchaser and its guarantee to the former as to prior endorsements includes

[3] NEGOTIABLE INSTRUMENTS LAW §66. Packard v. Windholz, 88 App. Div. 365, 84 N. Y. Supp. 666 (1903); Leonard v. Draper, 187 Mass. 563, 73 N. E. 644 (1905).

[4] National Bank of Commerce v. Farmers' & Merchants' Bank, 86 Neb. 841, 128 N. W. 522 (1910); First National Bank v. Brule National Bank, 38 S. D. 396, 161 N. W. 616 (1917); Woodward v. Savings & Trust Co., 178 N. C. 184, 100 S. E. 304 (1919); American Hominy Co. v. Millikan National Bank, 273 Fed. 550 (S. D. Ill. 1920); First National Bank v. U. S. National Bank, 100 Ore. 264, 197 Pac. 547 (1921). Presentation to the drawee for payment is not a negotiation of the check; for payment transmits the paper from a negotiable instrument into a mere cancelled voucher. Bank of Pulaski v. Bloomfield State Bank, 226 N. W. 119 (Iowa 1929); Louisa National Bank v. Kentucky National Bank, 239 Ky. 302, 39 S. W. (2d) 497 (1931).

[5] Neal v. Coburn, 92 Me. 139, 42 Atl. 348 (1898); National Bank of Commerce v. Mechanics American National Bank, 148 Mo. App. 1, 127 S. W. 429 (1910).

[6] Crocker-Woolworth National Bank v. Nevada Bank, 139 Cal. 564, 73 Pac. 456 (1903); Wellington National Bank v. Robbins, 71 Kan. 748, 81 Pac. 487 (1905); Moler v. State Bank of Bigelow, 176 Minn. 449, 223 N. W. 780 (1929); Anglo-California Trust Co. v. French American Bank, 108 Cal. App. 354, 291 Pac. 621 (1930); First National Bank v. Federal Reserve Bank of Minneapolis, 88 Mont. 589, 294 Pac. 1105 (1931).

[7] First National Bank v. City National Bank, 182 Mass. 130, 65 N. E. 24 (1902).

[8] Bank of Pulaski v. Bloomfield State Bank, *supra* note 4. NEGOTIABLE INSTRUMENTS LAW §196: "The rules of the Law Merchant shall govern in any case not provided for in this act." However, in the absence of negligence, the case would have been similarly decided on the ground of implied warranty or mistake of fact.

[9] Crocker-Woolworth National Bank v. Nevada Bank, *supra* note 6.

everything that its does to the latter.[10] The courts have held it to cover the genuineness of prior endorsements[11] (*i. e.* not forgeries), missing endorsements[12] and endorsements signed without authority by another.[13] It has also been said to guarantee any discrepancy or irregularity in prior endorsements.[14] The purpose of such endorsement is generally conceded to be to guarantee the genuineness, validity and regularity in every respect as an inducement to the drawee to pay.[15] The interpretation of such endorsement by both the clearing houses[16] and the Banker's Bank Collection Code[17] is in harmony with the above.

It is submitted that to construe the endorsement in any other way would be inconsistent with its *raison d'être.* The drawee's inability because of distance to determine easily for itself the validity of prior endorsements is no greater in the case of forgeries than in the case of unauthorized endorsements. However, the result in the principal case is not opposed to the foregoing authority. The court decides that here, the bank guaranteed only the genuineness of the endorsement, apparently on the ground that the drawee waived the protection of a portion of the guarantee by expressly reserving the right to determine the authority of the endorser. But it would seem that such reservation of right was more indicative of a desire for additional security than of a waiver.[18]

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[10] State v. Broadway National Bank, 153 Tenn. 113, 282 S. W. 194 (1926); Philadelphia National Bank v. Fulton National Bank, 25 Fed. (2d) 995 (N. D. Ga. 1928).

[11] Second National Bank v. Guarantee Trust & Safe Deposit Co., 206 Pa. 616, 56 Atl. 72 (1903); Philip Greer & Bros. Lumber Co. v. First National Bank, 143 Miss. 454, 109 So. 274 (1926); First National Bank of Winnesboro v. First National Bank of Quitman, 299 S. W. 856 (Tex. 1927); Real Estate-Land Title & Trust Co. v. United Security Co., 303 Pa. 273, 154 Atl. 593 (1931).

[12] City Trust Co. v. Botting, 139 Misc. Rep. 684, 248 N. Y. Supp. 204 (1930).

[13] McKinnon v. Boardman, 170 Fed. 920 (C. C. A. 2d, 1909); Endlich v. Bank of Black Creek, 200 Wis. 175, 227 N. W. 866 (1929). As to stock exchange rule see: Clarkson Home for Children v. Mo., K. & T. Ry. Co., 182 N. Y. 47, 74 N. E. 571 (1905).

[14] 2 PATON'S DIGEST (1926) §2755 (a). Where a payee is named "J. F. Smith" and the endorsement is "John Smith."

[15] An inquiry conducted among some of the outstanding banks in the country revealed this to be the prevalent view.

[16] First National Bank v. U. S. National Bank, *supra* note 4; Merchants' National Bank v. Continental National Bank, 98 Cal. App. 523, 277 Pac. 354 (1929).

[17] BANK COLLECTION CODE, §4. The code, to date, has become law in 18 states.

[18] The drawee doubtless would not have paid the draft had the bank's