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N.Y.U.C.C. § 3-419: Contract Cause of Action Exists Against Bank for Collecting an Instrument Over Forged Indorsement

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which counsel may be obtained. In any event, the *Settles* case represents another affirmative effort by the Court to "breathe life into the requirement that a waiver of a constitutional right . . . be competent, intelligent and voluntary."\(^{288}\)

*Gregory J. O'Connell*

**Uniform Commercial Code**

*N.Y.U.C.C. § 3-419: Contract cause of action exists against bank for collecting an instrument over forged indorsement*

Prior to the passage of the Uniform Commercial Code (UCC), the payee of a negotiable instrument possessed valid causes of action in contract and tort against a bank that had collected the instrument over a forged indorsement.\(^{287}\) By exercising control through collection in such a situation, the bank converted the instrument, and its liability for the conversion was limited by the 3-year tort statute of limitations.\(^{288}\) The payee, however, could elect to ratify the bank's collection of the instrument, thereby waiving the conversion remedy, and proceed under an implied contract for money had and received,\(^{289}\) with the resultant benefit of the longer

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\(^{289}\) E. Moch Co. v. Security Bank, 176 App. Div. 842, 846, 163 N.Y.S. 277, 280 (1st Dep't 1917), *aff'd*, 225 N.Y. 723, 122 N.E. 879 (1919). Since the collecting bank in Hechter had no title to the instrument because of the forged indorsement, see note 288 supra, by endeavoring to collect on the instrument, it became an agent [of the payee] for the purpose of collecting from the drawee bank the proceeds of the check delivered to it. When it [took] the check for collection, it
6-year statute of limitations for contract actions. With the enactment of section 3-419 of the UCC, uncertainty arose whether the payee of a wrongfully collected instrument still could maintain an action in contract against the collecting banks. Recently, in


The agency relationship created by the bank's holding of the proceeds for the payee established the privity that was necessary for the payee to maintain an action in contract against the collecting bank. See Henderson v. Lincoln Rochester Trust Co., 303 N.Y. 27, 32, 100 N.E.2d 117, 120 (1951) (quoting National Union Bank v. Miller Rubber Co., 148 Md. 449, 455-56, 129 A. 688, 690 (1925)); 9 C.J.S. Banks and Banking § 357(c)(1) (1938). In order for the payee to claim that the funds collected were rightfully his, it also was required that the payee ratify the bank's collection of the check. Depositary Bank Liability, supra note 287, at 683.

Under the Negotiable Instruments Law, the payee had no cause of action in contract against the drawee bank due to the absence of privity. Henderson v. Lincoln Rochester Trust Co., 303 N.Y. 27, 31-32, 100 N.E.2d 117, 119 (1951). Thus, as against the drawee bank, the payee was limited to a suit for conversion. Id. at 31, 100 N.E.2d at 119; Sonnenburg v. Manufacturers Hanover Trust Co., 87 Misc. 2d 202, 204, 383 N.Y.S.2d 863, 865 (Sup. Ct. N.Y. County 1976); Forman v. First Nat'l Bank, 66 Misc. 2d 433, 434, 320 N.Y.S.2d 648, 649 (Sup. Ct. Sullivan County 1971); accord, National Union Bank v. Miller Rubber Co., 148 Md. 449, 129 A. 688, 690 (1925).


When more than one legal remedy is available to a plaintiff, the statute of limitations applicable to the action is that which governs the remedy the plaintiff elects to pursue. Dentists' Supply Co. v. Cornelius, 281 App. Div. 306, 307, 119 N.Y.S.2d 570, 571 (1st Dep't), aff'd, 306 N.Y. 624, 116 N.E.2d 238 (1953). Thus, where the payee of a negotiable instrument sues in conversion, the statute of limitations is 3 years, but should the payee choose to sue in contract, the action is subject to a 6-year time limitation.

In addition to time limitations, the amount of the damages that are recoverable also may be an important consideration in the payee's election of remedies. Prior to the enactment of the UCC, although the amount of recovery in tort was prima facie the face value of the instrument, Depositary Bank Liability, supra note 287, at 683, a bank could prove that because of the drawer's insolvency or some other reason, the actual value of the instrument was less than the face amount. See E. Moch Co. v. Security Bank, 176 App. Div. 842, 847, 163 N.Y.S. 277, 281 (1917), aff'd, 225 N.Y. 723, 122 N.E. 879 (1919). Under a contract theory, recovery would be the amount that the bank collected. Id.; accord, Mackey-Woodard, Inc. v. Citizens State Bank, 197 Kan. 536, 419 P.2d 847, 853 (1966). The UCC left undisturbed these measures of recovery in actions against parties other than the drawee; the latter's liability is absolutely deemed the face value of the instrument. N.Y.U.C.C. § 3-419, Comment 4 (McKinney 1964).

N.Y.U.C.C. § 3-419 (McKinney 1964).

N.Y.U.C.C. § 3-419 (McKinney 1964) provides in pertinent part:
Hechter v. New York Life Insurance Co., the Court of Appeals held that a payee still possesses a contract cause of action against a collecting bank subject to a 6-year limitations period.

The plaintiff, named payee on three checks representing the proceeds of life insurance policies on her husband, authorized her attorney to deposit the checks into her bank account. The attorney, however, forged the plaintiff's indorsement and deposited the checks into his own account. The plaintiff eventually obtained a default judgment against the attorney. The default judgment was never satisfied, and the plaintiff therefore commenced an action against the collecting bank. By this time, however, more than 5 years had passed since the attorney had deposited the instruments. The collecting bank moved for summary judgment on

(1) An instrument is converted when

   (c) it is paid on a forged indorsement.

According to the New York annotations, "[s]ubsection (1)(c) adopts the result in such cases as Henderson v. Lincoln Rochester Trust Co. under which payment on a forged indorsement constitutes conversion of the instrument." N.Y.U.C.C. § 3-419, N.Y. Annots. at 372 (McKinney 1964): The Henderson Court, however, also held that the payee had a valid cause of action in contract against a collecting bank. 303 N.Y. 27, 32, 100 N.E.2d 117, 120 (1951). The UCC's failure to address expressly the contract cause of action has created confusion concerning the continued validity of this common-law action. Two lower courts have indicated that the action in contract has survived. See Sonnenberg v. Manufacturers Hanover Trust Co., 87 Misc. 2d 202, 204, 383 N.Y.S.2d 863, 865 (Sup. Ct. N.Y. County 1976); Forman v. First Nat'l Bank, 66 Misc. 2d 433, 434, 320 N.Y.S.2d 648, 649 (Sup. Ct. Sullivan County 1971).


8 Id. at 39-40, 385 N.E.2d at 554-55, 412 N.Y.S. 2d at 815. The Court, however, did not decide the conditions under which the bank would be liable. Id. at 38 & n.3, 385 N.E.2d at 553 & n.3, 412 N.Y.S.2d at 814 & n.3; see notes 319-322 and accompanying text infra.

46 N.Y.2d at 36, 385 N.E.2d at 552, 412 N.Y.S.2d at 813. The three checks were drawn in April 1970, and totaled more than $135,000. Id.

8 Id.

8 Id. The attorney maintained a personal account with Chemical Bank, where he deposited the plaintiff's checks. After the checks had been processed for collection and honored by the drawee banks, the attorney withdrew all the money in his account, including the funds belonging to the plaintiff. Id.

8 Id.

8 Id. The action was instituted against Chemical Bank, the depository bank in the collection process. Id.

8 Id. Because more than 3 years had passed since the attorney had deposited the checks, the conversion actions against the drawee and collecting banks were time-barred. See note 288 and accompanying text supra. Since the plaintiff was limited to an action in conversion against the drawee bank, see note 289 supra, she had no valid action against this bank. The attorney had long absconded with her funds, leaving the plaintiff with a viable action only in contract against the collecting banks, provided such a cause of action survived the adoption of the UCC.
the grounds that section 3-419(1)(c) of the UCC had abolished the contract action against a collecting bank for wrongfully collecting an instrument over a forged indorsement, and that since the 3-year tort statute of limitations had expired, the plaintiff's suit was time-barred. Special term denied the motion, and the appellate division unanimously affirmed.

In a unanimous opinion written by Judge Cooke, the Court of Appeals affirmed, concluding that the UCC did not abolish the contract remedy. The Court observed that the contract action at common law was merely an illustration of the general rule that "a litigant may abandon his tort cause of action in favor of one grounded in contract." While section 3-419 codifies the common-law principle that collection over a forged indorsement constitutes the tort of conversion, the Court held that the section does not preclude the plaintiff from electing to proceed on a contract theory and, consequently, taking advantage of the 6-year statute of limitations. Moreover, the Court found that the legislature had no design to abrogate the contract cause of action when it enacted section

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301 Chemical Bank's status as a collecting bank under the UCC was clear. 46 N.Y.2d at 36 & n.1, 385 N.E.2d at 552 & n.1, 412 N.Y.S.2d at 813 & n.1. A "collecting bank" is "any bank handling the item for collection except the payor bank." UCC 4-105(d).

302 See 46 N.Y.2d at 36, 38, 385 N.E.2d at 552, 554, 412 N.Y.S.2d at 813, 814; note 288 supra. Chemical also sought summary judgment on the grounds that the indorsement of the plaintiff's signature was not forged inasmuch as the attorney was authorized to deposit the checks and, at any rate, the plaintiff had subsequently ratified the forged indorsements. Brief for Defendant-Appellant at 4 n. The trial judge held these contentions presented issues of fact for the jury to determine and Chemical Bank did not appeal this decision. 46 N.Y.2d at 36 n.2, 385 N.E.2d at 553 n.2, 412 N.Y.S.2d at 813 n.2; Brief for Defendant-Appellant at 4 n.

303 46 N.Y.2d at 36, 385 N.E.2d at 552-53, 412 N.Y.S.2d at 813.

304 Id. at 36-37, 385 N.E.2d at 553, 412 N.Y.S.2d at 813.

305 All the judges joined in the opinion of Judge Cooke except Judge Fuchsberg who did not participate in the decision. Id. at 40, 385 N.E.2d at 555, 412 N.Y.S.2d at 815.

306 Id. at 39-40, 385 N.E.2d at 564-55, 412 N.Y.S.2d at 815. The Court held, therefore, that the plaintiff's action was not time-barred because it was commenced before the 6-year contract statute of limitations had expired. Id.


308 See note 288 and accompanying text supra.

309 46 N.Y.2d at 38-39, 385 N.E.2d at 554, 412 N.Y.S.2d at 814-15. The Court noted that it previously had recognized the uncertainty surrounding a collecting bank's liability following the enactment of section 3-419(3) of the Code. Id., see N.Y.U.C.C. § 3-419(3) (McKinney 1984); Hutzler v. Hertz Corp., 39 N.Y.2d 209, 217 n.3, 347 N.E.2d 627, 632 n.3, 383 N.Y.S.2d 266, 270 n.3 (1976); note 320 and accompanying text infra. The Hechter Court stated, however, that Hutzler did not "imply that such liability, if it continues to exist, may be asserted only in a conversion action." 46 N.Y.2d at 39, 385 N.E.2d at 554, 412 N.Y.S.2d at 815.
3-419.310 Since the UCC was meant to be supplemented by the common law "[u]nless displaced by the particular provisions of [the] Act,"311 the Court reasoned that the absence of a specific statutory nullification of the contract remedy indicated that the legislature had not intended to restrict the plaintiff's recourse to a suit for conversion.312 To the contrary, the Court found in section 3-419(3), which states that the collecting bank is not liable "in conversion or otherwise" when it has dealt with the instrument "in good faith and in accordance with the reasonable commercial standards . . . [of] the business,"313 a legislative purpose to continue all pre-UCC theories of recovery, subject to the defenses provided by that section.314

The significance of the Hechter Court's determination that the UCC did not supplant the contractual liability at common law of a collecting bank to the payee of an instrument collected over a forged indorsement is that a payee often may not become aware of the forgery until after the expiration of the tort statute of limitations.315 It is submitted that it would be manifestly unjust to foreclose the innocent payee from recourse against the collecting bank, which often represents the only feasible source of recovery.316 Moreover, the

310 46 N.Y.2d at 39, 385 N.E.2d at 554, 412 N.Y.S.2d at 815.
311 UCC 1-103 (emphasis added).
312 46 N.Y.2d at 39, 385 N.E.2d at 554, 412 N.Y.S.2d at 815. The Court stated that, "[u]nder the plain import of this section, nothing short of an express code provision limiting plaintiff's remedy to a conversion suit would suffice to destroy the action ex contractu." Id. (emphasis in original). The Court also relied on the basic principles of statutory construction that an unambiguous legislative intent is necessary to negate a rule of common law. Id.; see, e.g., Jones v. City of Albany, 151 N.Y. 223, 228, 45 N.E. 557 (1896).
313 N.Y.U.C.C. § 3-419(3) (McKinney 1964) provides:
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.
314 46 N.Y.2d at 39, 385 N.E.2d at 554, 412 N.Y.S.2d at 815.
316 In a situation such as that found in Hechter the forger often has disappeared or is insolvent. See note 289 supra. Thus, without a contract action against the collecting bank, actions commenced without the 3-year tort statute of limitations would be limited to suits against the drawer of the instrument under section 3-804. N.Y.U.C.C. § 3-804 (McKinney 1964). Such actions, however, would require the plaintiff to post a security "not less than twice the amount allegedly unpaid on the instrument." Id. The prohibitive burden that this can place on the plaintiff is illustrated by the Hechter case where the checks represented more
decision comports with fundamentals of statutory construction that require an unambiguous or explicit provision to negate a common-law rule.\textsuperscript{317}

By specifically holding that section 3-419 did not abolish the contract cause of action, the Court has resolved one of the problems that has arisen in cases involving that section.\textsuperscript{318} Difficulties remain, however, in determining the circumstances under which a collecting bank would be liable, regardless of the form of the action.\textsuperscript{319} Section 3-419(3) seems to provide immunity for a depositary or collecting bank that has acted reasonably and in good faith, whether the suit lies in "conversion or otherwise."\textsuperscript{320} The Court's interpretation of the
“or otherwise” language to include a contract cause of action would appear to extend the same defense to an action in contract. Since the issue was not presented, however, the Court preferred to avoid any attempt to resolve it. Nevertheless, the Hechter decision properly has placed the liability, and hence the duty to act with care and caution, on the collecting banks, the party best able to prevent the occurrence of such situations.

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321 This would appear to be the logical result of the Hechter Court’s reasoning. The Supreme Court, New York County, however, has held the defense to be invalid in a contract action because the bank had not paid the “proceeds” of the instrument to the forger; therefore, the proceeds remained in the bank’s hands for the payee. See Sonnenberg v. Manufacturers Hanover Trust Co., 87 Misc. 2d 202, 205, 383 N.Y.S.2d 863, 865 (Sup. Ct. N.Y. County 1976).