

Duties and Liabilities Arising from Bank-Depositor Relationship

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either or survivor," on the death of one of the named parties all of the rights of ownership vest in the survivor. By judicial decision,³² it is immaterial that an illusory transfer has taken place as long as the account has been made in full compliance with the Banking Law. However, it should be noted that the Law Revision Commission has recommended the amendment of this statute³³ to make the presumption a rebuttable one. Should such an amendment be enacted by the legislature, this type of savings bank account will in all probability have the same status as a "totten trust" where the rebuttable presumption was created by decisional law.³⁴ Joint accounts also would be subjected to the right of a surviving spouse who might complain of their illusory nature.

DUTIES AND LIABILITIES ARISING FROM BANK-DEPOSITOR RELATIONSHIP

The relation existing between bank and depositor is generally said to be that of debtor and creditor.¹ It is contractual in nature² and while the relationship is not that of trustee and cestui que trust,³ greater rights and obligations exist than are found in a mere debtor and creditor relation.⁴ The New York Court of Appeals has stated

³² *Inda v. Inda*, *supra* note 31.

³³ 1950 LEG. DOC. NO. 65(Q), 1950 REPORT, N. Y. LAW REVISION COMMISSION.

³⁴ The presumption, that the depositor intended that the avails of a savings bank account in trust form should become the property of the beneficiary on the depositor's death, is not a true presumption of law but is a mere inference of fact subject to rebuttal by contrary evidence. *In re Herle's Estate*, 165 Misc. 46, 300 N. Y. Supp. 103 (Surr. Ct. 1937).

¹ *Shipman v. Bank of the State of New York*, 126 N. Y. 318, 27 N. E. 371 (1891); *Bank of British North America v. Merchants' National Bank of the City of New York*, 91 N. Y. 106 (1883).

² ". . . the law implies a contract on the part of the defendant to disburse the money standing to the plaintiffs' credit only upon their order and in conformity with their directions." *Shipman v. Bank of the State of New York*, 126 N. Y. 318, 327, 27 N. E. 371, 372 (1891).

³ *The Buchanan Farm Oil Company v. Woodman*, 1 Hun 639 (N. Y. 1874).

⁴ "Ordinarily, the relation between a bank and its depositors is that of debtor and creditor However, a bank deposit is more than an ordinary debt, and the depositor's relation to the bank is not identical with that of an ordinary creditor." Hubbs, J., in *Gibraltar Realty Corporation v. Mount Vernon Trust Company*, 276 N. Y. 353, 356, 12 N. E. 2d 438, 439 (1938). "The relation between bank and customer is that of debtor and creditor, with a superadded obligation on the part of the banker to honour the customer's cheques if the account is in credit. A cheque drawn by a customer is in point of law a mandate to the banker to pay the amount according to the tenor of the cheque." *London Joint Stock Bank, Ltd. v. Macmillan*, [1918] A. C. 777, 789.

that in discharging its obligations, the bank's liability is fixed by rules which are akin to those governing the relation of principal and agent.⁵ "In disbursing the customer's funds, it [the bank] can pay them only in the usual course of business and in conformity to his [the depositor's] directions. In debiting his account it is not entitled to charge any payments except those made at the time when, to the person whom, and for the amount authorized by him. It receives the depositor's funds upon the implied condition of disbursing them according to his order, and upon an accounting is liable for all such sums deposited as it has paid away without receiving valid direction therefor."⁶ While legal commentators consider the rule axiomatic that, in the first instance, the drawee bank is not entitled to debit the depositor's account for money paid on altered and forged instruments,⁷ under certain circumstances the liability does fall on the drawer. Thus, when the depositor draws a check in such manner as to facilitate alteration by a subsequent holder and such neglect is found to be the proximate cause of loss to the bank, the drawer was denied recovery.⁸ So also, where the depositor has signed checks in blank which were thereafter stolen and later filled in, he has been held liable for the bank's loss in paying out such checks.⁹

This high degree of care, the breach of which results in liability, was first formulated in England well over 100 years ago¹⁰ and continues as a rule¹¹ in the United States today despite the enactment of the Uniform Negotiable Instruments Law and particularly Sections 15 and 124 thereof.¹²

⁵ "The relation existing between a bank and its depositor is, in a strict sense, that of debtor and creditor; but in discharging its obligation as a debtor, the bank must do so subject to the rules obtaining between principal and agent." *Crawford v. West Side Bank*, 100 N. Y. 50, 53, 2 N. E. 881 (1885).

⁶ *Ibid.*

⁷ BRITTON, HANDBOOK OF THE LAW OF BILLS AND NOTES 592 (1943).

⁸ *Timbel v. Garfield National Bank*, 121 App. Div. 870, 106 N. Y. Supp. 497 (1st Dep't 1907).

⁹ *Trust Company of America v. Conklin*, 65 Misc. 1, 119 N. Y. Supp. 367 (Sup. Ct. 1909). *But cf.* *Heimberg, Inc. v. Lincoln National Bank*, 113 N. J. L. 76, 172 Atl. 528 (1934).

¹⁰ *Young v. Grote*, 4 Bing. 253, 130 Eng. Rep. 764 (1827).

¹¹ See note 44 *infra*.

¹² Section 15 provides: "Where an incomplete instrument has not been delivered it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder, as against any person whose signature is placed thereon before delivery." This is identical with Section 34 of the New York Negotiable Instruments Law. Section 124 provides: "Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized or assented to the alteration and subsequent endorers. But where an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor." This is identical with Section 205 of the New York Negotiable Instruments Law.

The case of *Young v. Grote*¹³ continues as the leading authority on the subject. There the check was raised without its apparent validity being altered because the drawer unintentionally left blank spaces in filling in the amount. In holding the drawer liable for the loss sustained by the bank, the court said, "We decide here on the ground that the banker has been misled by want of proper caution on the part of his customer."¹⁴ In 1918 the principle enunciated in *Young v. Grote* was reaffirmed by the House of Lords¹⁵ in so far as it applied to bank and depositor although prior thereto it had been held¹⁶ that the rule did not apply as between parties on an ordinary bill of exchange.¹⁷ The common law rule can thus be stated: the depositor owes a duty of care to his depositary bank in drawing and handling a check so as to prevent the perpetration of a fraud on such bank, but no such duty exists as between the maker and a subsequent holder of a negotiable instrument.¹⁸ The basis for the rule is the contractual nature of the bank-depositor relation to which a subsequent holder is not in privity. In this respect, the rule is in accord with that applicable to ordinary contracts where a party not in privity sues for damage resulting from the negligent performance of a contract on which he placed reliance.¹⁹

In New York it has also been held that if a depositor draws a check in such manner as to facilitate alteration, he will be liable to the bank for the damage caused by his negligence. In the case of *Timbel v. Garfield National Bank*,²⁰ the plaintiff drew a check for "\$900" and left a space in front of both the word and figure "900" sufficient to permit another to raise the amount to "\$4900" by the insertion of the word and figure "four". In an action by the depositor against the bank to recover four thousand dollars over and above the original sum of the check, the court stated: "The textbooks are quite unanimous in asserting that where a drawer of a check has prepared his check so negligently that it can be easily altered without

¹³ See note 10 *supra*.

¹⁴ 4 Bing. 253, 260, 130 Eng. Rep. 764, 767 (1827).

¹⁵ London Joint Stock Bank, Ltd. v. Macmillan, [1918] A. C. 777.

¹⁶ Scholfield v. Earl of Londesborough, [1896] A. C. 514.

¹⁷ ". . . in the case of a cheque drawn by a customer on his banker there is a special duty . . . which does not exist in the same fashion in the instance of the acceptor of a bill of exchange, where the instrument is drawn for circulation among the members of the public generally, and is not a direction to a designated person to pay out of a balance for which he has to account . . ." London Joint Stock Bank, Ltd. v. Macmillan, [1918] A. C. 777, 815.

¹⁸ "The defense of negligence in cases of this sort is ordinarily available only to the drawee bank, to which alone, it has been said, the depositor owes a duty of care." City of New York v. Bronx County Trust Co., 261 N. Y. 64, 70, 184 N. E. 495, 497 (1933).

¹⁹ Ultramares Corp. v. Touche, 255 N. Y. 170, 174 N. E. 441 (1931). *But cf.* Mac Pherson v. Buick Motor Co., 217 N. Y. 382, 111 N. E. 1050 (1916); Chysky v. Drake Bros. Co., 235 N. Y. 468, 139 N. E. 576 (1923). In these latter cases the negligent performance created an unreasonable risk of bodily harm and lack of privity was held not to be a bar to recovery.

²⁰ See note 8 *supra*.

giving the instrument a suspicious appearance and alterations are afterwards made, he can blame no one but himself, and that in such case he cannot hold the bank liable for the consequences of his own negligence. . . ." ²¹

Although in the *Timbel* case,²² the Appellate Division has so ruled, a square holding to the effect that the depositor is liable to a bank for drawing his instrument in such a manner as to facilitate alteration has yet to be handed down by the Court of Appeals. However, that court has hinted on several occasions that it would impose such liability should the occasion arise.²³

As early as 1885, the Court of Appeals, in *Crawford v. West Side Bank*,²⁴ intimated that the leaving of unfilled blanks, or the commission of an affirmative act of negligence facilitating the alteration of an instrument would render the depositor liable for the damage caused thereby. In that case the plaintiff left a post-dated check with an employee with instructions to draw funds for a pay-roll on that date, but the employee altered the date of the instrument, cashed the check prior to the original date and absconded with the cash. Although the court placed the loss on the bank because the material alterations had vitiated the instrument, the court hinted that in instances where there was a finding that negligence on the part of the depositor led to the alteration of an instrument, a different result might be attained.²⁵ The mere fact that an instrument was successfully altered would not necessarily result in liability being imposed upon the drawer.²⁶ Whether the depositor's conduct constituted negligence is, in New York, a question of fact for the jury.²⁷

Even though the jury finds that the drawer acted negligently in executing the instrument, he will not be estopped from raising the defense of the invalidity of the instrument unless his act of negligence

²¹ *Timbel v. Garfield National Bank*, 121 App. Div. 870, 872, 106 N. Y. Supp. 497, 499 (1st Dep't 1907).

²² See note 21 *supra*.

²³ See notes 25, 26, 28 *infra*.

²⁴ 100 N. Y. 50, 2 N. E. 881 (1885).

²⁵ "The question of negligence cannot arise unless the depositor has, in drawing his check, left blanks unfilled or by some affirmative act of negligence has facilitated the commission of a fraud by those into whose hands the checks may come." 100 N. Y. 50, 55, 2 N. E. 881, 882 (1885).

²⁶ ". . . while the drawer of the check may be liable where he draws the instrument in such an incomplete state as to facilitate or invite fraudulent alterations, it is not the law that he is bound so to prepare the check that nobody else can successfully tamper with it." *Critten v. Chemical National Bank*, 171 N. Y. 219, 224, 63 N. E. 969, 971 (1902).

²⁷ "The defendant [bank] does not claim that in leaving spaces upon her check which could be filled in by her husband without exciting suspicion, the plaintiff was guilty of negligence as matter of law. What it does claim, and what it contended on the trial, was that it was a question of fact to be determined by the jury, from all the circumstances, whether or not she was negligent, and that if the jury found she was then the defendant should be relieved from repaying the amount to her. In this contention we think the

was the *proximate cause* of the loss.²⁸ The basis for the imposition of liability on the part of the drawer is that by his negligence, he is estopped from raising the defense of the invalidity of the instrument.²⁹ Therefore, if the drawee does not rely on, or is not misled by the negligence of the drawer, so that his negligence is not the proximate cause of the loss, the principle of estoppel cannot be invoked to alter the general rule that a drawer is not liable for unauthorized payments by a drawee bank. In *Gutfreund v. East River National Bank*³⁰ the payee firm was designated by a single name. By the mere insertion of an initial in front of the name of the firm, the clerk was able to make the check appear to bear the name of an individual rather than a firm. While the court was able to find sufficient evidence to justify a finding of negligence on the part of the plaintiff, it nevertheless held that the proximate cause of the loss was the defendant bank's breach of duty in failing to properly identify the payee. The negligent act of the plaintiff in signing an improperly drawn check was held not to be the proximate cause of the loss. The court indicated that where the negligence of the drawer has misled the bank, in spite of the latter's care, the drawer would be estopped from asserting the invalidity of the instrument.³¹

The problem of breach of duty also arises in cases where the depositor signs a blank check which is thereafter stolen from him and filled in by the thief. The risk placed on the bank by such conduct is particularly onerous. The problem has been considered in New York in a case³² where the signed blank checks were locked in the drawer of a safe from which one was stolen and filled in by a dishonest employee. The depositor was expressly found not negligent. On the contrary, he was found to have shown reasonable care; but nevertheless he was held liable to the bank for the amount of the

defendant was correct." *Timbel v. Garfield National Bank*, 121 App. Div. 870, 873, 106 N. Y. Supp. 497, 500 (1st Dep't 1907).

²⁸ *Gutfreund v. East River National Bank*, 251 N. Y. 58, 167 N. E. 171 (1929).

²⁹ "The grounds for the decision in *Young v. Grote* . . . resolve themselves into the principle that if the negligence of the depositor is the cause of the payment by the bank of a forged check he may not set up the invalidity of the paper which he has induced the bank to act on as genuine." Pound, J., in *Gutfreund v. East River National Bank*, 251 N. Y. 58, 63, 167 N. E. 171, 172 (1929).

³⁰ See note 28 *supra*.

³¹ "If by their negligence the checks had been made payable to genuine payees who received the amounts thereof, or if the amount of the checks has been raised through their carelessness, the case would have been different. The bank might then rely on the form of the checks and charge the plaintiffs with an estoppel. If we assume that the bank might rely on the checks as being genuine in form, still it did not exercise any care to identify the payees." *Gutfreund v. East River National Bank*, 251 N. Y. 58, 65, 167 N. E. 171, 173 (1929).

³² *Trust Co. of America v. Conklin*, 65 Misc. 1, 119 N. Y. Supp. 367 (Sup. Ct. 1909).

overdraft. "If the defendant is liable at all, it is because he owed the bank a duty which he violated by signing in blank."³³

One might think that the New York courts, to be consistent, would similarly hold the drawer estopped from asserting the invalidity of a negligently drawn instrument or a signed blank check, stolen and later filled in by the thief, as against a holder in due course. However, it has been held³⁴ that the accommodation indorser of a negotiable instrument is not liable for his negligence to an innocent purchaser for value. Likewise, it has been held that where negotiable instruments are signed in blank, stolen and filled in by the thief, the drawer is not liable to a holder in due course.³⁵ These decisions are predicated on the theory that it would be unjust to require the drawer to anticipate the intervening criminal act of another.³⁶ Section 124³⁷ of the Uniform Negotiable Instruments Law would apply to the case of an altered instrument and permit a holder in due course to enforce the instrument according to its original tenor, but not for the raised amount. Section 15³⁸ would apply to the case of a signed blank instrument stolen from its maker. The subsequent holder would have no claim as against the drawer. In such circumstances, no liability of the drawer to his bank could arise out of the instrument, for either Section 124 or Section 15 would apply. Liability can only be predicated on breach of the duty of care owing to the bank.

This greater duty of care owing from a depositor to a bank arises as an incident to the rights and duties flowing out of the banker-depositor relationship.³⁹ A bank has no right to refuse to honor a

³³ *Id.* at 3, 119 N. Y. Supp. at 369.

³⁴ National Exchange Bank of Albany v. Lester, 194 N. Y. 461, 87 N. E. 779 (1909).

³⁵ Holtzman, Cohen & Co. v. Teague, 172 App. Div. 75, 158 N. Y. Supp. 211 (1st Dep't 1916); ". . . a third person is under no obligation to honor his paper. He can take it or not as he pleases, and as a rule such paper is accepted in reliance on the immediate transferrer thereof." Linick v. A. J. Nutting & Co., 140 App. Div. 265, 267, 125 N. Y. Supp. 93, 96 (2d Dep't 1910) (negligence was not actionable as no duty was shown).

³⁶ "On what theory is the endorser negligent because he places his name on the paper without first seeing to it that these spaces are so occupied by cross lines or otherwise as to render forgery less feasible? It can only be on the theory that he is bound to assume that those to whom he delivers the paper or into whose hands it may come will be likely to commit a crime if it is comparatively easy to do so. I deny that there is any such presumption in the law. . . . On the contrary, the presumption is that men will do right rather than wrong." National Exchange Bank v. Lester, 194 N. Y. 461, 472, 87 N. E. 779, 783 (1909).

³⁷ See note 12 *supra*.

³⁸ See note 12 *supra*.

³⁹ ". . . this duty is greater than that which the maker of an instrument owes to subsequent holders for value." Trust Company of America v. Conklin, 65 Misc. 1, 4, 119 N. Y. Supp. 367, 369 (Sup. Ct. 1909); "It may be more reasonably urged that the duty of the drawer of a check to use care in drawing an instrument is placed upon him by law as an incident to the relation of banker and depositor." Britton, *Negligence in the Law of Bills and Notes*, 24 Col.

check. Since a check is, in legal contemplation, a mandate from the depositor to the bank to pay according to its tenor,⁴⁰ should the bank wrongfully and wilfully (in the sense of doing it intentionally with full knowledge of the risk involved) refuse to honor a check, it will be liable to the depositor for substantial damages.⁴¹ On the other hand, a purchaser for value has a choice as to whether he should take or refuse the draft, and can be said to have relied on the credit of the person from whom he secured the instrument.⁴² In addition, a definite contractual relationship exists between bank and depositor that cannot be said to exist between the depositor and the holder for value.⁴³

A number of jurisdictions have expressed approval of the New York view.⁴⁴ Professor Britton, while commenting on the scarcity of litigation involving this precise question, has stated that in no case decided under the common law, has the drawee bank's right to recover been denied where the drawer was negligent in executing the instrument.⁴⁵

However, in Kentucky,⁴⁶ Texas,⁴⁷ and possibly Oklahoma,⁴⁸ a

L. REV. 695, 710 (1924); BEUTEL'S BRANNAN NEGOTIABLE INSTRUMENTS LAW 1190-1194 (7th ed. 1948).

⁴⁰ London Joint Stock Bank, Ltd. v. Macmillan, [1918] A. C. 777.

⁴¹ Wildenberger v. Ridgewood National Bank, 230 N. Y. 425, 130 N. E. 600 (1921).

⁴² "A purchaser of a negotiable instrument can take it or not at his option and usually to some extent, relies on the responsibility of the last holder. A bank however, must at its peril, pay out the money deposited if the depositor directs it to." Trust Company of America v. Conklin, 65 Misc. 1, 4, 119 N. Y. Supp. 367, 369 (Sup. Ct. 1909); "Such parties [purchaser for value] take the paper relying solely upon the reputed responsibility of their transferrers, and the other parties to it, and its apparent genuineness, and they therefore deal in it at their peril." Crawford v. West Side Bank, 100 N. Y. 50, 54, 2 N. E. 881, 882 (1885).

⁴³ "The maker of a promissory note holds no such relation to the indorsees thereof as a customer does to his banker. The relation between banker and customer is created by their own contract, by which the banker is bound to honor the customer's drafts . . . and if the negligence of a customer affords opportunity to a clerk or other person in his employ to add to the terms of a draft and thereby mislead the banker, the customer may well be held liable to the banker." Greenfield Savings Bank v. Stowell, 121 Mass. 196, 202 (1877); 5 B. U. L. Rev. 193 (1925).

⁴⁴ Otis Elevator Co. v. First National Bank, 163 Cal. 31, 124 Pac. 704 (1912); Hardy v. Chesapeake Bank, 51 Md. 562 (1879); see Foutch v. Alexandria Bank & Trust Co., 177 Tenn. 348, 149 S. W. 2d 76, 77 (1941); Fordyce v. Kosminski, 49 Ark. 40, 44, 3 S. W. 892, 894 (1886); Greenfield Savings Bank v. Stowell, 121 Mass. 196, 202 (1877).

⁴⁵ BRITTON, HANDBOOK OF THE LAW OF BILLS AND NOTES 1068 (1943).

⁴⁶ Commercial Bank of Grayson v. Fraley, 117 Ky. 520, 197 S. W. 951 (1917).

⁴⁷ Glasscock v. First National Bank of San Angelo, 114 Tex. 207, 266 S. W. 393 (1924).

⁴⁸ See First National Bank of Cushing v. Ketchum, 68 Okla. 104, 172 Pac. 81, 83 (1918) (alteration being palpable, plaintiff's negligence was not proximate cause of the loss).

contrary rule, predicated largely on the enactment of the Uniform Negotiable Instruments Act, has denied the liability of the depositor to the bank even where his negligence facilitated alteration of the instrument. The latter courts primarily base their decisions on the reasoning that a person cannot ordinarily anticipate the commission of a crime, and further justify their view by pointing out, that regardless of the common law liability of a drawer, the enactment of Section 124⁴⁹ limits the liability of a drawer of an altered check to the original tenor of the instrument. By the same token Section 15⁵⁰ could be said to be conclusive as to the liability of the drawer on an undelivered, incomplete instrument.

While these arguments are persuasive it is submitted that the New York view, wherein the drawer is held liable to the bank for his negligence in facilitating the perpetration of a fraud, is the more equitable and reasonable rule. The duty of care placed on the drawer is slight in comparison to the risk undertaken by the bank. The former, with little inconvenience or bother, can adequately protect himself, while the latter, with the greatest diligence possible, in view of its large volume of business, can only protect itself to a small degree. The argument that a man should not be expected to anticipate the commission of a crime was concisely answered by Finlay, L. C. who said, "Everyday experience shows that advantage is taken of negligence for the purpose of perpetrating frauds. . . . Crime is indeed a very serious matter but everyone knows that crime is not uncommon."⁵¹

While at first glance, the enactment of Section 124⁵² might appear to have limited the drawer's liability to the bank, it is considered by legal commentators that the section should be limited in its scope to holders in due course and should not apply to the bank-depositor relationship.⁵³ They agree that the cause of action is not on the check itself, but is based on a breach of duty implied in the contract of deposit.⁵⁴ It results from the special rights and duties involved in the banker-depositor relationship.

While the Uniform Negotiable Instruments Act does not expressly confer a cause of action on a bank against the depositor, common law principles continue to apply in the absence of a contrary provision.⁵⁵ Moreover, the Negotiable Instruments Law specifically

⁴⁹ See note 12 *supra*.

⁵⁰ See note 12 *supra*.

⁵¹ London Joint Stock Bank, Ltd. v. Macmillan, [1918] A. C. 777, 789; Note, 31 HARV. L. REV. 779-83.

⁵² See note 12 *supra*.

⁵³ BRITTON, *op. cit. supra* note 44, at 1073; BEUTEL'S BRANNAN NEGOTIABLE INSTRUMENTS LAW 1190-1194 (7th ed. 1948); see also 23 MICH. L. REV. 775 (1925).

⁵⁴ BEUTEL, *op. cit. supra* note 53, at 1192-3.

⁵⁵ Section 196 provides: "In any case not provided for in this act the rules of the law merchant shall govern." This is identical with Section 7 of the New York Negotiable Instruments Law. "The enactment of the N.I.L. has

recognizes the continued existence of the doctrine of estoppel,⁵⁶ and since estoppel is the basis of the depositor's liability at common law, the same holds true today.

not destroyed common law and equitable principles merely because they have not been expressly preserved in the act." BRITTON, *op. cit. supra* note 42, at 1073.

⁵⁶ Section 23 provides: "Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, *unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority.*" (Italics supplied.) This is identical with Section 42 of the New York Negotiable Instruments Law.