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Banks—Forged Checks—Recovery by the Drawee Bank.—Mechanics National Bank of Worcester v. Worcester County Trust Company

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Federal standard is applied there would be nothing to prevent the States from frustrating Federal tax liens by statutorily labeling what now is characterized a lien as a property transfer from debtor to creditor.

The *Durham* classification could equally have satisfied the definition of a lien in the nature of a "mechanic's lien" which by virtue of § 67 of the Bankruptcy Act[15] would be valid even though made while the debtor was insolvent and within four (4) months of the petition of Bankruptcy, but would have been subjected to the Federal standard of "choateness" in order to qualify as a prior lien with respect to the Federal tax lien. However, since such transmutation was characterized by the State, or by the Federal Court's interpretation of the State law, as a property transfer, the Court never reaches the Federal question of the priority of liens. The Court in the *Durham* case accepted the State law determination as not unreasonable but failed to discuss the merits of the characterization. It cannot be determined from the cases what standard of reasonableness, if any, the Court is applying when viewing State property classifications but it would not be too conjectural to anticipate an amendment to the Bankruptcy Act defining exactly what property classification will be reasonable, based probably on a standard of "ownership incidents," if State law should develop so as to frustrate the Federal tax lien. However, even if such an eventuality were to transpire, an assignment for the benefit of creditors, as in the instant case, should most readily satisfy any reasonable standard.

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Banks—Forged Checks—Recovery by the Drawee Bank.— ***Mechanics National Bank of Worcester v. Worcester County Trust Company.***[1]— On September 9, 1952, an unknown man presented a $3940 check to a teller at the defendant Worcester County Trust Company (hereinafter referred to as the Trust Co.). The check, dated September 5, 1952, was drawn on the plaintiff National Bank of Worcester (hereafter referred to as National), payable to "cash" and signed "Anthony A. Borgatti." It was indorsed "Ralph Scola." The stranger also presented a deposit slip in the amount of $340 in the name of Ralph Scola, which was the name of one of the Trust Co.'s depositors. The indorsement and the deposit slip signatures were not in the same handwriting and the "S" in "Scola" had been scratched over. The Trust Co.'s teller took the check and deposit slip from the stranger without requiring identification and without comparing the signatures with the signature of Scola in the files. National's bookkeeper informed the Trust Co.'s teller by telephone that National had no account in the name of the drawer but had one in the name of "Brigida Borgatti, Conservator for Antonio Borgatti." The teller then credited Scola's account with the $340

[15] 30 Stat. 564 (1898), as amended, 11 U.S.C. § 107 (1958).

[1] 170 N.E.2d 476 (Mass. 1960).

deposit and paid over $3600 to the stranger. The Trust Co. indorsed the check, stating that it was payable to "the order of any bank, banker or Trust Co." and that "prior indorsements [were] guaranteed." On September 10, 1952, the Trust Co., as holder, presented the check for payment at Worcester Clearing House and National paid it by crediting the Trust Co.'s clearing house balance. National then charged the check to the Conservator's account. On September 19, 1952, National learned that the signatures of the drawer and Scola were forgeries and immediately notified the defendant Trust Co. Upon hearing that its depositor, Scola, knew nothing of the $340 deposit, the Trust Co. charged this amount to his account and paid it to National. National, seeking recovery of the $3600, brought suit in the Superior Court and a judgment was rendered in its favor. The Supreme Judicial Court of Massachusetts affirmed. HELD: Plaintiff drawee was entitled to recover from the defendant-cashing bank for money paid under a mistake of fact.

To the general rule that money paid under a mistake of fact can be recovered, the early English case of *Price v. Neal*[2] engrafted an important exception, i.e., that as between equally innocent parties the drawee must suffer the loss resulting from its failure to detect the forgery of its depositor's signature.[3] Most jurisdictions hold that the rule of *Price v. Neal* is itself subject to an exception, which permits recovery by the drawee of money paid on a forged check from one guilty of bad faith or negligence in taking the check.[4] This exception is most frequently invoked to permit recovery against a bank or other party who received a forged check from a stranger without identification.[5] The Court, in the instant case, held *Price v. Neal* inapplicable stating that the situation was controlled by *First National Bank of Danvers v. First National Bank of Salem,*[6] which illustrates the application of the above mentioned latter exception to a bearer check.[7]

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[2] 3 Burr. 1354, 97 Eng. Rep. 871 (1762).

[3] This is because a drawee of a draft is presumed to know the signature of his customer, the drawer.

[4] A hint of this exception is found in Price v. Neal itself, for in his opinion Lord Mansfield observed that "if there was any fault or negligence in any one, it certainly was in the plaintiff (drawee) and not in the defendant (holder).

[5] National Bank of North America of Boston v. Bangs, 106 Mass. 441 (1871) holds that in a Price v. Neal situation the drawee may recover the money if paid to a holder who purchased it from a stranger. Accord: First National Bank of Danvers v. First National Bank of Salem, 151 Mass. 280, 24 N.E. 44 (1890); State Bank of Chicago v. First National Bank of Omaha, 87 Neb. 351, 127 N.W. 244 (1910); Ellis & Morton v. Ohio Life Ins. & Trust Co., 4 Ohio St. 628 (1855); Greenwald v. Ford, 21 S.D. 28, 109 N.W. 516 (1906); People's Bank v. Franklin Bank, 88 Tenn. 299, 12 S.W. 716 (1838). Contra: Howard v. Mississippi Valley Bank, 28 La. Ann. 727 (1876); Commercial & Farmers' Bank of Baltimore v. First National Bank of Baltimore, 30 Md. 11 (1868); Salt Springs Bank v. Syracuse Savings Inst., 62 Barb. (N.Y.) 101 (1863); Bank of St. Albans v. Farmers' & M. Bank, 10 Vt. 141 (1838).

[6] 151 Mass. 280, 24 N.E. 44 (1890).

[7] In that case, the plaintiff-drawee was permitted to recover from the defendant, which cashed for a stranger a forged check payable to "Joel Kimball or bearer," despite the rule of Price v. Neal.

Section 62 of the NIL states that:

> "The acceptor by accepting the instrument engages that he will pay according to the tenor of his acceptance; and admits—1. The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument . . . ."

It is thus seen that Section 62 makes no explicit mention of forged checks, nor does it grant an exemption to the liability of the drawee when a forged check has been accepted by it under circumstances similar to those in the present case. But, several American courts have held that the NIL incorporates not only the doctrine of *Price v. Neal* but also the exception which allows the drawee to recover from the person to whom payment is made on a showing of the negligence, fraud or bad faith of such person.[8] How the holder's negligence affects the liability of the drawee has, however, presented some difficulty. Such negligence has been found to be immaterial when it appeared that the drawee was also negligent in making payment of an instrument on which the drawer's signature had been forged; the drawee's negligence in such a case has been termed "negligence at law" or constructive negligence.[9]

For a drawee to recover in Massachusetts it must be shown not only that the defendant-cashing-bank contributed to the success of the fraud or mistake of fact under which payment was made, but also, that the drawee was free from actual fault.[10] Since, in the instant case, no question of fraud is raised, the decision is correct under the common law of Massachusetts only if the Trust Co. is guilty of bad faith or negligence[11] and there is an absence of actual fault on the part of the plaintiff-drawee.[12]

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[8] The courts assume that the doctrine of Price v. Neal, with all its common law exceptions, real or apparent, have been carried into the Act or are available through § 196 NIL. Citizen's Bank of Fayette v. J. Blach & Sons, Inc., 228 Ala. 246, 153 So. 404 (1934); First Nat'l Bank of Orleans v. State Bank of Almo, 22 Neb. 769, 36 N.W. 289 (1888); First Nat'l Bank of Portland v. United States Bank of Portland, 100 Ore. 264, 197 P. 547 (1921); Newberry Savings Bank v. Bank of Columbia, 19 S.C. 294, 74 S.E. 615 (1912); First Nat'l Bank of Pukwana v. Brule Nat'l Bank, 41 S.D. 87, 168 N.W. 1054 (1918). In Massachusetts, Price v. Neal is held to be law, not by judicial construction of G.L. c. 107, § 85, NIL § 62, but as a principle of the common law which was unaffected by the uniform statute. South Boston Trust Co. v. Levin, 249 Mass. 45, 143 N.E. 816 (1924).

[9] First Nat'l Bank of Wichita Falls v. First Nat'l Bank of Borger, 37 S.W.2d 802 (Tex. Civ. App. 1931).

[10] Gloucester Bank v. Salem Bank, 17 Mass. 33, 42 (1820), "If the loss can be traced to the fault or negligence of either party, it should be fixed upon him."; National Bank of North America of Boston v. Bangs, supra note 4, at 444; First National Bank of Danvers v. First National Bank of Salem, supra note 6, at 283, 24 N.E. at 45, "In the absence of actual fault on the part of the drawee, his constructive fault in not knowing the signature of the drawer, and detecting the forgery, will not preclude his recovery from one who took the check under circumstances of suspicion, without proper precaution, or whose conduct has been such as to mislead the drawer, or induce him to pay the check without the usual security against fraud."

[11] Ibid.

[12] Ibid.

The Trust Co. argued, inter alia, (1) that since the check was a bearer instrument[13] and the indorsement "Ralph Scola" was thus superfluous, its failure to require identification of the person presenting the check and to compare the indorsement with the real Scola's file signature was therefore not negligence; and (2) that National should be charged with actual fault[14] in that its negligence, in crediting the Trust Co.'s clearing house balance, charging the conservator's account and in delaying so long before discovering the forgery, was the sole proximate cause of the loss suffered by it. Further, that since National had available to it an easy means of protecting itself,[15] its failure to take this simple precaution when it was obvious that the purported drawer was not a depositor or customer of the bank was ample evidence of lack of care of National for its own circumstances.

Danvers[16] presented a singularly similar fact situation and its holding would seem to nullify the Trust Co.'s first contention. The court said:

> "It [plaintiff] had a right to believe that the defendant, in cashing the check purporting to be drawn by one not its own customer . . . had by the usual and proper investigation satisfied itself of its authenticity. The indorsement, which was not necessary to the transfer of the check, was a guaranty of the signature of the drawer, and the plaintiff had a right to believe that the indorser was known to the defendant by proper inquiry."[17]

Phase two of the Trust Co.'s argument in the present case was also rejected by the court. It exonerated National of actual fault by adopting the trial judge's findings that:

> ". . . there was no contributory negligence on the part of the plaintiff . . . that had any causal relation with the acts that eventually led to the damages sustained."[18]

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[13] As such it would be negotiable by delivery alone and without the necessity of indorsement by the bearer.

[14] The theory was that no harm came to the plaintiff until it honored the check and the time for returning the same pursuant to the clearing house rules had elapsed.

[15] National, when it received the telephone call from the Trust Co.'s teller, could in some manner, significantly, have marked the Conservator's account records so that the check would never be charged against the account. This would insure that it would never be subject to any loss as a result of the check in question. It would protect the plaintiff against that possibility if the defendant or another party would present the check for payment.

[16] Supra note 6.

[17] Supra note 6, at 284, 24 N.E. at 45. The courts are not in agreement on this point. Farmers' & Merchants' Bank v. Bank of Rutherford, 115 Tenn. 64, 88 S.W. 939 (1905) [explained in Farmers' National Bank of Augusta v. Farmers' National Bank of Maysville, 159 Ky. 141, 166 S.W. 986 (1914)] holds that it is not negligence to take a bearer check from an unidentified person.

[18] Although the trial judge found that the plaintiff erred in receiving the check upon the clearing house balance, he held that the error was not the cause of the loss, since if the plaintiff had disclaimed the check the defendant "would have been the party damaged by the . . . (conduct) of its own teller." The judge also found that the plaintiff erred in debiting the amount of the check to the Conservator's account. He found,

It is believed that the decision is correct under the existing common law of Massachusetts.[19]

The Uniform Commercial Code, now law in Massachusetts[20] and eight other states,[21] provides in Section 3-302 that a "holder in due course" is:

> ". . . a holder who takes the instrument (a) for value; and (b) in good faith; and (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person."

It is submitted that the Trust Co., in the instant case, would be considered a "holder in due course" under the Code since it took the check for value[22] and in good faith[23] and the facts do not show that it had notice as defined in Section 3-304.[24] In this circumstance, it would seem that

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however, that this mistake was not harmful to the defendant. In support of this conclusion the judge said that it was true that National, upon discovery of the fraud, was under a duty to notify the defendant in order to reduce any loss that might result, but that National had performed this duty with dispatch. The Trust Co.'s claim that plaintiff's prompt return of the check would have enabled it to more quickly investigate and ascertain the identity of the imposter, was dismissed by the trial judge on the ground that the claim was only in the realm of possibility and not of probability. The judge's conclusions seem at first blush to be based on "boot-strap" reasoning until it is understood that in a case like the present one, the court is determining who shall bear the loss. Even though it appears that the plaintiff is already "out-of-pocket," it seems that the court considers the loss as suspended in air until it determines who caused it and thus who will be required to bear it. The result of this approach is that although the plaintiff has seemingly already incurred a loss, since the damage was done when the forger walked out of the defendant's bank with the money and since defendant's negligence allowed this damage, the defendant must bear the loss which descends and attaches to it as soon as the court determines that defendant's negligence caused it, and that whatever negligence was attributable to the plaintiff was not the proximate cause of the loss.

[19] Although the court does not refer to the defendant as a "holder in due course," it is interesting to observe that one may be a "holder in due course," even though he received the instrument from a stranger, or was otherwise negligent in acquiring it, provided he acted in good faith. Brannan, Negotiable Instruments Law 636-42 (6th ed. 1938). Thus the right to retain the proceeds of a forged check does not follow from the fact that the recipient was a holder in due course; it must also appear that he was not negligent. See Brannan, supra, at 771. Professor Britton says that, "The explanation can be found possibly in the fact that the techhical rule as to who are holders in due course is not involved in the Price v. Neal situation, and possibly in the fact that by making negligent purchase the basis for the drawee's recovery the court thereby narrows the field within which the rule may operate." Britton, Bills and Notes 632 (1943).

[20] Mass. Gen. Laws Ann. ch. 106 (1958).

[21] Pennsylvania (1953), Kentucky (1958), Connecticut (1959), New Hampshire (1959), Rhode Island (1960), Arkansas (1961), New Mexico (1961), and Wyoming (1961).

[22] UCC § 3-303 says that a holder takes an instrument for value "(a) to the extent that the agreed consideration has been performed . . . ."

[23] "Good faith" is defined in § 3-201 as ". . . honesty in fact in the conduct or transaction concerned."

[24] UCC § 3-304 states in part that, "(1) The purchaser has notice of a claim or defense if (a) the instrument is so incomplete, bears such visible evidence of forgery or

the Code provision applicable to the transaction would be Section 3-418 (Finality of Payment or Acceptance) which states that:

> "Except for recovery of bank payments as provided in Article on Bank Deposits and Collections (Article 4)[25] and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment."

Section 3-418 meets the problem of the principal case head-on in Comment (4), which states that:

> "The section rejects decisions under the original Act permitting recovery on the basis of mere negligence of the holder in taking the instrument. If such negligence amounts to a lack of good faith as defined in this Act (Section 1-201)[26] or to notice under the rules (Section 3-304)[27] relating to notice to a purchaser of an instrument, the holder is not a holder in due course and is not protected; but otherwise the holder's negligence does not affect the finality of the payment or acceptance."

Thus, under Section 3-418, once the Trust Co. is found to be a holder in due course, the drawee-bank is precluded from recovering.

In addition, it seems that the drawee could not recover on a breach of warranty of the genuiness of the drawer's signature, since under the Code where the holder obtains the drawee's acceptance or payment without knowledge (no showing that Trust Co. knew of the forgery) that the drawer's signature was unauthorized there is no warranty as to the genuineness of such signature running from the holder to the drawee-bank.[28] Nor could the drawee recover on the theory of breach of warranty of the genuineness of prior indorsements. The Code does not require an indorsement for a bearer instrument,[29] and so it seems that the Code's provision that one who obtains payment of a draft warrants the genuineness of any indorsements through which he claims to hold is inapplicable to bearer paper, even if, as here, the bearer has indorsed.

It is believed that the UCC modified existing law to such an extent

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alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay . . . ."

[25] This section is limited by the bank collection provision (§ 4-301) permitting a payor to recover a payment improperly paid if it returns the item or sends notice of dishonor within the limited time provided in that section, but it is submitted that § 4-301 would not affect the decision of a question like the present one.

[26] Supra note 23.

[27] Supra note 24. Notice is also defined in § 1-201: "A person has notice of a fact when (a) he has actual knowledge of it; or (b) he has received a notice or notification of it; or (c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists."

[28] UCC § 3-417. See also § 4-207.

[29] UCC § 3-202.

that the present case would have been decided differently if the cause of action had arisen after the Code had been enacted. If this be the case, one wonders why the court failed to seize upon this opportunity to render a decision in consonance with current legislative thinking in this area of the law.

ROBERT F. MCGRATH
Article and Book Review Editor

Constitutional Law—Due Process—Single Act Statute Will Subject Foreign Corporation to State Jurisdiction.—***Atkins v. Jones & Laughlin Steel Corp.***[1]—Jones & Laughlin, a Pennsylvania corporation,[2] manufactured liner and metal containers, and sold them to the defendant Montanin Co., a New York corporation, for use by Montanin's agents in bottling and labeling a hydrofluorsilicic acid, for subsequent resale by Montanin Co. Montanin had no agent, office, or qualification as a foreign corporation in Minnesota, and its only contacts in that state consisted in shipment of its product F.O.B. New York upon direct order from resident consumers, or indirect order from resident independent distributors. Operations had been carried on in this manner in Minnesota for fifty years, Montanin accepting all orders in New York, and billing consumers direct. Although the independent distributors did receive commissions on sales from their orders, there was allegedly no implied or express contractual relationship between them and Montanin. The plaintiff, a truck driver for a Minnesota carrier for the deliveries in Minnesota, was injured as a result of inhaling toxic fumes allegedly produced by leakage from a faulty container of acid. The suit was commenced pursuant to a Minnesota statute[3] which provided that commis-

[1] 104 N.W.2d 888 (Minn. 1960).

[2] The defendant Jones & Laughlin had no agents, made no contracts, and maintained neither an office nor solicitors in Minnesota. In fact its only connection with the principal case is that it manufactured the container for Montanin's acid, and allegedly inspected same without due care, since there was evidence that one of them was faulty—thus the claim against Jones & Laughlin on the basis of manufacturer's liability. This defendant did not appear in the case either specially to challenge jurisdiction, or to plead to the merits, and therefore suffered judgement by default as to the jurisdictional issue. It is submitted that this judgement might be challenged in another forum should action on a judgment be sought after successful trial on the merits still pending.

[3] Minn. Stat. Ann. § 303.13, subd. 1 (1957). "A foreign corporation shall be subject to service as follows:

(3) If a foreign corporation makes a contract with a resident of Minnesota to be performed in whole or in part by either party in Minnesota, or if such foreign corporation commits a tort in whole or in part in Minnesota against a resident of Minnesota, such acts shall be deemed to be doing business in Minnesota by the foreign corporation and shall be deemed equivalent to the appointment by the foreign corporation of the Secretary of the State of Minnesota and his sucessors to be its true and lawful attorney upon whom may be served all lawful process in any actions or proceedings against the foreign corporation arising from or growing out of such contract or tort . . . the making of the contract or the committing of the tort shall be deemed to be the agreement of the foreign corporation that any process against it which is so served upon the Secretary of State shall be of the same legal force and effect as if served personally within the State of Minnesota."