July 2015

The U.C.C. Section 4-205(2) Payment/Deposit Warranty: Allow a Drawer to Hold a Depositary Bank Liable For Collecting an Item With a Forged Indorsement

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THE U.C.C. SECTION 4-205(2) PAYMENT/DEPOSIT WARRANTY: ALLOW A DRAWER TO HOLD A DEPOSITORY BANK LIABLE FOR COLLECTING AN ITEM WITH A FORGED INDOREMENT

I. INTRODUCTION

Now is an exciting time for students and practitioners of commercial law. The gradual evolution of the Uniform Commercial Code [hereinafter "UCC" or "the Code"] has recently culminated in major revisions. Hardly an Article remains unscathed. New Articles were created in response to rapid changes in the conduct of commerce. For example, new U.C.C. Article 4A was drafted in an effort to cope with technological advances in electronic transfers of funds, and to provide a basis for adjudicating disputes arising from this form of payment where none had existed at common law. The uniform laws dealing with negotiable instruments were likewise amended.


2. See Frederick H. Miller, Analysis of New UCC Articles 3 and 4, C664 ALI-ABA 259 (1991) (for an overview of the provisions that were amended in the most recent drafting effort).

3. U.C.C. § 4A-102 cmt. 2 ("The funds transfer governed by Article 4A is in large part a product of recent and developing technological changes.")

4. Id. at cmt. 3 ("In the drafting of Article 4A, a deliberate decision was made ... to treat [electronic] funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised ... [and] to assign responsibility, define behavioral norms, allocate risks and establish limits on liability ... ").

5. Id. at cmt. 2 ("Before ... Article [4A] was drafted there was no comprehensive body of law - statutory or judicial - that defined the juridical nature of [electronic] funds transfer or the rights and obligations flowing from payment orders. Judicial authority with respect to [electronic] funds transfers is sparse, undeveloped and not uniform.").

6. U.C.C. arts. 3 & 4.


Certain provisions of Articles 1 and 4 as they related to the process of check collections were also amended. See Robert G. Ballen, et al., Commercial Paper, Bank Deposits and Collections, And Other Payment Systems, 46 BUS. LAW. 1521, 1552-56 (1991) (listing the
As the drafters explained, the old laws could not "adequately address the issues of responsibility and liability as they relate to modern technologies now employed and the procedures required by the current volume of checks" being processed annually.  

One such procedure, which evolved to accommodate certain commercial depositors who accumulate large numbers of checks during the course of their businesses, involves the use of "lock boxes." Generally speaking, there are two situations in which lock boxes are employed. First, institutions receiving a large daily volume of checks on a daily basis may direct payment to a post-office box, for which the depositary bank is responsible. Apparently, significant changes made to Article 4); Miller, supra note 2, at 267-70 (reviewing the changes made to Article 4).

8. This Comment will cite to the pre-revision, 1962 version of Articles 3 and 4 with the letters "PR" following the Article designation. For example, pre-revision section 4-205 would be cited as U.C.C. § 4PR-205.

9. Revised Article 3, Prefatory Note, Purpose of the Drafting Effort, at ¶ 2. See also id. at ¶ 1 ("Revised Article 3 (with miscellaneous and conforming amendments to Articles 1 and 4) . . . . [was] undertaken for the purpose of accommodating modern technologies and practices in payment systems with respect to negotiable instruments."); Henry J. Bailey, New 1990 Uniform Commercial Code: Article 3, Negotiable Instruments, and Article 4, Bank Deposits and Collections, 29 WILLAMETTE L. REV. 409 (1993); Fred H. Miller, U.C.C. Articles 3, 4, and 4A: A Study in Process and Scope, 42 ALA. L. REV. 405 (1991) (providing an excellent discussion of the history of the drafting efforts); Garland, supra note 7, at 558 ("The objectives of the redraft were to replace archaic terminology, make Article 3 more relevant to today's business transactions, and to recognize that notes and drafts have different functions as to merit different treatments."); Ballen, supra note 7, at 1556:

The revision of Articles 3 and 4 serves the underlying purposes and policies of the Uniform Commercial Code by clarifying and modernizing the law governing negotiable instruments and bank collections, by encouraging the expansion of modern practices concerning the negotiation and collection of checks and other instruments, and by resolving conflicting lines of authority, thereby promoting greater uniformity in the law among various states.

10. In the early 1950s, about 7 billion checks were handled for collection. By 1987, that number had swollen to an estimated 48 billion. See Revised Article 3, Prefatory Note, Purpose of Drafting Effort, at ¶ 1; U.C.C. § 4-101, cmt. 2 ("In 1950 . . . 6.7 billion checks were written annually. By . . . 1990 . . . annual volume was estimated by the American Banker's Association to be about 50 billion checks."); id. at cmt. 1 ("The great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections."); Donald W. Garland, A New Law of Deposits and Collections: Revised Article 4 of the UCC, 110 BANKING L.J. 51, 51 (1993).


Lock box operations are used by payees who are institutions that handle a substantial volume of checks. The payee sends the checks daily to the processing facility where the check is MICR encoded with the amount of the check and the depositary bank code. That information is electronically transmitted to the payor bank. If there are sufficient funds in the drawer's account, an electronic transfer is made from the drawer's account to the payee's account.

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these depositing institutions routinely failed to indorse the checks. Under prior Article 4, depositary banks could become holders of the unindorsed items for collection purposes if the bank placed some sort of statement on the item "to the effect that the item was deposited by a customer or credited to his account." Since the banks could provide missing indorsements, one can imagine that businesses accumulating large amounts of checks would be tempted to deposit them without indorsements. The second situation where lock boxes are used is where a bank has made loans to a business or other institution and wishes to exercise greater control over the collection of payments. Pursuant to an agreement, the borrower would instruct its customers to send their checks to the lock box for the collecting bank to process. Because the borrower is the named payee on all these checks but never came into possession of the checks, it obviously could not indorse them. In either situation the depositary banks found themselves encumbered with the time-consuming responsibility of supplying the missing indorsements.

The drafters of the revision recognized that such a chore is largely meaningless. Accordingly, revised U.C.C. section 4-205(1) accommodates this practice. It eliminates the need for the depositary banks to print anything on unindorsed items because they become holders upon receipt. Additionally, the drafters created a new warranty in paragraph two that runs from the depositary bank taking items for collection to a number of parties, including the

12. U.C.C. § 4-205 cmt. (“It is common practice for depositary banks to receive unindorsed checks under so-called “lock box” agreements from customers who receive a high volume of checks.”).
15. James J. Cunningham, Introduction to Secured Lending and Commercial Finance, 681 PLI/COMM 21, 31 (1994) (“A lender can utilize a ‘lockbox’ arrangement to have greater control over collections.”).
16. Here the borrower instructs its customers to make payments to a post office box to which the borrower does not have access. Only the collection bank has access to the post office box. The collection bank may be the lender itself (if it is a bank) or a different financial institution. The collection bank removes the collections from the post office box and deposits them in a bank account of the lender, on a daily basis. The proceeds are then applied to pay down the line of credit.
17. See U.C.C. § 4-205 cmt. (“No function would be served by requiring a depositary bank to run these [unindorsed checks] through a machine that would supply the customer’s indorsement. . . .”).
18. U.C.C. § 4-205(1). See infra section III(A) for the full text of the statute. See also U.C.C. § 4-205 cmt. (“Paragraph (1) provides that the depositary bank becomes a holder when it takes the item for deposit . . . . Whether it supplies the customer’s indorsement is immaterial.”).
drawers of the checks. Essentially this warranty imposes an obligation on the depositary banks to either pay or deposit the proceeds of the item to the benefit of the bank’s “customer.”

As written, the new section 4-205(2) Payment/Deposit Warranty may provide a new theory upon which to hold a depositary bank liable for handling a stolen check for the benefit of a thief. This Comment will propose that the word “customer” as used in U.C.C. section 4-205 should not be read to include a thief that steals a check, forges an indorsement, and transfers the item to a depositary bank for collection. Such a reading would allow the drawer of the stolen check to sue the depositary bank for breach of warranty. This Comment will first describe the existing recourses available to the drawer against the drawee bank, and the depositary bank. Second, it will analyze section 4-205(2) according to traditional and familiar rules of statutory construction in order to show that a new cause of action has been created by Revised Article 4 of the U.C.C.

II. EXISTING DRAWER’S RECOURSES

A drawer of a check may suffer an injury at the hands of a wrongdoer in a number of ways. The case law is replete with instances of faithless, embezzling employees who “pad the payroll,” induce an employer to issue checks to real or imagined payees and thereafter keep the proceeds, or otherwise dupe the hapless employer. The following paragraphs trace the drawer’s existing rights against its drawee bank and the depositary bank that accepted the item for collection from the forger.

A. Drawer’s Recourses Against the Drawee Bank

In reviewing the drawer’s recourses against the drawee bank, it is perhaps simpler to begin by reviewing what the drawer cannot do. The drawer cannot bring an action against the drawee bank for statutory conversion of the instru-

19. See U.C.C. § 4-205(2). See also infra section III(A) for the full text of the warranty.
20. See id.
21. See infra section II(A).
22. See infra section II(B).
23. See infra section III.
ment, as (i) such an action is expressly precluded by the Code, (ii) there are conceptual difficulties with allowing the drawer to sue in conversion, and (iii) the drawer has other, more efficient remedies available. Neither can the drawer bring an action for any existing presentment or transfer warranty.

The usual remedy for a drawer injured by the drawee’s mistaken payment over a forged indorsement is essentially a breach of contract action for reaccrediting of the drawer’s account. The Code permits a drawee bank to debit the depositor’s account after it has paid an item according to the depositor’s order, i.e., an item which is “properly payable.” An item is properly payable if the depositor has authorized payment to the individual presenting the item for payment. Expressly permitting the drawee bank to

25. The drawee bank may be a statutory converter. U.C.C. § 3-420(a) (“An instrument is also converted if . . . a bank makes . . . payment with respect to an instrument for a person not entitled to enforce the instrument or receive payment [i.e., a thief].”). The bank making payment, or the “payor bank,” is defined as the drawee. U.C.C. § 4-105(3).

26. U.C.C. § 3-420(a)(“An action for conversion may not be brought by (i) the issuer [the drawer].”).

27. See U.C.C. § 3-420 cmt. 1 (“There is no reason why a drawer should have an action in conversion. The [stolen] check represents an obligation of the drawer rather than the property of the drawer.”); AMF, Inc. v. Algo Distributors, Ltd., 369 N.Y.S.2d 460, 464 (N.Y. App. Div. 1975) (“In order to establish a cause of action for conversion . . . the plaintiff must demonstrate legal ownership or an immediate superior right of possession to a specific identifiable thing . . .”).

28. See U.C.C. § 3-420 cmt. 1 (A drawer should not have a cause of action for conversion because “[t]he drawer has an adequate remedy against the payor bank for reaccredit of the drawer’s account for unauthorized payment of the check.”); Stone & Webster Engineering Corp. v. The First National Bank & Trust Co., 184 N.E.2d 358, 362 (Mass. 1962). See also infra notes 55-60 and accompanying text for details.

29. The transfer warranties of U.C.C. § 4-207 and § 3-416 run only to transferees of the instrument. The drawer is a person who issues the instrument. U.C.C. § 3-105(a). The drawer is always a transferor, never a transferee. Therefore, the transfer warranties do not run to the drawer. Under U.C.C. § 4-208(a) and § 3-417, the presentment warranty runs only to the drawee bank, not the drawer.

30. Stone & Webster, 184 N.E.2d. at 363 (“The drawer can insist that the drawee reaccredit his account with the amount of any unauthorized payment.”); Ambassador Financial Services, Inc. v. Indiana National Bank, 605 N.E.2d 746, 751 (Ind. 1992) (“The drawer’s remedy for improper payment [of a check over a forged indorsement] is to obtain reaccredit of his account from the drawee bank in the amount of the improper payment.”); Fireman’s Fund, 149 Cal. Rptr. at 889 n.5 (“Absent its ratification or negligence, a drawer can demand that the drawee reaccredit its account on the ground that a check bearing a forged drawer’s signature is not ‘properly payable’ within the meaning of code section 4-401(1).”).

31. U.C.C. § 4-401(a) (“A bank may charge against the account of a customer an item that is properly payable. . . .”); Wilder Binding Co. v. Oak Park Trust & Savings Bank, 527 N.E.2d 354, 357 (Ill. App. Ct. 1988) (Under [U.C.C.] section 4-401, the [drawee] bank may charge against a customer’s account only those items which are ‘properly payable.’”).

32. See U.C.C. § 4-401 cmt. 1 (“An item is properly payable from a customer’s account if the customer has authorized the payment. . . .”).
debit their depositor's accounts for any items which are properly payable implies that such banks cannot debit their depositor's accounts for items not properly payable. A negotiable instrument bearing a forged indorsement is not a properly payable item. Therefore, a drawer whose check was paid over a forged indorsement may sue a drawee bank for wrongful payment.

This having been said, an action by a drawer against a drawee bank for reaccrediting of the drawer's account is no easy feat. There are a number of defenses a drawee bank may raise that will operate to prevent the drawer from shifting the loss to the bank. First, the drawer may be held to have ratified the unauthorized signature. Second, there are a number of defenses that, if warranted by the factual circumstances, make the forger's unauthorized signature "effective," thereby converting an item not ordinarily properly payable to one that is properly payable. If the bank can establish one of these circum-

33. Ambassador Financial, 605 N.E.2d at 751 (“[Under U.C.C. 4-401] A drawee bank may debit a drawer's account for any items that are properly payable. By negative implication, section 4-401 denies the drawee bank the right to charge amounts not properly payable.”) (citations and quotations omitted).

34. U.C.C. § 4-401 cmt. 1 (“An item containing a . . . forged indorsement is not properly payable.”); Wilder Binding, 527 N.E.2d at 357 (“A forgery is obviously an unauthorized signature that is not properly payable by the [drawee] bank in the first instance.”); Fireman's Fund, 149 Cal. Rptr. at 889 (“The code provides that as between the drawee bank and the depositor, losses from a forged or unauthorized signature are borne by the bank since payment not made pursuant to directions of a 'properly payable' order cannot be charged to the depositor's account.”); Ambassador Financial, 605 N.E.2d at 751 (“Checks bearing forged indorsements are not properly payable.”).


36. U.C.C. § 3-403(a) (“An unauthorized signature may be ratified for all purposes of this Article.”); U.C.C. § 1-201(43) (“'Unauthorized' signature means one made without actual, implied, or apparent authority and includes a forgery.”); U.C.C. § 3-403 cmt. 3 (“The last sentence of subsection (a) allows an unauthorized signature to be ratified.”). The District Court for the Northern District of Mississippi has held that drawer of a check who sent the check to his wife in California in order to start a joint business had arguably ratified the wife's indorsement, and could not sue the drawee bank for a reaccrediting. Polles v. FDIC, 749 F. Supp. 136, 142 (N.D. Miss. 1990).

37. The first of these defenses is the Imposter Rule. See U.C.C. § 3-404(a) (“If an imposter, . . . induces [the issuance of the check to the imposter] . . . an indorsement . . . by any person [including a forger] in the name of the payee is effective.”). The second is the No-Interest Rule. See U.C.C. § 3-404(b)(i) (“If (i) [the wrongdoer procuring issuance of the check] . . . does not intend the person identified as payee to have any interest in the [check] . . . An indorsement by any person [including a forger] in the name of the [designated] payee . . . is effective.”). The third is the Fictitious Payee Rule. See U.C.C. § 3-404(b)(ii) (“If . . . (ii) the person identified as payee of [the check] is a fictitious person . . . (2) An indorsement by any person in the name of the [designated] payee . . . is effective.”).
stances, it will be relieved from liability for wrongful payment of a check bearing a forged indorsement. Third, there are a number of defenses involving the drawer’s own negligence in allowing the forgery to occur. If any of these defenses are established, the drawer will be precluded from asserting the forgery against the drawee bank. If, however, the drawer can show the bank was also negligent in paying the checks with the forged indorsements, then the Code allocates the loss between them based on comparative negligence principles. Last, there are a number of common-law defenses which supplement the statutory defenses.

38. In Shube v. Cheng, 596 N.Y.S.2d 335 (N.Y. Sup. Ct. 1993), someone purporting to be the payee of a check induced an agent of a drawer to issue a check to him at a real estate closing. The court held that this imposter’s indorsement of the check was “effective.” Id. at 339. In Northbrook Property & Casualty Ins. Co. v. Citizens & Southern National Bank, 361 S.E.2d 531 (Ga. Ct. App. 1987), a bookkeeper fraudulently issued company checks to real persons whom the bookkeeper intended to have no interest. The court held that her unauthorized signature was “effective,” and the company-drawer could not maintain an action against the drawee bank for reaccrediting. Id. at 533. In Merrill Lynch, Pierce, Fenner & Smith, Inc. v. NCNB National Bank of North Carolina, 695 F. Supp. 162 (S.D.N.Y. 1988), an employee of the drawer-company submitted false invoices and induced the company to issue checks to a nonexistent, fictitious company. The court held that the employee’s signature was “effective,” and that the drawer-company could not maintain an action against the drawee bank for reaccrediting. Id. at 164.

39. See U.C.C. § 3-406(a) (dealing with negligence of drawer that “substantially contributes” to the forgery); U.C.C. § 4-406 (dealing with drawer’s negligence in failing to examine his bank statement for evidence of forgeries); U.C.C. § 4-405 (dealing with employer’s negligence in selecting and/or supervising an employee having “responsibility” for the checkbook who forges signatures).

40. See U.C.C. § 3-406(a) (“A [drawer] whose failure to exercise ordinary care substantially contributes . . . to the making of a forged signature . . . is precluded from asserting the . . . forgery against [a drawee bank].”); Dubin v. Hudson County Probation Department, 630 A.2d 1207, 1211 (N.J. Super. 1993) (holding that drawer who (i) waited several months before destroying or shredding blank, unused checks from a closed account, and (ii) whose agent responsible for guarding the checks left them unattended in a place accessible to the public committed negligence which “substantially contributed” to the forgery; drawer was therefore precluded from asserting the forgeries.); U.C.C. § 4-406(d) (“If the bank proves that the customer failed [to examine his account statement for evidence of forgeries], the customer is precluded from asserting against the bank . . . [the customer’s forged signature].”); Simcoe & Erie General Ins., Co. v. Chemical Bank, 770 F. Supp 149, 153 (S.D.N.Y. 1991) (holding that drawer was negligent in examining account statement and was precluded); U.C.C. § 3-405(b) (if employee entrusted with “responsibility” for checks makes a fraudulent indorsement, the employee’s signature is “effective.”).


42. For example, some jurisdictions allow a depositary bank to raise the so-called Intended Payee defense. See Ambassador Financial, 605 N.E.2d at 752 (“The intended payee defense is . . . aimed at preventing a drawer from being unjustly enriched by recovering for an improperly paid check when the proceeds of the check in fact were received by the payee.
If the drawee bank establishes any of these defenses, the drawer’s right to recovery of moneys subtracted from his account and paid out over a forged indorsement will be severely restricted, if not eliminated altogether. One fact pattern that could very well lead to the successful assertion of one of these defenses against a drawer may be found in the Official Comment to U.C.C. section 3-406. There the drafters have included a number of examples intended to illustrate when the Drawer’s Negligence defense might apply. The second example reads as follows:

An insurance company draws a check to the order of Sarah Smith in payment of a claim of a policyholder, Sarah Smith, who lives in Alabama. The insurance company also has a policyholder with the same name who lives in Illinois. By mistake, the insurance company mails the check to the Illinois Sarah Smith who indorses [forges] the check and obtains payment.

Under these circumstances, the insurance company is likely to admit its mistake and issue a new check to the Alabama Sarah, who was never paid the proceeds of her policy. Thus, the payee would drop out of the litigation picture, leaving the insurance company to assess its recourses under the U.C.C. against other parties. Assuming Illinois Sarah’s indorsement was not authorized by Alabama Sarah, Illinois Sarah’s indorsement is a forgery. The insurance company’s bank had no right to charge the insurance company’s intended by the drawer and the drawer suffered no damages caused by the improper payment.”."

43. If the drawee bank can assert any defense detailed in note 40 above, then the operation of comparative negligence will reduce the drawer’s recovery.

44. If the drawee can establish any of the defenses detailed in notes 37 and 38 above, the drawer will be precluded altogether from recovery.

45. U.C.C. § 3-406 cmt. 3, Case #2.

46. See U.C.C. § 3-420 cmt. 1, which states that in a situation where:

the check was mailed to an address different from that of the [true] payee and was stolen after it arrived at that address[,]... the drawer of the check [normally] intends to pay an obligation owed to the payee. But if the check is never delivered to the payee, the obligation owed to the payee is not affected. If the check falls into the hands of a thief who obtains payment after forging the signature of the payee as an indorsement, the obligation owed to the payee continues to exist after the thief receives payment. ... [T]he payee’s right to enforce the underlying obligation is unaffected. ...

47. Except the Illinois Sarah. It should go without saying that the drawer may sue the thief directly, if the thief can be brought to trial. Frequently, thieves disappear after committing their crime. Direct suits against the wrongdoer are beyond the scope of this Comment, which is limited to discussing the drawer’s ability to shift the loss to the depositary bank.

48. See U.C.C. § 3-406 cmt. 3, Case #2, which stipulates that Illinois Sarah’s indorsement is a forgery. “Unauthorized” signatures are considered forgeries under the Code. See U.C.C. § 1-201(43) (“Unauthorized signature means one made without actual, implied, or apparent authority and includes a forgery.”) (quotations omitted); U.C.C. § 3-403 cmt. 1 (suggesting that unauthorized signatures constitute forgeries).
checking account. Therefore, the insurance company may bring an action for wrongful payment and seek a reaccrediting. For the sake of tracing the usual route of litigation, assume that the insurance company attempts to do so. This fact pattern was included in the Official Comment to section 3-406 as an example of drawer’s negligence which a finder of fact could determine had “substantially contributed” to the making of the forgery. For the sake of this discussion, let us assume this is the case, and the drawer-insurance company is precluded from asserting the forgery against the drawee bank. Let us further assume that the drawee bank has committed no negligence in accepting and paying the forged check. Under these circumstances, the insurance company may not recover from the drawee bank, and must look elsewhere in order to pass the loss to a different party. The only parties remaining are the collecting banks, including the depositary bank.

B. Drawer’s Recourses Against the Depositary Bank

There has been much scholarly and judicial debate over the question whether a drawer of a stolen and forged check may bring an action against a depositary bank that accepted the check for collection. Over the years, drawers have attempted to sue depositary banks on a number of theories, including conversion, negligence, and breach of warranty. However, attempts to sustain such actions are generally fraught with difficulties.

1. Conversion

There are only meager possibilities for a drawer to hold the depositary bank liable for conversion. Although like the drawee bank, a depositary bank

49. 422 A.2d at 438, aff’d, 430 A.2d 902 (N.J. 1981) (“[A] drawee bank may not properly debit the account of a customer whose check bears the forged indorsement of a payee.”).

50. See U.C.C. § 3-406 cmt. 3, Case #2 (“[Under the facts presented] the trier of fact could find that the insurance company [i.e., the drawer] failed to exercise ordinary care when it mailed the check to the wrong person and that the failure substantially contributed to the making of the forged indorsement.”).

51. Under U.C.C. § 3-406(b), if the drawer can prove that the drawee bank was also negligent, they will share the loss each to the extent to which their individual negligence had contributed to the forgery. See also U.C.C. § 3-406 cmt. 4 which states:

Subsection (b) differs from former Section 3-406 in that it adopts a concept of comparative negligence. If the person . . . asserting the preclusion [i.e., the drawee] failed to exercise ordinary care and that failure substantially contributed to the loss, the loss may be allocated between the two parties on a comparative negligence basis.

52. The Code defines a collecting bank as any bank handling an item except a payor bank. See U.C.C. § 4-105(5). This includes a depositary bank. See U.C.C. § 4-105(5).

53. See the cases cited below in sections II(B)(i) - (iii).
is subject to liability for statutory conversion, the revised Code forecloses
the possibility of the drawer suing for conversion of the item. Similarly, a
drawer cannot maintain a cause of action for conversion of the proceeds of
the check, which the depositary bank handles on behalf of its depositor. It is well
settled that when a customer deposits money into his account, title to the
money passes to the bank. The drawer loses all title and interest. To
maintain an action for conversion under the common law, the aggrieved
party must have title to the allegedly converted property. Drawers simply
do not have sufficient interest in the proceeds their drawee banks pay out over
forged indorsements to maintain a cause of action for conversion.

54. U.C.C. § 3-420(a) ("An instrument is also converted if . . . a bank . . . obtains payment
with respect to the instrument for a person not entitled to enforce the instrument or receive
payment."). Depositary banks are "collecting banks" that obtain payment under U.C.C. § 4-
105(5).

55. See supra notes 27-29. See also U.C.C. § 3-420 cmt. 1 ("Under former Article 3, the
cases were divided on the issue of whether the drawer of a check with a forged indorsement
can assert rights against a depositary bank that took the check . . . . There is no reason why a
drawer should have an action in conversion.").

56. E.g., Goralsky v. Taylor, 571 N.E.2d 720, 722 (Ohio 1991) ("Money deposited in a
bank becomes the property of the bank."); Aspinall v. United States, 984 F.2d 355, 358 (10th
Cir. 1993) ("[W]hen money is deposited into a bank account, title to the funds passes to the
bank."); United States v. Citizens & Southern National Bank, 538 F.2d 1101, 1105 (5th Cir.
1976) ("A person who places money in a bank on general deposit loses title to the money.");
funds on general deposit [with the bank] are property of the bank, not of the depositor.");
title to the money).

does not 'own' the funds it has on deposit with the drawee.").

58. The U.C.C. does not set forth the elements which constitute the tort of conversion. The
elements of a claim for conversion are found in principles of common law which supplement

59. E.g., Wilder v. Charles Bell Pontiac-Buick, Cadillac-GMC, Inc., 565 So. 2d 205, 206
(Ala. 1990) ("To maintain an action for conversion, a plaintiff must establish that . . . at the
time of the conversion, the plaintiff had a general or specific title [to the converted property].");
Satterfield v. Sunny Day Resources, Inc., 581 P.2d 1386, 1388 (Wyo. 1978) ("In order to
recover damages in an action for conversion, a plaintiff’s proof must show that: (a) the plaintiff
had a legal title."); AMF, Inc., Ltd., 369 N.Y.S.2d at 464 ("In order to establish a cause of
action for conversion, two things must be shown: first, the plaintiff must demonstrate legal
ownership or an immediate superior right of possession to a specific identifiable thing . . . .");
Gallimore v. Sink, 218 S.E.2d 181, 183 (N.C. Ct. App. 1975) ("It is clear then that two
essential elements are necessary in a complaint for conversion – there must be ownership in
the plaintiff and a wrongful conversion by the defendant.").

60. In 1990, the California Supreme Court issued an opinion testing the theoretical limits
of an action for conversion. In Moore v. Regents of the University of California, 793 P.2d
479 (1990), the court considered whether a patient could maintain a cause of action for
conversion of tissues and cells that were excised from his body. The court recognized that
"to establish a conversion, a plaintiff must establish an actual interference with his ownership
Taking a somewhat different approach, the New York courts have developed a specialized cause of action for conversion of the proceeds of the item available to drawers under specific circumstances. In Underpinning & Foundation Constructors, Inc. v. Chase Manhattan Bank, a faithless accounting department employee prepared bogus invoices from real payees with whom the employer did a substantial amount of business. The employee then induced the employer to write checks to pay the fictitious invoices. Later, the employee would employ a restrictive indorsement stamp similar to the one used by the real payees, forge the necessary indorsements, and deposit the checks into his private account. The employer, as drawer of the checks, brought a suit against the depositary bank for conversion. The court considered that since the employee never intended for the real payees to have any interest, the forgeries became “effective” under the No-Interest Rule. The checks were therefore valid orders to the drawee bank authorizing it to debit the drawer’s account. However, the depositary bank applied the collected proceeds in violation of the rubber-stamped restrictive indorsement. The court held that under these two circumstances, where (a) the payee’s unauthorized indorsement is “effective” and (b) “the depositary bank has acted in such a way as to make it liable to the drawer,” the drawer has a cause of action against the depositary bank for conversion.

or right of possession. . . . Where the plaintiff neither has title to the property alleged to have been converted, nor possession thereof, he cannot maintain an action for conversion.” Id. at 488. The court went further to hold that since patients retain no ownership interests in excised cells and tissues, and therefore, the plaintiff could not maintain an action for conversion. Id. at 489. If a patient cannot sue for the alleged conversion of cells and tissues excised from his body, neither can a drawer sue for the alleged conversion of money excised from his estate. See Benjamin A. Appelbaum, Comment, Moore v. Regents of the University of California: Now that the California Supreme Court has Spoken, What has It Really Said?, 9 N.Y.L. Sch. J. Hum. Rts. 495 (1992) (for more information on the Moore case); Lisa Mundrake, Biotechnology and Moore v. Regents of the University of California: The Revolution of the Future, 13 Whittier L. Rev. 1009 (1992).


62. Id. at 1322. The court was considering U.C.C. § 3PR-405(1)(c). See U.C.C. § 3-404(b)(i) (for the current version of the No-Interest Rule).

63. Forged indorsements made “effective” by an applicable defensive statute become properly payable. See supra notes 37-38.

64. Underpinning, 386 N.E.2d at 1322. Here the court considered the depositary bank’s act of applying the proceeds of the item to an account in violation of the restrictive covenant as rendering it liable to the drawer. See Robert G. Ballen, et al., Commercial Paper, Bank Deposits and Collections, and Other Payment Systems, 45 Bus. Law. 2341, 2368 (1990) (suggesting that the Underpinning court allowed the drawer to sue the depositary bank because the operation of the Fictitious Payee Rule, which places the loss on the drawer, endowed the drawer with sufficient property interest in the check in order to maintain a conversion action).

65. Underpinning, 386 N.E.2d at 1322.
Underpinning has been accepted in New York, but has been limited to its particular constellation of facts. Few jurisdictions elsewhere recognize this cause of action. Perhaps this theory has not caught on because of the same theoretical difficulties with allowing drawers to sue for conversion of the proceeds without either of the "special circumstances" in Underpinning. Since title to the funds rests with the drawee bank, any funds the depositary bank handles do not belong to the drawer. It is difficult to fathom how the drawer's indorsement that was made "effective" by the Code bears any relation to the drawer's ability to bring an action for conversion of the proceeds. The operation of U.C.C. section 3-404 does not wrest title to the transferred funds from the drawee bank and bestow it in the drawer so as to endow him with sufficient interest to maintain an action for conversion. Even if his payee's forged indorsement was made "effective," the drawer does not own the funds that were transferred. In all, there is little hope for a hapless drawer to be able to sue the depositary bank for conversion of either the item or the funds.

2. Negligence

A second theory upon which a drawer has been held to be able to sue the depositary bank is negligence, presumably for failure to detect the forged indorsement. The cases are split as to whether the drawer may bring such an action. Despite the intermittent support, there are persuasive reasons why


67. See, e.g., Shube v. Cheng, 596 N.Y.S.2d 335, 337 (N.Y. Sup. Ct. 1993) (holding that in general drawer does not have a cause of action against collecting/depositary banks, and Underpinning applies in only "specific limited circumstances."); Prudential-Bache Securities, Inc. v. Citibank, 536 N.E.2d 1118, 1123 (N.Y. 1989) (holding that Underpinning should be narrowly construed to apply only to those cases where the depositary bank accepts the item presented for deposit in contradiction of a restrictive indorsement; also holding the decision does not recognize a cause of action for simple conversion or money had and received).

68. For cases which discuss the viability of an Underpinning-type claim in their jurisdictions, see, e.g., Cairo Cooperative Exchange v. First National Bank of Cunningham, 620 P.2d 1805, 1808 (Kan. 1980) (holding that drawers may bring an action against depositary bank for collecting an item over a forged restrictive indorsement).

69. See supra notes 56-57.

a court should reject this action. In general, a depositary bank is under no duty
to examine all indorsements for forgeries.\textsuperscript{71} Even in those cases where a
depositary bank was held to be under such a duty, the courts have narrowly
confined it to apply only when "suspicious circumstances" warrant that the
bank investigate further.\textsuperscript{72} In 1980, the Superior Court of New Jersey iden-
tified an additional two reasons to reject a drawer’s action for negligence.\textsuperscript{73}
First, even if the depositary bank was negligent, this negligence is not the
cause of the drawer’s loss, which actually occurs when the \textit{drawee} wrongly
debits the drawer’s account.\textsuperscript{74} Second, since whenever the drawer is attempt-
ing to assert an action against the depositary bank he is usually foreclosed
from recovering from the drawee bank by the applicability of one of the statu-
tory defenses to an action for reaccrediting the drawer’s account, allowing the
drawer to then proceed against the depositary bank circumvents the general
policy of the Code to allocate such losses to the drawer.\textsuperscript{75} When taken
together, there is little hope that a drawer might be able to bring a suit for
negligence against a depositary bank.

\textsuperscript{71} Northern Trust Co. v. Chase Manhattan Bank, 582 F. Supp. 1380 (S.D.N.Y.), \textit{aff’d},
748 F.2d 803 (2d Cir. 1984) (per curiam); J. Gordon Neely Enters, Inc. v. American National
Bank of Huntsville, 403 So. 2d 887 (Ala. 1981); Lasley v. Bank of Northeast Arkansas, 627
S.W.2d 261 (Ark. App. 1982); Trail Leasing, Inc. v. Drovers First American Bank, 447
N.W.2d 190 (Minn. 1989); \textit{See} Julian B. McDonnell, \textit{Bank Liability for Fraudulent Checks:}
The Clash of the Utilitarian and Paternalist Creeds Under the Uniform Commercial Code, 73
GEO. L. J. 1399, 1399 (1985) ("[It is a] standard banking practice in computerized systems of
paying all checks below a threshold sum, such as $5,000, without a sight review of the
signatures.").

\textsuperscript{72} Travelers Indemnity Co. v. Center Bank, 275 N.W.2d 73, 75 (Neb. 1979); \textit{Sun ‘N Sand},
582 P.2d at 935.

\textsuperscript{73} \textit{See} Brighton, Inc. v. Colonial First National Bank, 422 A.2d 433 (N.J. Super. 1980),

\textsuperscript{74} \textit{Brighton}, 422 A.2d at 440. This point creates a serious challenge to the establishment
of proximate cause.

\textsuperscript{75} \textit{Id.} at 441. The plaintiff in \textit{Brighton} was precluded from suing the drawee bank because
the forged indorsements were validated under the Fictitious Payee Rule. \textit{Id.} at 439. \textit{See also}
U.C.C. § 3-404 cmt. 3:

If a check payable to an imposter, fictitious payee, or payee not intended to have an interest
in the check is paid, the effect of subsections (a) and (b) [making the forged indorsement
"effective"] is to place the loss on the drawer of the check rather than on the drawee or
depositary bank that took the check for collection.
3. Breach of Warranty

A third theory upon which the drawer might hold the depositary bank liable is breach of warranty. At first glance, such a suit may seem impossible because no existing statutory warranty runs from the depositary bank to the drawer. However, some courts have attempted to surmount this difficulty by proposing that the drawer is the third-party beneficiary of the existing warranties running from the depositary bank to other parties. Other courts had reached this result by holding the drawer to be an “other payor” to whom the presentment warranty in pre-revision section 4-207 ran. Under the Revised Code, the presentment warranties only run to the drawee bank, not to any other payor. This omission of the words “or other payor” from the Code’s presentment warranties militates strongly against interpreting the warranties contained in the revision as running to the drawer. There simply is little basis in the traditional warranties in the Code for supporting a drawer’s cause of action against the depositary bank for accepting an item bearing a forged indorsement for collection.

4. A New Recourse in Warranty

As previously indicated, the revised version of Article 4 contains a


77. See, e.g., Allied Concord Financial Corp. v. Bank of America National Trust and Savings Assoc., 80 Cal.Rptr 622, 624 (1969) (“On third-party beneficiary principles we think the benefit of warranties given by a bank which negotiates a check on a forged endorsement extends by implication to the drawer of the check.”).

78. Sun ‘N Sand, 582 P.2d at 928 (“[T]he structure of section 4[PR]-207 indicates the Code contemplates that the drawer of a check is an ‘other payor’ . . . [and] . . . may, claim the benefits of the warranties therein created.”); Insurance Co. of North Amer. v. Atlas Supply Co., 172 S.E.2d 632, 636 (Ga. Ct. App. 1970) (holding that the warranty of good title in section 4PR-207(1) runs to the drawer as an “other payor”); U.C.C. §4PR-207(1) (“Each . . . collecting bank . . . warrants to the payor bank or other payor . . .”) (emphasis added).

79. See U.C.C. § 4-208(a) (providing that various persons “warrant to the drawee [only] that pays or accepts the draft in good faith that . . .” etc.).

80. Donald J. Rapson, Loss Allocation in Forgyery and Fraud Cases: Significant Changes under Revised Articles 3 and 4, 48 ALI-ABA 529, 538 (1992) (suggesting that because the revision stipulates that presentment warranties run only to the drawee bank, and that U.C.C. § 3-417 specifically rejects Sun ‘N Sand, all possibilities for a drawer to sue a depositary bank directly are foreclosed); Miller, supra note 2, at 266 (suggesting that the revision settles the controversy surrounding the liability of a depositary bank for handling an item with an unauthorized indorsement by denying the drawer’s right to sue on a breach of warranty theory).

81. See supra notes 19-20 and accompanying text.
new Payment/Deposit Warranty in section 4-205(2). For the first time a warranty runs directly to the drawer. The last sentence of the Official Comment, sentence number nine, indicates that the person to whom the amount of the item was paid, or into whose account the proceeds of the item were deposited, is to be a holder. In order to be a holder of order paper, the person in possession must have obtained the instrument following the necessary indorsement of the transferor. Thieves who steal order paper and forge a necessary indorsement are not holders. Therefore, the drawer may have a cause of action against a depositary bank for applying the proceeds of an item bearing a forged indorsement, to the benefit of a non-holder/thief, if the word “customer” in code section 4-205(2) is read to mean the holder or owner of the item. As revised Article 4 was only recently completed and offered to the states for adoption, there is no litigation directly on point. The following sections will attempt to show that courts should recognize a new cause of action by a drawer against the depositary bank that accepts an item for collection on behalf of a thief, thereby breaching the section 4-205(2) Payment/Deposit Warranty.

III. ANALYSIS

The interpretation of section 4-205(2) is primarily a task of statutory construction. The competing interpretations are simple enough to articulate. In deciding whether a drawer may have a cause of action against a depositary bank for accepting an item bearing a forged signature, a court may construe the word “customer” broadly enough to encompass a number of persons, including a thief. Alternatively, it may construe the word “customer” narrowly as meaning only the true owner of the item, which necessarily excludes

82. Section 4-205 was entirely rewritten. Compare U.C.C. § 4PR-205 with U.C.C. § 4-205.
83. See infra section III(A) for the full text of the Warranty.
84. U.C.C. § 4-205 cmt., Sentence Number Nine (“This warranty runs not only to collecting banks and to the payor bank or a non-bank drawee but also to the drawer, affording protection to these parties that the depositary bank received the item and applied it to the benefit of the holder.”) (emphasis added).
85. See U.C.C. § 3-201(b) (“if an instrument is payable to an identified person, negotiation requires transfer of possession . . . and its indorsement by the [previous] holder.”).

One who [takes an item] under a forged indorsement . . . cannot be a holder. . . . Title does not pass in such a situation because the transferee who takes under the thief’s forged indorsement cannot qualify as a holder. . . . Since the thief lacks the status of a holder, he cannot effectively indorse the instrument, and his transferee cannot acquire that status. . . . Thus, no one in the chain of title which begins with the theft of an order instrument can attain the status of holder.
If the court considering this issue selected the broader construction, then the depositary bank would not breach the Payment/Deposit Warranty by accepting a stolen item bearing a forged signature from a thief. Under these circumstances, it would be reasonable to hold that the text of the U.C.C. does not authorize a drawer to bring such an action, i.e., that such an cause of action does not exist. On the other hand, if the court selected the narrower construction, then the depositary bank would breach the Payment/Deposit Warranty for accepting the item, collecting the proceeds, and either paying them to a thief or depositing them in a thief’s account. Under these circumstances, the court will have essentially determined that a drawer’s cause of action against a depositary bank indeed exists. The following paragraphs apply familiar principles of statutory construction to section 4-205(2) in an effort to persuade a court that may be asked to ponder this question to adopt the narrow interpretation of the word “customer.”

A. Plain Meaning Rule

It is the first and perhaps most elementary principle of statutory construction that “the meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain, . . . the sole function of the courts is to enforce it according to its terms.”\(^{87}\) In determining the meaning of the word “customer,” a court would first look to the four corners of the statutory text, giving the words their plain and ordinary meaning.\(^{88}\) Upon doing so, it will become evident that section 4-205(2) is clear.

§ 4-205. Depositary Bank Holder of Unindorsed Item.

If a customer delivers an item to a depositary bank for collection:

(1) the depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the item, and, if the bank satisfies the other requirements of Section 3-302, it is a holder in due course; and

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88. State v. One 1990 Chevrolet Pickup, 523 N.W.2d 389, 392 (N.D. 1994) (When interpreting a statute, “we begin with the statutory language, and give those words their plain, ordinary, and commonly understood meaning.”); Smith v. Zufelt, 880 P.2d 1178, 1183 (Colo. 1994) (“In an effort to effectuate the legislative intent, we first look to the statutory language and give words and phrases their plain and ordinary meaning.”); Allstate Ins., Co. v. Hirose, 884 P.2d 1138, 1140 (Ha. 1994) (“Our duty in interpreting statutes is to give effect to the legislature’s intent which is obtained primarily from the language of the statute.”); Adkisson v. City of Columbus, 333 N.W.2d 661, 664 (Neb. 1983) (“A statute should be construed so that an ordinary person reading it would get from it the usual, accepted meaning.”); SUTHERLAND, STAT. CONST. § 46.01 (5th ed. 1992).
(2) the depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited in the customer’s account.\textsuperscript{89}

This provision expressly states that when a \textit{customer} gives an item to the depositary bank, the bank warrants that it has applied the collected proceeds on the \textit{customer’s} behalf.\textsuperscript{90} The word “customer” is in turn defined in section 4-104(5) as “a person having an account with a bank or for whom a bank has agreed to collect items.”\textsuperscript{91} There would appear to be no logical reason to re-interpret a word that is already clearly defined in the statute.\textsuperscript{92} Since the statute lacks any textual ambiguity whatsoever, a court might be inclined to confine its interpretation of the word “customer” to the plain meaning of section 4-104(5).\textsuperscript{93}

According to this construction, there is no controversy. The statute says “customer.” If the thief deposited the stolen check with a depositary bank where the thief maintains an account, the thief obviously constitutes the bank’s “customer.”\textsuperscript{94} Even if the thief did not maintain an account with the depositary bank, the simple act of accepting the check for collection makes any person, even a thief, a “customer” of the depositary bank under the second part of the definition.\textsuperscript{95} In either case, simply handling the stolen check on behalf of the thief makes the thief a “customer” of the depositary bank \textit{whether or not the thief has an account at the bank}.\textsuperscript{96} Therefore, by applying the plain meaning of section 4-205(2), as modified and further explained by

\textsuperscript{89} U.C.C. § 4-205.

\textsuperscript{90} \textit{Id.}

\textsuperscript{91} U.C.C. § 4-104(5).

\textsuperscript{92} Lawson v. Suwanee Fruit & Steamship Co., 336 U.S. 198, 201 (1949) (“Statutory definitions control the meaning of statutory words.”).

\textsuperscript{93} \textit{See} Jacksonville Bulk Terminals, Inc. v. Int’l Longshoreman’s Ass’n, 457 U.S. 702, 727 (1982) (“The ‘common-sense’ meaning of a term is not controlling when [the legislature] has provided... an explicit definition. ... ‘Common-sense’ and legislative history ought not to change the meaning of the unambiguous words [defined in] a statute.”) (Burger, J., dissenting opinion).

\textsuperscript{94} \textit{See infra} notes 156-60 (cases dealing with the issue whether thieves can be “customers”).

\textsuperscript{95} \textit{See, e.g.,} Marine Midland Bank v. Price, Miller, Evans & Flowers, 446 N.Y.S.2d 797, 799 (N.Y. App. Div. 1981) (holding that a party, for whom the depositary bank accepted a check in exchange for the bank’s wire transfer to a creditor of the party, constituted a “customer” of the bank, despite a lack of an account agreement).

\textsuperscript{96} Under this analysis, the only way the thief could not be a “customer” of the depositary bank is if the thief had no account, \textit{and} the bank had not accepted the item for collection despite a lack of an account. \textit{See} Papadopoulos v. Chase Manhattan Bank, 791 F. Supp. 72, 74 n.6 (S.D.N.Y. 1990) (holding that payee of a draft was not a “customer” because there was no account agreement and bank had accepted the item for purposes other than for collection); Quistgaard v. EAB European American Bank & Trust Co., 583 N.Y.S.2d 210, 213 (N.Y. App. Div. 1992) (holding that payee of a check who presented the check for acceptance was

\textsuperscript{93} Spring 1995] THE U.C.C. PAYMENT/DEPOSIT WARRANTY 589

\textsuperscript{94} Scislowski: The U.C.C. Payment/Deposit Warranty

\textsuperscript{95} Published by IdeaExchange@UAkron, 1995
section 4-104(5), a court would in the first instance reach the conclusion that the depositary bank has not breached the Payment/Deposit Warranty when it either paid the thief or deposited the proceeds of the check into the thief’s account. A cause of action by the drawer against a depositary bank for taking a stolen item from a thief would not appear to be warranted by a simple, cursory examination of the statutory text.

B. Other Sources of Legislative Intent

However, there appears to be a long-standing split of authority as to whether a court should proceed and consider other sources of legislative intent beyond the words the legislature used if those words appear clear on the surface. Some courts hold that no other rules of construction are necessary if there is no ambiguity on the face of the statutory text.97 Other courts hold that in all cases the Plain Meaning Rule must be applied in the context of a broader search for legislative intent.98 The latter position appears to be the more rational.99 It is the duty of a court examining a statute to discover and effectuate the intent or purpose of the legislature in enacting it.100 Thus, a court must not a “customer” of the bank, because there was no account and bank had not taken the check for collection).

97. See, e.g., DeVore v. IHC Hospitals, Inc., 884 P.2d 1246, 1251 (Utah 1994) (“Only when we find ambiguity in the plain language of the statute need we seek guidance from legislative history and relevant policy considerations.”)(citations omitted); State v. One 1990 Chevrolet Pickup, 523 N.W.2d at 392 (“[Only] when a statute is ambiguous...[do we] look beyond the express language to the purpose of the statute, to the circumstances of its enactment, and to its legislative history.”)(quotations and citations omitted); Austin v. Memphis Publishing Co., 655 S.W.2d 146, 148 (Tenn. 1983) (“The courts are restricted to the natural and ordinary meaning of the language used by the legislature within the four corners of the statute, unless an ambiguity requires resort elsewhere to ascertain legislative intent.”); Caminetti v. United States, 242 U.S. 470, 485 (1917) (“Where the language [of a statute] is plain and admits no more than one meaning, the duty of interpretation does not arise, and the rules which are to aid doubtful meanings need no discussion.”).

98. Allstate Ins., 884 at 1140 (“Our duty in interpreting statutes is to give effect to the legislature’s intent which is obtained primarily from the language of the statute. However, we must construe statutory language in a manner consistent with the purpose of the statute.”); Nahrstedt v. Lakeside Village Condo Ass’n, Inc., 33 Cal. Rptr.2d 63, 73 (Cal. 1994) (“In construing a statute[,] our primary task is to ascertain legislative intent, giving the words of the statute their ordinary meaning. The words, however, must be read in context, considering the nature and purpose of the statutory enactment.”); Park 100 Development Co. v. Indiana Dept. of State Revenue, 429 N.E.2d 220, 222 (Ind. 1981) (“[The Plain Meaning Rule] must be applied in conjunction with the basic principle that all statutes should be read where possible to give effect to the intent of the legislature.”).

99. Not everyone would agree with this assessment. Justice Antonin Scalia argues that a court should strictly construe statutes when the legislature’s intent is not fully articulated in order to encourage the legislature to express their intentions more clearly. See Bradley C. Karkkainen, ‘Plain Meaning’: Justice Scalia’s Jurisprudence of Strict Statutory Construction, 17 HARV. J. L. & PUB. POL’Y 401, 410 (1994).

100. Conte v. Meyer, 882 P.2d 962, 965 (Colo. 1994) (“In construing statutory provisions,
determine this intent and construe the text in such a way as to avoid defeating it. As the Supreme Court of Rhode Island recently noted, "if a mechanical application of a statutory definition produces an absurd result or defeats legislative intent, this court will look beyond mere semantics and give effect to the purpose of the act." There simply is no way to determine if the "mechanical" application of the statutory definition of "customer" in U.C.C. section 4-104(5) produces absurd results or defeats legislative intent other than by actually looking beyond the four corners of the text to examine the consequences of that application and other evidences of legislative intent. Accordingly, the following paragraphs explore extra-textual sources of legislative intent in order to determine whether a narrow or a broad reading of the word "customer" in section 4-205(2) best effectuates the statute's purpose.

1. Substance of Official Commentary

The purpose of an enactment may become clear upon examining the evils or mischief the legislation was designed to prevent. Apparently, depository banks sometimes mistakenly credit the wrong account when gathering checks from customer's lock boxes. Obviously the drawer has a vested responsibility is to give full meaning to the legislative intent.

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101. E.g., Williams v. State, 853 P.2d 537, 538 (Alaska 1993) ("A court is obliged to avoid construing statutes in a way that leads to patently absurd results or to defeat of the obvious legislative purpose behind the statute."); Brennan v. Kirby, 529 A.2d 633, 637 (R.I. 1987) ("A statute or enactment may not be construed in a way that... would defeat the underlying purpose."); Adkisson v. City of Columbus, 333 N.W.2d 661, 665 (Neb. 1983) ("The court must look to the object to be accomplished or the purpose to be subserved and place such construction on the statute that will best effect that purpose, rather than one that will defeat it.").

102. Sorenson, 650 A.2d at 129.

103. Adkisson, 333 N.W.2d at 644-65 ("A sensible construction will be placed upon a statute... rather than a literal meaning that would have the effect of defeating the legislative intent."); Park 100, 429 N.E.2d at 222 ("It is also well settled that the legislative intent as ascertained from an Act as a whole will prevail over the strict literal meaning of any word or term used therein.").

104. Thompson v. State, 524 N.W.2d 160, 162 (Iowa 1994) ("When construing statutes, we look to the object to be accomplished and the evils and mischiefs sought to be remedied in order to reach a result which will best effectuate the statute’s purpose rather than one that will defeat it.").

105. For example, in the case Continental Airlines, Inc. v. Boatmen’s National Bank of St. Louis, 13 F.3d 1254 (8th Cir. 1994) the customer and the depository bank entered into a lock box agreement where the customer would instruct drawers of checks payable to the customer to send them directly to the depository bank. As it so happened, one drawer correctly identified...
interest in seeing that the proceeds are accredited to the intended payee's account. The drafters have indicated in the Official Commentary that they included the Payment/Deposit Warranty in section 4-205(2) to fill the need for some kind of receipt flowing from the depositary bank to the drawer to indicate that the depositary bank correctly disposed of the collected proceeds. No such receipt existed under the prior version of the code.

If the word "customer" were construed broadly enough to mean any person with an account at the depositary bank, then the depositary bank would not breach this warranty for incorrectly disposing of the collected proceeds. If the depositary bank took the proceeds of the item and accredited any account at random, then by definition it has "deposited the item to the customer's account." Any account is a customer's account. If the word "customer" were construed broadly enough to mean any person having an account with the bank, then in effect the Payment/Deposit Warranty would become a promise that the depositary bank applied the proceeds to any account, not the correct account. In this case, the drawer could not hold the depositary bank liable for incorrectly disposing of the proceeds of the item, thereby depriving such drawer of the intended benefits of the Warranty. Such a result is absurd, and should not be tolerated, as this construction obviously defeats the purpose of the section 4-205(2) Warranty.

On the other hand, if the word "customer" were construed narrowly so as to refer only to the holder or true owner of the item, then the drawer could hold the depositary bank responsible for depositing the proceeds into the

106. Since the payee has not received the collected proceeds, it can be argued that he has not been paid to his satisfaction under U.C.C. § 3PR-603. His right to sue the drawer on the underlying transaction remains unaffected. See supra note 46. The payee may be tempted to sue the drawer. See Ronald L. Hersbergen, Banking Law, 49 LA. L. REV. 259, 271 (1988) ("Alternatively, the true owner can forego his action against the payor and collecting banks and sue the drawer on the underlying obligation."). Thus, the drawer was subject to liabilities for the depositary bank's mistake.

107. U.C.C. § 4-205 cmt. ("Paragraph (2) satisfies the need for a receipt of funds by the depositary bank by imposing on that bank a warranty that it paid the customer or deposited the item to the customer's account.").

108. Id.

109. Conte, 882 P.2d at 965 ("It is presumed that [the Legislature] intends a just and reasonable result when it enacts a statute, and a construction which leads to an absurd result will not be followed."); Fleck v. ANG Coal Gasification Co., 522 N.W.2d 445, 454 (N.D. 1994) ("In interpreting a statute we must presume that the legislature did not intend an absurd or ludicrous result.").
wrong account, including one belonging to a thief. Since there can be only one holder/owner of an item, the bank’s promise to apply the proceeds to the “customer’s,” i.e. the holder/owner’s account remains a promise to apply the proceeds to the correct account. If the bank wrongly deposited the money into an account of a non-holder, then it would have breached the section 4-205(2) Payment/Deposit Warranty. This construction effectuates the purpose of the section 4-205(2) Warranty. A court should therefore construe the word “customer” narrowly to mean only the holder or owner of the item.

2. Words Used in Official Commentary

The actual words employed in the Official Commentary to section 4-205 may provide some guidance as to the intended construction of the text.\textsuperscript{110} Unfortunately, an examination of the official commentary proves to be inconclusive. On the one hand, sentence number eight of the Comment reads “Paragraph (2) [the Payment/Deposit Warranty] satisfies the need for a receipt of funds by the depositary bank by imposing on that bank a warranty that it paid the customer or deposited the item into the customer’s account.”\textsuperscript{111} This language closely mimics the language used in the text of section 4-205(2).\textsuperscript{112} This sentence tends to suggest that drafters did not mean “owner” or “holder” when they used the word “customer” in the text, when part of the Official Comment also uses the word “customer.” It is unlikely that the word “customer” in the text was merely an oversight, since the drafters used the same word again in sentence number eight of the comment. The next sentence of the Official Comment, however, is different. Sentence number nine, states that “the depositary bank received the item and applied it to the benefit of the holder.”\textsuperscript{113} Because the text and the previous sentence of the official comment both use the word “customer,” it might appear that the word “holder” in sentence number nine is merely an anomaly.\textsuperscript{114} Against this backdrop, it is interesting to note that in commenting on the new Payment/Deposit Warranty, Hawkland paraphrased sentence number nine to read that the depositary bank warrants that to the drawer that it “received the item and applied the proceeds to the benefit of its customer.”\textsuperscript{115} However, a court could not

\textsuperscript{110} See SUTHERLAND STAT. CONST. § 52.05 (5th ed. 1992).
\textsuperscript{111} U.C.C. § 4-205 cmt. (emphasis added).
\textsuperscript{112} See supra section III(A) for the full text of the Warranty.
\textsuperscript{113} U.C.C. § 4-205 cmt., Sentence Number Nine (“This warranty runs not only to collecting banks and to the payor bank or a nonbank drawee but also to the drawer, affording protection to these parties that the depositary bank received the item and applied it to the benefit of the holder.”) (emphasis added).
\textsuperscript{114} Id.
\textsuperscript{115} HAWKLAND U.C.C. [Rev] § 4-205:03.
merely ignore the word "holder" in sentence number nine, because of the use of the word "holder" in paragraph one of the text of U.C.C. section 4-205(1). In total, the official comment contains one "customer" sentence and one "holder" sentence. It is therefore inconclusive whether the drafters intended to allow a drawer to bring an action against a depositary bank for accepting an item for collection from a thief.

3. Legislative History

One of the primary resources a court may refer to in searching for legislative intent is of course the legislative history of the statute. The U.C.C. is in actuality only a model which the American Law Institute ("ALI") has created and proposed to the individual states for their adoption. It is a reasonable assumption that most state legislators are not experts in commercial law. Consequently, they tend to consider entire articles as a single piece of legislation to be passed or defeated as a whole. Hence, there has been little legislative comment on any individual section of either revised Articles 3 or 4. The legislative processes of the individual states do not provide any evidence whatsoever of the intended effect or operation of the section 4-205(2) Payment/Deposit Warranty.

4. Intent of the Drafters

Examining the actual drafting process of section 4-205 yields better results. Although such indirect evidence of the intent of the drafters of a statute carries less weight than the intent of the actual lawmakers who enacted it, a quick inspection of the drafting process may nevertheless provide an insight to the meaning of the text. Perhaps this is especially true when the draft-

116. See infra section III(C).

117. Cheshire Mortgage Service, Inc. v. Montes, 612 A.2d 1130, 1139 (Conn. 1992) ("In seeking to discern [legislative] intent, we look to the words of the statute itself, [and] to the legislative history and circumstances surrounding its enactment."); Long Beach Police Officer's Ass'n v. City of Long Beach, 759 P.2d 504, 508 (Cal. 1988) ("To discern legislative intent, we must examine the legislative history and statutory context of the act under scrutiny.").

118. See Wisconsin Knife Works v. National Metal Crafters, 781 F.2d 1280, 1291 (7th Cir. 1986) ("The UCC is one of the most carefully assembled statutes in American History. It was written under the guidance of a few people, all careful drafters, debated for a decade by the American Law Institute and committees of commercial practitioners, and adopted en bloc by the states.").

119. Parsons v. Jefferson-Pilot Corp., 426 S.E.2d 685, 689 (N.C. 1993) ("The [official] commentary to a statutory provision can be helpful in some cases in discerning legislative intent."); United States National Bank of Oregon v. Boge, 814 P.2d 1082, 1090 ( Ore. 1991) ("Although the Official Comments lack the force of law, they are instructive, because [i]f the legislature took note of them at the time of adoption, [ii] because they are consistent with the
ers of the statute, being a collection of independent specialists in commercial law, are much more knowledgeable than the legislators. Revising Articles 3 and 4 was largely the responsibility of Professors Robert L. Jordan and William D. Warren. These men were assisted in their efforts by the Drafting Committee of the National Conference of Commissioners on Uniform State Laws. After working on the project for four years, the drafters finally produced a rough draft for consideration by the full membership of the ALI at their 67th Annual Meeting. The section of the proposed final draft dealing with U.C.C. section 4PR-205 is significant to the discussion at hand. The proposed amended version of section 4-205 contained in that draft reads as follows:

§ 4-205. DEPOSITARY BANK HOLDER OF UNINDORSED ITEM
If a customer is a holder of an item that is delivered to a depositary bank for collection

(1) the depositary bank becomes a holder of the item at the time it receives the item for collection, whether or not the customer indorses, and, if it satisfies the other requirements of Section 3-302, it may be a holder in due course; and

(2) the depositary bank warrants to subsequent collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer’s account.

The first thing that should be noted about this draft is the preamble. Section 4-205 is designed as what logicians refer to as a conditional statement.
A conditional statement is an idea that finds expression in English sentences constructed according to an “if . . . then” format.\textsuperscript{126} This section operates once the “if” part of the conditional, called the \textit{antecedent},\textsuperscript{127} becomes true. In other words, under this provision, the depositary bank becomes a holder under paragraph one and makes the Payment/Deposit Warranty under paragraph two only if the customer depositing the item was a holder. Notice that this section could be read as providing that the depositary bank makes the section 4-205(2) Warranty only when it takes the item from the holder, and not when it takes the item from a thief or other non-holder.

Unfortunately, there is no record that the members of the ALI debated the content of section 4-205 at their 1990 meeting.\textsuperscript{128} After this meeting, the ALI ratified the final version, and the revised articles were eventually proposed to the states for ratification.\textsuperscript{129} We can only infer the intent of the drafters by scrutinizing changes made to the draft.

The most significant change, in the final version involves the phrase “is a holder of an item.” This holder phrase was situated in the preamble, or antecedent, of the draft. In this position, the holder phrase relates to both paragraphs. In the final version, the holder phrase was stricken from the preamble and inserted in paragraph one.\textsuperscript{130} In this position, the statute must be interpreted such that the depositary bank becomes a holder of the item under paragraph one only if the customer who deposited it was also the holder of the item. Conversely, the depositary bank makes the Payment/Deposit Warranty to the designated parties irrespective of whether or not the depositor is also the holder. The bank makes the Warranty under both contingencies, i.e., when the depositor is either the holder or a non-holder, such as a thief. There is no reason for extending the Warranty, and hence the liability for breach, to those situations where the depositary bank accepts the item from a thief if the drafters did not intend that any of the designated parties to whom the warranty runs could make use of it by suing the depositary bank for tak-

\textsuperscript{126} G.N. GEORGACARAKOS \& ROBIN SMITH, ELEMENTARY FORMAL LOGIC 49 (1979) ("Typically, conditionals in English are statements containing the dyadic connecting word if . . . then.") (emphasis in original).
\textsuperscript{127} Id.
\textsuperscript{128} Section 4-205 was only mentioned once during the entire four-day meeting, and then only in passing. \textit{See} 67th Annual Proceedings of the American Law Institute at 442 (1990) (remarks of Professor Robert L. Jordan: "[Revised Article 4] has a provision in it which eliminates the requirement of indorsements when a check is deposited for collection. That is in Section 4-205.").
\textsuperscript{129} Proposed Final Draft of UCC Changes Approved by American Law Institute, 54 BBR 920 (May 28, 1990).
\textsuperscript{130} Compare the draft, supra note 124 and accompanying text, with the statute, supra note 89 and accompanying text.
ing an item from a thief. If the drafters wanted to insulate the depositary bank from the possibility of being sued by one of the designated parties when it deals with a thief, they would have left the holder phrase in the preamble, thereby negating the very existence of the Warranty, and hence the liability, in that situation. By moving the holder phrase, they have indirectly indicated that they contemplated, expected, and even intended depositary banks to be subject to liability for breach. This is persuasive evidence in favor of a narrow construction of the word “customer” in the text so as to effectuate the intent of the drafters.

C. In pari materia

Yet a third reason to construe the word “customer” narrowly enough to be only the holder/owner of the item can be found after considering other sections of the Code dealing with the same subject matter. Such sections are relevant because of the principle of statutory construction that the interpretations of related sections should concur so as to produce a harmonious theoretical whole. Stated conversely, courts should avoid constructions of statutes that place a provision in conflict with other provisions addressing the same topic. Accordingly, a perusal of the other sections of the Code that deal with the subjects which section 4-205(2) addresses is in order.

1. U.C.C. Section 4-205(1)

The statute uses the word “holder” in paragraph one of section 4-205. In that paragraph, the customer who deposits the check must also be a holder of the item. These concepts are conjoined; both must exist in the particular

131. State v. Joubert, 518 N.W.2d 887, 892 (Neb. 1994) ("A series or collection of statutes pertaining to a certain subject matter, [as well as] statutory components of acts which are in pari materia, may be conjunctively considered and construed to determine the intent of the legislature so that different provisions of an act are consistent, harmonious, and sensible."); State ex rel. Sprynczynatyk v. Mills, 523 N.W.2d 537, 540 (N.D. 1994) ("Statutory provisions must be considered as a whole with each provision harmonized, if possible."); Van Raden Homes, Inc. v. Dakota View Estates, 520 N.W.2d 866, 867 (N.D. 1994) ("When faced with conflicting statutory provisions on the same subject matter, we make every attempt to harmonize and give meaning to each without rendering one or the other useless."); SUTHERLAND, STAT. CONST. § 46.05 (5th ed. 1992).

132. Alexdex Corp. v. Nachon Enterprises, Inc., 641 So. 2d 858, 861 (Fla. 1994) (holding that courts must attempt to reconcile any inconsistencies in conflicting statutes); State ex rel Boone v. Sundquist, 884 S.W.2d 438, 444 (Tenn. 1994) ("In construing statutes, it is the duty of the court to avoid a construction which will place one statute in conflict with another; therefore, the court should resolve any possible conflict between the statutes in favor of each other, whenever possible, so as to provide a harmonious operation of the laws.").

133. See U.C.C. § 4-205(2) text at section III(A).
factual situation in order for a depositary bank to be deemed a holder of the unindorsed item.\textsuperscript{134} It would be inconsistent to require that a depositary bank deal with only the owner of the item under paragraph one in order for that bank to enjoy the benefits of holdership, and then to construe paragraph two in such a way as to exempt the depositary bank from extending the Payment/Deposit Warranty, thereby incurring liability for dealing with non-owners. If paragraph one rewards depositary banks for dealing with the true owners of the item taken for collection, paragraph two should operate to punish depositary banks for dealing with non-owners. To formulate a coherent, integrated, harmonious scheme demanding that the depositary banks deal only with the true owners of the items they take for collection, a court should interpret the word "customer" in section 4-205(2) narrowly to mean only the owner or holder of the item.

2. U.C.C. Section 4-201

Another section of the Code dealing with this subject, i.e., the identification of the principal in the agency relationship when a depositary bank accepts an item for collection, is U.C.C. section 4-201. Under paragraph (a), the depositary/collecting bank is "an agent or sub-agent of the owner of the item."\textsuperscript{135} For the most part, this principle is affirmed by the cases considering it.\textsuperscript{136} It would be inconsistent to consider a depositary bank as an agent of the owner of the item for the purpose of determining agency during the collection process under section 4-201 and then to consider the same bank as acting on behalf of a "customer," i.e., a non-owner/thief, during the collection process under section 4-205.\textsuperscript{137} To integrate the interpretations of these two

\textsuperscript{134}. See id.
\textsuperscript{135}. U.C.C. § 4-201(a).
\textsuperscript{137}. In Knesz v. Central Jersey Bank & Trust Co. of Freehold, 477 A.2d 806 (N.J. 1984), the Supreme Court of New Jersey considered and ultimately rejected an analogous argument that a bank should not be considered a "representative" who deals with an instrument on behalf of one who is not the true owner for the purpose of determining if it should enjoy the immunity granted by U.C.C. § 3PR-419(3) to comport to the rule in § 4PR-201 that a depositary bank is an agent of the owner of the item. See 477 A.2d at 810. The court argued that §§ 3PR-419(3) and 4PR-201 "contemplate" different sorts of "agency" under different circumstances, and apparently that a determination that a depositary bank may act as a "representative" of a thief that was inconsistent with § 4PR-201 was acceptable. Id. Such an argument would not be available here, as both §§ 4-205 and 4-201 "contemplate" the depositary bank's actions on behalf of the depositor during the initial stages of the collection process. A
sections, a court should interpret the word "customer" narrowly to mean only the owner/holder of the item.

3. U.C.C. Section 3-602

A third section that bears on the question here can be found in Part 6 of Article 3. The section 4-205(2) Warranty is partially a payment warranty. Under certain circumstances, a depositary bank may make final payment of the item to the depositor. Under U.C.C. section 3-602, a bank may only pay a person who is entitled to enforce the instrument. A bank which wrongly pays a person not entitled to enforce the instrument violates its account agreement with the drawer, and subjects the bank to various liabilities. The code defines a "person entitled to enforce" as simply the holder of the item. In order for the depositor to be a holder of order paper, the depositor must be in possession of the paper, and the paper must bear the proper indorsement indicating the bank must pay the person in possession. Only the prior holder or his agent can place the necessary indorsement on the item in order to make the next possessor, such as the depositor, a holder. In the case of stolen determination that a depositary bank could act on behalf of a thief under § 4-205 would produce unacceptable dissonance with § 4-201.

138. See U.C.C. § 4-205(2) ("the depositary bank warrants . . . that the amount of the item was paid to the customer . . .").

139. BRADY ON BANK CHECKS, ¶ 15.4, 15-7 (Henry J. Bailey ed., 6th ed. 1987) (indicating that a bank which accepts an "on us" item makes final payment of the item in the 3-602 sense when the provisional credit extended to the depositor becomes final after the bank's midnight deadline). See also Pracht v. Oklahoma State Bank, 592 P.2d 976, 979 (Okla. 1979) (holding that drawee bank that also acts as depositary bank may be held accountable on, i.e., has finally paid, the drawn on and deposited in the bank if it failed to timely revoke the provisional credit); Dozier v. First Alabama Bank, 363 So. 2d 781, 783 (Ala. Civ. App. 1978) ("Final payment occurred because the [depositary/drawee] bank failed to return the ["on-us"] item or send notice of dishonor before its midnight deadline.").

140. U.C.C. § 3-602(a) ("an instrument is paid to the extent payment is made . . . (ii) to a person entitled to enforce the instrument.").

141. The drawee who has mistakenly paid a person not entitled to enforce is immediately subject to an action by the drawer to reaccredit the account. If the drawer bounces other checks because of the wrongful payment, the bank may be subject to an action for wrongful dishonor.

142. U.C.C. § 3-301 ("Person entitled to enforce’ an instrument means (i) the holder of the instrument").

143. U.C.C. § 1-201(20) (defining a holder of a negotiable instrument that is payable to an identified person as that identified person, if that person is also in possession of the item).

144. Maryland Industrial Finishing Co., Inc. v. Citizens Bank of Maryland, 642 A.2d 317, 322 (Md. App. 1994) (holding that since negotiation of an instrument requires any necessary indorsement, a party receiving the check over the unauthorized indorsement of someone other than the true payee cannot be a holder); Humberto Decorators, Inc. v. Plaza National Bank, 434 A.2d 618, 619 (N.J. Super. 1981) ("A proper negotiation of the instrument require[s] the
order paper, the prior holder has not properly indorsed the item over to the thief. The thief’s forgery of the true owner’s indorsement does not operate to negotiate the paper to the thief. The thief cannot be the holder of stolen order paper, and is not a person entitled to enforce the instrument. Therefore, a thief cannot be paid under section 3-602.

If the thief takes the stolen draft directly to the drawee bank and deposits it into his account, the drawee bank cannot “pay” the item to the thief under 3-602. If the word “customer” in section 4-205(2) were interpreted broadly enough to include a thief, then the Warranty would not be breached in this same situation, where the thief takes the stolen draft directly to the drawee bank and obtains “payment” when the drawee bank provides a firm, non-revocable credit. If this construction were adopted, the drawee bank, acting in its capacity as the depositary bank, would in effect be allowed to pay the thief under section 4-205(2), an act forbidden by section 3-602. In order to integrate the operation of these two sections, a court should construe the word “customer” in section 4-205(2) narrowly to mean only the owner or holder of the item. That way, the drawee bank acting as a depositary bank would be consistently subjected to liability for paying a thief under both sections.

payee’s indorsement.”); Wright v. Bank of California, National Ass’n., 81 Cal. Rptr. 11, 13 (Cal. Ct. App. 1969) (“Endorsement of ... a check is necessary for the negotiation thereof.”).

145. Morris v. Ohio Casualty Ins., Co., 517 N.E.2d 904, 909 (Ohio 1988) (“An unauthorized signature does not operate as the signature of the named payee and, accordingly, may not act to pass title to an instrument.”); Stone & Webster Engineering Corp. v. First National Bank & Trust Co. of Greenfield, 184 N.E.2d 358, 361 (Mass. 1962) (holding that transfer of an item from a thief forger to collecting bank is not a negotiation due to the lack of the necessary indorsement of the payee).

146. See DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON COMMERCIAL LAW, 599 (3d ed. 1993) (“By definition, a holder must have at least two things: possession of the instrument and good title thereto.”) (emphasis in original); Id. at 601-02 (no possessors of the stolen check payable to payee’s order containing the forged payee’s indorsement are holders. This includes the thief.).

147. Santos v. First National State Bank of New Jersey, 451 A.2d 401, 411 (N.J. Super. 1982) (“[Since] a forged indorsement is wholly inoperative, ... the possessor has no right to enforce payment by any party to the check.”). While the paper is in the thief’s hands, the thief cannot hold anyone on their statutory contracts. The thief cannot enforce the paper against the drawer, as the drawer owes his obligation only to a person entitled to enforce the paper. See U.C.C. § 3-414(b). The thief cannot hold any prior indorsers, because their obligation to pay the draft runs only to a person entitled to enforce. See U.C.C. § 3-415(a). The thief cannot hold the true owner because the true owner did not actually place his signature on the paper. See U.C.C. § 3-401(a). Finally, the thief has no legal right to take the paper to the drawee bank and receive payment, as the item bearing the unauthorized signature is not properly payable.

148. Champion International Corp. v. Union National Bank, 325 S.E.2d 656, 657-58 (N.C. Ct. App. 1985) (holding that a defalcating employee who was not in possession of the CDs was not a holder, and bank that paid him violated its account agreement with the drawer to pay only the holder).
D. No Superfluous Language

One of the elementary canons of statutory construction is that a court should construe a section in such a way as to avoid rendering any of the words superfluous. As the Supreme Court of Hawaii stated in 1993:

It is a cardinal rule of statutory construction that courts are bound, if rational and practicable, to give effect to all parts of a statute, and that no clause, sentence, or word shall be construed as superfluous, void, or insignificant if a construction can be legitimately found which will give force to and preserve all [the] words of a statute.

Thus, in interpreting U.C.C. section 4-205(2), the court must construe the words the drafters employed so as to give it legal effect. On its face, section 4-205(2) creates a new warranty, and presumably subjects the warrantor, the depositary bank, to liability for breach. If the word “customer” appearing therein were interpreted broadly according to the definition in U.C.C. section 4-104(5) to include a thief, then the warranty would have no legal effect. By definition, a depositary bank can only take an item for collection from a person for whom it has agreed to collect the item, whether or not such a person has an account with the bank. Thus, a drawer’s account will eventually be debited at the end of a chain of events that always begins when the depositary bank agrees to collect an item for a person. In all cases where the drawer’s account was wrongly debited, the depositary bank was acting on behalf of someone for whom it agreed to collect the item. Therefore, if the section 4-205(2) Payment/Deposit Warranty were construed as a promise that the depositary bank paid the “customer” or deposited the proceeds in the “customer’s” account, the warranty would be breached under no circumstances. None of the designated parties could hold the depositary bank liable. Thus, no real liability attaches to the depositary bank by the operation

149. United States v. Nordic Village, Inc., 112 S. Ct. 1011, 1015 (1992) (“[It is a] settled rule that a statute must, if possible, be construed in such a fashion that every word must have some operative effect.”); Reiter v. Sonotone Corp., 442 U.S. 330, 338 (1979) (“In construing a statute, we are obliged to give effect, if possible, to every word [the legislature] used.”); Progressive Animal Welfare Society v. University of Washington, 884 P.2d 592, 602 (Wash. 1994) (“We will not interpret statutes in a manner that renders portions of the statutes superfluous.”).


151. Except, of course, in those rare instances where the depositary bank purchases the item, and thereafter collects the proceeds on its own behalf.

152. Under this construction, the only way the Payment/Deposit Warranty would be breached would be if the depositary bank sent the item for collection, but did not deposit the collected proceeds into any account. This result is nearly impossible in the age of computerized transactions.
of section 4-205(2). A warranty that can never be invoked is useless. By construing the word “customer” broadly to include any person for whom the bank agrees to collect an item, section 4-205 loses all legal effect, and becomes a superfluous appendage to the Uniform Commercial Code. Therefore, a court should construe the word “customer” narrowly to mean only the owner or holder of the item in order to avoid rendering the section 4-205(2) Warranty meaningless.

E. Prior Judicial Interpretation of “Customer”

In trying to determine the meaning of a statute, a court may turn to interpretations of other courts directly on point for guidance. As the section is new, no court has yet directly considered whether a thief can be a “customer” for the purposes of section 4-205(2). Most cases dealing directly with the issue of who can be a “customer” within the ambit of section 4-104(5) arise in the context of determining if the plaintiff has standing to sue a drawee bank for wrongfully paying a check over a forged indorsement153 or wrongful dishonor.154 In all of these cases, the courts were asked to determine who exactly was the drawee bank’s “customer.” Typically, the courts had a choice between two potential plaintiffs.155 In two of cases, the court had to decide

153. See, e.g., United Virginia Bank v. E.L.B. Tank Construction, Inc., 311 S.E.2d 773, 775 (Va. 1984) (holding that where person A deposits money on behalf of person B, person B is the “customer” entitled to maintain an action for wrongful payment); Swiss Baco Skyline Logging, Inc. v. Haliewicz, 567 P.2d 1141, 1146 (Wash. Ct. App. 1977) (holding that plaintiff could not maintain an action against drawee bank for negligently paying a check because the plaintiff was not a “customer”); Atlas Building Supply Co. v. First Independent Bank of Vancouver, 550 P.2d 26,29 (Wash. Ct. App. 1976) (holding that a copayee could not maintain an action for wrongful payment of check to other copayee over an unauthorized indorsement absent a showing copayee was a “customer” of the bank); Columbian Peanut Co. v. Frosteg, 472 F.2d 476, 480 (5th Cir. 1973) (holding that a corporation was a “customer” such that it could sue drawee bank for wrongful payment); First National Bank of Springdale v. Hobbs, 450 S.W.2d 298, 301 (Ark. 1970) (holding that corporate president was the “customer” of the bank such that he could sue the drawee in his individual capacity for wrongful payment).

154. See, e.g., Scali v. Key Bank of New York, 611 N.Y.S.2d 21, 22 (1994) (holding that the plaintiff could not maintain an action against drawee bank for wrongful dishonor because plaintiff was not a “customer”); Agostino v. Monticello Greenhouses, Inc., 560 N.Y.S.2d 690, 691 (N.Y. App. Div. 1990) (holding that corporation, not the president individually, was the “customer,” and the president could not maintain an action against drawee for wrongful dishonor); Kesner v. Liberty Bank & Trust Co., 390 N.E.2d 259, 259 (Mass. Ct. App. 1979) (holding that the corporation, not the treasurer individually, was the “customer” of the bank, and treasurer could not maintain an action for wrongful dishonor); Sinwellan Corp v. Farmer’s Bank of Delaware, 345 A.2d 430, 433 (Del. Super. Ct. 1975) (holding that the employee, not the corporation, was the “customer” of the drawee bank, and could maintain an action for wrongful dishonor), rev’d, 367 A.2d 180, 182 (Del. 1976) (holding that the corporation, not the employee individually, was the “customer” and employee could not maintain an action for wrongful dishonor).

155. See supra notes 153-54.
whether the plaintiff or a thief was the "customer." In Mid-Atlantic Tennis Courts, Inc. v. Citizens Bank & Trust Co. of Maryland, a faithless employee-salesman solicited jobs for the employer, but never informed the employer of the new customers. The employee then diverted the down payment checks from the customers to his own account. The court held specifically that although the checks were intended for the employer, it was not the drawee bank's "customer" under section 4-104. The court remarked incidentally that the defalcating employee (a thief), who maintained an account with the bank, was its "customer." In Federal Insurance Co. v. First National Bank of Boston, an embezzling agent of the drawer, impersonating a real person (Mrs. Whitaker), opened a new account in Mrs. Whitaker's name at the defendant bank. The embezzler then redeemed Mrs. Whitaker's stock certificates, and induced the drawer to issue a $40,000.00 check payable to the defendant bank "a/c Helen Whitaker." The embezzler deposited the check in defendant bank, then withdrew the funds. Mrs. Whitaker's insurer attempted to recover the proceeds form the depositary bank on her behalf. The court held that the embezzler (a thief) was the "customer" of the depositary bank, not the real Mrs. Whitaker.

The Mid-Atlantic Tennis Courts and Federal Ins. Co. courts were essentially asked to decide if a plaintiff, not being the thief, was entitled to maintain a cause of action against a bank dealing with a thief. Their remarks about the status of the thief vis-a-vis the banks was not strictly necessary to the determination of whether the plaintiff was a "customer." As such, these remarks are properly classified as dicta. Further, as these courts are Federal District courts, their interpretations of state substantive law are not binding on state courts. As a result, the entire common law embodied in those decisions construing the word "customer" in section 4-104(5) does not provide any relevant or binding assistance in construing the word "customer" in

157. Id. at 143.
158. Id.
160. Id. at 140.
161. In re Guardianship and Conservatorship of Bloomquist, 523 N.W.2d 352, 357 (Neb. 1994) (holding that a point discussed in a previous case that is not necessary to the determination of that case or not specifically raised as an issue addressed by the court is merely non-binding dicta).
162. The U.C.C. is a uniform law that every state has adopted. See Whaley, supra note 146, at 615 ("The UCC is a state statute . . ."). Therefore, in deciding a case under the U.C.C., a Federal District Court is necessarily interpreting a state's substantive law.
section 4-205(2).

Beyond the above cases applying the definition of "customer" in section 4-104(5), there is other, very famous case law that supports the idea that a bank may properly act on behalf of a thief. In *Knesz v. Central Jersey Bank & Trust Co. of Freehold*, the depositary/collecting bank had accepted two checks bearing the forged indorsements of the true owner. The Supreme Court of New Jersey held that under pre-revision section 3-419(3), a depositary or collecting bank can act as the "representative" of a party who is not the true owner of the instrument, so that the bank was immune from a suit in conversion by the payee. Although the rule in *Knesz* has been rejected by the drafters of the revision, the New Jersey court’s discussion of the question whether a depositary bank can act on behalf of one who is not the true owner is applicable to the issue at hand. A court interpreting section 4-205(2) might use this case to reason by analogy. Just as the *Knesz* court could not help but apply the plain terms of section 3PR-419(3) and arrive at the conclusion that a depositary bank may act as a "representative" of a thief, a court today may find itself powerless but to apply the plain terms of sections 4-205(2) and 4-104(5) and arrive at the conclusion that a thief may be the "customer" of a depositary bank. However, like the case law dealing with section 4-104(5), this decision is not directly on point. It is only tangentially relevant to the interpretation of the word "customer" in section 4-205(2).

**F. Policy Arguments**

In determining the meaning of statutory language, courts will routinely consider the virtues and consequences of each competing interpretation, and

165. U.C.C. § 3PR-419(3). See U.C.C. § 3-420(c) for the current statement of the law.
166. *Knesz*, 477 A.2d at 810.
167. See U.C.C. § 3PR-419(3).

Subject to the provisions of this Act concerning restrictive indorsements a representative, including a depositary or collecting bank, who has in good faith and in accordance with the reasonable commercial standards applicable to the business of such representative dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.

*Id.* (emphasis added).

168. Compare U.C.C. § 3PR-419(3), supra note 167 with U.C.C. § 3-420(c), text and cmt. 3 (denying the conversion defense’s availability to a depositary bank).

169. *Knesz*, 477 A.2d at 814. (“We are in consequence not persuaded that the underlying policy served by the common law – the recognition of a single direct action by an owner-payee against the depositary or collecting bank and the avoidance of circuitous or chain litigation – overrides the plain terms of § 3(PR)-419(3).”).

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select an interpretation that best promotes or least harms the public good.¹⁷⁰ In so doing, it is proper to weigh the putative benefits and burdens experienced by the litigants, the courts, and society as a whole.

1. Culpability.

In asking a court to determine if a drawer may sue the depositary bank for accepting an item from a thief over a forged indorsement, the drawer pressing the issue is attempting to pass the loss caused by the thief onto the bank. One of the relevant considerations in making that determination is who should bear that loss. In general, the more culpable person should incur the loss.¹⁷¹ On the one hand, the depositary bank does not have clean hands; it dealt with, and acted on behalf of a wrongdoer. On the other hand, if the drawer is pressing to sue the depositary bank, it will usually be because the drawer has been precluded from recovering from the drawee bank by the operation of one of the defenses.¹⁷² Thus, the drawer has likewise misbehaved in some manner. Both parties seem equally culpable in this matter.

2. Character of the Parties

Since the losses caused by theft tend to be substantial, in considering whether a drawer may sue a depositary bank and attempt to pass the loss along, it is relevant to consider which of these parties is better able to absorb and/or spread these losses.¹⁷³ In most cases, the drawer would be an individual. In some cases, the drawer might be a corporation or other business entity. However, in nearly all cases, the bank will be much stronger economically than the drawer. To avoid shock losses, and to better spread the losses caused by thievery, a court should interpret section 2-405(2) so as to allow the drawer his day in court.

¹⁷⁰. Wichelman v. Messner, 83 N.W.2d 800, 811 (Minn. 1957) (holding that in construing a statute, a court must consider the consequences of a particular interpretation, and endeavor to find a construction that promotes the public interests).
¹⁷². See supra notes 37-42 and accompanying text discussing defenses.
¹⁷³. This argument has found favor in Article 2 breach of warranty actions for defective products. See Spring Motors Distributors, Inc. v. Ford Motor Co., 489 A.2d 660, 666 (N.J. 1983) (holding that in general, a manufacturer is a better risk-bearer than an individual, and should bear the risk of loss from injuries caused by a defective product); Jones & Laughlin Steel Corp. v. Johns-Manville Sales Corp., 626 F.2d 280, 288 (3d Cir. 1980) (“Courts have adopted strict liability for cases involving injury to persons or other property in order to place the cost of such injuries on . . . the party best able to distribute the costs.”). The argument is equally applicable in the Article 4 context.
3. The Policy of the U.C.C. Loss Allocation System

The general scheme of the warranty provisions in the U.C.C. is to place the loss on the person who could best have prevented the loss.\(^{174}\) In cases of forged indorsements, the net effect of the warranties is to eventually place the loss on the depositary bank.\(^{175}\) If the drawer were allowed to sue the depositary bank, and if the drawer succeeds, then the loss would be placed exactly where the warranty scheme operates to place it. However, if the drawer is pressing to sue the depositary bank, it will be because the drawer has been precluded from recovering from the drawee bank by operation of one of the defenses. The overarching policy of the statutory defenses is to place any loss partially or entirely caused by the drawer on the drawer.\(^{176}\) If the drawer would be allowed to sue the depositary bank under these circumstances, it would amount to an attempt to circumvent this policy.\(^{177}\) In sum, these con-

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175. McCarthy, Kenney & Reidy, P.C. v. First National Bank of Boston, 524 N.E.2d 390, 392 (Mass. 1988) (holding that the loss caused by a forged indorsement falls on first bank dealing with the thief by operation of UCC warranties); Great American Ins., Co. v. Amer. State Bank of Dickinson, 385 N.W.2d 460, 465 (N.D. 1986) (holding that the objective of the UCC warranty provisions in forged indorsement cases is to place the loss on the depositary bank because "that party is in the best position to verify and obtain the necessary indorsements."); Robert D. Cooter & Edward L. Rubin, A Theory of Loss Allocation for Consumer Payments, 66 TEX. L. REV. 63, 105-106 (1987) (liability for forged indorsement falls on depositary bank); McDonnell, supra note 71, at 1404 (strict liability underlying the UCC warranties allocates losses to the depositary bank as the first taker of the checks with the forged indorsement from the wrongdoer); WHITE & SUMMERS, UNIFORM COMMERCIAL CODE § 16 (3d ed. 1988) ("Depositary banks . . . are in the best position to prevent certain kinds of fraud, particularly those involving indorsements.").

176. See U.C.C. § 3-404 cmt. 3 (If a check payable to an imposter, fictitious payee, or payee not intended to have an interest . . . the effect of subsections (a) and (b) is to place the loss on the drawer. . . . The drawer is in the best position to avoid the fraud and thus should take the loss."); U.C.C. § 3-405 cmt. 1 ("Section 3-405 adopts the principle that the risk of loss for fraudulent indorsements by [responsible] employees . . . should fall on the employer rather than the [depositary or drawee] bank."); McCarthy, 524 N.E.2d at 392 (holding that loss caused by check issued to a fictitious payee is on the drawer); McDonnell, supra note 175, at 1406 (drafters intended that when a defense applies, the drawer should bear the loss rather than the bank).

siderations cancel each other, and do not provide a court a compelling reason to either allow or prevent a drawer's suit under section 4-205(2).

4. Judicial Economy

As previously indicated, the usual course of action for a drawer injured by the payment of a check over a forged indorsement is an action to reaccredit the drawer's account. In such an action, several defenses can be asserted against the drawer. These same defenses may be assertable in a direct action by the drawer against a depositary bank for breach of warranty. If the courts were to allow the drawer to assert an action against the depositary banks after an action for reaccrediting the drawer's account against the drawee fails, then the drawer would be afforded the opportunity to relitigate issues relating to the defenses. It is inconsistent with our judicial system's ideal that every plaintiff be given his single day in court if drawers were allowed to turn around and sue depositary banks after a suit broaching the same issues fails against a drawee. However, if the word "customer" in section 4-205(2) were construed narrowly so that the drawer had the option to sue the depositary bank directly, the drawer may decide not to pursue an action against his own bank. If the drawer elected to sue the depositary bank, then there would be no res judicata problems.

direct suit by the drawer against the depositary bank could be viewed as a circumvention of the statutory scheme.

178. See supra note 30.
179. See supra notes 37-42.
180. See U.C.C. § 4-208(c) (suggesting that in an action for breach of warranty, "the warrantor [a collecting/depositary bank] may defend by proving that the indorsement is effective under Section 3-404 or 3-405 or the drawer is precluded under Section 3-406 or 4-406 from asserting against the drawee the unauthorized indorsement or alteration.").


181. State v. Simms, 881 P.2d 840, 843 (Utah 1994) (holding that the doctrine of Res Judicata "bars a second adjudication of the same facts under the same rule of law.").
182. McDonnell, supra note 175, at 1413 ("A drawer may hesitate to sue its own bank, for fear of damaging its banking relationship."); Cooter & Rubin, supra note 175, at 109:
These considerations, however valid, are counterbalanced by a very persuasive reason to allow a direct drawer's suit against a depositary bank. Under the current system, whenever a drawer incurs a loss due to the payment of an item over a forged indorsement, he or she must first look to the drawee bank. In turn, the drawee bank usually turns to the presenting bank with which it received the item in order to pass the loss on a breach of presentment warranty theory. The presenting bank in turn looks to the statutory transfer warranties to pass the loss to prior collecting banks. So, too, do these collecting banks resort to the transfer warranties to pass the loss down the collection chain until it lands upon the depositary bank. This system has been roundly criticized as circuitous and needlessly time-consuming. If a court were to interpret the word “customer” in section 4-205(2) narrowly as to mean only the owner or holder of the item, then a new cause of action by the drawer directly against the depositary bank will be recognized, thereby achieving the “short cut” that effectively by-passes the circuitous effects of the Code’s current loss allocation scheme.

While it is convenient to sue one’s own bank, certain practical problems can arise. Financial institutions tend to become irritated when they are sued, and the drawer’s bank can express its irritation by cancelling the drawer’s accounts, or accelerating any outstanding loans. As a result, the drawer may prefer to sue the depositary bank.

183. See supra note 30. See also Cooter & Rubin, supra note 175, at 108:

In the second category of forged indorsement cases, the loss initially falls on the drawer rather than the payee. Most typically, an employee or family member steals a check after the drawer has written it, forges the payee’s indorsement, and cashes it. The drawer’s right of action, which is for improper payment, lies against the drawee.

184. Stone & Webster Engineering Corp. v. First National Bank & Trust Co., of Greenfield 184 N.E.2d 358, 363 (Mass. 1962) (“If the drawee recredits the drawer’s account and is not precluded by 4[PR]-406(5), it may claim against the presenting bank on the relevant [presentment] warranties in 3[PR]-417 and 4[PR]-207.”).

185. Id. (“Each transferee has rights against his transferor under [the transfer warranties] those sections.”).

186. See supra note 175.


188. See Stone & Webster, 184 N.E.2d at 362 (“An action by the drawer against the collecting bank might have some theoretical appeal as avoiding circuitry of action.”).
IV. CONCLUSION

There are many reasons why a court should narrowly construe the word "customer" in section 4-205(2) to mean only the holder or owner of the item. Although the text of section 4-205(2) may appear clear on the surface, considerations of extra-textual sources of legislative intent reveal that a narrow reading best effectuates legislative purpose. A narrow construction is also warranted to harmonize the interpretation of section 4-205(2) with other sections of the code dealing with the same subject matter. By interpreting the word "customer" to mean only the holder or owner of the item, a court would avoid a construction that renders section 4-205(2) superfluous. Although a review of prior case law interpreting the word "customer" does not aide in the determination of the issue at hand, considerations of public policy on balance militate for a narrow reading.

The new sections in the Revision create new opportunities for litigation. The nascent section 4-205(2) provides a new cause of action by a drawer of a check against a depositary bank that accepts a check for collection over a forged indorsement. The arguments assembled in this Comment should assist the commercial law practitioner in persuading a court that a drawer may now sue a depositary bank for breach of warranty, thereby furthering the evolving understanding and utility of the Uniform Commercial Code.

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189. See supra section III (A).
190. See supra section III (B).
191. See supra section III (C).
192. See supra section III (D).
193. See supra section III (E).
194. See supra section III (F).