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NEGLIGENCE AND NEGOTIABLE INSTRUMENTS

DOUGLAS J. WHALEY†

Following the death of her husband, Mrs. Anna Bagby discovered that she and her two children were beneficiaries of the Savings and Profit Sharing Pension Fund of Sears, Roebuck and Company, the husband's former employer. Before the children could receive benefits from the fund, Mrs. Bagby had to be appointed as their legal guardian, and to achieve this end she hired a Kansas City, Missouri, attorney named Marshall Lyons. She was duly appointed, and Lyons sent the required documents to Sears. Shortly thereafter, as part of the pension plan, Sears issued several shares of its own stock to Mrs. Bagby, registered in her name both individually and as guardian of the children. Unfortunately, Sears sent the stock to Lyons, and he decided to sell it for his own benefit.

Enter Merrill Lynch, Pierce, Fenner & Smith, Inc., stockbrokers. Without Mrs. Bagby's knowledge, Lyons opened an account for her with Merrill Lynch and on four occasions in the spring of 1968 had Merrill Lynch sell the Sears stock and issue checks payable to Anna Bagby but delivered to him. He then forged her name to the backs of the checks, signed his own name and deposited the checks in his personal account with a local bank, which forwarded them to the drawee bank, the Commerce Bank of Kansas City, and received payment. Mrs. Bagby eventually found out what was going on and sued Merrill Lynch for conversion of the shares of stock. Merrill Lynch brought a third-party action against its bank, the Commerce Bank of Kansas City, for paying the checks without a proper indorsement,¹ and this bank passed on the lawsuit in the form of a fourth-party action against Lyon's bank, which had guaranteed the validity of the payee's indorsement when making collection of the checks.²

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1. The basis for an action by the drawer of a check against the drawee bank for improperly charging his account is found in UNIFORM COMMERCIAL CODE § 4-401, which permits a bank to honor checks only if they are "properly payable." A check which the payee has not indorsed is not "properly payable," and it is basic negotiable instruments law that a forged payee's signature has no legal effect as an indorsement; *see id.* § 3-404.

2. Federal Reserve regulations require member banks to stamp such a guarantee on all checks in the federal check collection machinery. A similar UCC warranty is automatically made on presentment of the check; *see id.* §§ 3-417(1)(a), 4-207(1)(a).

Mrs. Bagby's suit was settled, but Merrill Lynch's third-party action went to trial in a federal court in Missouri. The banks based their defense on section 3-406 of the Uniform Commercial Code, which reads:

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 against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business.

To establish Merrill Lynch's negligence, the banks proved that both New York Stock Exchange rules and Merrill Lynch's own operations manual established a strict "Know Your Customer" rule and forbade stockbrokers to deal with a purported attorney for a customer without checking with the customer himself, getting a written power of attorney, and sending duplicates of all communications to the customer as well as to the attorney.³ Failure of a stockbroker to observe the rigid identification procedures of the New York Stock Exchange rules can result in civil liability under the Federal Securities Exchange Act.⁴ The banks argued that, given this absolute duty, Merrill Lynch was negligent in issuing the checks in question without checking with Mrs. Bagby to ascertain whether she was the customer the rule required them to "know" and if so, whether she authorized Merrill Lynch to deal with her through Lyons. The district court so held in *Bagby v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, but on appeal the Eighth Circuit reversed.⁵

The Eighth Circuit agreed with the district court that Merrill Lynch was negligent, but found that negligence in the *issuance* of the check was not the "proximate cause" of the loss, "proximate cause" being the relevant question under pre-Code Missouri law. The court noted that in the earlier Missouri decisions⁶ the drawer was precluded

3. See N.Y. STOCK EXCHANGE rules 401, 405 reprinted along with the *Merrill Lynch Operations Manual* in the district court's opinion, *Bagby v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 348 F. Supp. 969, 976-77 nn.2-5, 11 UCC Rep. Serv. 766, 774-76 nn.2-5 (W.D. Mo. 1972), *rev'd*, 491 F.2d 192, 13 UCC Rep. Serv. 1069 (8th Cir. 1974).

4. See Comment, *The "Know Your Customer" Rule of the NYSE: Liability of Broker-Dealers Under the UCC and Federal Securities Laws*, 1973 DUKE L.J. 489, 506 n.64 (describing the mechanics of the identification required by the NYSE "Know Your Customer" rule).

5. 348 F. Supp. 969, 11 UCC Rep. Serv. 766 (W.D. Mo. 1972), *rev'd*, 491 F.2d 192, 13 UCC Rep. Serv. 1069 (8th Cir. 1974).

6. Specifically *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938); *American Sash & Door Co. v. Commerce Trust Co.*, 332 Mo. 98, 56 S.W.2d 1034

from recovering only when his negligence led to the *forgery*, not merely to the *issuance* of the check. Section 3-406 of the UCC, according to the court, had no effect on this pre-Code rule.

What does the court mean when it says that the negligence of Merrill Lynch led to the issuance of the check but not the forgery? Is it that the negligence was not the "proximate cause" of the loss? These questions, and the further one of whether the court was right in its reading of section 3-406, are the topics of this article. When I began this project I discovered that no one (that I could find) had ever written more than a few words about this one area in which negligence and negotiable instruments law overlap. I soon tumbled onto the reason why. It requires a specialist in both fields to say anything meaningful about the subject, and few scholars have the time to conquer these two diverse fields.⁷ While I profess to know something about negotiable instruments, the complicated ideas still being hotly contested in the negligence arena are not my usual playthings (though I spent a not inconsiderable amount of time in my first year of law school scrutinizing them under the watchful eye of the eminent torts scholar, Leon Green).⁸ Still the subject is too important to be ignored, and someone

(1933). These cases were both clearly overruled by UNIFORM COMMERCIAL CODE § 3-405(1)(c) (the "impostor" rule) which makes the court's reliance on them a bit strained.

7. The only law review article to tackle the subject directly is Britton, *Negligence in the Law of Bills and Notes*, 24 COLUM. L. REV. 695 (1924), a rather short (though helpful) discussion. For partial treatment, useful ideas can be found in Note, *Careless Spaces on Negotiable Instruments*, 31 HARV. L. REV. 779 (1918); Comment, *Allocation of Losses from Check Forgeries under the Law of Negotiable Instruments and the Uniform Commercial Code*, 62 YALE L.J. 417 (1953). Good source materials on the meaning of UNIFORM COMMERCIAL CODE § 3-406, particularly on the technical title problems, are in J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* §§ 16-5 to -7 (1972); Palizzi, *Forgeries and Double Forgeries Under Articles 3 and 4 of the UCC*, 42 S. CAL. L. REV. 659 (1969).

8. Leon Green hates the term "proximate cause" and has attacked it in innumerable books and articles. See, e.g., L. GREEN, *RATIONALE OF PROXIMATE CAUSE* (1927); many of his splendid law review articles on the subject are collected in L. GREEN, *THE LITIGATION PROCESS IN TORT LAW* (1965). One of the articles not reprinted there is Green, *Proximate Cause in Texas Negligence Law*, 28 TEXAS L. REV. 471 (1950), where he had this to say about proximate cause:

In little more than a century proximate cause has come to dominate the administration of negligence law. Its glamor is probably due to several factors. Having no integrated meaning of its own, its chameleon quality permits it to be substituted for any one of the elements of a negligence case when decision on that element becomes difficult. The ease with which it permits the lumping of a whole case into a single conceptual bundle saves the pains of bit by bit consideration of details and holds out the temptation to save the time and trouble required for basic analysis. The inability to identify its meaning for sure renders it immune to effectual argument. No court that takes refuge in "proximate cause" can ever be convicted of error except by a higher court that does likewise. Moreover there is a sort of pretension to philosophic learning implied in seeking a solution of a difficult problem through a search for

has to make a start at explaining the concepts involved. Though I have now done much reading in the negligence field, I am hardly an expert, and I invite anyone who is to try a similar article from that point of view.

The end result of my ruminations is that the court meant that even had Lyons been authorized by Mrs. Bagby to receive (but not sign) her checks, he might still have forged her name to them and appropriated the proceeds. Thus, the negligent delivery (issuance) of the checks to Lyons was not necessarily the cause of the loss to the bank—the criminal act of Lyons and the failure of the collecting banks to detect the forgery was the “proximate cause” of the loss. Though it is a close case, I have come to the conclusion that the court was wrong and that section 3-406 calls for a different test and arguably a different result.

To follow my reasoning it is necessary to look at the common law, the relevant Uniform Commercial Code sections, and the legal development of etiology (the study of causation). We begin with a little history.

I. THE PRE-CODE POSITION

The 1827 English case of *Young v. Grote*⁹ was the first major case to use the doctrine of drawer's negligence to excuse a drawee who had paid out the drawer's funds in a manner not authorized by the drawer's order. The drawer, Peter Young, signed five blank checks and left them with his wife while he went on a business trip. She was to use the checks to pay the wages of his employees. One of these—the villain of the case—showed her how to fill out the check for fifty pounds, but instructed her so that she left sufficient blanks in which he “raised” the amount to three hundred and fifty pounds and cashed the check with the drawee. Upon his return, Young sued his bankers, contending that he had ordered them to pay only fifty pounds. The Court of Common Pleas recognized the general rule that a banker must pay checks strictly according to the drawer's order, but held that the rule did not apply when the drawer was “at fault” and guilty of “gross negligence.”

“a,” “the,” or “the sole,” or some other of the numerous variants of the “proximate cause” concept. No other formula . . . so nearly does the work of Aladdin's lamp.

Id. at 471-72. Green's dislike of “proximate cause” is so strong that there was a rumor among his students that anyone using the term on the exam, even to comment on it unfavorably, was a certain failure. Doubtless the rumor was untrue, but no one had the temerity to try it. I may mention that the man is much loved by his students.

9. 130 Eng. Rep. 764 (C.P. 1827).

The court thought it negligent to have left the signed blank checks with "a female" instead of with "a person conversant with business as well as trustworthy." This unfortunate male chauvinistic language has often been criticized,¹⁰ but the case is quite sound on its more general premise that it is negligence to leave blank, signed checks about without taking great care to insure that they will be properly completed. To the extent that the blanks are completed in an unauthorized manner, the drawer has elected to take the risk and cannot pass the loss onto his bank. The case has often been cited by later courts as the premier recognition of a *duty* of the drawer to the drawee to draw checks in a fashion preventing easy alteration.¹¹

Young v. Grote seems an obvious enough decision, and in similar fact situations (where drawers sign blank checks and leave them lying about) all courts reached the same result.¹² *Young v. Grote* was not, however, a popular decision in either England¹³ or the United States,¹⁴ and the courts usually refused to extend it beyond its own facts. The reason, I suspect, was two-fold. The courts looked with suspicion on any rule which favored a large solvent bank over its frequently impecunious customer, and the courts were reluctant to impose gigantic financial penalties for what was often a small fault. In the retreat from *Young v. Grote*, some courts said that the rule did not apply to promissory notes at all.¹⁵ The rationale most often given was that the maker owed no duty to later holders and was not in privity with them in the same way that a drawer was tied to his bank by a pre-existing contract. The later holders were not forced to take the promissory note so that their voluntary action in doing so subjected them to the risk of criminal conduct on the part of their transferor.¹⁶ Other courts found the maker

10. See W. BRITTON, HANDBOOK OF THE LAW OF BILLS & NOTES 664 (2d ed. 1961).

11. *Holmes v. Trumper*, 22 Mich. 427, 436-37 (1871); *Foutch v. Alexandria Bank & Trust Co.*, 177 Tenn. 348, 359, 149 S.W.2d 76, 80 (1941).

12. See, e.g., *Phillips v. A.W. Joy Co.*, 114 Me. 403, 96 A. 727 (1916); *S.S. Allen Grocery Co. v. Bank of Buchanan County*, 192 Mo. App. 476, 182 S.W. 777 (1916).

13. See *Baxendale v. Bennett*, 3 Q.B.D. 525 (1878) (refusing to hold an acceptor liable where an accepted draft with no drawer's name was left unattended in a writing table, stolen and negotiated to a holder in due course). The English reaction to *Young v. Grote* is discussed in W. BRITTON, *supra* note 10, at 664-65; Note, 31 HARV. L. REV., *supra* note 7, at 779-81.

14. See *Walsh v. Hunt*, 120 Cal. 46, 52 P. 115 (1898); *Hart v. Moore*, 171 Miss. 838, 158 So. 490 (1935).

15. *Knoxville Nat'l Bank v. Clark*, 51 Iowa 264, 1 N.W. 491 (1879); *Cape Ann Nat'l Bank v. Burns*, 129 Mass. 596 (1880); *Greenfield Sav. Bank v. Stowell*, 123 Mass. 196 (1877); *Holmes v. Trumper*, 22 Mich. 427 (1871); cf. *Foutch v. Alexandria Bank & Trust Co.*, 177 Tenn. 348, 373, 149 S.W.2d 76, 85 (1941).

16. See the Michigan Supreme Court's lengthy discussion of this point in *Holmes v. Trumper*, 22 Mich. 427, 435 (1871).

of the note or the drawer of a draft liable when he left blanks in the body of the instrument that were later improperly filled in, but not liable for carelessly leaving spaces in an apparently complete instrument when a wrongdoer used the spaces to change the nature of the obligation.¹⁷ In drawing this distinction, most courts talked in terms of *duty*; those preparing commercial paper have a duty to guard against improper completion of blanks, but have no duty to see to it that every possible space on the instrument is rendered harmless.¹⁸ One court, in much-quoted language, said:

Whenever a party in good faith signs a complete promissory note, however awkwardly drawn, he should, we think be equally protected from its alteration by forgery in whatever mode it may be accomplished

If promissory notes were only given by first-class business men who are skillful in drawing them up in the best possible manner to prevent forgery, it might be well to adopt the high standard of accuracy and perfection which the argument in behalf of plaintiff in error would require. But for the great mass of people who are not thus skillful, nor in the habit of frequently drawing or executing such paper, such a standard would be altogether too high, and would place the great majority of men, of even fair education and competency for business, at the mercy of knaves and tend to encourage forgery by the protection it would give to forged paper.¹⁹

As negligence law developed its doctrinal jargon, many courts drifted away from an inquiry into duty and began to ask whether the negligence of the instrument's creator was the "proximate cause" of the injury. A few courts borrowed the "last human wrongdoer" rule from tort law²⁰ and held that the action of the wrongdoer—the intervening criminal activity—was the proximate cause of the loss; the negligence of the drawer or payee was irrelevant.²¹ Thus in *Home Indemnity Co.*

17. See, e.g., *National Exch. Bank v. Lester*, 194 N.Y. 461, 78 N.E. 779 (1909).

18. *Id.* See also *Critten v. Chemical Nat'l Bank*, 171 N.Y. 219, 224, 63 N.E. 969, 971 (1902) ("It is not the law that [the drawer] is bound so to prepare the check that nobody else can successfully tamper with it").

19. *Holmes v. Trumper*, 22 Mich. 427, 435 (1871). Note that the court assumes that forgery and material alteration are the same thing and call for the same rules. There is of course a difference between them, forgery being the wrongful signing of another's name and alteration being the changing of the terms of the instrument. See *UNIFORM COMMERCIAL CODE* §§ 1-201(43), 3-404, -407. Nonetheless, both the courts and the UCC treat the two problems as identical for purposes of determining the legal effect of negligence leading to one or the other. See *id.* § 3-406.

20. See generally *Eldredge, Culpable Intervention as Superseding Cause*, 86 U. PA. L. REV. 121 (1937); *Feezer, Intervening Crime and Liability for Negligence*, 24 MINN. L. REV. 635 (1940).

21. *Walsh v. Hunt*, 120 Cal. 46, 52 P. 115 (1898); *Bank of Herington v. Wangerin*, 65 Kan. 423, 70 P. 330 (1902); *Glasscock v. First Nat'l Bank*, 114 Tex. 207,

v. State Bank,²² the Iowa Supreme Court held it was *not* negligence to hire a paroled ex-forgery, put him in charge of the company's claims department, and not supervise his activities to see if he was practicing his old trade;²³ but the court noted that even had this been negligence, the proximate cause of the drawee bank's loss was the forger's activities and not the negligent supervision by the employer. "If it was negligence, it was not proximate negligence."²⁴

[T]he negligence or conduct to be a defense against the negotiable instrument, must amount to a representation operating as an estoppel, and not the mere mistaken issuance of the check, or the possible cause of the forger's getting its possession. The fraud committed upon the drawer, or his negligence in not discovering the imposition upon him, and the forgery of the endorsement and the wrong committed on the collecting bank are independent torts. The latter are causes which intervene between the negligent issuance of the check and its payment.²⁵

This idea—that negligence in the *issuance* of the check was not the proximate cause of the loss—was picked up and adopted by many,²⁶ but not all,²⁷ courts. As observed above, the Eighth Circuit in the *Bagby* case found that the doctrine lives on in spite of section 3-406 of

266 S.W. 393 (1924); *Greenville Nat'l Exch. Bank v. Nussbaum*, 154 S.W.2d 672 (Tex. Civ. App. 1941); cf. *Saugerties Bank v. Delaware & Hudson Co.*, 236 N.Y. 425, 141 N.E. 904 (1923) (similar result in spent bill of lading problem).

22. 233 Iowa 103, 8 N.W.2d 757 (1943).

23. As to the hiring of a convicted forger, the court said that the Board of Parole thought him worthy of another try and noted that "he had good references." The court presumed as a matter of law that this was not negligence:

One of the purposes of punishment for crime is reformation of the wrongdoer. We may fairly assume this object is accomplished. Was [the employer] reasonably justified in accepting this view? Certainly the company's efforts in seeking to give such unfortunates an opportunity to regenerate themselves were laudable. It had employed many such parolees. Placing trust in them certainly would be helpful in giving them a more hopeful outlook.

Id. at 151, 8 N.W.2d at 784. For similar conclusions see *First Nat'l Bank v. Barnes*, 44 Idaho 167, 255 P. 907 (1927) (not negligent for mother to entrust checks to her ex-convict son); *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938) (not negligent to rehire an employee fired for embezzling \$12,500 and put in charge of financial records).

24. 233 Iowa at 155, 8 N.W.2d at 786.

25. *Id.* at 156, 8 N.W.2d at 786. The intervening criminal activity rule applied as well to alteration of the instrument as to forgery. See Bigelow, *Alteration of Negotiable Instruments*, 7 HARV. L. REV. 1, 9 (1893).

26. *Washington Loan & Trust Co. v. United States*, 134 F.2d 59 (D.C. Cir. 1943); *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 182 P. 293 (1919); *American Sash & Door Co. v. Commerce Trust Co.*, 332 Mo. 98, 56 S.W.2d 1034 (1933); *Fitzgibbons Boiler Co. v. National City Bank*, 287 N.Y. 326, 39 N.E.2d 897 (1942); *Coffin v. Fidelity-Philadelphia Trust Co.*, 374 Pa. 378, 97 A.2d 857 (1953); *Land Title Bank & Trust Co. v. Cheltenham Nat'l Bank*, 362 Pa. 30, 66 A.2d 768 (1949); *Morris Plan Bank v. Continental Nat'l Bank*, 155 S.W.2d 407 (Tex. Civ. App. 1941).

27. *Connecticut Sav. Bank v. First Nat'l Bank & Trust Co.*, 138 Conn. 298, 84 A.2d 267 (1951); *Goldsmith v. Atlantic Nat'l Bank*, 55 So. 2d 804 (Fla. 1951); *Foutch*

the UCC.²⁸ In one circumstance, however, all the courts reached the result that negligence in the issuance was the proximate cause of the loss—when the drawer mailed the check to someone having the same name as the payee intended to receive the check; however, none of the opinions explained the apparent inconsistency with their other decisions.²⁹ In *S. Weisberger Co. v. Barberton Savings Bank Co.*,³⁰ the Ohio Supreme Court held that the drawer was estopped by its negligence from suing its bank for reimbursement when the drawer, owing a debt to a Max Roth living in New York, mailed a check to Max Roth in Cleveland, and the latter cashed the check and made off with the proceeds. Here there was negligence in the issuance, but the drawee bank escaped liability. The court said, "The misdirected letter was the source of possibilities that became realities in this case. In other words, the plaintiff was first at fault, and its mistake made possible what in fact has transpired."³¹ The court added that where two innocent

v. Alexandria Bank & Trust Co., 117 Tenn. 348, 149 S.W.2d 76 (1941); *Defiance Lumber Co. v. Bank of Cal.*, 180 Wash. 533, 41 P.2d 135 (1935).

28. The now repealed Negotiable Instruments Law, which was in effect when many of these decisions were written, was no more help than section 3-406. Section 23 of the NIL invalidated forgeries unless the alleged signer was "precluded" from setting up the forgery; cf. UNIFORM COMMERCIAL CODE § 3-404. The courts held that "precluded" meant "estopped" and that any estoppel was grounded on ratification or negligence; see, e.g., *Citizens' Union Nat'l Bank v. Terrell*, 244 Ky. 16, 50 S.W.2d 60 (1932); *First Nat'l Bank v. Albright*, 111 Pa. Super. 392, 170 A. 370 (1934); Woodward, *The Risk of Forgery or Alteration of Negotiable Instruments*, 24 COLUM. L. REV. 469, 472 (1924); Annot., 87 A.L.R.2d 638 (1963); Annot., 39 A.L.R.2d 641 (1955). The NIL had no general provision on the effect of negligence. As to material alteration, the NIL appeared to provide for absolute discharge of the drawer or maker irrespective of his negligence. NEGOTIABLE INSTRUMENTS LAW §§ 15, 124. At least one court so held. *Commercial Bank v. Arden & Fraley*, 177 Ky. 520, 197 S.W. 951 (1917), criticized in W. BRITTON, *supra* note 10, at 668. Other courts held that the NIL worked no change on the law of negligence and subsequent material alterations; see, e.g., *S.S. Allen Grocery Co. v. Bank of Buchanan County*, 192 Mo. App. 476, 182 S.W. 777 (1916).

29. *United States v. Union Trust Co.*, 139 F. Supp. 819 (D. Md. 1956) (confusion in VA office resulting in years of mismailed checks); *Citizens' Union Nat'l Bank v. Terrell*, 244 Ky. 16, 50 S.W.2d 60 (1932) (probate settlement check mailed to wrong person); *Slattery & Co. v. National City Bank*, 114 Misc. 48, 186 N.Y.S. 679 (New York City Mun. Ct. 1920) (stockbroker mailed check to wrong client having same name as owner of stock); *S. Weisberger Co. v. Barberton Sav. Bank Co.*, 84 Ohio St. 21, 95 N.E. 379 (1911) (see text accompanying notes 30-32 *infra*); *Jones v. Citizens Nat'l Bank*, 106 Okla. 162, 233 P. 472 (1923) (holding that drawer was negligent in mailing a check to wrong payee, but that this negligence was not available as a defense in a suit by the drawee bank against the depository bank). The only cases to the contrary are either very old, *Graves v. American Exch. Bank*, 17 N.Y. 205 (1858), or have since been impliedly overruled. Compare *State Bank v. Mid-City Trust & Sav. Bank*, 232 Ill. App. 186, 129 N.E. 498 (1924), with *Park State Bank v. Arena Auto Auction, Inc.*, 59 Ill. App. 2d 235, 207 N.E.2d 158, 2 UCC Rep. Serv. 903 (1965) (a UCC case reaching a result in harmony with the above decisions); cf. UNIFORM COMMERCIAL CODE § 3-406, Comment 7.

30. 84 Ohio St. 21, 95 N.E. 379 (1911).

31. *Id.* at 31, 95 N.E. at 381.

persons are involved in a lawsuit, "justice imposes the burden upon him who is first at fault and put in operation the power which resulted in the fraud or forgery."³²

It is hard to see why negligence in the issuance in this situation is the "proximate cause" of the loss and in other situations it is not. Similarly, we must ask why courts denied recovery to a drawer or maker who negligently signed an instrument containing blanks, but permitted his recovery in many cases in which he carelessly left large spaces on an apparently complete instrument. One simple answer is that the negligence of the drawer/maker was a bar to his assertion of forgery or alteration if his conduct was considered to be outrageous in the sense of "grossly negligent" or "commercially unreasonable." This explanation does not account for decisions like the Iowa case discussed above³³ in which the employer hired a paroled felon and did not carefully watch his handling of the company's checks, but was still allowed to recover from its bank. Surely this conduct is extremely negligent. On the other hand, the mailing of a check to a payee with the same name as the intended recipient, while careless, does not seem to be outrageous or grossly negligent conduct, particularly if the drawer is a large company with thousands of creditors; yet, here, the courts uniformly imposed estoppel by negligence. In addition, the "outrageous conduct" test does not explain why many courts held the creator of an instrument bound by blanks completed by a wrongdoer but not by spaces, even large ones, left on the instrument and utilized by a malefactor. "Outrageous conduct" was of course the basis of many decisions,³⁴ but most

32. *Id.* This "two innocent persons" rule has been variously stated and is regularly trotted out to decorate an opinion in which the court has decided to let the negligence be a bar to the lawsuit; see *Cureton v. Farmers' State Bank*, 147 Ark. 312, 318, 227 S.W. 423, 424 (1921) ("[T]he loss must fall upon that one whose acts contributed most to produce it."); *Goldsmith v. Atlantic Nat'l Bank*, 50 So. 2d 804 (Fla. 1951); *Citizens' Union Nat'l Bank v. Terrell*, 244 Ky. 16, 50 S.W.2d 60 (1932); *Phillips v. A.W. Joy Co.*, 114 Me. 403, 96 A. 727 (1916); *Garrard v. Haddan*, 67 Pa. 82, 85 (1870); *Defiance Lumber Co. v. Bank of Cal.*, 180 Wash. 533, 41 P.2d 135 (1935). On the other hand, when the negligence is excused by the court, the "two innocent persons" rule is generally pooh-poohed; see *Bank of Herington v. Wangerin*, 65 Kan. 423, 70 P. 330 (1902) (rule applies only where trust reposed in wrongdoer); *Holmes v. Trumper*, 22 Mich. 427 (1871) (rule applies only where the wrongdoer is the agent of the maker); *Broad St. Bank v. National Bank*, 183 N.C. 463, 112 S.E. 11 (1922) (rule applies only where the wrongdoer was an agent of the drawer). See also *Gresham State Bank v. O & K Constr. Co.*, 231 Ore. 106, 115-19, 370 P.2d 726, 729, 1 UCC Rep. Serv. 276, 280 (1962) (the first UCC case to consider whether this was a substantive defense; the court concluded it was not).

33. See text accompanying note 22 *supra*.

34. Examples of a more liberal use of the "negligence as estoppel" principle are *Connecticut Sav. Bank v. First Nat'l Bank & Trust Co.*, 138 Conn. 298, 84 A.2d 267 (1951) (delivery of check to non-agent); *Goldsmith v. Atlantic Nat'l Bank*, 55 So. 2d

courts demanded something more. I submit that this "something more" was the complete inability of later parties to protect themselves from the negligent party's conduct.

In the situation of a drawer of a check who simply signs an instrument containing one or more blanks that later are improperly filled in, no amount of care by the drawee bank can detect the wrongdoing, at least in the typical case. It is not unusual for check writers to let someone else fill in the body of the check, and the drawee dishonors such a check at the risk of substantial damages.³⁵ The same thing is true of holders purchasing a promissory note with blanks completed by someone other than the maker—hardly an extraordinary circumstance. How are they to know the completion is unauthorized? When the drawer mails the check to someone having the same name as the payee, the wrongful recipient will be able to produce legitimate identification when the check is cashed; the drawee has no way of knowing that the drawer meant the check to go elsewhere.

In the cases in which the negligence was held not to be a bar to the drawer/maker's recovery, the drawee or the later holders had some chance, though sometimes a slim one, to detect the wrongdoing and avoid the loss. Thus the use of spaces between words on an instrument to change the original obligation may act as a red light (or at least a pink one) to those taking the instrument due to the necessarily cramped appearance or the contrast with the other words. If there is negligent supervision of employees or issuance of a check to a non-agent, the wrongdoer must still convince someone that the forged indorsement is valid or the check cannot be negotiated. It is this existence of a second chance to avoid the loss that dispelled the effect of the earlier negligence at common law.

II. THE UNIFORM COMMERCIAL CODE POSITION

The basic position taken by the Uniform Commercial Code is that

804 (Fla. 1951) (letting employee fill out own paycheck and signing by employer without noting spaces making check easily raised); *Hackett v. First Nat'l Bank*, 114 Ky. 193, 70 S.W. 664 (1902) (accommodation maker liable for signing note containing spaces used by the maker to raise the amount); *Harvey v. Smith*, 55 Ill. 224 (1870) (using pencil held to be "gross carelessness"); *Foutch v. Alexandria Bank & Trust Co.*, 177 Tenn. 348, 149 S.W.2d 76 (1941) (negligence of drawer was letting payee make out the check in pencil and leaving spaces thereon); *Defiance Lumber Co. v. Bank of Cal.*, 180 Wash. 533, 41 P.2d 135 (1935) (failure to supervise employee).

35. See UNIFORM COMMERCIAL CODE § 4-402, which limits the bank's responsibility for *mistaken* dishonor. As for *deliberate* dishonor, the bank may still be subject to punitive damages. See J. WHITE & R. SUMMERS, *supra* note 7, at § 17-4.

forgery³⁶ and material alteration³⁷ render an instrument ineffective unless the defendant is precluded from raising these defenses. This "preclusion" may take the form of ratification,³⁸ apparent authority granted to a non-agent by careless conduct on the part of a principal,³⁹ and negligence. Negligence as a precluding act is dealt with under three different sections: section 3-405, which establishes the validity of forged signatures in imposter/fictitious payee situations, section 3-406, the basic negligence rule quoted above in the discussion of the *Bagby* case, and section 4-406, dealing with failure of the drawer to examine his bank statements and discover the wrongdoing. It is these latter three sections, and particularly section 3-406, with which we are concerned.

Section 3-405⁴⁰ is a codification and extension of the common law "impostor" rule⁴¹ and the "fictitious payee" rule found in section 9(3) of the Negotiable Instruments Law.⁴² The "impostor" rule places the

36. UNIFORM COMMERCIAL CODE § 3-404(1) states: "Any unauthorized signature is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it; but it operates as the signature of the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value."

37. *Id.* § 3-407(2) provides that a fraudulent material alteration by a holder completely discharges any party whose contract is changed thereby, "[u]nless that party . . . is precluded from asserting the defense . . ." A holder in due course and the drawee bank may enforce the instrument according to its original tenor; *id.* §§ 3-407(3), 4-401(2). As to blanks in instruments see *id.* § 3-115.

38. See *id.* § 3-404. Ratification, for negotiable instrument purposes, occurs when the party in question, with full knowledge of the forgery or alteration, accepts the benefits thereof or actively assents to the wrongful activity; see *Rakestraw v. Rodrigues*, 8 Cal. 3d 67, 500 P.2d 1401, 104 Cal. Rptr. 57, 11 UCC Rep. Serv. 780 (1972); cf. *Salsman v. National Community Bank*, 102 N.J. Super. 482, 246 A.2d 162, 5 UCC Rep. Serv. 779 (L. Div. 1968), *aff'd per curiam*, 105 N.J. Super. 164, 251 A.2d 460, 6 UCC Rep. Serv. 168 (App. Div. 1969).

39. See UNIFORM COMMERCIAL CODE § 3-403(1) & Comment 1. The major UCC case is *Senate Motors, Inc. v. Industrial Bank*, 9 UCC Rep. Serv. 387 (D.C. Super. Ct. 1971). For pre-Code cases finding apparent authority in an agent to cash the alleged principal's checks see *Corbett v. Kleinsmith*, 112 F.2d 511 (6th Cir. 1940); *Commercial Cas. Ins. Co. v. Isbell Nat'l Bank*, 223 Ala. 48, 134 So. 810 (1931); *Arcade Realty Co. v. Bank of Commerce*, 180 Cal. 318, 181 P. 66 (1919); *Rosser-Moon Furniture Co. v. Oklahoma State Bank*, 192 Okla. 169, 135 P.2d 336 (1943).

40. UNIFORM COMMERCIAL CODE § 3-405(1) states:

(1) An indorsement by any person in the name of a named payee is effective if

- (a) an impostor by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee; or
- (b) a person signing as or on behalf of a maker or drawer intends the payee to have no interest in the instrument; or
- (c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.

41. For an example of the common law version of the impostor rule (which was usually based on the drawer's negligence in failing to ascertain the true identity of his issuee) see *Cureton v. Farmers' State Bank*, 147 Ark. 312, 227 S.W. 423 (1921).

42. NEGOTIABLE INSTRUMENTS LAW § 9(3) provided that an instrument was bearer

risk of forgery on the maker/drawer if he has been duped into issuing the instrument to a person posing as the payee. The section 3-405 (1)(a) version of this rule rejects the occasional pre-Code cases that relied on the "negligent issuance not proximate cause" rationale to permit the drawer/maker to assert the forgery.⁴³ Sections 3-405(1)(b) and (c) validate the forged payee's signature whenever the drawer/maker (or his agent or employee) does not intend that the named payee have an interest in the instrument. The normal situations requiring the application of this rule involve an employee of the drawer who either pads the payroll by adding phoney employees or submits non-existent bills from supposed creditors⁴⁴ and then absconds with proceeds of the resulting checks. There are fifty or more pre-Code cases holding that check issuance in this situation was not the proximate cause of the loss, and section 3-405 overthrows them completely.⁴⁵ Official Comment 4 to section 3-405 states the policy justification for imposing liability on the employer:

The principle followed is that the loss should fall upon the employer as a risk of his business enterprise rather than upon the subsequent holder or drawee. The reasons are that the employer is

paper when it was knowingly made payable to the order of a fictitious person. Under section 3-405 of the UCC such paper is order paper (not bearer) and requires the apparent indorsement of the nominal payee. See UNIFORM COMMERCIAL CODE § 3-405, Comment 1.

43. See, e.g., *Land Title Bank & Trust Co. v. Cheltenham Nat'l Bank*, 362 Pa. 30, 66 A.2d 768 (1949).

44. There is considerable doubt as to whether section 3-405 applies to the agent's submission of the names of real creditors having currently due claims. See *Snug Harbor Realty Co. v. First Nat'l Bank*, 105 N.J. Super. 572, 253 A.2d 581, 6 UCC Rep. Serv. 689 (App. Div. 1969), *aff'd per curiam*, 54 N.J. 95, 253 A.2d 545 (1969); J. WHITE & R. SUMMERS, *supra* note 7, at § 16-8 (good discussion of this and other § 3-405 problems).

45. Included in this list are some of the most cited negligence/negotiable instruments cases, among which are the two Missouri cases relied upon by the Eighth Circuit in *Bagby*; see note 6 *supra*. Since these cases are overruled by the Code on their major point, hopefully their precedential value will collapse and the courts will examine the subject anew. Cases excusing the drawer from the onus of his negligence in situations where he would now be bound under section 3-405 are, e.g., *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 182 P. 293 (1919); *Home Indem. Co. v. State Bank*, 233 Iowa 103, 8 N.W.2d 757 (1943); *Grand Lodge v. State Bank*, 92 Kan. 876, 142 P. 974 (1914); *Jordan Marsh Co. v. National Shawmut Bank*, 201 Mass. 397, 87 N.E. 740 (1909); *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938); *City of New York v. Bronx County Trust Co.*, 261 N.Y. 64, 184 N.E. 495 (1933); *National Sur. Co. v. President & Directors of Manhattan Co.*, 252 N.Y. 247, 169 N.E. 372 (1929); *Gutfreund v. East River Nat'l Bank*, 251 N.Y. 58, 167 N.E. 171 (1929); *Coffin v. Fidelity-Philadelphia Trust Co.*, 374 Pa. 378, 97 A.2d 857 (1953). The reason these cases were not resolved under the "fictitious payee" rule of NEGOTIABLE INSTRUMENTS LAW § 9(3) was that the technical drawer of the check was not the forger himself, but a clerk who did intend the check to be paid to the named individual. The NIL had no section equivalent to UNIFORM COMMERCIAL CODE § 3-405(1)(c).

normally in a better position to prevent such forgeries by reasonable care in the selection or supervision of his employees, or, if he is not, is at least in a better position to cover the loss by fidelity insurance; and that the cost of such insurance is properly an expense of his business rather than of the business of the holder or drawee.

Note that section 3-405 does not depend on negligence *vel non* of the drawer/maker but rather imposes strict liability for the forgeries resulting from these situations. The section also protects later parties even if they are negligent themselves (unlike sections 3-406 and 4-406). Only the forger himself is liable to the drawer-maker.⁴⁶

The "bank statement rule" found in section 4-406 of the UCC resolves the pre-Code conflict over the effect of a drawer's failure to examine his bank statement.⁴⁷ Subsection (1) of section 4-406 es-

46. Subsection (2) of section 3-405 states that the section shall not "affect the criminal or civil liability of the person so indorsing." Though the drawee bank's negligence is immaterial in section 3-405 problems, the bank must still observe a standard of good faith to escape liability. *Prudential Ins. Co. of America v. Marine Nat'l Exch. Bank*, 371 F. Supp. 1002, 14 UCC Rep. Serv. 462 (E.D. Wis. 1974).

47. UNIFORM COMMERCIAL CODE § 4-406 states in full:

(1) When a bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries or holds the statement and items pursuant to a request or instructions of its customer or otherwise in a reasonable manner makes the statement and items available to the customer, the customer must exercise reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof.

(2) If the bank establishes that the customer failed with respect to an item to comply with the duties imposed on the customer by subsection (1) the customer is precluded from asserting against the bank

(a) his unauthorized signature or any alteration on the item if the bank also establishes that it suffered a loss by reason of such failure; and

(b) an unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank after the first item and statement was available to the customer for a reasonable period not exceeding fourteen calendar days and before the bank receives notification from the customer of any such unauthorized signature or alteration.

(3) The preclusion under subsection (2) does not apply if the customer establishes lack of ordinary care on the part of the bank in paying the item(s).

(4) Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.

(5) If under this section a payor bank has a valid defense against a claim of a customer upon or resulting from payment of an item and waives or fails upon request to assert the defense the bank may not assert against any collecting bank or other prior party presenting or transferring the item a claim based upon the unauthorized signature or alteration giving rise to the customer's claim.

tablishes the duty of the bank's customer to use reasonable care and promptness in examining the statement and discovering and reporting his unauthorized signature or any alteration of the checks. If the bank demonstrates that the customer failed to do this and that it suffered a loss thereby, the customer is precluded by subsection (2) from complaining about that particular check, or later ones if other forgeries or alterations are committed by the same wrongdoer and these checks are paid fourteen days after the statement was available to the customer (the "repeated offenses" rule).⁴⁸ If, however, the customer can establish that the bank itself failed to use ordinary care in paying the check, the section then adopts the common-law rule that none of the above applies, and the customer is not estopped by his failure to examine the statement.⁴⁹ Thus there is no balancing test or rule of contributory negligence; if the bank failed to use ordinary care it always loses, whether the customer was negligent or not.

Section 3-406 (the "negligence" rule) has a similar provision.⁵⁰ Under section 3-406 the negligence leading to a material alteration or an unauthorized signature is immaterial unless the party against whom the material alteration or forgery is asserted (the later party) was either a holder in due course or a drawee or other payor paying the instrument "in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business." If the later party cannot establish his own good faith and reasonable behavior, the prior negligence is excused.

There is an important rule here for attorneys and courts with cases

This subject was covered by non-uniform statutes in more than forty jurisdictions. The leading common-law case establishing the duty to examine bank statements is *Leather Mfrs. Bank v. Morgan*, 117 U.S. 96 (1886). See also Arant, *Forged Checks—The Duty of the Depositor to His Bank*, 31 YALE L.J. 598 (1922).

48. The fourteen days for examination is a maximum not a minimum period; see the exact language in section 4-406(2)(b) reprinted in note 47 *supra*. A jury could find that the reasonable period for reconciliation was shorter than fourteen days, so that the customer would be bound on other checks paid at the end of the shorter period. See *Winkler v. Commercial Nat'l Bank*, 42 Mich. App. 740, 202 N.W.2d 468, 11 UCC Rep. Serv. 1031 (1972).

49. Cases representative of the common-law result are *Leather Mfrs. Bank v. Morgan*, 117 U.S. 96 (1886); *First Nat'l Bank v. Ketchum*, 68 Okla. 104, 172 P. 81 (1918).

50. Section 4-406 requires the bank to use "ordinary care" in paying the item; section 3-406 requires the bank to pay "in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business." Though different language is used, it is believed that the two sections require the bank to observe the same standards. See Note, *Forgeries and Material Alterations: Allocation of Risks Under the Uniform Commercial Code*, 50 B.U.L. REV. 536, 547-48 (1970). Thus decisions under either section defining what is or is not reasonable conduct by the bank should be precedent for cases arising under both sections.

in which either section 3-406 or section 4-406 is being litigated. The reasonableness of the conduct of the later party (section 3-406) or of bank (section 4-406) should always be determined *before* any attention is given to whether the other party's negligence substantially contributed to the forgery or alteration (section 3-406), or whether a customer exercised reasonable care in examining his bank statement (section 4-406). If the later party or the bank is found to be in violation of the duty of ordinary care or is not a holder in due course, there is no need to explore the issues of negligence or failure to examine the statement.

As to what is "ordinary care in paying the item" (the section 4-406(3) test) or payment "in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business" (the section 3-406 test), there are a few definite rules. First, section 4-103(3) states that conduct pursuant to Article 4 or to the Federal Reserve regulations, operating letters, clearing house rules, and general banking usage is *prima facie* the exercise of ordinary care. The attorney representing a bank in a section 3-406 or section 4-406 lawsuit is therefore well advised to investigate these matters and to introduce into evidence the above documents or expert testimony on banking usage.⁵¹ The requirement that the bank follow general banking usage of course means that the bank must observe certain routine steps before charging the customer's account, such as ascertaining that all necessary indorsements are on the check, comparing the drawer's signature with that on file, and debiting the correct account.⁵² Secondly, the courts have always held that banks and other parties taking checks are strictly accountable for ascertaining the authority of an agent to indorse or sign

51. The courts have rightfully declined to define "general banking usage" as a matter of law or to set rigid standards. See *Cooper v. Union Bank*, 27 Cal. App. 3d 85, —, 103 Cal. Rptr. 610, 616, 11 UCC Rep. Serv. 343, 352 (Dist. Ct. App. 1972), *rev'd on other grounds*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1, 12 UCC Rep. Serv. 209 (1973).

52. Cases in which the bank did not do these or similar things are *First Nat'l Bank v. Hobbs*, 248 Ark. 76, 450 S.W.2d 298, 7 UCC Rep. Serv. 323 (1970) (letting unauthorized individual sign signature card); *Taylor v. Equitable Trust Co.*, 269 Md. 149, 304 A.2d 838, 12 UCC Rep. Serv. 922 (1973) (failure to get payee's indorsement); *First Nat'l Bank & Trust Co. v. Cutright*, 189 Neb. 805, 205 N.W.2d 542, 12 UCC Rep. Serv. 313 (1973) (failure to compare check with signature card); *Mortimer Agency, Inc. v. Underwriters Trust Co.*, 73 Misc. 2d 970, 341 N.Y.S.2d 75, 13 UCC Rep. Serv. 270 (New York City Civ. Ct. 1973) (same); *Jackson v. First Nat'l Bank*, 55 Tenn. App. 545, 403 S.W.2d 109, 3 UCC Rep. Serv. 630 (1966) (same); *Frost Nat'l Bank v. Nicholas & Barrera*, 500 S.W.2d 906, 13 UCC Rep. Serv. 887 (Tex. Civ. App. 1973) (failure to get payee's indorsement); *W.P. Harlin Constr. Co. v. Continental Bank & Trust Co.*, 23 Utah 2d 422, 464 P.2d 585, 7 UCC Rep. Serv. 521 (1970) (failure to check signature card). For an article exploring whether banks actually do compare each check with the signature card see *Murray, Price v. Neal in the Electronic Age*, 87 BANKING L.J. 686 (1970).

the checks of his principal; this rule holds true in both the pre-Code⁵³ and UCC cases.⁵⁴ The authority of an agent to cash checks for another will not be presumed.⁵⁵ A corollary of this rule is that banks must exercise some care in checking the identity of a stranger opening a new account⁵⁶ or cashing a check.⁵⁷ Beyond this, only generalities are possible. The courts have said that the banks and others taking negotiable instruments will not be protected if "suspicious circumstances" should have alerted them to problems with the instrument. "Suspicious circumstances" include sloppy or obvious alterations,⁵⁸ presentment by dubious characters,⁵⁹ and, in some instances, fiduciary negotiations

53. See, e.g., *Fargo Nat'l Bank v. Massey-Ferguson, Inc.*, 400 F.2d 223 (8th Cir. 1968); *R. Mars, The Contract Co. v. Massanutten Bank*, 284 F.2d 158 (4th Cir. 1960); *Walsh v. American Trust Co.*, 7 Cal. App. 2d 654, 47 P.2d 323 (Dist. Ct. App. 1935); *Butler Produce & Canning Co. v. Edgerton State Bank*, 91 Ohio App. 385, 108 N.E.2d 324, *rev'd on other grounds*, 159 Ohio St. 267, 112 N.E.2d 23 (1952); *California Stucco Co. v. Marine Nat'l Bank*, 148 Wash. 341, 268 P. 891 (1928).

54. *Taylor v. Equitable Trust Co.*, 269 Md. 149, 304 A.2d 838, 12 UCC Rep. Serv. 922 (1973); *Salsman v. National Community Bank*, 102 N.J. Super. 482, 246 A.2d 162, 5 UCC Rep. Serv. 779 (L. Div. 1968), *aff'd per curiam*, 105 N.J. Super. 164, 251 A.2d 460, 6 UCC Rep. Serv. 168 (App. Div. 1969); *Gresham State Bank v. O & K Constr. Co.*, 231 Ore. 106, 370 P.2d 726, 1 UCC Rep. Serv. 276 (1972); *McConnico v. Third Nat'l Bank*, 227 Tenn. —, 499 S.W.2d 874, 13 UCC Rep. Serv. 641 (1973); *Womack Mach. Supply Co. v. Fannin Bank*, 499 S.W.2d 917, 13 UCC Rep. Serv. 669 (Tex. Civ. App. 1973); *DoAll Dallas Co. v. Trinity Nat'l Bank*, 498 S.W.2d 396, 13 UCC Rep. Serv. 666 (Tex. Civ. App. 1973); *Von Gohren v. Pacific Nat'l Bank*, 8 Wash. App. 245, 505 P.2d 467, 12 UCC Rep. Serv. 133 (1973).

55. *Great Am. Ins. Co. v. United States*, 481 F.2d 1298, 1311 (Ct. Cl. 1973); *Senate Motors, Inc. v. Industrial Bank*, 9 UCC Rep. Serv. 387, 392 (D.C. Super. Ct. 1971). *But see* note 41 *supra* for cases in which the courts did hold the agent had apparent authority to cash the principal's checks.

56. See *Cooper v. Union Bank*, 27 Cal. App. 3d 85, 103 Cal. Rptr. 610, 11 UCC Rep. Serv. 343 (Dist. Ct. App. 1972), *rev'd on other grounds*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1, 12 UCC Rep. Serv. 209 (1973); *Hartford Accident & Indem. Co. v. All Am. Nut Co.*, 220 Cal. App. 2d 545, 34 Cal. Rptr. 23 (1963); *Commerce-Guardian Bank v. Toledo Trust Co.*, 60 Ohio App. 337, 21 N.E.2d 173 (1938).

57. See, e.g., *First Nat'l Bank v. United States Nat'l Bank*, 100 Ore. 264, 197 P. 547 (1921). The right of a drawee bank to require identification of a presenter is found in UNIFORM COMMERCIAL CODE § 3-505(1)(b), though one court had held that this section is permissive, not mandatory; *Wright v. Bank of Cal.*, 281 Cal. App. 2d 485, 81 Cal. Rptr. 11, 6 UCC Rep. Serv. 1165 (1969). Professor Dugan has suggested that courts develop a test whereby those cashing checks would be protected only if they took them from a "qualified" person, defined as "one who acquires third-party checks in the normal course of his business," such as payroll and welfare check recipients. See Dugan, *Stolen Checks—The Payee's Predicament*, 53 B.U.L. REV. 955, 982-83 (1973).

58. *Connecticut Sav. Bank v. First Nat'l Bank & Trust Co.*, 138 Conn. 298, 84 A.2d 267 (1951); *Critten v. Chemical Nat'l Bank*, 171 N.Y. 219, 63 N.E. 969 (1902); *First Nat'l Bank v. Ketchum*, 68 Okla. 104, 172 P. 81 (1918); *Exchange Bank & Trust Co. v. Kidwell Constr. Co.*, 463 S.W.2d 465, 8 UCC Rep. Serv. 1079 (Tex. Civ. App.), *writ refused*, 472 S.W.2d 117, 9 UCC Rep. Serv. 482 (Tex. 1971).

59. In *Citizens Bank v. Blach & Sons*, 228 Ala. 246, 153 So. 404 (1934) a clothing store got stuck with a check it cashed for a stranger who was "a dirty kind of faced fellow" that "talked kind of fast" and had a "kind of a growth of beard on him."

which appear out of the ordinary.⁶⁰ Some courts have gone quite far in holding the bank responsible for investigating the underlying transaction whenever a detailed examination of the checks coupled with normal human curiosity should have led to further inquiry.⁶¹ For instance, in *Jackson v. First National Bank*,⁶² a bank was held responsible for paying a church organization's unauthorized checks made out by the church's financial secretary, payable to himself and cashed at a dog-racing track.

From the above it is apparent that the banks and others taking checks following the alleged negligence may have a difficult task in proving their own due care. Since this burden must be met *before* the prior negligence becomes relevant under sections 3-406 or 4-406, I emphasize that this issue should be tried first. These sections are, in effect, "last clear chance" statutes. If the later parties had the last chance to avoid the loss and should have seen and taken it, the prior negligence is excused.

60. Some courts have held that the bank must investigate the underlying transaction whenever it has "notice" that an agent is using his principal's fund for his own purposes. See *Jackson v. First Nat'l Bank*, 55 Tenn. App. 545, 403 S.W.2d 109, 3 UCC Rep. Serv. 630 (1966). Here the court held that a bank had such notice because the checks were made payable to the agent, by the agent, and were cashed at a dog track, all of which was apparent from an examination of the indorsements. In an age when banks handle thousands of checks each day, a rule requiring them to take cognizance of the possible significance of the indorsements seems a bit much. A better rule would permit the banks to ignore the possible meaning behind the indorsements unless special circumstances demanded closer examination of the instrument. For a decision on the duty of a depository bank taking corporate checks for the benefit of an agent see *Von Gohren v. Pacific Nat'l Bank*, 8 Wash. App. 245, 505 P.2d 467, 12 UCC Rep. Serv. 133 (1973). *Contra*, *Cooper v. Union Bank*, 27 Cal. App. 3d 85, 103 Cal. Rptr. 610, 11 UCC Rep. Serv. 343 (1972), *rev'd on other grounds*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1, 12 UCC Rep. Serv. 209 (1973).

61. My comments in the preceding footnote apply here too. In *Gutfreund v. East River Nat'l Bank*, 251 N.Y. 58, 167 N.E. 171 (1929) the plaintiff was a wholesale meat dealer who employed a dishonest clerk. The clerk drew checks payable to "Swift" (meaning "Swift & Co.", a regular creditor), and after getting the company's signature, inserted an initial before the word "Swift." He then signed the purported payee's name, indorsed the checks himself, and deposited the checks in his account with defendant bank. The court held that defendant was negligent in (1) not noting that the checks were probably meant for "Swift & Co." (defendant knew plaintiff's business), and (2) not noting that the payee's signature and the clerk's were in the same handwriting. As I said in the prior footnote, this seems an impossible burden to place on the banks. See also *Mortimer Agency, Inc. v. Underwriters Trust Co.*, 73 Misc. 2d 970, 341 N.Y.S.2d 75, 13 UCC Rep. Serv. 270 (New York City Civ. Ct. 1973) (negligent to pay a large check); *W.P. Harlin Constr. Co. v. Continental Bank & Trust Co.*, 23 Utah 2d 422, 464 P.2d 585, 7 UCC Rep. Serv. 521 (1970) (negligent to pay a large check five months old). *Contra*, *S.S. Allen Grocery Co. v. Bank of Buchanan County*, 192 Mo. App. 476, 182 S.W. 777 (1916) (not negligent to create overdraft or to pay a large check).

62. 55 Tenn. App. 545, 403 S.W.2d 109, 3 UCC Rep. Serv. 630 (1966); see discussion in note 60 *supra*.

Section 3-406, as the primary code section concerning negligence, deserves detailed examination. Since the exact language is important, it is set out again:

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 against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business.

Before defining "negligence" and "substantially contributed," there are two troublesome, technical points raised by section 3-406. The first arises from the basic rule of negotiable instruments that no one can qualify as a "holder" (and therefore as a "*holder* in due course") following the forgery of a name necessary to the chain of title.⁶³ Thus, if the payee's name is forged on the back of the check, none of the later takers will be "holders." One of section 3-406's three protected parties is a "holder in due course," but how can such an animal exist if an unauthorized signature necessary to the chain of title is placed on the instrument? If the payee's own negligence substantially contributes to the forgery of the payee's own name, section 3-406 suggests that there can be a later holder in due course, but does not explain how the defective title is cured. One explanation is that the "holder in due course" language refers only to material alteration problems, and that for forgeries, later parties must qualify as either the drawee or a "payor," with the latter term meaning those transferring the instrument for value. The problem here is that although "payor"⁶⁴ is not defined in the Code, the drafters were undoubtedly using it to mean the party making the final payment on the instrument (for example, the maker of a promissory note or the issuer of a certificate of deposit) and not an intermediary party. Nonetheless, at least one court⁶⁵ and one major commentary⁶⁶ have held or suggested that the word "payor" may be expanded to include intermediaries. Other solutions are that "holder in due course" in section 3-406 was not used in its technical

63. See W. BRITTON, *supra* note 10, at 250. For a discussion *ad nauseam* of this problem see Whaley, *Forged Indorsements and the UCC's "Holder"*, 6 IND. L. REV. 45 (1972).

64. "Payor bank" is defined in UNIFORM COMMERCIAL CODE § 4-105(b) as "a bank by which an item is payable as drawn or accepted."

65. *Gresham State Bank v. O & K Constr. Co.*, 231 Ore. 106, 370 P.2d 726 (1962); see 48 IOWA L. REV. 1077 (1963) (criticizing the case on the point in question).

66. J. WHITE & R. SUMMERS, *supra* note 7, at 540-41 n.42. The authors therein admit that this solution will "bend the devil out of the 'payor' language" and will give "the draftsman gas pains."

sense, but means instead "transferee in due course,"⁶⁷ or that the drafters did not consider the issue at all, but, had they done so, they would want the courts to extend section 3-406 by analogy to *transferees* in due course.⁶⁸

The problem is best solved by reference to UCC section 3-307, the procedural section. Under subsection (1) thereof, signatures are initially presumed to be genuine or authorized unless challenged, in which case the burden is on the person claiming thereunder. If that person can prove that the other party's negligence substantially contributed to the unauthorized signature, section 3-307 ought to preclude the negligent party from challenging the signature. Once the unchallenged signature is admitted, the non-negligent party becomes a "holder"⁶⁹ and can maintain his action per section 3-307(2). Thus, although the court ought to try the issue of whether the suing party is "in due course" first, it should reserve decision on his "holder" status until the issue of precluding negligence is resolved.⁷⁰

The second technical aspect of section 3-406 is that the section is phrased as a matter of *estoppel* to raise certain issues and does not authorize an affirmative action for negligence. This estoppel works against the negligent party only—it does not prevent other parties to the instrument from raising the matters of forgery or alteration. In one case the California Supreme Court failed to understand this point and held that the negligence validated the forgery involved and thus estab-

67. This view was first suggested by Palizzi, *supra* note 7, at 670-73.

68. J. WHITE & R. SUMMERS, *supra* note 7, at 541-42 n.42, presents quite a strong case for claiming oversight by the drafters.

69. This assumes that his title is not defective in some other manner. If there were a second unauthorized signature prior to the negotiation to him (e.g., a missing indorsement necessary to the chain of title), the suing party would not qualify as a "holder" for that reason.

70. The procedural steps in a section 3-406 lawsuit would be (1) production of the instrument; (2) examination of the instrument by the court to determine if all necessary indorsements appear to be on the instrument; (3) objection by the allegedly negligent party to the lack of authority by which one of the signatures was placed on the instrument; (4) a ruling by the court that resolution of this objection should await proof by the other party of the precluding section 3-406 negligence; (5) proof by the alleged "holder" that he took "in due course"; see UNIFORM COMMERCIAL CODE § 3-302; (6) if this last burden is carried, proof by the same individual that the other party's negligence substantially contributed to the making of the unauthorized signature; (7) a ruling by the court on this last issue (with jury consideration of the factual issues involved); (8) if section 3-406 preclusion is found, a ruling by the trial court that the negligent party is estopped to question the lack of authority by which the questioned signature was made, along with an overruling of the initial objection above and a finding that the other party is a "holder in due course." Of course if the suit is between an allegedly negligent customer and his bank, none of this is necessary since the bank need not qualify as a holder in due course, but only as a drawee which in good faith observed reasonable banking practices. See *id.* § 4-406.

lished "good title" in the transferees so that they became "holders."⁷¹ I believe that giving the transferees "good title" is a mistake because it unfairly throws the burden of litigating the issue of negligence on a remote party. If the rule is that the negligence works only as an estoppel against the negligent party, then, if a forgery necessary to the chain of title is involved, later transferees will breach the warranty of good title⁷² and will either have to take up the instrument and themselves litigate the section 3-406 issue with the negligent party or join, as third-party defendants, the lawsuit between the negligent party and the remote transferee. This can be better illustrated by the *Bagby* fact situation, assuming only that Merrill Lynch was estopped by its negligence to raise the forgery of Mrs. Bagby's name. Two further questions concerning the other parties are presented: (1) did the attorney's bank (Traders National Bank) which collected the proceeds of the check from Merrill Lynch's bank (Commerce Bank of Kansas City) breach the warranty of good title, and (2) which of the two banks should bear the expenses of defending Merrill Lynch's suit?

These are complicated issues and since my major subject is the proximate cause logomachy, I will briefly present my conclusions. One is stated above—the negligence validates the forgery only against the negligent party. Thus Traders Bank did breach its warranty of good title, and, between it and Commerce Bank, the former should bear the expenses of litigation.⁷³ This does not mean that Commerce Bank is free to ignore Merrill Lynch's negligence when Merrill Lynch sues. Although the cases are divided,⁷⁴ I believe the better rule is that subsection (5) of section 4-406⁷⁵ requires a payor bank to assert the section 3-406 defense

71. *Cooper v. Union Bank*, 9 Cal. 3d 123, 136, 507 P.2d 609, 619, 107 Cal. Rptr. 1, 11, 12 UCC Rep. Serv. 209, 223-24 (1973).

72. UNIFORM COMMERCIAL CODE § 4-207(1)(a).

73. *Bagby v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 348 F. Supp. 969, 11 UCC Rep. Serv. 776 (W.D. Mo. 1972), *rev'd*, 491 F.2d 192, 13 UCC Rep. Serv. 1069 (8th Cir. 1974). The court so held and awarded Commerce Bank attorneys' fees. See UNIFORM COMMERCIAL CODE § 4-207(3) & Comment 5.

74. Compare *East Gadsden Bank v. First City Nat'l Bank*, 50 Ala. App. 576, 281 So. 2d 431, 13 UCC Rep. Serv. 275 (1973) (payor bank need not assert § 3-406 in drawer's suit) and *Society Nat'l Bank v. Capital Nat'l Bank*, 30 Ohio App. 2d 1, 281 N.E.2d 563, 10 UCC Rep. Serv. 831 (1972) (same), with *Canadian Imperial Bank of Commerce v. Federal Reserve Bank*, 64 Misc. 2d 959, 316 N.Y.S.2d 507, 8 UCC Rep. Serv. 365 (Sup. Ct. New York County 1970) (payor bank must raise drawer's negligence or be barred from suing collecting banks) and *Stone & Webster Eng'r Corp. v. First Nat'l Bank & Trust Co.*, 345 Mass. 1, 184 N.E.2d 358, 1 UCC Rep. Serv. 195 (1962) (same). The reason for this dichotomy is the beginning words of subsection (5), "under this section." The first two courts cited state that this means only section 4-406 defenses. I agree, but note that Official Comment 6 incorporates sections 3-405 and 3-406 into this section. As discussed in the text, there are good policy reasons for trying the issue of drawer's negligence at this stage.

75. Quoted in note 49 *supra*.

against the drawer, give a vouching-in notice⁷⁶ to the collecting banks, and pass the litigation expenses to them. As between the payor and the collecting banks, the latter had the best chance to avoid the loss, and, traditionally, collecting banks bear the risk of forged indorsements. If the payor bank could ignore the drawer's negligence and pass the loss to the collecting bank, what cause of action would the latter have against the drawer? Section 3-406 does not authorize an affirmative tort action for negligence; it simply provides that the negligence may work an estoppel to raise certain issues as part of some other lawsuit connected with the instrument⁷⁷—normally a suit on one of the negotiable instruments “contracts.”⁷⁸ The drawer's contract of section 3-413(2) runs only to a “holder,” which the collecting bank is not.⁷⁹ To avoid this lack-of-remedy dilemma, section 4-406(5) should be read as requiring the payor bank to raise the section 3-406 negligence in the manner of that section, as a defense, but the collecting banks should bear the expense of the litigation win or lose since they are in the breach of their section 4-207(1)(a) warranty of good title either way. A decision like the California one, cited above, which has the negligence validate the title for all parties, unfairly puts the expense of litigation on the payor bank, a party in no way responsible for the title defect.

76. UNIFORM COMMERCIAL CODE § 3-803 permits defendants to give notice to those answerable over to the defendant to come in and defend or be bound by the judgment.

77. The reason is stated in *id.* § 3-406:

[I]n the usual case the extent of the loss, which involves the possibility of ultimate recovery from the wrongdoer, cannot be determined at the time of litigation, and the decision would have to be made on the unsatisfactory basis of burden of proof. The holder or drawee is protected by an estoppel, and the task of pursuing the wrongdoer is left to the negligent party. Any amount in fact recovered from the wrongdoer must be held for the benefit of the negligent party under ordinary principles of equity.

The few cases to the contrary should be disapproved; see *Wright v. Bank of Cal.*, 276 Cal. App. 2d 485, 81 Cal. Rptr. 11, 6 UCC Rep. Serv. 1165 (Dist. Ct. App. 1969), criticized in 7 SAN DIEGO L. REV. 349 (1970); *Von Gohren v. Pacific Nat'l Bank*, 8 Wash. App. 245, 505 P.2d 467, 12 UCC Rep. Serv. 133 (1973); cf. *Taylor v. Equitable Trust Co.*, 269 Md. 149, 304 A.2d 838, 12 UCC Rep. Serv. 922 (1973) (dicta). A common law negligence action might survive the prohibition quoted above; see UNIFORM COMMERCIAL CODE § 1-103. At least one other section of the Code recognizes the availability of such an action for the negligent loss of an instrument; see *id.* § 3-419, Comment 2.

78. UNIFORM COMMERCIAL CODE § 3-413(1) (contract of maker or acceptor); *id.* § 3-413(2) (contract of drawer); *id.* § 3-414 (contract of indorser); *id.* § 3-416 (contract of guarantor). The basis of an action by a drawer against the drawee for wrongfully charging his account is, *id.* § 4-401. There is no reason, however, why section 3-406 should not be raised in warranty actions, see *id.* §§ 3-417, 4-207, or in conversion actions, see *id.* § 3-419.

79. It has neither good title, a *sine qua non* of “holder” status, nor possession of the instrument, another basic. In addition, the original final payment of the instrument is said to discharge the contractual liability of the prior parties; *id.* § 3-418.

Most of the section 3-406 cases have not involved these technical problems, but instead have explored the more substantive questions of the meaning of "negligence" and "substantially contributes." *Bagby's* incorporation of "proximate cause" and the "intervening criminal activity" rule into these terms was something of a surprise.⁸⁰ The early section 3-406 cases all went the other way.

The first of these was the Oregon Supreme Court's decision in *Gresham State Bank v. O & K Construction Co.*,⁸¹ in which the payee's unsupervised employee was forging the employer's name to the back of checks and cashing them at a local store. The court held that the employer was negligent in failing to supervise the employee or audit the company's books and concluded that "proximate cause" was no longer an issue in these cases. The court held that "substantially contributes" was the equivalent of the "substantial factor" test of the Restatement (Second) of Torts section 433, and that certainly the failure to supervise the employee was a substantial factor in the ensuing loss. Because the store that cashed the checks was also negligent in not checking the authority of the employee to cash company checks, however, the employer's negligence did not work an estoppel.

The leading case on section 3-406 is *Thompson Maple Products, Inc. v. Citizens National Bank*,⁸² a decision of the Pennsylvania Superior Court. In *Thompson*, a log hauler named Albers submitted bogus log delivery slips to the company, which then issued him checks for transmittal to the timber dealers it thought owned the logs. Albers forged the dealers' names to the checks and cashed them at the defendant bank on which they were drawn. Albers pocketed over 100,000 dollars before he was caught and sent to prison.⁸³ The bank defended by al-

80. UCC decisions agreeing with the *Bagby* conclusion that negligence in the issuance of the check is not the proximate cause of the loss (stated as a rule with little or no discussion) are *East Gadsden Bank v. First City Nat'l Bank*, 50 Ala. App. 576, 281 So. 2d 431, 13 UCC Rep. Serv. 275 (1973); *Sam Goody, Inc. v. Franklin Nat'l Bank*, 57 Misc. 2d 193, 291 N.Y.S.2d 429, 5 UCC Rep. Serv. 502 (Sup. Ct. Nassau County 1968) (negligent certification held not proximate cause). *But see* *Brower v. Franklin Nat'l Bank*, 311 F. Supp. 675, 7 UCC Rep. Serv. 1021 (S.D.N.Y. 1970) (negligent certification can be the proximate cause). A major case with facts similar to *Bagby* came out the opposite way. *Fidelity & Deposit Co. v. Chemical Bank N.Y. Trust Co.*, 65 Misc. 2d 619, 318 N.Y.S.2d 957, 8 UCC Rep. Serv. 541 (App. T. 1970), *aff'd*, 39 App. Div. 2d 1019, 333 N.Y.S.2d 726, 10 UCC Rep. Serv. 1080 (1972) (holding that a stockbroker/drawer's failure to follow the "Know Your Customer" rule was negligence under § 3-406).

81. 231 Ore. 106, 370 P.2d 726, 1 UCC Rep. Serv. 276, *clarified on denial of rehearing*, 231 Ore. 106, 372 P.2d 187 (1962).

82. 211 Pa. Super. 42, 234 A.2d 32, 4 UCC Rep. Serv. 624 (1967).

83. The naivete of the crooks and forgers in these cases is incredible. They typically engage in their nefarious schemes for years and the very passage of time makes

leging the company's negligence in (1) not safeguarding the blank delivery slips, (2) not following its own practice of making duplicate delivery slips for separate transmission to the company's bookkeeper prior to the writing of the checks, (3) giving Albers blank delivery slips to use as scratch paper, and (4) delivering the checks to Albers for forwarding to the true owners (Albers was not the agent of the timber dealers). The court held for the bank deciding that the negligent conduct of the drawer's business did substantially contribute to the making of an unauthorized signature. The court decided that the section 3-406 drafters did not mean to continue the strict proximate cause rule of the pre-Code cases and held that section 3-406 called for a "shortened chain" of causation. This term was not further defined, but presumably a "shortened chain" of causation at least rejects the "intervening criminal activity" rule.

Thereafter several courts cited *Thompson* and adopted its "shortened chain" of causation test, frequently with a reference to the *Gresham* conclusion that "substantially contributes" was the same as the "substantial factor" test of the Restatement (Second) of Torts.⁸⁴ Later Pennsylvania courts managed to get themselves into a muddle by reading section 3-406 so that the word "substantially" modified "negligence" and

it virtually certain they will be caught. Though some escape, *First Nat'l Bank v. Hobbs*, 248 Ark. 76, 450 S.W.2d 298, 7 UCC Rep. Serv. 323 (1970) (withdrew money and absconded); *Park State Bank v. Arena Auto Auction, Inc.*, 59 Ill. App. 2d 235, 207 N.E.2d 158, 2 UCC Rep. Serv. 903 (1965) (telephoned from Mississippi, saying "You'll never find me"); *Commerce-Guardian Bank v. Toledo Trust Co.*, 60 Ohio App. 337, 21 N.E.2d 173 (1938) (on being informed that the bank officers wanted to see him, forger was "gone with the wind"), more commonly the wrongdoer comes to an unhappy end. *Cooper v. Union Bank*, 27 Cal. App. 3d 85, 103 Cal. Rptr. 610, 11 UCC Rep. Serv. 343 (Dist. Ct. App. 1970), *rev'd on other grounds*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1, 12 UCC Rep. Serv. 209 (1973) (suspended sentence); *Grand Lodge v. State Bank*, 92 Kan. 876, 142 P. 974 (1914) (suicide); *Commercial Bank v. Arden & Fraley*, 177 Ky. 520, 197 S.W. 951 (1917) (penitentiary); *American Sash & Door Co. v. Commerce Trust Co.*, 332 Mo. 98, 56 S.W.2d 1034 (1933) (jail); *Salsman v. National Community Bank*, 102 N.J. Super. 482, 246 A.2d 162, 5 UCC Rep. Serv. 779 (L. Div. 1968), *aff'd per curiam*, 105 N.J. Super. 164, 251 A.2d 460, 6 UCC Rep. Serv. 168 (App. Div. 1969) (prison); *National Sur. Co. v. President & Directors of Manhattan Co.*, 252 N.Y. 247, 169 N.E. 372 (1929) (prison); *Hardex-Steubenville Corp. v. Western Pa. Nat'l Bank*, 446 Pa. 446, 285 A.2d 874, 10 UCC Rep. Serv. 448 (1971) (pleaded guilty); *Von Gohren v. Pacific Nat'l Bank*, 8 Wash. App. 245, 505 P.2d 467, 12 UCC Rep. Serv. 133 (1973) (prison); *Price v. Neal*, 97 Eng. Rep. 871 (K.B. 1762) (hanged). Frequently the forger turns up as a major witness to help the bank establish the negligence of the drawer; see *Leather Mfrs. Bank v. Morgan*, 117 U.S. 96 (1886); *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938). I hate to digress in this fashion, but I thought it worthwhile to point out that in appellate cases at least, crime does not pay.

84. *Taylor v. Equitable Trust Co.*, 269 Md. 149, 304 A.2d 838, 12 UCC Rep. Serv. 922 (1973); *Fidelity & Deposit Co. v. Chemical Bank N.Y. Trust Co.*, 65 Misc. 2d 619, 318 N.Y.S.2d 957, 8 UCC Rep. Serv. 541 (App. T. 1970), *aff'd*, 39 App. Div. 2d 1019,

not "contributes."⁸⁵ The upshot of this is that causation is shortened but "more than ordinary negligence" is required before section 3-406's preclusion occurs.⁸⁶ This transmogrification of section 3-406 has been rejected by a New Jersey court: "The language of the statute cannot be read to support such an interpretation; it states plainly that it is the contribution to the forgery rather than the negligence that must be substantial."⁸⁷ Until the Eighth Circuit's *Bagby* opinion was handed down, no court exploring the issue had found that "proximate cause" was alive and well as part of section 3-406. To determine whether it is or ought to be requires an analysis of the basic principles of negligence law.

III. THE ELEMENTS OF NEGLIGENCE

To recover in negligence, plaintiff must prove the following four elements:

(1) *Duty*. The defendant must be shown to have had a legal responsibility to do or not do the act complained of by plaintiff.

(2) *Violation of Duty*. Defendant must be proven to have failed as a matter of fact to meet this responsibility.

(3) *Causation*. Defendant's violation of his duty must be shown to have resulted in the harm to plaintiff.

(4) *Damages*. Plaintiff must prove the extent of his injury.

One of the major problems with the above formula is the meaning

333 N.Y.S.2d 726, 10 UCC Rep. Serv. 1080 (1972); *Commonwealth v. National Bank & Trust Co.*, 56 Pa. D. & C.2d 1, 10 UCC Rep. Serv. 1421 (Dauphin County C.P. 1972), *aff'd*, 9 Pa. Commw. 358, 305 A.2d 769, 12 UCC Rep. Serv. 896 (1973); *cf.* *Gast v. American Cas. Co.*, 99 N.J. Super. 538, 240 A.2d 682, 5 UCC Rep. Serv. 155 (App. Div. 1968). Other courts finding section 3-406 estoppel for negligent issuance are *Brower v. Franklin Nat'l Bank*, 311 F. Supp. 675, 7 UCC Rep. Serv. 1021 (S.D.N.Y. 1970); *Gordon v. State St. Bank & Trust Co.*, — Mass. App. —, 9 UCC Rep. Serv. 697 (1971); *Ocean First Nat'l Bank v. Baird*, 9 UCC Rep. Serv. 1092 (Sup. Ct. New York County 1971). As this article went to press Maryland joined the list of states adopting a shortened chain of causation and rejecting "proximate cause" in section 3-406 cases; *Dominion Constr., Inc. v. First Nat'l Bank*, 271 Md. 154, 315 A.2d 69, 14 UCC Rep. Serv. 129 (1974).

85. *Commonwealth v. National Bank & Trust Co.*, 56 Pa. D. & C.2d 1, 10 UCC Rep. Serv. 1421 (Dauphin County C.P. 1972), *aff'd*, 9 Pa. Commw. 358, 305 A.2d 769, 12 UCC Rep. Serv. 896 (1973).

86. The strong dissent by Judge Rogers (joined by two other judges) in the Commonwealth Court decision rightly states that this reading imposes an impossible task for a jury, which must determine what is "more than ordinary negligence." *National Bank & Trust Co. v. Commonwealth*, 9 Pa. Commw. 358, —, 305 A.2d 769, 773, 12 UCC Rep. Serv. 896, 901 (1973).

87. *Gast v. American Cas. Co.*, 99 N.J. Super. 538, 543, 240 A.2d 682, 685, 5 UCC Rep. Serv. 155, 159 (App. Div. 1968). Maryland has also rejected this idea; *Dominion Constr., Inc. v. First Nat'l Bank*, 271 Md. 154, 315 A.2d 69, 14 UCC Rep. Serv. 129 (1974).

of "causation." In a world where every action can be shown to have multiple effects far into the future, how close a connection must there be between the defendant's actions and the plaintiff's harm? The courts initially resolved this problem by finding that the defendant had no *duty* to the plaintiff in cases in which there was some causal connection but in which it seemed unfair to impose liability on the defendant. When the term "proximate cause" came into its own, the courts continued to do the same thing, but now they based their policy decision on the element of causation, saying that defendant had a duty, but the violation thereof was not the "proximate cause" of the loss. This mysterious burial of the duty issue in the causation issue has been decried by torts scholars,⁸⁸ who argue that it confuses the law to subsume the policy considerations inherent in the development of duty standards under the catch-all phrase "proximate cause." The Restatement has abandoned the term in favor of "legal cause," which is defined as:

The actor's negligent conduct is a legal cause of harm to another if

- (a) his conduct is a substantial factor in bringing about the harm, and
- (b) there is no rule of law relieving the actor from liability because of the manner in which his negligence has resulted in the harm.⁸⁹

"Substantial factor" is a jury question; it is a return to the issue of whether the defendant's conduct was *in fact* a cause of the resulting harm and has little to do with the questions of policy found in the duty issue.⁹⁰ The second part of section 431, however, seems to resurrect the duty issue as part of its "no rule of law" language. The Restatement then lists some of the "rules of law" which destroy "legal cause" and the defendant's liability for negligence.⁹¹ Among these is section 448, which is most relevant to our inquiry:

The act of a third person in committing an intentional tort or crime is a superseding cause of harm to another resulting therefrom, although the actor's negligent conduct created a situation which afforded an opportunity to the third person to commit such

88. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 42 (4th ed. 1971); Green, 28 TEXAS L. REV., *supra* note 8, at 471-72.

89. RESTATEMENT (SECOND) OF TORTS § 431 (1965).

90. In a well known article, Professor Malone pointed out that some policy considerations are necessarily involved in the factual determination of causation. Malone, *Ruminations on Cause-In-Fact*, 9 STAN. L. REV. 60 (1956). Section 433 of the Restatement lists some of the possible considerations for the fact finder in determining "substantial factor," including the number of other possible contributing factors, the intervention of other forces, and the lapse of time.

91. RESTATEMENT (SECOND) OF TORTS §§ 435-61 (1965).

a tort or crime, unless the actor at the time of his negligent conduct realized or should have realized the likelihood that such a situation might be created, and that a third person might avail himself of the opportunity to commit such a tort or crime.

This of course is a foreseeability test, and comment "c" to section 448 makes it clear that the basic test is whether the actor should have realized that his conduct was creating an "unreasonable risk of criminal aggression." All of this sounds unduly terrifying when applied to the prosaic crime of forgery; nonetheless, the "unreasonable risk" test sounds suspiciously like a test of duty, not causation.

The Restatement does not address itself to the meaning of the language of UCC section 3-406, nor does Prosser, although he was the original drafter of that section. The courts, *Bagby* excepted, seem to agree that section 3-406 works a major change in the law, but there is little guidance as to what and how much. The Official Comment to section 3-406 expressly disclaims any attempt to define "negligence."⁹²

It seems to me that this dearth of authority on the meaning of a piece of legislation enacted in virtually every state in the country presents the courts with a splendid opportunity to start afresh in the development of workable negligence principles. In filling in this blank slate, the courts are best advised to eschew the "proximate/legal cause" maze in favor of a more open statement of the factors involved.

Section 3-406 states that "negligence" which "substantially contributes" works the preclusion involved. The courts must give scope and meaning to these two terms.

"Substantially contributes" should be viewed as meaning nothing more than cause-in-fact, the sole issue being whether the negligence was a substantial factor (the Restatement test) in the making of either an unauthorized signature or a material alteration. This is a jury question unless no reasonable person could find a causal connection between the negligence and the wrongdoing. For instance, if the drawer of a check is negligent in leaving spaces on the instrument but the wrongdoer uses chemicals to erase all written matter except the signature and writes in completely new words and figures, the negligence does not substantially contribute to the material alteration.⁹³ But the lack of causal connection is rarely clear enough to be decided as a matter of law, and in most cases should go to the jury. It is inappropriate

92. UNIFORM COMMERCIAL CODE § 3-406, Comment 3.

93. See *id.* § 3-406, Comment 4.

for the court to use jury pre-empting doctrines such as the "negligence in issuance" or "intervening criminal activity" rules to decide this cause-in-fact issue. If these doctrines are to live on, they should be considered only in constructing the duty segment of the negligence issue.

"Negligence" in a negotiable instruments problem becomes a manageable concept if it is defined as "the violation of a duty created by the courts." There are two elements to this definition—the question of law as to whether a duty exists and the question of fact as to whether the duty has been violated. Whenever section 3-406 becomes an issue, and it has been found that the person raising section 3-406 is either a holder in due course or a drawee or payor paying in good faith, the court should first make a decision on whether the allegedly negligent party had a duty to do or not do the questioned act. In resolving this issue the court must take into account many policy factors such as the degree of commercial awareness of the party accused, the financial impact of an adverse decision, the foreseeability of the harm, the ability of later parties to protect themselves from the wrongdoer, the degree of fault, and, perhaps most important, the extent to which the party's actions are out of step with those of others in similar situations. The courts should avoid presumptions when creating duty; the commercial world is not so stable that yesterday's practices are likely to have lasting meaning for even a fiscal year. The maxims of the "proximate cause" decisions (decisions that were really deciding questions of duty) have no place cluttering up section 3-406. "Negligence in the issuance is not the proximate cause of the forgery" meant only that the drawer had no duty to be careful in the issuance of the check, an idea which explodes when phrased as a duty question. Article Three abounds with situations in which careless issuance leads to strict liability.⁹⁴ "Intervening criminal activity breaks the chain of causation" is a statement that no one has a duty to foresee and guard against crime, but every checkwriter knows this is untrue as he carefully scores the rest of the amount line after writing out the figures and

94. See, e.g., *id.* § 3-405 (the impostor rule). Note the effect of being careless with the issuance of bearer paper. *Id.* §§ 3-202(1), -207, -305, -306. Section 3-413(3) creates absolute presumptions on issuance, careless or not. And mistaken signing of instruments, except in limited circumstances, is simply tough luck if the instrument is transferred to a holder in due course. See *id.* § 3-305(2)(c); *Burchett v. Allied Concord Fin. Corp.*, 74 N.M. 575, 396 P.2d 186, 2 UCC Rep. Serv. 279 (1964). UNIFORM COMMERCIAL CODE § 3-406, Comment 7 preserves the common law result that mailing a check to someone with the same name as the intended payee is precluding negligence even though it is negligence in the issuance.

00/100. Unfortunately the proclivity of criminals to tamper with commercial paper is too well known to say it is a risk of banks alone. The conclusion of some courts that blanks in an instrument but not spaces could lead to precluding negligence (since in the latter instance an "entire instrument was intended") was a duty decision: Those signing an instrument had a duty to complete all blanks but no duty to fill up every space which may possibly lead to alterations. It is certainly true that not every space on the instrument need be crossed out; as a practical matter no one will do that. But this does not mean that there is no duty to be careful with some spaces. We all know enough to write the check amount on the left side of the blanks provided and would not be startled to learn that we had a legal duty to do so or be liable for the consequences.

The major problem with the duty issue arises in deciding how specific the trial judge should be in formulating the law's requirements. If the issue is phrased in a very general fashion the jury has great freedom to fill in the void left by the lack of detailed guidance. This gives the law flexibility but not much predictability. If, on the other hand, the judge makes the duty very specific, the jury's decision in determining whether that duty has been violated becomes a foregone conclusion. As an example, consider the recurring problem of the allegedly negligent conduct of mailing a check to someone having the same name as the intended payee. The judge can phrase the duty issue in a number of ways. The most general would be an instruction that check drawers have a duty to use reasonable care in the delivery of the check. If the instruction goes no further, the jury-room discussion is likely to be long and heated as the jury resolves the issue of the violation of this duty. But, if the judge is more specific and tells the jury that sending a check to someone having the same name as the payee is a violation of the drawer's duty, the jury will hardly need to leave the box.

The trick is to strike a balance between these possibilities, but I believe that in the area of negotiable instruments any error should be made on the side of specificity. In commercial matters (*Bagby* is a good example) the jury is unlikely to have the experience necessary to resolve the factual violation question unless the trial court gives them definite guidelines with which to work. Granted, the judge himself may have little commercial orientation, but he is still in a better position to explore the matter by checking past appellate decisions, scholarly articles, etc. A general (and flexible) duty instruction may be appropriate in noncommercial negligence cases in which the jury often has a

real appreciation of the community's expectations, but the law of negotiable instruments needs the predictability of more clearly defined duty. This is not to say that the duty should be made so specific that we revive the seventeenth century idea of a rule of law for every possible fact situation, but certain recurring problems⁹⁵ should invoke a more or less uniform duty formulation.

Once the court has defined the duty, the fact finder must determine whether that duty has been breached. This is not always an easy question, but it is always a question of fact. The judge may instruct the jury that it is the duty of all check drawers to place the numerals and written figures on the instrument in a fashion so that the amount of the check is not easily altered. Whether the drawer has done so is then in the domain of the jury, which must study the check and use its collective judgement to reach a conclusion.

Apply these tests to the facts of *Bagby* and arguably the Eighth Circuit should have ruled against Merrill Lynch. What the court in effect held was either that Merrill Lynch had no duty to see that its checks reached the hands of its legitimate customers or that no reasonable man could find that the attorney's possession of Mrs. Bagby's check was a substantial factor in the forgery of her name. Neither of these conclusions seems valid. The strict duty to know its customer was imposed on Merrill Lynch by the New York Stock Exchange rule 405 (and by its own operations manual) for the very purpose of preventing negotiable instruments and securities from getting into unauthorized hands. With such items the risk of forgery and wrongful transfer is great. When Merrill Lynch itself recognized the duty, it should not have been permitted to pass this loss to later innocent parties because of a technical presumption of lack of cause and effect. In addition, the court's recognition of this duty is not an impossible burden for Merrill Lynch or entities of similar financial stature. When the factors of foreseeability, fault, and ability of later parties to protect themselves are considered, the existence of a duty of care in the issuance of these checks becomes clearer. The issue of violation of the duty, as well as the cause-in-fact ("substantially contributes") question, were for the fact finder and not the appellate court.

IV. NEGLIGENCE IN SPECIFIC SITUATIONS

Certain negotiable instruments/negligence situations occur with sufficient regularity that they deserve more elaborate discussion of the

95. Some of these commonly recurring problems are detailed in Part IV of this article *infra*.

policy considerations involved. Hopefully the material below will be useful to courts involved with the process of defining the duty of care required by UCC section 3-406 and related sections.

A. *Incomplete Instruments*

By "incomplete" I mean instruments containing obvious blank portions meant to be filled in at some point, as opposed to instruments on which there are spaces never intended to be filled even though a wrongdoer finds a use for them. Section 3-115 provides that incomplete instruments are negotiable when completed as authorized. If the completion is unauthorized, section 3-407(3) and 4-401(2)(b) permit later holders in due course and the drawee bank to enforce the instrument as completed *whether or not* the drawer/maker was negligent in dealing with the instrument. As against others, section 3-407(2) provides that an unauthorized fraudulent completion of an instrument operates as a complete discharge of prior parties affected by the completion unless they are "precluded" from denying the validity of the completion. The section 3-407(2) preclusion would occur if a party were negligent within the meaning of section 3-406, though it is difficult to see how a non-holder in due course fits into the categories of protected parties enumerated in that section.⁹⁶ The only mention of blanks on incomplete instruments in the Code is in Official Comment 3 to section 3-406, which states that the section does not change decisions holding that it is not negligence to leave blanks "in which a provision for interest or the like" can be written.⁹⁷ This comment seems strange in light of the strict liability for completed blanks found in sections 3-115, 3-407(3), and 4-401(2)(b), and I cannot help but believe that if a maker left blank the provision saying "with interest at—%," the courts would use these sections to hold him to the amount inserted as long as it was within legal limits and the note was in the hands of a holder in due course. It is only right that in most instances parties are bound by the completion of instruments they signed and sent out "into a sea of strangers"; it is no surprise that the note may return with the blanks filled in in an unauthorized way.

What then should the courts do with a consumer who signs a printed promissory note containing many blanks (some of which may be hard to see through all the Truth-In-Lending hieroglyphics)? This problem is disappearing with the adoption of statutes prohibiting nego-

96. Perhaps as a "payor"; see J. WHITE & R. SUMMERS, *supra* note 7, at 540-41 n.42.

97. *Holmes v. Trumper*, 22 Mich. 427 (1871), is such a case.

liable consumer notes or expressly preserving all defenses against later parties, but not all states have such statutes. I suspect that a court might decide that the duty not to leave blanks on the instrument does not extend to the leaving of blanks as to minor matters on printed consumer notes. Consumer paper purchasers already know they are involved in high risk business; it would not seem unconscionable to let them look only to their transferors. The duty issue can be phrased very generally here: the consumer maker has a duty to behave reasonably when signing a printed form note containing blanks. The jury, consumers all, is in a good position to decide what is reasonable under the circumstances.

B. *Careless Spaces*

Official Comment 3 to section 3-406 states that it is usually negligence "where spaces are left in the body of the instrument in which words or figures may be inserted." Rephrased this means the court should instruct the jury that the drawer/maker has a duty to score spaces on the instrument in which it is foreseeable that insertions may be made.⁹⁸ The jury must then decide if this has been done. There are several pre-Code cases in which the drawer/maker signed an instrument prepared by the payee, who deliberately left such spaces so as to facilitate the raising of the amount of the instrument. A Texas court found there was no negligence when a mother-in-law signed a check prepared by her faithless son-in-law in this fashion,⁹⁹ but a Tennessee court refused to extend similar protection to a farmer buying a cow,¹⁰⁰ and a Florida court held it was negligent for an employer to sign a paycheck drawn with spaces and presented for signature by the employee/payee.¹⁰¹ These are all duty decisions with the courts holding (impliedly) that a mother-in-law has no duty to eliminate spaces on a check prepared by her son-in-law, but a farmer has such a duty when the check is prepared by a seller, as does an employer signing the checks prepared by an employee. The degree of commercial sophistication of the drawer and his relationship with the payee may be the decisive factors. A mother-in-law may trust her son-in-law, but why

98. See UNIFORM COMMERCIAL CODE § 3-407(2); the word "precluded" is a reference to *id.* § 3-406.

99. *Glasscock v. First Nat'l Bank*, 114 Tex. 207, 266 S.W. 393 (1924).

100. *Foutch v. Alexandria Bank & Trust Co.*, 177 Tenn. 348, 149 S.W.2d 76 (1941).

101. *Goldsmith v. Atlantic Nat'l Bank*, 55 So. 2d 804 (Fla. 1951). *Contra*, *Reiter v. Western State Bank*, 240 Minn. 484, 62 N.W.2d 344 (1953); *cf.* *Gutfreund v. East River Nat'l Bank*, 251 N.Y. 58, 167 N.E. 171 (1929) (held negligence for employer not to cross out spaces, but drawee bank also negligent in paying the checks).

should a farmer permit a stranger to draw the farmer's own checks, at least without careful examination before he signs his name? Later parties will have trouble detecting the alteration since the instrument was created to accommodate it and the alteration will be in the same handwriting as the body of the check. As for an employer's trust of his employee, section 3-405(1)(c) already makes the employer absolutely liable for checks made out to non-existent payees and submitted for signature. Official Comment 4 to that section adds that employee defalcation in check preparation is a risk of business which may be foreseen and insured. It is but a short step from that proposition to the creation of a duty of the employer, particularly large solvent employers, to examine carefully all checks presented for signature to see if they contain spaces facilitating alteration.

One more problem with spaces is the payee line on checks. Most people know enough to score the unused portion of the amount line, but many check writers leave the rest of the line following the payee's name blank. If the payee's name is typed at the beginning of the line, as it was on a check I received recently from a credit union, a thief could type in "or (thief's name)" after the payee's name and then negotiate the check to his bank. Section 3-116(a) provides that a check payable to the order of alternative payees may be negotiated by *either's* indorsement. If the typing matched fairly well, the drawee bank would be justified in paying the check. There are problems with establishing a duty to score the payee's line: (1) many drawers, including large corporate drawers, do not currently do so, (2) the imposition of such a duty is then out of step with current practices, (3) the equities of later parties is strong, but the drawer's fault is slight. The problem does not seem to have arisen often,¹⁰² and it may be that most checks with alternative payee names would themselves alert later takers to the possibility of alteration. A check stolen from the mails at tax time should cause some comment if it was presented apparently payable to "The Internal Revenue Service or John Doe" and is presented by the latter to the drawee bank. A bank probably does not observe reasonable commercial standards in paying such a check without conferring with the drawer.

C. *Instruments Written in Pencil*

An early Illinois case took the position that writing a portion

102. *But see* Gutfreund v. East River Nat'l Bank, 251 N.Y. 58, 167 N.E. 171 (1929), where the court in dicta stated that a drawer has a duty to score the unused portion of the payee line.

of a promissory note in pencil was "gross carelessness" because penciled writing is so easily altered,¹⁰³ but some courts have held the other way.¹⁰⁴ The California Supreme Court in 1898 was unwilling to say that "pencil writing is more readily effaced than ink or other substance."¹⁰⁵ This seems to be an ostrich approach to the world, and a court might easily find a duty in most situations to not write checks or notes in pencil. When the ease with which a penciled decimal point can disappear is contemplated, the risk of alteration of such instruments is properly placed on the pencil user. Most people will not write negotiable instruments in pencil, so it is not hard to find a duty to avoid the use. This is not to say that check writers have a duty to use indelible ink, sensitized paper, or protectograph,¹⁰⁶ though a court might some day find such a duty on the part of very sophisticated drawers, such as banks, should the evolution of commercial practice demand it.

D. Rubber Stamps

Official Comment 7 section 3-406 states that it is obviously negligent to keep a signature stamp or other automatic signing device without proper safeguarding to prevent unauthorized use. The cases agree,¹⁰⁷ even if the signature stamp was not meant to be a check-signing device.¹⁰⁸ The rule, however, only applied if the stamp contains a facsimile signature—a mere printed name is not enough.¹⁰⁹ When the drawer puts his facsimile signature on a rubber stamp or other device, he has created a dangerous situation and the courts should

103. *Harvey v. Smith*, 55 Ill. 224 (1870). See also *Foutch v. Alexandria Bank & Trust Co.*, 177 Tenn. 348, 149 S.W.2d 76 (1941).

104. See *Commercial Bank v. Arden & Fraley*, 177 Ky. 520, 197 S.W. 951 (1917); *Glasscock v. First Nat'l Bank*, 114 Tex. 207, 266 S.W. 393 (1924); *Lanier v. Clarke*, 63 Tex. Civ. App. 266, 133 S.W. 1093 (1910).

105. *Walsh v. Hunt*, 120 Cal. 46, 52 P. 115 (1898).

106. UNIFORM COMMERCIAL CODE § 3-406, Comment 3; *accord*, *Broad St. Bank v. National Bank*, 183 N.C. 463, 112 S.E. 11 (1922). The strong dissent in this last case has meaning for the future, and I'm not sure that I don't agree with it.

107. Cf. *First Am. Nat'l Bank v. Christian Foundation Life Ins. Co.*, 242 Ark. 678, 420 S.W.2d 912, 4 UCC Rep. Serv. 287 (1967). The alleged drawer, however, frequently escapes liability because the subsequent taker and/or the drawee should have been put on notice by the age of the stamp or the fact that payment on a facsimile signature is not authorized on the bank's signature card. See *First Nat'l Bank & Trust Co. v. Cutright*, 189 Neb. 805, 205 N.W.2d 542, 12 UCC Rep. Serv. 313 (1973); *Mortimer Agency, Inc. v. Underwriters Trust Co.*, 73 Misc. 2d 970, 341 N.Y.S.2d 75, 13 UCC Rep. Serv. 270 (New York City Civ. Ct. 1973).

108. *Robb v. Pennsylvania Co. For Ins. on Lives*, 186 Pa. 456, 40 A. 960 (1898) (stamp normally used to sign banquet invitations).

109. *Gresham State Bank v. O & K Constr. Co.*, 231 Ore. 106, 370 P.2d 726, 1 UCC Rep. Serv. 276, *clarified on denial of rehearing*, 231 Ore. 106, 372 P.2d 187 (1962).

hold him to a duty of reasonable care in the protection of the stamp.

E. Delivery to Someone Other Than the Payee

It is clear from Official Comment 7 to section 3-406 and from the one UCC case to date which involved the issue,¹¹⁰ that a drawer has a duty not to send the check to someone having the same name as the payee. A more difficult question is whether the drawer has a duty to avoid entrusting the check to someone other than the payee when their names are dissimilar. In *Thompson Maple Products, Inc. v. Citizens National Bank*¹¹¹ the drawer was found negligent for asking a log hauler to deliver checks to timber dealers and giving him the checks; he was not the agent for either the drawer or the timber dealers. In *Fidelity & Deposit Co. v. Chemical Bank New York Trust Co.*,¹¹² a case similar to *Bagby* but reaching the opposite result, the stockbroker/drawer was deemed negligent for delivering checks to an attorney who misrepresented his status as agent of the stock owners (failure to check his authority was a violation of the New York Stock Exchange "Know Your Customer" rule).¹¹³ It may be that a court will find a duty to investigate the authority of a purported agent before handing over a check made out to the principal, since any time a check is held by someone other than the payee there is a risk of forgery. This does not mean that it is always negligent to entrust a check to one not the payee. As discussed below the drawer frequently must trust his own agents to mail checks to the proper parties. As a solution, I suggest that the jury be instructed that the maker/drawer has a duty not to entrust the instrument to a person other than the payee unless the maker/drawer has a reasonable belief that the transferee will deliver the instrument to the true owner. The jury may then decide the reasonableness of the maker's/drawer's trust in the person taking the instrument.

F. Hiring and Supervising Employees

The basic idea behind respondeat superior is that those who would

110. *Park State Bank v. Arena Auto Auction, Inc.*, 59 Ill. App. 2d 235, 207 N.E.2d 158, 2 UCC Rep. Serv. 903 (1965).

111. 211 Pa. Super. 42, 234 A.2d 32, 4 UCC Rep. Serv. 624 (1967).

112. 65 Misc. 2d 619, 318 N.Y.S.2d 957, 8 UCC Rep. Serv. 541 (App. T. 1970), *aff'd*, 39 App. Div. 2d 1019, 333 N.Y.S.2d 726, 10 UCC Rep. Serv. 1080 (1972).

113. The impostor rule is not applicable in a misrepresentation of agency problem because the person dealing with the drawer does not pretend to be the principal. *See* UNIFORM COMMERCIAL CODE § 3-405, Comment 2. *But see* the clever way in which Judge Younger of the New York County Civil Court worked around this rule in *Fidelity & Deposit Co. v. Manufacturers Hanover Trust Co.*, 63 Misc. 2d 960, 313 N.Y.S.2d 823, 7 UCC Rep. Serv. 1142 (New York County Civ. Ct. 1970).

deal with the world through the use of agents must bear some responsibility for the agent's activities. Employee defalcations injuring others are not generally attributable to the employer unless he was in some way responsible for the defalcation. In Article 3 of the Code the employer may become liable for the employee's actions if the agent had apparent authority to do the questioned act,¹¹⁴ or if the acts are ratified.¹¹⁵ Beyond this, section 3-405 creates strict employer/principal liability if the employee/agent submits checks for signature in which the latter has no intention of giving an interest to the nominal payee. The resulting indorsement of the payee's name, no matter who signs it, is "effective" under section 3-405 and is not a forgery. In the negligence section, section 3-406, the issue is the extent of the employer's duty to later transferees of the instrument to exercise care in the hiring and supervision of employees.

Despite some pre-Code decisions which found no duty (using the thaumaturgy of "proximate cause"),¹¹⁶ most pre-Code¹¹⁷ and UCC¹¹⁸ decisions have recognized an employer duty to hire and supervise those employees who will handle the employer's commercial paper. All

114. UNIFORM COMMERCIAL CODE § 3-403(1); see the authorities cited in note 41 *supra*.

115. UNIFORM COMMERCIAL CODE § 3-404 permits an unauthorized signature, even a blatant forgery, to be ratified; cf. authorities cited in note 40 *supra*.

116. Hensley-Johnson Motors v. Citizens Nat'l Bank, 122 Cal. App. 2d 22, 264 P.2d 973 (Dist. Ct. App. 1953); Home Indem. Co. v. State Bank, 233 Iowa 103, 8 N.W.2d 757 (1943); Scott v. First Nat'l Bank, 343 Mo. 77, 119 S.W.2d 929 (1938); American Sash & Door Co. v. Commerce Trust Co., 332 Mo. 98, 56 S.W.2d 1034 (1932).

117. Corbett v. Kleinsmith, 112 F.2d 511 (6th Cir. 1940) (overconfidence of employer in clerk and failure to supervise her activities permitted her to steal \$46,000 worth of checks); C.E. Erickson Co. v. Iowa Nat'l Bank, 211 Iowa 495, 230 N.W. 342 (1930) (employer did not follow own system of comparing paychecks with time cards); Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank, 252 Mich. 163, 233 N.W. 185 (1930) (failure to audit payroll after costs rose dramatically); Defiance Lumber Co. v. Bank of Cal., 180 Wash. 533, 41 P.2d 135 (1935) (failure to supervise personnel manager, who added phony names to the payroll for two years).

118. Prudential Ins. Co. of America v. Marine Nat'l Exch. Bank, 55 F.R.D. 436, 11 UCC Rep. Serv. 129 (E.D. Wis. 1972) (employing known gambler); Cooper v. Union Bank, 27 Cal. App. 3d 85, 103 Cal. Rptr. 610, 11 UCC Rep. Serv. 343 (Dist. Ct. App. 1972), *rev'd on other grounds*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1 (1973) (employing gambler and not supervising her); Westport Bank & Trust Co. v. Lodge, 12 UCC Rep. Serv. 450 (Conn. 1973) (failure to call secretary to accounting in spite of suspicious activity); Gresham State Bank v. O & K Constr. Co., 231 Ore. 106, 370 P.2d 726, 1 UCC Rep. Serv. 276 (1962) (failure to supervise office manager); Frost Nat'l Bank v. Nicholas & Barrera, 500 S.W.2d 906, 13 UCC Rep. Serv. 887 (Tex. Civ. App. 1973) (hiring accountant without investigation and not supervising him); Womack Mach. Supply Co. v. Fannin Bank, 499 S.W.2d 917, 13 UCC Rep. Serv. 669 (Tex. Civ. App. 1973) (same); Exchange Bank & Trust Co. v. Kidwell Constr. Co., 463 S.W.2d 465, 8 UCC Rep. Serv. 1079 (Tex. Civ. App. 1971) (general recognition of the duty).

courts would agree with the California Supreme Court's statement in *Los Angeles Investment Co. v. Home Savings Bank*:¹¹⁹

Complaint is chiefly made that the company relied upon the honesty of its heads of departments and the regularity on their face of the demands or requisitions which such heads approved, and made no investigation to determine whether such demands were fraudulent or not. But trust must be placed in someone, . . . and necessarily in heads of departments. If trusting them in regard to demands for checks disbursements regular upon their face is negligence, so it would be negligence to trust them in a hundred other ways in which it is within their power to defraud their employer. Business could not be conducted on any such basis. It is impossible for any large concern to investigate minutely in advance every demand for disbursement necessary for it to make in its daily business. The delay and expense of doing so would be too great.¹²⁰

No court, however, should hold that an employer may hire a paroled ex-forgery, place him in charge of check disbursements, and fail to supervise his activities. The desire to help life's unfortunates is noble, but it is a bit much to take such a chance and then ask the drawee bank to be, in effect, the insurer of a risk over which it had no control. The same is true of hiring and failing to supervise individuals with suspicious pasts. Further, even those with impeccable records may turn to crime. It is for this reason that companies set up security systems, cross checks, and audits.

A number of factors play a part in deciding the scope of the duty of supervision. Some relate to the employer's business: its size, its compliance with accepted business practices for scrutinizing employees, the amount of the checks written or received in the business, and the enterprise's financial ability to bear the loss (has it, for instance, bonded its employees—should it have?). Other factors involve the faithless employee: his background and references, his financial status, the quality of his performance, the amount of his responsibility, and the ease with which he could defraud the company were he of a mind to do so. The fact that an employee has given years of faithful service may justify the employer in lowering his guard,¹²¹ but even

119. 180 Cal. 601, 182 P. 293 (1919).

120. *Id.* at 610, 182 P. at 296-97.

121. This fact has impressed courts in the past. See *Jackson v. First Nat'l Bank*, 55 Tenn. App. 545, 403 S.W.2d 109, 3 UCC Rep. Serv. 630 (1966) (church officer had a good record and reputation for twenty years); *Exchange Bank & Trust Co. v. Kidwell Constr. Co.*, 463 S.W.2d 465, 8 UCC Rep. Serv. 1079 (Tex. Civ. App. 1971) (employer had no reason to suspect long-time employee, though she forged the employer's signature on checks totaling \$63,000 over a three-year period).

longtime employees must not go completely unwatched.¹²²

Courts have found it a duty of most businesses to conduct a periodic audit of sufficient thoroughness to catch at least routine defalcations.¹²³ In addition, employers have a duty to investigate the possibility of employee misuse of checks whenever suspicious circumstances occur, such as dramatically rising production costs,¹²⁴ sudden unexplained affluence in a previously impecunious employee,¹²⁵ and missing records.¹²⁶ Section 3-406 negligence is not limited to pre-forgery or pre-alteration conduct, but includes failure to take protective action when the forgery or alteration is discovered.¹²⁷ No one may sit idly by and let known forgeries of his name go unreported; but for his laches, the forger might have been caught.¹²⁸ The employer who winks at discovered check misconduct cannot later complain to his bank about that check or later ones. Phrased another way there is a duty to take action when the first forgery or alteration is discovered and the penalty for failure to do so is a preclusion from later asserting the wrongdoing.

122. *Westport Bank & Trust Co. v. Lodge*, 12 UCC Rep. Serv. 450 (Conn. 1973); *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 121, 492 P.2d 534, 10 UCC Rep. Serv. 173 (1972).

123. *Goodyear Tire & Rubber Co. v. First Nat'l Bank*, 95 Colo. 34, 32 P.2d 268 (1934) (no audit for five years); *Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank*, 252 Mich. 163, 233 N.W. 185 (1930) (failure to conduct thorough audit); *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938) (audit disclosed a \$15,000 shortage but employer did not investigate further).

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

125. *Corbett v. Kleinsmith*, 112 F.2d 511 (6th Cir. 1940) (employee bought a \$46,000 home though earning \$135 a month); *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938) (impoverished employee suddenly bought a nightclub and refurbished it lavishly); cf. *Coffin v. Fidelity-Philadelphia Trust Co.*, 374 Pa. 378, 97 A.2d 857 (1953).

126. *Westport Bank & Trust Co. v. Lodge*, 12 UCC Rep. Serv. 450 (Conn. 1973); *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 121, 492 P.2d 534, 10 UCC Rep. Serv. 173 (1972). But see *Jackson v. First Nat'l Bank*, 55 Tenn. App. 545, 403 S.W.2d 109, 3 UCC Rep. Serv. 630 (1966).

127. UNIFORM COMMERCIAL CODE § 3-406, Comment 7, provides that the section extends "to cases where the party has notice that forgeries of his signature have occurred and is negligent in failing to prevent further forgeries by the same person." Cf. *id.* § 4-406(2)(b), quoted note 49 *supra*.

128. Of course, this principle is not limited to the employer-employee relationship; see *Westport Bank & Trust Co. v. Lodge*, 12 UCC Rep. Serv. 450 (Conn. 1973) (employer discovered forgeries but said nothing); *Myrick v. National Sav. & Trust Co.*, 268 A.2d 526, 7 UCC Rep. Serv. 1139 (D.C. Ct. App. 1970) (bank official told depositor her account was depleted and she was surprised but said nothing for three months before deciding to raise the forgeries); *Neal v. First Nat'l Bank*, 26 Ind. App. 503, 60 N.E. 164 (1901) (husband knew of wife's forgeries of his name but didn't complain until she left him); *Coffin v. Fidelity-Philadelphia Trust Co.*, 374 Pa. 378, 97 A.2d 857 (1953) (partnership gave no notice of forgeries because it feared publicity and was trying to get the money back from the forger).

Whenever an employer sets up special procedures to avoid forgery or alteration, courts have usually found a duty to follow the procedures.¹²⁹ Thus in *Thompson Maple Products, Inc. v. Citizens National Bank*,¹³⁰ the log buyer's mill operator was supposed to issue one copy of a delivery receipt to a hauler delivering logs and send a duplicate by separate route to the company's bookkeeper office. At the office the clerks were to issue checks in payment for the logs only when both receipts had arrived. In actual practice the mill operator normally gave both copies of the receipt to the hauler for transmittal to the office, and thus the office did not become suspicious when one hauler drew up phony receipts and submitted both copies to the office himself. The court noted that the purpose of separate transmission of the copies was to prevent exactly what happened, and found the company negligent under section 3-406. With this decision compare *Bagby*,¹³¹ in which the Eighth Circuit held that it was negligent (but not "proximate" negligence) for Merrill Lynch to fail to follow its own operations manual procedures in dealing with purported attorneys and prospective customers. The irony of such a rule is that the organization which takes special steps to protect itself may be held to a duty to use reasonable care in enforcing compliance with its procedure.¹³² Since the alleged safeguards may give the company's commercial paper increased credence in the eyes of those dealing with it outside the company,¹³³ such a duty to comply with the higher procedures should exist. There is an analogy here to the general tort rule that one need not rescue someone in danger, but if such a rescue is attempted the actor must observe due care in carrying it out.¹³⁴

129. *C.E. Erickson Co. v. Iowa Nat'l Bank*, 211 Iowa 495, 230 N.W. 185 (1930); *Defiance Lumber Co. v. Bank of Cal.*, 180 Wash. 533, 41 P.2d 135 (1935). But see *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938) (failure to follow own system negligent but not "proximate cause" of loss); *City of New York v. Bronx County Trust Co.*, 261 N.Y. 64, 184 N.E. 495 (1933). The last case is a fascinating problem wherein the City of New York set up an "absolutely foolproof" plan whereby payroll checks were "self identifying" and "as good as currency." When city employees discovered a loophole in the plan which made forgery easier, the City sued its drawee banks and the court, using the "unforeseeable intervening criminal activity" rule, held for the City.

130. 211 Pa. Super. 42, 234 A.2d 32, 4 UCC Rep. Serv. 624 (1967).

131. *Bagby v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 348 F. Supp. 969, 11 UCC Rep. Serv. 766 (W.D. Mo. 1972), *rev'd*, 491 F.2d 192, 13 UCC Rep. Serv. 1069 (8th Cir. 1974).

132. See J. WHITE & R. SUMMERS, *supra* note 7, at 538.

133. *City of New York v. Bronx County Trust Co.*, 261 N.Y. 64, 184 N.E. 495 (1933) (Lehman, Kellogg, J.J., dissenting).

134. See, e.g., *United States v. Gavagan*, 280 F.2d 319 (5th Cir. 1960); *Lacey v. United States*, 98 F. Supp. 219 (D. Mass. 1951); *Black v. New York, N.H. & H.R.R.*, 193 Mass. 448, 79 N.E. 797 (1907); *Zelenko v. Gimbel Bros.*, 158 Misc. 904, 287 N.Y.S. 134 (Sup. Ct. 1935), *aff'd*, 247 App. Div. 867, 287 N.Y.S. 136 (1936).

G. Bank Statement Reconciliation

The duty to use reasonable care and promptness in examining a bank statement for the drawer's unauthorized signature or any alteration is established by section 4-406(1). "Reasonable care" in this regard is a question of fact, although an examination of the language in section 4-406 supplies a few rules. First, the only things the drawer is required to review are *his* unauthorized signature and any alteration of the checks returned. Section 4-406 does not require the drawer to examine the checks for forgeries of the names of other parties to the check, such as the payee. If such a duty exists, and in unusual situations the courts have been willing to say it does,¹³⁵ it would have to arise under section 3-406 and not section 4-406.¹³⁶ Nor does section 4-406 require the drawer to reconcile the statement with his own records, though the courts generally found such a duty at common law¹³⁷ and should continue to do so under section 3-406.

When an employer delegates the task of bank statement examination to an employee, the employee is frequently the forger/alterer and will not of course report his own wrongdoing. In this situation the guilty knowledge of the agent is not imputed to the principal, but the overwhelming weight of authority is that the principal is bound by what an honest agent performing the reconciliation conscientiously would have discovered.¹³⁸ Professors White and Summers have stated that

135. As a general rule there is no duty to check the indorsements. *See* Critten v. Chemical Nat'l Bank, 171 N.Y. 219, 228, 63 N.E. 969, 972 (1902). Special circumstances, however, may call for a closer examination of the checks so that the failure to do so bars the assertion of forged indorsements. For example, in *Prudential Ins. Co. of America v. National Bank of Commerce*, 227 N.Y. 510, 125 N.E. 824 (1920), the drawer was found negligent in not investigating the validity of the indorsements where it received letters from its customers complaining that they had not received the checks involved. *See also* *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938); *American Sash & Door Co. v. Commerce Trust Co.*, 332 Mo. 98, 56 S.W.2d 1034 (1933). The reason this duty does not usually exist is that typically the drawer is not in a position to know the signatures of the indorsers; unless circumstances alert him to the possibility of forged indorsements, he may presume the signatures on the back of the check are valid.

136. Nonetheless, section 4-406(4) has an absolute three-year period during which the drawer must discover forged indorsements or lose his right to complain to the bank. *See* UNIFORM COMMERCIAL CODE § 4-406, Comment 5. If the drawer does discover a forgery of a name necessary to the chain of title, the item was not "properly payable" from the account and the bank must recredit the amount of the check; *see id.* § 4-401; *cf. id.* § 4-407. The drawee will then sue prior parties for breach of the presentment warranty of good title found in section 4-207(1)(a).

137. *C.E. Erickson Co. v. Iowa Nat'l Bank*, 211 Iowa 495, 230 N.W. 342 (1930); *Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank*, 252 Mich. 163, 233 N.W. 185 (1930); *Morgan v. United States Mortgage & Trust Co.*, 208 N.Y. 218, 101 N.E. 871 (1913).

138. *See, e.g., Leather Mfrs. Bank v. Morgan*, 117 U.S. 96 (1886); *C.E. Erickson*

it is arguably negligent under both sections 3-406 and 4-406 for most employers to permit the same employee who disburses checks to do the bank statement reconciliation.¹³⁹

Finally, under section 3-406 the courts have established a duty on the part of the drawer to inquire of the bank if he does not receive statements for an unusual period of time.¹⁴⁰ If the bank statements are disappearing there is usually an ominous reason—someone doesn't want the contents revealed.

H. Certification

Section 3-406 has played a part in three remarkably similar check certification cases, all from New York. In these cases the drawer of a check procured the drawee bank's certification of a check containing spaces which the drawer filled in after the certification to raise the amount. In none of the cases did the certification stamp make mention of the amount certified. The later holders in due course, who were suing the bank on its certification contract,¹⁴¹ argued that there was two-fold negligence by the bank in certifying a check with spaces facilitating alteration and in failing to specify on the instrument the amount certified. Two lower New York state courts held for the bank, finding no duty on the part of the bank to study checks for spaces or to state the amount certified (though both courts thought this was probably a "desirable" procedure).¹⁴² The United States District Court for the Southern District of New York respectfully disagreed, noting that it doubted that the New York Court of Appeals would read section 3-406 so restrictively.¹⁴³ The federal court found the "any person" language broad enough to include certifying banks and ruled that

Co. v. Iowa Nat'l Bank, 211 Iowa 495, 230 N.W. 342 (1930); Morgan v. United States Mortgage & Trust Co., 208 N.Y. 218, 101 N.E. 871 (1913); Exchange Bank & Trust Co. v. Kidwell Constr. Co., 463 S.W.2d 465, 8 UCC Rep. Serv. 1079 (Tex. Civ. App.), writ refused, 472 S.W.2d 117, 9 UCC Rep. Serv. 482 (Tex. 1971).

139. J. WHITE & R. SUMMERS, *supra* note 7, §§ 16-6, -7 at 538-40.

140. Myrick v. National Sav. & Trust Co., 268 A.2d 526, 7 UCC Rep. Serv. 1139 (D.C. Ct. App. 1970) (six months); Terry v. Puget Sound Nat'l Bank, 80 Wash. 2d 121, 492 P.2d 534, 10 UCC Rep. Serv. 173 (1972) (four months); cf. Gennone v. Peoples Nat'l Bank & Trust Co., 51 Pa. D. & C.2d 529, 9 UCC Rep. Serv. 707 (Montgomery County C.P. 1971) (duty of inquiry under § 3-406 met, but then drawer failed to comply with his § 4-406 duty to examine the statements).

141. UNIFORM COMMERCIAL CODE §§ 3-413(1), -410(1), -411(1); cf. *id.* § 3-418.

142. Wallach Sons, Inc. v. Bankers Trust Co., 62 Misc. 2d 19, 307 N.Y.S.2d 297, 7 UCC Rep. Serv. 141 (New York City Civ. Ct. 1970); Sam Goody, Inc. v. Franklin Nat'l Bank, 57 Misc. 2d 193, 291 N.Y.S.2d 429, 5 UCC Rep. Serv. 502 (Sup. Ct. Nassau County 1968).

143. Brower v. Franklin Nat'l Bank, 311 F. Supp. 675, 7 UCC Rep. Serv. 1021 (S.D.N.Y. 1970), noted with approval in 39 FORDHAM L. REV. 557 (1971).

there was a duty of the bank to exercise care in the process of certification.

The federal decision seems the better result; certifying banks should be held to the duty not to certify instruments containing spaces facilitating alteration unless the certification stamp clearly states the amount certified. The very purpose for procuring certification is to lend verisimilitude to the check by backing it with the bank's personal obligation. This purpose will be frustrated if later holders cannot reasonably rely on the apparent amount of the check. At the time they receive it there will be no spaces on the instrument. The policy considerations above apply here as well.

The cases have also placed liability on the certifying bank when the alteration has taken place prior to the certification, and this rule is clearly continued in the Code.¹⁴⁴ When a thief steals the instrument prior to certification, erases the payee's name, substitutes his own, and then procures certification, the pre-Code cases¹⁴⁵ held against the certifying bank using NIL section 62(2), which stated that the acceptor admits the "existence of the payee and his then capacity to indorse." This language is now found in section 3-413(3) of the UCC, and the pre-Code cases are expressly approved by Official Comment 5 to section 3-417. In effect, the admission of the existence of the payee found in section 3-413(3) amounts to a quasi-"Know Your Customer" rule; it is also analogous to the impostor rule, section 3-405(1)(a), since by certifying the check as presented, the bank is doing something akin to issuing it to an impostor. Section 3-505(1)(b) gives the certifying bank the right to get reasonable identification of the person requesting certification, and the above sections coupled with the negligence rule of section 3-406 seem to convert this into a duty to do so.

V. CONCLUSION

The enactment of section 3-406 provides the courts with the opportunity to untangle the pre-Code inconsistencies and set up a system of risk allocation based on rational factors. The early common law bias in favor of excusing negligence and permitting the negligent party to pass the loss onto others was based in large part on the fact that a bank was usually the losing party, and, when the negligence was slight, the courts felt more comfortable in placing the risk on a solvent enterprise

144. See Part IV B *supra*.

145. See sections cited note 139 *supra*. See also UNIFORM COMMERCIAL CODE §§ 3-417(1)(b)-(c).

well able to absorb the loss.¹⁴⁶ As time passed the courts lost sight of utilitarian considerations and unthinkingly began to embrace doctrine for doctrine's sake, most specifically the undefinable idea of "proximate cause." This term was used in one case to permit an employer to fire an employee who embezzled 12,500 dollars, rehire him and put him in charge of check issuance and bank statement reconciliation, not supervise his activities, ignore the fact that the supposedly impoverished man had bought and refurbished a nightclub, and, when the forgeries were discovered, pass most of the loss off onto the drawee bank since the negligence was not the "proximate cause" of the check payments.¹⁴⁷ This same decision is cited with approval by the Eighth Circuit in the *Bagby* case.

In negotiable instruments law as well as elsewhere, "proximate cause" has become a wild card doctrine and caused enormous confusion in an area where some degree of certainty is a commercial necessity. The courts will better promote this policy (and others such as uniformity, increased negotiability, and rational risk allocation) if "proximate cause" is discarded in section 3-406 suits in favor of a simpler test. If the court finds that the accused party had a duty to do or not do the act involved, and the fact-finder decides the duty was violated and that this violation was a substantial factor contributing to the forgery or alteration, section 3-406 precludes the raising of these defenses against later non-negligent parties. Rephrasing the "proximate cause" issue as one of duty is not iconoclasm; rather it is the appropriate judicial response to the legislative mandate "to simplify, clarify and modernize the law governing commercial transactions."¹⁴⁸

146. *Wells Fargo Bank & Union Trust Co. v. Bank of Italy*, 214 Cal. 156, 4 P.2d 781 (1931); *National City Bank v. National Bank of Republic*, 300 Ill. 103, 132 N.E. 832 (1921); cf. *UNIFORM COMMERCIAL CODE* § 3-417, Comment 5 (adopting these decisions).

147. *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938). The court did find that failure of the employer to investigate a \$15,000 shortage disclosed by an audit was negligence proximately causing the loss on checks issued after the audit.

148. *UNIFORM COMMERCIAL CODE* § 1-102(2)(a).