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THE CHECK COLLECTION MUDDLE

ROScoe T. STEFFEN *

Were it not for the fact that checks are already in general use, in order that transactions might continue to be carried on with the facility and dispatch which we have come to expect, some such instrument would have to be invented promptly. A suggestion that we return to the more cumbersome and very much more hazardous method of settling accounts with cash is unthinkable today. Nor is there much likelihood of such a suggestion being made, for despite its age of well over two centuries,¹ the check still presents a satisfyingly modern, even streamlined, appearance. It has long been fully negotiable,²—more aptly a "courier without luggage" than any other commercial instrument. But, while the holder has thus been highly favored as respects prior parties, we have been amazingly slow to build any comparable legal machinery to facilitate collections. The fact is that in recent years the holder has too often lost a large part or all of the proceeds of his item in the process of collection, a queer state of affairs indeed.

It is not difficult, however, to see in broad outline how this situation has come about, whatever may be suggested for its correction. Of course, the unprecedented plague of bank failures during the Coolidge and Hoover administrations, culminating in the closing of all banks in March, 1933, accounted for vast losses.³ But while this dramatized the situation, it should not be allowed to obscure the point that important changes in banking practice as respects collections had already been taking place. At one time it was customary—as it still is to some extent—to give credit subject to immediate drawing upon the deposit of demand paper, more or less

¹Professor of Law, Yale Law School; draftsman of the proposed Uniform Bank Collection Act. The writer wishes to acknowledge gratefully the aid and assistance of John M. Prutzman, of the class of 1937, Yale Law School, in preparing this paper.

²"The earliest printed cheques are those of Childs, and are believed to date from 1762. Cheque books began to be issued about 1781." Powell, Evolution of the Money Market (1915) 103. There are examples of checks, not printed, dating back at least as far as 1684. Id., at p. 101.

³Bank failures for the years 1921 to 1933 are as follows: 1921, 505; 1922, 367; 1923, 646; 1924, 775; 1925, 618; 1926, 976; 1927, 669; 1928, 499; 1929, 659; 1930, 1,352; 1931, 2,294; 1932, 1,456. This represents a total of 10,816 banks having a total capitalization of $653,245,000 and involving deposit liabilities amounting to $4,885,126,000. 19th Annual Report of the Federal Reserve Board (1933) 151.
as though the bank had purchased it. Nor was this practice unprofitable, for the item in turn could often be used to build up the bank's reserve account with its correspondent, immediate credit being again given, and on occasion such balances bore interest. But much of this practice was swept away by the inauguration of the Federal Reserve system in 1913, with its requirement that only collected balances should count as reserves. The paper reserve system, accompanied as it was by a practice of circuitous routing to suit the banker's convenience, neither provided protection for depositors, nor an efficient collection system for check holders.

But even before this the banker had had his misgivings of the immediate credit plan. The banker did not relish the notion of being obligated to pay drawings against checks which might never be collected. It was an extension of credit, of a sort, without any corresponding interest charge. Nor did he like the notion that, as purchaser, he would be responsible for collection risks. Of course, when the shoe was on the other foot and the depositor of the paper had failed owing money to the banker, he was quite glad to appear as a holder in due course of the paper; in this case, he was clear that he had purchased it. The result of this dissatisfaction was a long period of experimentation in which various clauses were designed to absolve the bank from first one risk, and then another. It was stipulated that paper was taken for collection only. If credited, it was not subject to drawing until paid or, since it might be paid but not remitted for, until

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4Turner, Deposits of Demand Paper as "Purchases", 37 Yale L. Jour. 374 (1928).
6See particularly the discussion of this whole development in Spahr, The Clearing and Collection of Checks (1926) 84-130.
7There are very few cases holding that the bank must pay in such case, but this does not indicate so much that the point is unsettled as that banks have avoided, as much as possible, being put in a position to have to litigate the point. See, Dirmfield v. Fourteenth Street Savings Bank, 37 App. D. C. 11 (1911).
8See comments of the court adverse to the purchase, or discount, idea from the business standpoint in Falls City Woolen Mills v. Louisville National Banking Co., 145 Ky. 64, 140 S. W. 66, 67 (1911). The teller receiving paper on deposit is not a competent representative of the bank to purchase commercial paper.
9See, for example, Metropolitan National Bank v. Loyd, 90 N. Y. 530, 535 (1882).
10The court, in the early case of Taft v. Quinsigamond Nat. Bank, 172 Mass. 363, 52 N. E. 387 (1899), rather went out of its way to suggest to the banker that he should make use of such clauses to define his position as agent, if that was the result he wanted. Cf. National Bank of Commerce v. Bossemeyer, 101 Nebr. 96, 162 N. W. 503 (1917).
proceeds were actually received.\textsuperscript{11} And credit might be charged back at any time, whether the relative item could be returned or not.\textsuperscript{12} No responsibility was assumed for correspondents—or for losses in the mail—or otherwise.\textsuperscript{13} The net result was to shift to the check holder all risks, many of which had once been borne by the banks—or, at least, the evidence is overwhelming that such was the intent.

Nor did the thing stop here. Many banks further stipulated that they might forward paper by mail directly to the bank on which drawn—all without responsibility—notwithstanding the well settled rule of the courts that to do so was hazardous and constituted negligence. And when in 1924 the Supreme Court in the \textit{Malloy} case\textsuperscript{14} ruled that notwithstanding such a stipulation the forwarding bank should nevertheless be liable for receiving remittance by draft, cash or bullion being the approved medium, the bankers, or their counsel, said quite loudly that the decision was "archaic".\textsuperscript{15} Not that it was "horse and buggy" law exactly, but still it did not fit modern conditions. In fact most of the carefully constructed law of the courts was too "ancient" to be useful any longer. Even so, many bankers, being rugged individualists, were still slow to "regiment" themselves under the protection of the complete waiver thoughtfully prepared for them by general counsel, notwithstanding that it was heralded as being only one hundred and thirty-four words long.\textsuperscript{16} But when shortly afterwards Justice Stone decided in the \textit{City of Douglas} case\textsuperscript{17} that the purchase rule still obtained in the federal courts—thus making the initial bank liable for collection losses—it was evident that the time had come to go to the legislature.

\textsuperscript{11}See, for example, the clause set out in Security Savings & Trust Co. v. \textsc{King}, 69 Ore. 228, 138 Pac. 465 (1914).
\textsuperscript{12}The "charge back" clauses gave a great deal of trouble to the courts, for many were unable to see how such clauses could be reconciled with the "purchase" notion. See generally \textsc{Vickers v. Machinery Warehouse and Sales Co.}, 111 Wash. 576, 191 Pac. 869 (1920).
\textsuperscript{13}These and other clauses are discussed in Note, 27 Col. L. Rev. 73 (1927).
\textsuperscript{14}Federal Reserve Bank v. \textsc{Malloy}, 264 U. S. 160, 44 Sup. Ct. 298, 68 L. Ed. 617 (1924).
\textsuperscript{15}\textsc{Paton}, Uniform Bank Collections Code, 21 Am. Bankers Ass'n. Jour. 907 (1929). "No one will question the statement that this decision is \textit{archaic} when applied to the present methods of collection." Of course, this neglects the point that, even so, the banker should bear the risk if new and more dangerous methods of collection are employed. See Note, 33 Yale L. Jour. 752 (1924).
\textsuperscript{16}\textsc{Paton's Digest} (1926) 239, § 1446 \ldots 2 \textit{id.}, at p. 1462, § 1446a.
\textsuperscript{17}City of \textsc{Douglas} v. Federal Reserve Bank, 271 U. S. 439, 46 Sup. Ct. 554, 70 L. Ed. 1051 (1926).
The matter reached the stage for action in 1928. And, since bankers were then riding the crest of the wave, it was decided to call the new act the *Uniform* Bank Collection Code, thus trading without permission on the prestige of the Commissioners on Uniform State Laws. And, why not? for the name Uniform is not patented. But it does not appear from the record either, that the depositor of paper for collection was ever consulted in the drafting of this legislation. Perhaps, as the case was both technical and complicated, it was thought that his interests, if important, could be best protected by the banker. At all events when the Commissioners on Uniform State Laws themselves undertook to draft a comprehensive collection act, in 1928, and the draftsman invited the bankers to co-operate, it was pointed out that the matter was already being well taken care of. Not only did the bankers give no assistance, but on the contrary, they hurried their own statute all the more. The upshot of the matter was that the banker's act was quickly drafted as a glorified form of bank collection waiver, and as promptly adopted by some nine states in 1929 which were quickly followed by nine others. Since 1931, however, progress in this direction has ceased.

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18 Indeed, the matter went even further in some States, as in New York, where the act was adopted as a separate article of the Negotiable Instruments Law, 37 N. Y. McKinney's Consol. Laws Ann. (Supp. 1933) §§ 350-350(1).  
19 Handbook of the National Conference of Commissioners on Uniform State Laws (1928) 138. Mr. Beutel's statement that the bankers or their attorneys had a hand in preparing the Commissioners' act from the start is entirely without foundation. See Beutel, Bank Collections Act, 9 Tulane L. Rev. 378, 385 (1935).  
No doubt in a well-ordered world, where the race is to the strong, this discourse should end here. The banker had been given all he had asked for. But unfortunately he had asked for a little too much. Possibly to make amends to the check holder for unceremoniously putting all losses on him, the act was made to provide further that, upon the insolvency of any collecting bank with proceeds of an item in hand, such proceeds should be held in trust. By this means it was thought to salvage, ahead of general depositors in the failed bank, as much as possible in the interest of the forwarder of collection paper; and, one may suspect, the banker did not lose sight of the fact that this would be helpful to the initial bank itself, in case it owned or had a lien upon the paper in question. Then, to make the remedy water tight, it was provided that the customary augmentation of assets requirement should be waived and that no tracing of "trust" proceeds was necessary.

But even this was not enough, for an insolvency might occur where there literally were no assets upon which to assert a trust. Accordingly it was further provided that, in case of the failure of a drawee or payor bank (to which an

Aug. 3, 1929); Wyo. Laws of 1931, c. 74, pp. 138-143 (effective May 22, 1931).

The relevant provision of section 13 of the Banker's Code follows:

"When a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to such item or items and such drawee or payor shall fail or close for business as above, after having charged such item or items to the account of the maker or drawer thereof or otherwise discharged his liability thereon but without such item or items having been paid or settled for by the drawee or payor either in money or by an unconditional credit given on its books or on the books of any other bank, which has been requested or accepted so as to constitute such drawee or payor or other bank debtor therefor, the assets of such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, or for the balance upon a number of items which have been exchanged, and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank." A similar provision follows to cover proceeds in the hands of a failed collecting bank other than the drawee or payor.

Many courts have held for example that where the drawer or maker pays the item in question by check on the collecting bank that its assets have not been "augmented" and that accordingly there is nothing on which to assert a trust. Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Co., 242 Mass. 181, 136 N. E. 333 (1922); Ellerbe v. Studebaker Corporation of America, 21 F. (2d) 993 (C. C. A. 4th 1927); cf. Messenger v. Carroll Trust & Sav. Bank, 193 Iowa 608, 187 N. W. 545 (1922). See Comment, 36 Yale L. Jour. 682, 685-686 (1927).

For a comprehensive survey of this problem, see Townsend, Tracing Technique in Bank Preference Cases. 7 U. Cin. L. Rev. 201 (1933).
item had been sent by mail for payment) before its remittance draft should be collected, the forwarding bank, at its election, might treat the original item as wholly unpaid.\(^{24}\)

Thus by one way, if not another, losses were to be put on the depositors of the failed bank. Of course the decisions have been fairly uniform to the effect that when the drawer’s account is charged and his check cancelled, it is deemed paid and all parties are discharged.\(^{25}\) Moreover, once discharged, their liability may not be so casually revived, and certainly not at the election of some bank not the real owner of the paper. Indeed, one may well imagine the pained surprise with which the maker of a note payable at a bank would hear the announcement that the forwarding bank had elected to hold him liable—notwithstanding the fact that he had paid in cash already and had taken up the cancelled note. But so the law was written; according to its terms recourse might even be had against indorsers in such case, regardless of the long settled rule to the contrary as codified in the Negotiable Instrument Law.\(^{26}\) If the court’s law was “archaic”, local depositors at least would seem justified in calling that of the banker “unconscionable”.

It is only the “trust” provision, however, which has proved vulnerable in the courts so far. This is not to say that the holder’s rights on a “revived” instrument are necessarily

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\(^{24}\)The relevant part of section 11 of the Bankers Code follows:

“Where an item is duly presented by mail to the drawee or payor, whether or not the same has been charged to the account of the maker or drawer thereof or returned to such maker or drawer, the agent collecting bank so presenting may, at its election, exercised with reasonable diligence, treat such item as dishonored by nonpayment and recourse may be had upon prior parties thereto in any of the following cases:

(1) Where the check or draft of the drawee or payor bank upon another bank received in payment therefor shall not be paid in due course; . . .”

\(^{25}\)This was the rule of Federal Reserve Bank v. Malloy, supra note 14. See also Stout Lumber Co. v. Hayes, 25 F. (2d) 841 (C. C. A. 5th 1928); Morris v. Cleve, 197 N. C. 253, 148 S. E. 253 (1929). The opposite result was reached, however, in Cleve v. Craven Chemical Co. 18 F. (2d) 711 (C. C. A. 4th 1927) (by construction of the anti-par clearance statute, in force in North Carolina); and in Lake Charles Feed Co. v. Sabatier, 12 La. App. 89, 125 So. 318 (1929) (by recourse to the doctrine that the giving of a check or draft is only conditional, not absolute payment). Of course, an insuperable technical difficulty with this last argument is that, whether paid or not, secondary parties still may be discharged by the delay.

\(^{26}\)It is further provided under § 12 of the Banker’s Code that notices of dishonor to indorsers shall be sufficient if given within a reasonable time after “such dishonor.” Presumably the “dishonor” occurs when the collecting bank in its discretion, exercised with reasonable diligence, elects to treat it as dishonored.
clear, for the contrary is the case,\textsuperscript{27} but the banker has had no cause to complain of the decisions as yet. For that matter, the trust provision came up early and was fully sanctioned,\textsuperscript{28} even in the face of the National Bank Act, which provides for a \textit{pro rata} distribution of assets.\textsuperscript{29} Here was complete success, for it had been hoped that, by simulating the common law trust, state legislation alone would suffice. Nor was this so unreasonable for, after all, who is to say what constitutes a trust?\textsuperscript{30} It did seem, however, that the Illinois court had gone a little too far when it gave the holder of a certified check a preferred claim under the statute.\textsuperscript{31} for the provision was not intended to give everyone a preferred status.

Still, the so-called "trust" provided by the statute was much too crude a device to stand very close inspection. No effort whatever had been made to conform it to the increasing number of decisions which had granted the forwarder a preferred claim.\textsuperscript{32} These cases had shown a willingness to disregard the \textit{dictum} that the ordinary mingling of assets, necessary in usual collection practice, is an indication of a debtor-creditor relation.\textsuperscript{33} and moreover many had not insisted upon

\textsuperscript{27}The difficulty has arisen in determining what facts will constitute an election on the part of the collecting bank. In the case of \textit{In re Jayne \\& Mason}, 140 Misc. 822, 251 N. Y. S. 768 (1931) the Federal Reserve Bank had charged back the items in question to its customers, but had not asked for the return of the checks or taken any proceedings as upon their dishonor. It was ruled that there had been no election to treat the paper as dishonored and a preferred claim was accordingly allowed. In \textit{Jones v. Board of Education} 242 App. Div. 17, 272 N. Y. S. 5 (1934), the Federal Reserve Bank had been able to regain the original check and had returned it on charging back the account. This was held to operate as an election to treat the paper as dishonored and the payee was permitted to recover from the drawer.


\textsuperscript{30}Where federal and state court rules conflict, it has been supposed that either would prevail, depending on the jurisdiction in which suit was brought. But see Central National Bank v. First National Bank, 115 Neb. 444, 216 N. W. 302 (1927).


\textsuperscript{32}For a comprehensive survey, see Bogert, \textit{Failed Banks, Collection Items, and Trust Preferences}, 29 Mich. L. Rev. 446, 550 (1931).

\textsuperscript{33}In Cameron v. Carnegie Trust Co., 292 Pa. 114, 140 Atl. 768 (1938), the court regarded the custom to commingle funds as ineffectual to defeat the trust. \textit{Cf.} Bassett v. Mechanics' Bank of New Haven, 118 Conn.
strict compliance with the common law tracing requirements. But the courts in these cases had usually found at least that the proceeds of the forwarder's item could fairly be said to have gone into or tended to preserve the liquid assets of the bank. The Banker's Code on the contrary was drawn to charge everything in sight; the bank building itself, although perhaps acquired fifty years before the forwarder's item was received, could be sold to provide funds to pay the forwarder's claim in full. Evidently nothing but the name resembled the common law trust and, as had been freely predicted, when the provision came before the Supreme Court it was quickly held invalid as applied to national banks.

The result was a body blow to the Banker's Code. Of course it still purported to give the check holder a preferred claim in case of a state bank insolvency, and it seemed that the various provisions designed to shift risks from the forwarding and collecting banker to his customers would still obtain. The first intimation to the contrary came when the Wyoming court said that possibly the whole act was invalid. But the issue was not raised squarely until late in 1935, in People v. Union Bank & Trust Co., when the Illinois court decided that "the Legislature had no intention to create a situation where the rights of owners of commercial paper depend upon whether it is payable by or at a state or a national bank." This accounted for the preference provision; if the "trust" was invalid in the case of failed national banks, so was it also in the case of state banks. The court

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490, 173 Atl. 223 (1934); In re International Milling Co., 259 N. Y. 77, 181 N. E. 54 (1932). In the case last cited Hubbs, J., was careful to point out that the forwarder would have a position even superior to that of a forwarder under section 13 of the Bankers Code. But here the forwarder had provided in his indorsement that proceeds should not be mingled, a purely rhetorical provision.

34 Nor is it possible, if worth the effort and expense, to do a very certain job of tracing. Cf. Lane v. First National Bank of Yale, 131 Ore. 350, 281 Pac. 172 (1929), noted in 39 Yale L. Jour. 576 (1930).

35 See supra note 21.

36 Bogert, loc. cit. supra note 32, at p. 567; Dunham, The Incidence of Loss by Non-Clearance of Checks through Bank Failure, 4 Assoc. of Life Ins. Counsel Proceedings 595, 609 (1930).


39 362 Ill. 164, 199 N. E. 272 (1935).

40 People v. Union Bank & Trust Co., 362 Ill. 164, 199 N. E. 272, 274 (1935).
then went on to say that, since this provision was designed to compensate holders for the increased risks thrown upon them by the act, the whole scheme of the statute would be affected by its omission. The entire act was accordingly declared void.

If these decisions signalize the final passing of the Banker's Code, there are those who will not sorrow unduly.\(^41\) According to Beutel, "the code is one of the most vicious types of class legislation present on the statute books in America, in that it attempts to throw all the risks of the collection procession upon the depositors ..."\(^42\) But, at least, the Bankers Code is "frank in its viciousness",\(^43\) for the plan of the act is laid bare to anyone who reads. "Except as otherwise provided by agreement ... where an item is deposited or received for collection, the bank of deposit shall be agent of the depositor for its collection and each subsequent collecting bank shall be sub-agent of the depositor ... and any credit given by any such agent or sub-agent bank therefore shall be revocable until such time as the proceeds are received in actual money or an unconditional credit given on the books of another bank ..."\(^44\) In other words the intent is very clear to avoid the burdens of the purchase rule as defined in the City of Douglas case\(^45\) and to contract for the immunity to be had under the Massachusetts collection rule.\(^46\) The initial banker is to be a mere "conduit", through which all out of town paper flows.

But whether this "conduit" notion is "vicious", or merely good business, some courts have been slow to give the banker his due. In one of the first cases to come up the depositor had been allowed to draw against a credit given for out of

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\(^41\)The Code has been severely criticized both from the standpoint of policy and of draftsmanship. See Donley, Some Problems in the Collection of Checks, 38 W. Va. L. Quar. 195 (1932).

\(^42\)Beutel, Bank Collections Act, 9 Tulane L. Rev. 378, 385 (1935).

\(^43\)Ibid.

\(^44\)A. B. A. Code § 2.

\(^45\)Supra, note 17.

\(^46\)Under this rule the initial bank assumes no responsibility for correspondents, though it must exercise care in selecting a competent one. Fabens v. Mercantile Bank, 23 Pick. 330 (Mass. 1839). In contrast, the New York rule makes the forwarding bank responsible not only for its correspondent's handling of the collection, but for losses due to the latter's insolvency. Gilpin v. Columbia Nat. Bank, 220 N. Y. 406, 115 N. E. 982, L. R. A. 1917F 864 (1917).
town paper. No stipulation was used by the bank, while the credit was, in the words of the statute, merely "revocable" and so would seem not to upset the agency relation. The South Carolina court decided, however, that the statute had no application to such a case, since the bank must still be taken to have "purchased" the paper, inasmuch as it allowed drawings, and accordingly held that it was responsible for collection losses. The result of this case warned the banker that his law was not alone sufficient; he still needed to make use of stipulations denying positively that he was in any sense a "debtor" to the depositor.

A more important test of the "conduit" concept occurred with insolvency of the bank of deposit, that is, the forwarding bank. Unfortunately in the first case to come up the bank had again allowed drawings ($21.78 against an item for $1973.50). In some measure offsetting this, however, the bank had stipulated: "All checks credited subject to final payment." In this setting the Missouri court held that the bank, or rather its receiver, could recover upon the paper as though it were an owner, not an agent, even although it was recognized that to do so would force the depositor to come in as a general creditor. But in the court's view:

To hold otherwise would be to give an unfair and unjustified advantage to the depositor ... In daily bank transactions, to give the depositor of a check or draft such an advantage over other depositors is so far removed from equity and justice as to be repugnant to public policy.

In the next cases to come up the depositor had not even asked for "immediate" credit, but had placed his paper with the bank for "collection and credit". Here, although the bank had actually received the proceeds—ordinarily enough in itself to give rise to a debtor-creditor relation—the depositor was given a preferred claim, for the reason that no formal book entry to his credit had been made previous to the insolvency. And more recently, the same result was reached in

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47See supra note 44.
49Farmers' Exchange Bank v. Farm & Home Sav. & Loan Ass'n, 52 S. W. (2d) 608 (Mo. App. 1932).
50See Farmers' Exchange Bank v. Farm & Home Sav. & Loan Ass'n, 52 S. W. (2d) 608, 609-610 (Mo. App. 1932), revd. 332 Mo. 1041, 61 S. W. (2d) 717 (1933).
51Denkichi Tsuji v. Moody, 173 Wash. 376, 23 P.(2d) 403 (1933); State v. Kingston, 215 Wis. 80, 254 N. W. 126 (1934).
a case where provisional credit had in fact been given, be-
cause an advice of collection had not been received. These
courts did not say why such a depositor should have a claim
superior to that of other depositors in the failed bank; it was
enough that such is the purport of the statute.

Whether their reasoning was “vicious” or not, at least the
banker had no complaint to make of these decisions. He did
have some doubts, however, of Dakin v. Bayly, decided in
1933 under legislation in some respects like that of the
Banker’s Code, for in this case there were intimations that
the “conduit” idea might have its shortcomings. This time
the contest arose as between the bank of deposit and the col-
lecting bank to which it had forwarded customers’ paper for
collection. It seems that the latter had failed after having
remitted by draft—the typical situation giving trouble. But
the forwarding bank was indebted to the failed collecting
bank and when sued on this indebtedness it sought to set-off
the amount of the remittance drafts, which it still held. The
defense was denied, for, in the opinion of Mr. Justice Roberts,
the claims were not “mutual”. The paper having gone
through the forwarding bank as a mere agent, the bank could
not thereafter use the remittance drafts to pay its own obli-
gations. But, of course, the result did not directly affect the
forwarding banker’s pocket, although it did close the door to
one means whereby owners of collection items might recover
in full on their paper.

But the Dakin case was of concern to the collecting banker.
His relation, on the “conduit” theory, to the depositors in the
forwarding bank was too clearly disclosed. In the event that
the forwarding bank should fail, would the collecting bank’s
traditional claim upon the depositor’s paper, or its proceeds,
be entirely respected? The matter finally came to a head in
Leonardi v. The Chase National Bank of New York. This
was a suit by a Florida depositor in a Miami bank to recover
the proceeds of his New York collection, which the collecting
bank sought to apply upon the forwarding bank’s indebted-
ness. It appeared that the collecting bank had collected the
paper, credited the Miami bank with the amount and sent a

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52 In re Harr, 179 Atl. 723 (Pa. 1935). But cf. State v. South Omaha
State Bank, 129 Neb. 43, 260 N. W. 815 (1935). In this case, however,
the credit was subject to drawing.
notice thereof—all before the latter's insolvency became known. The argument centered on the effect of the credit entry; did it create a debtor-creditor relation between the two banks, so that the Florida depositor could thereafter look only to the Miami bank? The court was quite clear that it did not and that the depositor could disregard the Miami bank and recover in full from Chase; surely not a "vicious" result, at least from the depositor's viewpoint.

The result would seem to be fully consistent with the "conduit" theory, assuming that that theory was intended to work both ways. But the fact is that such was not the intention. While the banker has been very zealous to appear to his customer as a mere conduit, he has always dealt with the customer's paper as though it were his own. Moreover, the collecting banker to whom he has sent it—as in this case—always has treated the paper as an asset of the forwarding bank. Indeed, the Banker's Code itself is very careful to say that, notwithstanding that the initial bank is an agent, still all "subsequent holders shall have the right to rely on the presumption that the bank of deposit is the owner of the item." Thus the way is prepared, verbally at least, for a rather high-handed disregard of the depositor's interest, though how a court can permit such a violent presumption to stand in a world where all paper is taken for collection is difficult to see. But, even so, when the facts are brought home to the collecting bank by the depositor, it can only defend by showing either, that it has become a holder in due course of the paper, or that it has remitted for the item and no longer holds any proceeds belonging to the depositor. The court in the Leonardi case decided—that a mere credit entry, in the circumstances before it, did not constitute such a remittance. And a charge after insolvency, of course, came too late.

55 A great many cases could be cited illustrating this point, if necessary. In one of the most flagrant and recent examples, State v. Kingston, supra note 51, bonds and coupons to the amount of $73,810 were deposited by the State Treasury Department for collection and credit. These the bank forwarded to its Chicago correspondent for immediate credit, making out and holding in its own records a certificate of deposit evidencing the transaction. And see Bank of Aurora v. Fruit Growers' Union, 52 S. W.(2d) 574, 575 (Mo. App. 1932).

56 A. B. A. Code § 4. This provision was inserted to get around cases like Schram v. Askegaard, 34 F.(2d) 348, 349 (D. C. Minn. 1929), where Sanborn, J., said—realistically—that the collecting bank must assume that the forwarding bank was an agent. This meant that it could not recover against the forwarding bank's depositor on the latter's indorsement, even though it had given value.
The court did not discuss the further possibility that the collecting bank had become a holder in due course of the depositor's item. An argument, though not a very good one, could have been made that by merely giving credit it had satisfied the value requirements of the N. I. L.\(^{57}\) Of course, it would have to be recognized that under the Banker's Code the collecting bank, like the forwarding bank, must be taken to have received the paper as agent only, not as purchaser. And the giving of credit under such circumstances, except as drawings may have been allowed, could be said to amount to only a preliminary step in the process of making remittance. But there was an even more serious obstacle, for the Miami bank had used a "Pay any bank or banker" indorsement, which, under the Banker's Code, has been made restrictive.\(^{58}\) Thus, at best, the collecting bank could have obtained no better title to the item than the Miami bank had, and since the latter was a mere "conduit" this would not be helpful at all. In fact the depositor had used a "for deposit" indorsement, which also is made restrictive under the statute,\(^{59}\) so that the former bank could not even "presume" that the Miami bank was an owner.\(^{60}\) And as for title to the proceeds, it must not be lost sight of that the collecting bank's rights to these can rise no higher than its rights to the item itself. The title question was thus not argued because the statute had left the collecting bank with nothing to argue.

Thus, far from being "vicious", the Banker's Code is rather to be described as "altruistic" in this respect. Perhaps the banker intended to adopt the merchant's slogan, that the customer is always right. Certainly his statute indicates that he must henceforth refrain from the commoner forms of mis-

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\(^{57}\)Brannan, Negotiable Instruments Law (Beutel's 5th ed. 1932) 381. See infra note 113.

\(^{58}\)A. B. A. Code § 4. The result would seem to be that collecting banks holding paper through such an indorsement obtain no title to it, although, of course, as holders they may bring suit upon it in their representative capacity. See Williams, Beacon & Co. v. Shadbolt, 1 Cab. & El. 529 (1885). And see Farmers' Exchange Bank v. Farm & Home Sav. & Loan Ass'n, supra note 50.

\(^{59}\)A. B. A. Code § 4. "An indorsement of an item by the payee or other depositor 'for deposit' shall be deemed a restrictive indorsement and indicate that the indorsee bank is an agent for collection and not owner of the item." There was a conflict on this point at common law. In First National Bank of Sioux City v. John Morrell & Co., 58 S. D. 496, 221 N. W. 95, 60 A. L. R. 363 (1928), such an indorsement was held restrictive. Contra, Security Bank v. Northwestern Fuel Co., 58 Minn. 141, 59 N. W. 387 (1894); Ditch v. Western Nat. Bank, 79 Md. 192, 29 Atl. 72 (1894); see also Note, 60 A. L. R. 866 (1929).

appropriation, at least where his customer can be trained to indorse his paper "for deposit". In the good old days, the New York court protected a banker in the position of the collecting bank by calling him a sub-purchaser,\textsuperscript{61} not a sub-agent as provided in the statute. But this was at a time when both forwarder and collecting bank allowed drawings against uncollected paper. The court, moreover, did not even require that the collecting bank show that it had paid out value, its undertaking alone being enough.\textsuperscript{62} And likewise, on the remittance theory, the court held that a credit given by the collecting bank to the forwarder, at a time when the latter's account was overdrawn, would constitute a remittance, in spite of the fact that the forwarding bank had merely taken the paper as "agent".\textsuperscript{63} But in this case too there was no restrictive indorsement; in fact had the depositor "indorsed the check ‘for collection’ a different question would ... [have been] presented."\textsuperscript{64} Still, the "bad" bank is not entirely without friends, for the Pennsylvania court recently condoned the outright sale by an "agent" bank of its customers' paper,\textsuperscript{65} and rode rough shod over a restrictive indorsement to protect the collecting bank under the Code.

Why did the banker throw over his early favorable precedents and tinker with the restrictive indorsement in this way? One suspects he did not fully understand what he was doing. But he had a reason, for it seems the collecting banker wanted to guard against loss in presenting altered paper to

\textsuperscript{61}Metropolitan National Bank v. Loyd, 90 N. Y. 530 (1882).

\textsuperscript{62}The forwarding bank being a purchaser, it was of course immaterial, in the absence of fraud, whether the sub-purchaser had paid out value or not before learning of the forwarding bank's insolvency. See First Nat. Bank v. Mt. Pleasant Milling Co., 103 Iowa 518, 72 N. W. 689, 690 (1897).


\textsuperscript{65}Lipshutz v. Philadelphia Savings Fund Soc., 107 Pa. Super. Ct. 481, 164 Atl. 74 (1933). Evidently the holder had used a blank indorsement in depositing the paper and the bank of deposit a restrictive "Pay any bank or banker" indorsement on forwarding it, receiving the "full consideration" for the item. Next day the forwarding bank failed and the depositor sought to recover his item, which was refused. A comparison with the attitude of the courts in denying an agent any authority to collect before maturity, Oren v. Seim, 192 Wis. 551, 212 N. W. 949, (1927), makes it impossible to see how the forwarding bank's action could be approved. And as for the collecting bank, not only did it obtain no title by virtue of the restrictive indorsement, but as agent to collect it must have known that there was no authority given it to buy. Banks do not use restrictive indorsements when discounting their own paper.
to drawee for payment. By appearing from his customer's restrictive indorsement to be an agent, the drawee was put on notice that any overplus paid out to him on raised paper could not be recovered, where the proceeds had in turn been paid over—this on familiar principles of agency law. In the companion situation, however, involving paper bearing a prior forged or unauthorized indorsement, the opposite result was provided for; in such case the collecting banker was made to warrant his title to the drawee. By so doing, any further need of using the familiar "prior indorsements guaranteed" stamp was obviated. But how any line in policy may be drawn between indorsement and alteration risks, not even a banker's lawyer can explain intelligently. And, since the Leonardi case, it may be surmised that not many depositor indorsements have been made over into restrictive indorsements, as the statute permits the banker to do. Perhaps the banker is even beginning to rue his haste in making the "Pay any bank or banker" indorsement restrictive; but this may do him an injustice.

It is the banker's penchant for blowing both hot and cold at the same time which has gotten him into trouble, plus his inordinate fear of minor risks. Even this brief survey indicates that his collection statute, so far from achieving uniformity, rather has increased the confusion in the field. It is not even constitutional as applied to national bank liquidations, nor in any respect in at least one state. His effort to pose as an agent when dealing with his customer, and then to act as an owner when forwarding paper to his correspondents, is something less than ethical. So much so, indeed, that it is amusing to see him come a cropper over the restrictive indorsement, all in a strenuous effort to win a pawn. But this is only to touch upon a few sore points; there are many other matters of questionable policy not possible to mention here. Enough has been said, at all events, to indicate that the present statute is far too pro-banker in spirit ever to be

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66 Paton, loc. cit. supra note 15.
69 There has been some suggestion that the usual prior indorsements guaranteed stamp covers both alteration and indorsement risks. New York Produce Exchange Bank v. Twelfth Ward Bank, 134 App. Div. 953, 119 N. Y. Supp. 938 (1909), and see Note, 11 N. C. L. Rev. 318 (1933).
70 Supra note 54.
widely adopted, much less to become a uniform statute. It does not even serve the bankers' best interests, to say nothing of those of the financial community.

It would be fortunate, at this juncture, if the collection statute being prepared by the Commissioners on Uniform State Laws were ready for adoption, but it is not. Nor can it well be made ready until agreement is reached on some broad questions of policy. Indeed, Beutel would have it that the 1934 draft of the proposed Uniform Act, being more skilfully drawn, is not only "vicious" but even "more dangerous socially" than the Bankers Code. It too favors "the bankers at the expense of the depositors in almost every case,"—as he sees it. And, while Beutel apparently does not disapprove of the plan to compensate the depositor by creating a "trust" in his favor on the liquid assets in the hands of the failed collecting bank, without tracing, there are others who do and very positively. According to Bogert, although admitting that the tendency both by statute and decision has been decidedly in that direction, such a use of the "trust" concept "is to be deplored." Not only is it "vicious in that it makes the law uncertain and contradictory," but it is unsound as a matter of economics. The holder or the forwarding bank should assume all risk in the first instance, with the idea that they may "distribute" losses over as large a part of the commercial community as possible.

One of Bogert's points at least may readily be conceded; there is no reason why a legislature today should use the "trust" as a means of protecting forwarders against collection losses. Even a carefully drawn state provision would now, in all probability, be held invalid as applied to national banks. And, if Congress must act in the matter, it may provide directly for the order of preference which it considers desirable in the case. So may the states as applied to state banks. In fact there have already been at least two statutes introduced in Congress designed to pay the forwarder out in full ahead of the local depositors, much as is done under the Banker's Code, but without using the word "trust". And, both failed of passage, though not for reasons of form.
The fate of these efforts at federal legislation is instructive. The first, known as the Strong bill, was introduced in 1930 with the active support of various millers and grain dealers associations. At the hearing before the Committee on Banking and Currency the millers brought out that they were losing thousands of dollars each year through loss of collection proceeds in failed national banks. It was pointed out that they had no means of passing upon the solvency of the particular collecting banks which might come to handle their paper; that no credit was wanted on the books of such banks as in the case of a deposit; that, in fact, such banks should be regarded as mere "conduits" having by chance money belonging to the forwarder in their possession. But the local depositors were also well represented, for Secretary Mellon in a letter to the committee made it clear that the absence of any "tracing" or "augmentation" provision would "result in penalizing the general creditors," clearly an "unjust" result. Moreover, figures were introduced showing that in 1929 amounts paid out on preferred and secured claims very nearly equalled those paid to general creditors. Evidently the matter would be well enough taken care of if left with the courts, though they admittedly were in a state of confusion. The 1935 bill, broadened to cover all items collected through national banks, fell before the same opposition.

No one, evidently, is going to volunteer to assume the burden of collection losses. The local depositor has his friends in the Treasury; the collecting banks have been too zealously represented by their association; the large check holders, manufacturers, millers and insurance companies, while forced by stipulation to assume many risks, have been aided by court and legislature to a very great extent. Moreover the large creditors have been able to put the whole loss back on the drawer by use of a simple stipulation that the drawer's check will not be regarded as payment of his debt until the payee is actually put in funds. The whole thing is

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77 H. R. Bill #5634, 71st Congress (1930).
78 H. R. Bill #5634, 71st Congress (1930), Hearings, p. 72 (May 16, 1930).
79 Ibid., p. 77.
80 S. Bill #1078, introduced in the Senate on January 16, 1935, by Mr. Sheppard.
81 Dunham, loc. cit. supra note 36, at p. 612, points out very clearly the practice to be followed. The policy holder is to be told that: "Remittance may be made by check or draft subject to the condition that such check
in a delightful muddle. Nor will it clear up matters to resort to personalities and call the banker or the large creditor "vicious", merely because he has had the economic power and "vision" to force his position. Our institutions are built on freedom of contract as a basic principle, which of course involves an element of exploitation at times. It is but "natural", perhaps, that the drawer should come out at the little end of the horn.

But why not face this word "vicious"? If a pro-banker statute is "vicious", does it follow that a pro-depositor or a pro-drawer act would be "beneficial"? To say so would make this whole battle of adjectives a purely emotional outburst, conditioned by the desire of one group or another for personal gain. After all by what values should a collection system be tested? In the writer's view the standard should be the same as that by which a sound currency system is tested. For it must not be lost sight of that the check has today largely displaced the bank note as a medium of exchange. And when one goes back in our history over the long and very troubled path by which the bank note finally came to its present state of security, backed by the United States government, it is evident that the matter is not one which can be left to the pulling and hauling of different groups impelled by self interest. There is a national interest to be considered.

The first essentials, from this viewpoint, are to provide maximum safety and efficiency in handling collections and to have done with the bickering about who should bear what

or draft may be handled for collection in accordance with the practice of the collecting bank or banks, and that any receipt issued therefore shall be void unless the amount due is actually received by the company." The object is clear, that the drawer should take the entire collection risk, even though he is, perhaps, the least able of anyone in the transaction to do so.

At least Jessel, M. R., thought so. "... if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting ..." Printing and Numerical Registering Co. v. Sampson L. R. 19 Eq. Cas. 462, 465 (1875). But see 8 Holdsworth, A History of English Law (1926) 56; Hamilton, Affectation with Public Interest, 39 Yale L. Jour. 1089 (1930). According to Bowen, L. J., who put the thing mildly, "the interests of contracting parties are not necessarily the same as the interests of the commonwealth." Maxim Nordenfelt Co. v. Nordenfelt L. R. [1892] 1 Ch. Div. 650, 661.


See Conant, History of Modern Banks of Issue (1896) 286-385; Knox, A History of Banking in the United States (1900) 399-413.

For an instructive commentary on the politics by which this result was reached, see Hibben, The Peerless Leader, William Jennings Bryan (1929) 332.
risks. Of course it is not going to be possible in the nature of things to give assurances that every man's check is at all times actually worth its face value, except, indeed, as it has been certified. But the matter of losses in collection, whether due to some bank's insolvency or its negligence in handling the paper, should be eliminated as far as possible. These are of concern to the banking fraternity, but they should be of none whatever to the depositor. And conversely the current effort, verbally at least, to lock up and hold apart the millions of dollars of paper always in process of collection, that is the "float", is financially speaking extremely short sighted. To convert the banker actually into a "conduit" neither serves the banker nor the depositor in the long run. If this be "vicious", those who care to "may make the most of it."

At the threshold to any sane solution, as a stumbling block, has been the riddle of how to surmount the failed bank losses. These out of the way, the losses due to bank negligence can be seen in their right perspective. Several years ago the writer suggested that the matter was a proper one to be covered by insurance, but no private company to date has been interested—except, of course, as it has sought to shunt its own losses on to its policy holders. Possibly the risk has been regarded as too large for a private company to undertake.

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88 Nor even then, unless the certified check can be brought clearly within the protection of the Federal Deposit Insurance Corporation. See, Steffen and Starr, A Blue Print for the Certified Check, 13 N. C. L. Rev. 450, 476 (1935). Precisely what constitutes a deposit within the statute is not clearly pointed out. A mere purchase of a bank draft or cashier's check would probably not be considered a deposit. See Widman v. Kellogg, 22 N. D. 396, 133 N. W. 1020, 1022 (1911); Kidder v. Hall, 113 Tex. 49, 251 S. W. 497, 499 (1923). On the other hand, a deposit is not extinguished by the acceptance therefor of a bank draft or cashier's check. Gilmore & P. R. Co. v. United States Fidelity & Guaranty Co., 208 Fed. 277 (C. C. A. 3d 1913); Middlekauff v. State Banking Board, 111 Tex. 561, 242 S. W. 442 (1922); State v. Tyler County State Bank, 277 S. W. 625 (Tex. Com. App. 1925). By analogy, it would seem that a customer's account is guaranteed without any reduction for checks drawn upon it until such checks are paid. Certification, if procured by the drawer, would seemingly not change the result. See Downey v. Citizens State Bank, 194 N. E. 743, 744 (Ind. App. 1935). But if procured by the payee, it could be held to have extinguished the deposit. See Borne v. First Nat. Bank, 123 Ind. 78, 24 N. E. 173 (1890). It would be desirable, as an aid to the certified check, to find that a new guaranteed deposit had been created in such case in favor of the holder.

89 It may be pointed out that the finance companies and commercial factors have built up a substantial business under the very noses of the bankers by dealings in receivables of a no more liquid character. See Steffen and Danziger, The Rebirth of the Commercial Factor, 36 Col. L. Rev. 745, 773 (1936).

86 See Turner, loc. cit. supra note 4, at p. 906.

88 See supra note 81.
More likely it is thought that with 49 varieties of commercial banks, each variety with a constantly changing legal structure, there are elements of risk against which no private company dare insure. But these reasons do not apply to government insurance in the same degree. Wherefore, why not broaden the Federal Deposit Insurance statute to include collections? The machinery is already set up. And assuredly nothing could do more at one stroke to bring order out of chaos in the collection field than to banish forever the spectre of bank failure.

But the banker does not like the guaranty of deposits statute, and with some reason. Moreover, he has been telling himself, and the world, so long that he functions merely as a "conduit" in handling out of town checks; that any credit given the depositor is merely provisional; that any drawings allowed are but an act of grace on his part; that, in short, he would probably oppose the suggestion vehemently, even though it were to his best interest to approve it. At all events, the banker's chief argument against the guaranty of deposits—that it charges the strong, carefully managed bank to protect the depositors in the weak—would have no application. For once the shoe would be on the right foot, for the forwarding bank and its depositors would gain protection in direct proportion to their part in the insurance cost. Nor need the cost be exorbitant, if we have at last attained to something like banking security.

If the banker can now be induced to sit down and look at the situation calmly he will see that broadly speaking three

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91On what is a "deposit" within the act, see generally, Breckenridge, The Banking Act of 1935, 32 Am. Bar Ass'n. Jour., 93, 95 (1936).

92See Willis, The Folly of Deposit Guaranty, 31 Amer. Mercury 16 (1934).

93The banker was outspoken in opposition to the Federal Reserve Act when it was before Congress. And many will remember the open defiance with which one Charles E. Mitchel, as president of one of the large New York banks, met the Federal Reserve Board efforts late in 1929 to curtail speculation. But, of course, the lawyer has not always exactly welcomed suggestions looking toward procedural reform.


95Some 34 licensed banks failed during 1935, with aggregate deposit liabilities of $10,158,000, which number, while still too large, is yet much too small even to compare with previous failures. 22 Fed. Res. Bul. 62 (1936).
types of paper are affected. First is the discounted item such as the trade acceptance, as to which the bank already bears the full risk of collection hazards, for neither the Banker’s Code⁹⁸ nor the usual collection waiver has anything to do with “purchased” paper.⁹⁷ A guaranty of collections would be of great advantage to the banker here, and incidentally to the customer. At the other extreme is the time note or other item, including all restrictively indorsed paper, which is taken for collection, no credit being given until proceeds are received. Here, if anywhere, the bank should function as a “conduit” and without responsibility except for its own fault.⁹⁸ And, moreover, since the depositor alone would gain by the guaranty provision, he should pay the costs, unless the matter is one de minimis. Which leaves the vast middle ground occupied by the blank indorsed check deposited for credit, the item with which this paper is principally concerned. Obviously if the banker is going to use these items—as he does—to build up his balances with a correspondent, and if the depositor is going to be allowed on occasion—as he is—to draw against his credit, both banker and depositor gain here by elimination of the hazard of a collecting bank’s failure.

It was on this analysis that the Commissioners’ Uniform Act was drafted to make the initial bank a “purchaser”, both of checks and of discounted drafts.⁹⁹ Whether the depositor might draw immediately in the case of his check, however, was recognized as being a credit matter to be arranged between bank and depositor.¹⁰⁰ But it was also recognized, as a practical matter, that it would not be possible to put the

⁹⁶See supra note 48.
⁹⁷The point is incontestable on the authorities, although, of course, where the necessary proceedings can be taken on dishonoured paper, the customer would remain liable upon his indorsement. This is, in fact, the basis for the charge back practice. Noble v. Doughten, 72 Kan. 336, 83 Pac. 1048 (1905); and see Twin Falls Bank & Trust Co. v. Pringle, 43 P.(2d) 515 (Idaho 1935).
⁹⁸The 1934 draft of the Uniform Act (§ 33) adopts the Massachusetts rule as to this type of paper only. All other paper is deemed purchased (§ 16), with a limited right of charge back (§ 25). See Fifth Tentative Draft of Uniform Bank Collection Act, Handbook of the National Conference of Commissioners on Uniform State Laws (1931) 160. Mr. Beutel erroneously assumes that the section applies to all deposited paper and condemns the act as archaic. See Beutel, loc. cit. supra note 42, at p. 404. If one is to be at all realistic about the matter, it must be recognized that banks should be permitted to handle certain paper without responsibility. Consider, for example, foreign items in war time.
⁹⁹U. B. C. A. § 16.
bank in such a position, unless the "trust" device would really work. As a matter of plain realism no bank could have assumed the collection losses of the last ten years and stayed solvent—unless indeed, an elaborate system of charging depositors were to have been set up to provide an insurance fund. And it was more than clear that state legislation could not reach so far as to require this of national banks; state legislation was stretched to the breaking point in setting up the "trust". But even apart from its invalidity as applied to national banks, the "trust" device was but makeshift protection. For one thing, where there were several preferred claims, it might not even suffice to pay out in full, and for another, it made no provision for delays and costs in collection. There was nothing else to do but to authorize the bank to charge back any item whose proceeds were not received in regular course due to the insolvency of a collecting bank.\footnote{U. B. C. A. § 25.}

That chapter is now fortunately closed; plainly both state and national legislation is needed. And, if a satisfactory collection guaranty system can be worked out, as seems easily possible, it is even more apparent than heretofore that the forwarding bank should hold collection paper as a "purchaser" and not merely as the depositor’s "agent". The great mass of paper even today is collected without difficulty. There should in the future be no need (or privilege) to charge back paper for the reason only that some correspondent bank may have become insolvent; the item having been paid the depositor should be able to proceed as though no failure had occurred, as should the drawer also. Nor will this be burdensome to the bank, for the Federal Deposit Insurance Corporation would itself pay up the loss promptly to it, and in full.\footnote{To insure less than all of a collection item would simply be to perpetuate if not to increase the present confusion, though restricted to the uninsured portion. And, while it may appear to be favoring check holders unduly, as compared with drawers, since deposits at present are only insured up to $5000, it must not be lost sight of that the latter are now being forced to assume the entire collection risk anyway, and would actually benefit correspondingly by the provision. Moreover, there is a great deal in the argument of those courts which were finding a constructive trust in the forwarder’s favor; there are many reasons why the forwarder is to be differentiated from the depositor. To mention only one, the latter contemplates a continuing debtor-creditor relation, the former does not. The present suggestion would recognize this difference, but would put the remedy on a much sounder footing than the courts could possibly put it.} It could then proceed with the slower process of realizing upon the assets of the failed bank. And, should the forward-
ing bank fail, it is of course necessary to show a debtor-creditor relation in order that the depositor may come within the protection of the guaranty law. This the Commissioner's Act provided for by its "purchase" provision.\textsuperscript{103} At the same time, of course, it is always open to any depositor to contract for his common law protection, since the restrictive indorsement is readily at hand for his use, as witness the \textit{Leonardi} case.\textsuperscript{104}

The element of unreality in the situation is that the forwarding banker says he will not allow drawings against uncollected paper. And Beutel asks, what kind of a "purchaser" is this who makes no agreement to pay? Moreover, is he a "holder", a "holder for value" or a "holder in due course"?\textsuperscript{105} Surely these well defined terms should suffice without introducing the word "purchaser", or for that matter the word "agent".\textsuperscript{106} The Banker's Code meets the situation, characteristically, by saying that although credit is given for an item the bank still continues to be an "agent"; but to the extent that it allows such credit "to be withdrawn", it also becomes an "owner".\textsuperscript{107} Nothing could be simpler, providing the banker is willing to lead a double life. But the point is that the present non-drawing practice is artificial, induced by the very real fear on the part of the banker that to allow any drawing—no matter how small or how justified as a credit matter—will be construed by many courts to convert him into something other than an agent and so make him

\textsuperscript{103}U. B. C. A. § 16. The bank becoming a purchaser of the deposited item upon credit being given to the depositor in his drawing account, there should be no question but that the transaction represents a deposit within the federal act. This was one reason why the depositor was denied a preferred claim upon the insolvency of the forwarding bank. In Beutel's view, however, "Here is another piece of gross injustice" to the depositor. Beutel, \textit{loc. cit. supra} note 42, at p. 397.

\textsuperscript{104}\textit{Supra}, note 54.

\textsuperscript{105}Beutel, \textit{loc. cit. supra} note 42, at p. 394.

\textsuperscript{106}Beutel, \textit{loc. cit. supra} note 42, at p. 385. The objection is made here that to denominate a bank handling collection paper an "agent" is a mistake, "because the customer exercises no control over the bank." And, "surely the customer is not liable for the bank's torts in collecting his paper ..." Of course the customer does give instructions concerning collection paper which the bank must follow. And equally clearly there is nothing inconsistent with the authorities in treating the bank both as "agent" and "independent contractor." See Steffen, Cases on Agency (1933) 228 \textit{et seq.}, where the problem is considered.

\textsuperscript{107}A. B. A. Code § 2. It has never been satisfactorily explained, though, how a forwarding bank—by allowing credit withdrawals—becomes an "owner" of paper which it may have already forwarded on to a collecting bank, especially since the latter becomes a sub-agent of the customer and may itself acquire a lien or purchase position.
liable for collection losses. By removing this fear (and forbidding charge back of collected paper) his obligation to honor drawings, deferred though it may be, becomes real enough.

The use of "holder" to describe the forwarding banker's interest in deposited paper would obviously be quite meaningless for present purposes. He might be a "purchaser" even though not a holder, and as holder his interest might range all the way from that of an "agent", a "bailee", a "trustee", a "donee" on to that of a "converter". But the further suggestion that the banker should be treated as a "holder for value" upon credit being given for a deposited item, raises a more important question. Mr. Beutel's thought that the bank in such case should be a "holder in due course", if it acted in good faith, shows a curious confusion of ideas. Of course giving credit alone, where that means the depositor may draw at once, constitutes "value" as defined in all the uniform acts. Moreover, and this Mr. Beutel has failed to see, it may be taken as an indication that the bank is a "purchaser" of the paper, rather than an "agent" or whatnot. But it is one thing to say that a bank by giving credit has become a purchaser and quite another to say that it has therefore paid out value in such fashion as to have become a holder in due course; to reach such a result is to read § 54 of the N.I.L. entirely out of the act.

108See supra note 48.
109N. I. L. § 49.
110The point is made more fully in Brannan's, Negotiable Instruments Law (Beutel's 5th ed. 1932) 330 et seq., § 25.
111For example, in Blacher v. National Bank of Baltimore, 151 Md. 514, 135 Atl. 383 (1926), the forwarding bank had given credit (not subject to drawing) for three blank indorsed checks and in turn had forwarded them to the defendant collecting bank for credit subject to immediate drawing. The items were duly paid. Upon the failure of the forwarding bank, shortly afterward, the customer sought to recover the proceeds in the hands of the collecting bank, but without success. Obviously this did not raise a question as to whether the defendant was a holder in due course, but merely as to whether it was a sub-purchaser. To translate in terms of the horse, suppose that A sells a horse to B on credit and B in turn sells to C on credit. If thereafter B should fail without paying A there is no doubt but that A has no right whatever against C, even though C should not have paid a cent to B. This was all that the Blacher case decided, as is true also of First Nat. Bank v. Cross & Napper, 157 So. 636 (La. App. 1934), which Beutel cites as further authority. These cases are no authority for the proposition that the collecting bank would be a holder in due course free of equities or entitled to cut off defenses of prior parties, merely because it had given credit.

112Which Mr. Beutel attempts to do, for in his opinion "this section does not apply to credits because the credit itself is the full amount to be given." Brannan, op. cit. supra note 110, at p. 331, § 25. This sounds
No such truly "vicious", not to say pro-banker, suggestion has been made in years. Fortunately it is not law. But, as a matter of policy, why should Beutel even be anxious to aid a banker who has merely given credit for an item, as against a maker who has been defrauded by the bank's depositor? Surely it is not too much to ask the banker in such case to charge the item back to the wrong-doer and forego collection from the victim. Or, where the banker holds stolen paper under such circumstances, to require that it be delivered up to the true owner. In fact Bogert goes to the other extreme and insists on the constructive trust rule, that the paper or its proceeds should be recoverable so long as the depositor's balance has not been reduced below the amount of the item in question. And even the Banker's Code asked only that the banker be given an "owner" position, whatever that is, to the extent that he should have allowed drawings against a credit. This last is substantially the position of the Uniform Act, with the significant addition that an effort is made to state how drawing should be allocated, in order to determine when a credit may be said to have been withdrawn. The point is one of considerable confusion in the decisions. To go farther and provide that giving credit alone is enough would be "outrageous" in this day.

It remains to consider the negligence risks. The courts, working from case to case, built up a fairly strict body of law to govern the forwarding banker. He must act with diligence, he must use care to select a competent correspondent.

very much like pro-banker sophistry. N. I. L. § 59 reads as follows: "Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him." A credit is at most a promise to pay for an instrument, not a payment.

All of the cases cited under the act—as before—require that the bank have allowed drawings before it may be regarded as a holder in due course. The courts phrase their decisions loosely by saying that credit alone is not value. See Brannan, op. cit. supra note 110, at p. 331 et seq., § 25.

See Fifth Tentative Draft of Uniform Bank Collection Act, loc. cit. supra note 98, at pp. 179, 180, where the reasons for not following Mr. Bogert's suggestion are stated. For a case discussing the point, see First Nat. Bank of Appleton v. Court, 183 Wis. 203, 197 N. W. 798, 799 (1924).

See supra, note 107.

U. B. C. A. § 22. The section as drafted follows the majority decisions in applying the so-called "first-in, first-out," rule. See Fifth Tentative Draft of Uniform Bank Collection Act, loc. cit. supra note 98, at p. 179, for discussion and citations.
and he must not route his customers paper in an unduly circuitous manner. The first two rulings are still good law, but the third quickly gave way before banker statutes saying that it should be due care to route paper in any manner according to banking usage. Again it was ruled, in spite of some early doubts on the point, that it was negligence to forward paper directly to the drawee and further that to receive anything but money in payment should be at the banker's own peril. Both of these rulings, as mentioned above, are now generally avoided, if not by statute, then by contract stipulation. Moreover, the New York collection rule making the forwarding bank responsible for the negligence of its correspondents is now a thing of the past, for all practical purposes. All told, these are no doubt but minor risks as compared with those growing out of bank failure, but still, what is to be done with them? A loss of even one dollar in the collection department causes the banker, as a good shepherd, more concern than ninety and nine in any other.

There are three ways to go about the matter. The first is to let things stand as they are, with all that that signifies in terms of charge-back, delay and expense. It at least permits the non-negligent banker to avoid loss. The second would be to force the adoption of the New York collection rules. In the writer's view this has always seemed the sounder policy, granted it were feasible, if for no other reason than because it enlists the active support of the forwarding bank in adjusting a loss. Not exactly that one should appear to be setting a banker to catch a banker, but simply that a small depositor is at a hopeless disadvantage if he must press a claim against a distant bank. It would usually be cheaper to abandon it entirely. For this reason as much as for any other, the initial carrier was long ago made liable to the shipper for the negligence of connecting roads. The

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117 Turner, Bank Collections—The Direct Routing Practice, 39 Yale L. Jour. 468, 469 (1930). For a case showing to what lengths this legislation permits the forwarding bank to go without responsibility, see Montsdoca v. Highlands Bank & Trust Co., 85 Fla. 158, 95 So. 666 (1923).

118 See favorable comments on the practice by the court in Thomas v. Supervisors of Westchester County, 115 N. Y. 47, 51, 21 N. E. 674 (1889).

119 Supra note 14.

120 Turner, loc. cit. supra note 4, at p. 906.

121 This was provided by the so-called Carmack Amendment, Act of June 29, 1906, c. 3591, 34 Stat. at L. 593, 49 U. S. C. § 20(11). For a case discussing the shipper's plight before the amendment, which compares with that of the check holder, see Atlantic Coast Line v. Riverside Mills, 219 U. S. 186, 31 Sup. Ct. 164, 55 L. Ed. 107 (1911). Under
third would be to insure the risk in the same manner as it is suggested the insolvency risk should be covered, letting the Insurance Corporation adjust the negligence claim directly with the bank at fault.

It may simplify matters to differentiate between negligence losses occurring before and those occurring after payment of an item. From the forwarding banks viewpoint it is impossible to know, when an item has been returned unpaid, whether the reason was that the postal authorities had delayed unduly, that the collecting bank presented to the wrong person, or, more likely, that the drawer or maker in fact had no funds on deposit. The last clearly, and probably the first, are chargeable to the depositor, as conditions under which he does business. But the true reason for the dishonor may not be ascertained for weeks and in the interim there should be no question but that the forwarding bank should be permitted to charge the item back as unpaid.122 For the same reason it would be very difficult to frame a guaranty provision which would work. But once the item has been paid, and the drawer and indorsers discharged, the transaction takes on a very different appearance. From the depositor's angle it should be immaterial why the proceeds do not return, whether because of some remitting bank's negligence or because of its insolvency. It is purely an inter-bank matter. Here clearly the guaranty machinery should be called into play.

But of course Rome was not built in a day, and by the same token it would probably not be possible to give all items even so much protection as is here suggested at the start. In the first place it would be essential that the Insurance Corporation be given charge of the liquidation of any collecting bank failing with proceeds in hand.123 Foreign items would clearly be ineligible. Moreover, it would probably be desirable also to give the Corporation some power in an administrative capacity to control the conditions under which collections are handled. Accordingly it would only be such items as are drawn on or are to be handled by banks to join the guaranty system which could be covered. But even so, the advantages

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the common law, a carrier could make such contract with the shipper as it saw fit. As a result, the initial carrier usually limited its liability to losses occurring on its own line.

122See the amazing case of Jacobs v. Mohnton Trust Co., 299 Pa. 527, 149 Atl. 587, 888 (1930), where indorsers were released through no fault of either the forwarding bank, the postal service or the collecting bank.

123The present federal act is set up on that basis.
to customers would be so obvious, it would seem, that no bank could well remain out of the system. It might well be possible, moreover, to develop a service whereby the Corporation could handle the customer's ordinary negligence claims on unpaid items or on items not included within the protection of the guaranty. While no banker particularly likes to have such an organization at hand to look down his collar, it would nevertheless serve to eliminate much of the customer's loss and uncertainty now prevailing, and without requiring recourse to litigation.

To draw so sharp a line between paid and unpaid items gives great prominence to what constitutes payment. It is all very well to speak of insuring the proceeds of a paid item and of preserving the usual contract rights on unpaid paper—including the drawer's claim to deposit insurance under the present law—but the courts have never charted the field very thoroughly in the bank cases. The uncertainty is particularly glaring where paper has been sent by mail to the drawee. The latter may hold items without doing anything for a day or so, or charge the drawer's account without making remittance by draft, or both charge and remit by draft but fail before its draft can be collected. Even the clearing house payment, involving millions of dollars daily, is uncer-

124The experience with the Federal Deposit Insurance Corporation is interesting. On December 31, 1935, insured commercial banks numbered 14,123, of which 5,386 were national banks and members of the Federal Reserve System, 1,001 were state bank members, and 7,736 were banks not members of the Federal Reserve System. While member banks constitute a minority of insured banks (6,387 as compared to 7,736), they account for almost nine-tenths of the resources of all insured commercial banks. The total number of banks reported upon was 15,836, of which 570 were mutual savings banks and 138 private banks. See 22 Fed. Res. Bul. 316, 395, 398, 399 (May, 1936).

125A further reason for differentiating paid from unpaid items lies here. If the drawer's item is unpaid and he is not discharged, it follows that he has all the rights of any depositor under the Deposit Insurance statute as to his deposit, if any.

126The Negotiable Instruments Law was drawn to fit the simple pattern of a personal presentment (§ 74) and a payment in cash (§ 88). There is obviously great need, not to amend, but to amplify the act, to cover the banking cases having to do with mail presentment and payment by book debit or by draft. Mr. Beutel objects to such provisions being adopted in a Collection Act. Beutel, loc. cit. supra note 42, at p. 384. But the Commissioners have been fully aware of the situation, and every effort, as Mr. Beutel knows, has been made to conform the Collection Act provisions to similar ones being prepared as amendments or additions to the present N. I. L. There is good precedent, as witness the bills of lading legislation, for a single provision to appear in several acts.

127The problem is discussed in detail in Turner, loc. cit. supra note 117, at p. 492 et seq.
tain on the decisions. Is payment final when the drawer's account is charged or only when the time fixed for returning unpaid items under clearing house rules has expired,—or even then? Of course here again the banker has wanted to keep things in his own hands, so that he may blow either hot or cold as seems best in the circumstances. But from the customer's viewpoint this alone is reason enough to require that the law be clarified.

There is one truly "vicious" situation left to consider. It gives rise to the question: What is to become of the collecting banker's lien on unpaid collection items? For many generations he has been accustomed to lay hold of customers' paper coming to his possession, as security for advances made to the forwarding bank. And, under the protection carefully worked out for bona fide, or innocent, or good faith purchasers of negotiable instruments, he not only may retain the paper, but may actually recover of the customer on his indorsement. The result is, that where an intermediate bank fails and the customer's bank charges the item back unpaid, the customer has his fingers badly burned. It is a complete loss. Almost the thing smacks of the jungle, when set off against a paternalistic effort to safeguard the forwarder of collection paper. Yet surely the collecting banker is as much entitled to plead his good faith as any other taker of negotiable paper. The answer probably lies in the customer's use of the restrictive indorsement, though it may be true that not one customer in ten has ever heard of such an indorsement. Still, why should not the forwarding banker likewise be charged with using a restrictive indorsement, unless, indeed, he obtains sufficient accommodation from the collecting bank to be willing to take the risk? Possibly

128 U. B. C. A. § 9, has a provision designed to clarify this point. See discussion, Fifth Tentative Draft of Uniform Bank Collection Code, loc. cit. supra note 98, at p. 167.

129 See, for example, Standard Trust Co. v. Commercial Nat. Bank, 240 Fed. 303 (C. C. A. 4th 1917), where the defendant drawee to which paper had been forwarded for collection delayed until after the drawer's account had been exhausted (a note of the drawer held by the bank having been charged to the account) and then returned the paper unpaid. Obviously it was liable for a breach of good faith, though ordinarily it is difficult for the forwarder to obtain the facts in such cases.

130 A typical leading case is Bank of the Metropolis v. New England Bank, 1 How. 234, 11 L. Ed. 115 (1843).

131 U. B. C. A. § 36 makes the further point that the forwarding bank should be charged with responsibility to convert bearer indorsements into special indorsements where that is possible.
the framers of the Banker's Code builted better than they knew when they made the "Pay any Bank or Banker" endorsement restrictive.

Without going into further detail, enough has been said at least to disclose the general scheme of the proposed legislation. The essential point, on which all else depends, is the elimination of loss through bank failure. Were we willing to reduce the number of our banks to a dozen or so, each with a nation wide branch system, as in England and Canada, that in itself would be one way to solve the thing. It would also eliminate much of the bickering as to which bank should assume what risks, if any. But a collection system built on such a structure should not be so strong, nor essentially so well conceived, as one brought within the protection of a guaranty statute; for if a failure should occur the ensuing credit rupture would be all the greater. Of course there is perhaps not sufficient actuarial data today on which to proceed with complete assurance, but neither was there when the private companies began writing fire and life insurance. At times, if not always, it is necessary to build experimentally.

The process of writing such a scheme into law is surprisingly complicated. In spite of all the political propaganda to the contrary today it is probable that our forefathers—had the matter come to their attention—would have lodged complete control of banking, including check collection, with the central government. That there should be a unified system as an economic matter no one denies, anymore than that the law pertaining to negotiable paper should be uniform. But under our present scheme, Congress must set up the insurance part of the plan, which would be effective at once as respects the national banks, and then hope that the state banks will voluntarily subscribe. As for the negligence risks, the states must assume the initiative, since Congressional

132 Bank failures have been far greater in this country than in countries having branch banking, whether or not there is any relation of cause and effect. Spahr, Bank Failures in the United States, 22 Am. Econ. Rev. Supp. 208, 215 (1932). But, whether this country should encourage a greater amount of branch banking is, of course, a separate question. See Gayer, Gold, Banks and the New Deal, 49 Pol. Sci. Quar. 481, 498 (1934).

133 But see Taggert and Jennings, The Insurance of Bank Deposits, 42 Jour. of Pol. Econ. 508 (1934).

134 Not, of course, for purposes of obstructing banking developments in the interest of justice to the depositor, but with the idea of freeing it from state legislation having that purpose. Probably the tables are turned now. See the brilliant study by Rodell, Fifty-Five Men (1936).
action, binding alone on national banks, might unduly penalize
them, before the state legislatures had acted. In fact it has
been this playing off of state against national legislation, by
the banker, which has done as much as any other thing to
block the development of a strong banking system in the
country.

The far sighted banker, however, should approve the intent
and purpose of the present proposal. With his own some-
what one sided effort at legislation blocked by the courts, or
badly crippled, he should now be willing to co-operate in a
broader effort. Some means must be found to eliminate the
waste and risk incident to the present collection process. And,
granting that the check has now become our principal medium
of exchange, there can be no more doubt of the appropriaten-
ness of governmental backing than there is in the case of
the bank note. That is, this all is true, if we actually want
a wholly sound currency system.