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The Souza and Helfend decisions could represent a major turning point for the future of the collateral source rule in California. Although there have been no indications that the holdings will be so extended, they could be extended to apply to individuals as well as governmental entities, so that the rule would virtually cease to exist. The question turns on the policy considerations of where the burden of compensation should lie, and the desirability of sanctioning double recovery by certain plaintiffs as against allowing the defendant to avoid full liability. The middle course, while perhaps not a total solution, is indemnification. The extremes are the abolition or the retention of the collateral source rule as it now exists for private defendants. Regardless of the outcome, Helfend has caused the option of abolition to be within easy grasp of the court.

MARVIN R. DUNLAP

Appellant Wright maintained a joint checking account with one Feinberg. The account was maintained with the respondent Bank of California so as to further a joint venture agreement between Wright and Feinberg. Feinberg fraudulently induced Wright to co-sign a check for $24,500 payable to March Construction Company, Inc., as partial payment of a contract associated with the joint venture. Feinberg knew that the payee would not accept partial payment on the above contract since he had been so informed by Kruley, the Secretary-Treasurer of March Construction. Feinberg took the check and offered it to Kruley who refused to accept it. Feinberg’s partner, Campanile, then went to the respondent bank where Campanile, falsely representing himself as the payee’s agent, presented the unendorsed check for payment. A forged application for a cashier’s check payable to March Construction Co. was presented at the same time with the request to receive payment in that form. Without requesting any identification of the purported agent of the payee, and without checking with the drawer as to the validity of the check, the bank made payment as requested. The joint account of Wright and Feinberg was then charged $24,500. After receipt of the cashier’s check, Campanile again offered it to Kruley who again refused to accept it. However, on the pretext of redepositing the check into the Wright-Feinberg joint account, a blank endorsement was obtained from Kruley. The cashier’s check was then presented to the Hayward National Bank which issued its own cashier’s check payable to Feinberg only. Feinberg then negotiated that check and diverted the funds to his own use. The complaint stated four causes of action against the Bank of California based on conversion, negligence, common count for money had and received, and declaratory relief. The superior court granted, without leave to amend, respondent bank’s general demurrer to all four causes of action.

On appeal to the California Court of Appeals, First District, held, reversed and remanded as to the second cause of action. Payment by drawee bank of an unendorsed personal check, by the issuance of a cashier’s check payable to the same corporate payee,

1. The reason Feinberg presented the check to Kruley is unclear. However, both appellant and respondent agreed that Feinberg had always intended to make the presentation. Opening Brief for Appellant at 3; Respondent’s Brief at 3.

2. Hayward National Bank was a party at the original hearing but is not involved in the present appellate action.

It is submitted that the correct result was reached but for the wrong reasons. The court first erred in testing the applicability of the California Commercial Code solely in reference to section 3405. Secondly, the court failed to apply the provisions of section 4103 as the standard of care with respect to the negligence action. And thirdly, the court erred in failing to recognize the controlling applicability of section 4401 which imposed a contractual duty upon the bank.

3. **CAL. COMM. CODE** (West 1964). All section references are to the **CAL. COMM. CODE** (West 1964).

4. **CAL. COMM. CODE** § 3405 (West 1964) states:
   - Imposters; Signature in Name of Payee. (1) An indorsement by any person in the name of a named payee is effective if
     - (a) An imposter by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee; or
     - (b) A person signing as or on behalf of a maker or drawer intends the payee to have no interest in the instrument; or
     - (c) An agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.
   - (2) Nothing in this section shall affect the criminal or civil liability of the person so indorsing. (Stats. 1963, c.819, § 3405.)

5. **CAL. COMM. CODE** § 4103 (West 1964) provides:
   - Variation by Agreement; Measure of Damages; Certain Action Constituting Ordinary Care. (1) The effect of the provisions of this division may be varied by agreement except that no agreement can disclaim a bank’s responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.
   - (2) . . .
   - (3) . . . action or nonaction consistent with clearinghouse rules and the like or with a general banking usage not disapproved by this division, prima facie constitutes the exercise of ordinary care.
   - (4) The specification or approval of certain procedures by this division does not constitute disapproval of other procedures which may be reasonable under the circumstances.
   - (5) . . .

6. **CAL. COMM. CODE** § 4401 (West 1964) states:
   - When Bank May Charge Customer’s Account. (1) As against its customer, a bank may charge against his account any item which is otherwise
Respondent drawee bank had maintained that payment of the check to Campanile was proper, arguing that the check was payable to a fictitious payee.\(^7\) With the adoption of the Uniform Commercial Code in California\(^8\) the fictitious payee doctrine is governed by section 3405. The court correctly noted\(^9\) that section 3405 is ineffective without an endorsement.\(^10\) Since payment of a negotiable instrument does not require an endorsement,\(^11\) it

properly payable from that account even though the charge creates an overdraft and in such event recover or obtain refund of the amount of the overdraft.

(2) A bank which in good faith makes payment to a holder may charge the indicated account of its customer according to
(a) The original tenor of his altered item; or
(b) The tenor of his completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper. (Stats. 1963, c.819, § 4401.)

7. Respondent drawee bank maintained that March was a fictitious payee arguing that Feinberg did not intend March to have any interest in the check. In this respect, the court first examined the question of whose intent controlled since Wright "did not share the intention that March Construction Company be merely a 'fictitious payee.'" 276 Adv. Cal. App. at 577, 81 Cal. Rptr. at 14. The court reaffirmed the rule regarding the divergent intent of joint makers, as stated in Goodyear Tire and Rubber Co. v. Wells Fargo Bank, 1 Cal. App. 2d 694, 37 P.2d 483 (1934), where the court stated:

[T]hat a maker or drawer of a check is bound in every instance where multiple signatures are required, by the intention of a single person with reference to such check when it is necessary for such a single person to do something in the making of the check essential to its validity which is done within the scope of the authority of such single person and when such single person is the person, who within the scope of this authority, actively creates the check or puts it into circulation.

Id. at 707, 37 P.2d at 488. Thus, the intention of only one of the co-makers to make the check payable to a fictitious payee is controlling with regard to the application of the fictitious payee doctrine.

8. The Uniform Commercial Code was adopted, as amended, by California and became effective on January 1, 1965.


10. CAL. COMM. CODE § 3405 (West 1964), Comment 1, amplifies the reasoning behind the endorsement requirement. It states, in part:

[T]he instrument is not made payable to bearer and indorsements are still necessary to negotiation. The section however recognizes as effective indorsement of the types of paper covered no matter by whom made. This solution is thought preferable to making such instruments bearer paper; on the face of things they are payable to order and a subsequent taker should require what purports to be a regular chain of indorsements. . . . To recapitulate: the instrument does not become bearer paper, a purportedly regular chain in indorsements is required, but any person—first thief, second imposter or third murderer—can effectively indorse in the name of the payee.

Additionally, it is apparent that the application is not sufficient to meet the requirements of an endorsement, as specified in CAL. COMM. CODE § 3203 (West 1964), because the signature was not on the check itself or on a paper attached thereto.

11. CAL. COMM. CODE § 3505 (West 1964) allows the drawee to "require
appears that section 3405 is applicable only to negotiations. Thus, the California Commercial Code is silent with respect to payment of a negotiable instrument and the possible application of the fictitious payee doctrine.

Although the appellate court correctly concluded that the answer to the question of respondent’s liability could not be found in section 3405, its involvement with the section initially was erroneous. It was clearly incorrect to accept the bank’s contention that March Construction Company was a fictitious payee since Feinberg had always intended that March was to have an opportunity to endorse the check. As pointed out in Pacific Indemnity Company v. Security First National Bank, it is not whether the named payee is to have an interest in the proceeds but whether he is “intended to receive the check itself and to place an endorsement thereon.”

Finding section 3405 inapplicable, the court improperly concluded “that the Commercial Code provisions do not either establish or negate respondent bank’s liability.” The court then looked to the alleged circumstances to determine if liability could be founded on negligence alone. The court applied general tort principles to the case and stated the issue:

[C]ould the facts pleaded possibly support a determination that loss to appellant was proximately caused by lack of due care on the part of respondent bank in dealing with appellant’s account and funds?

In this context a crucial factor to be remembered is that the cashier’s check was made payable to the same payee as the personal check. It can hardly be said that the respondent or its agents should have been clearly able to foresee the results of their action. However, as the court said:

But it is not impossible that Campanile’s possession of a cashier’s check induced Kruley to put on the check the writing,
construed by the Hayward bank as an endorsement, which enabled Feinberg to procure its negotiation. 16

Additionally, the appellant's contention that the issuance of the cashier's check "changed the nature of plaintiff's order" 17 seems to be well founded. It seems apparent that the check could not have been negotiated outright, without proper identification of the presentor and substantiation of the check by the drawers. Obtaining the cashier's check was critical to the fraudulent scheme of Feinberg and Campanile. Any attempt to receive payment, in cash, upon presentation of the personal check would have initiated immediate inquiries concerning the presentor's identity and authority to receive payment.

However, the court's reversal, based on common tort principles, ignores the applicable standard of care explicitly stated in section 4103. Specifically, the bank owes a duty of ordinary care as measured by general banking usage. 18 Conformity to general banking practices is prima facie evidence of ordinary care absent any agreements to the contrary. 19

It appears that the Bank of California did deviate from common banking practices by making payment by cashier's check to a corporate payee, 20 in failing to require identification of the presentor, 21 and in failing to demand proof of the agency relationship between the bank and the purported agent. 22 Furthermore, when the bank sought to escape liability on the basis that it did not "cash" the March check but only made payment as directed by the drawer, the court was presented with ample basis for holding that the bank was liable to the drawer for breach

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16. Id. at 580, 81 Cal. Rptr. at 15.
17. As the appellant pointed out:

Defendant Bank's negligent breaches of these duties was further compounded and enlarged by the fact that in making payment on plaintiff's check by issuing its cashier's check, defendant Bank changed the nature of plaintiff's order. In so substituting its own guaranty for plaintiff's defendant Bank made an irrevocable payment of plaintiff's funds, and thereby precluded plaintiff from issuing a stop-order, which is a statutory right, binding upon defendant Bank, should his check fall into the hands of a thief.

Opening Brief for Appellant at 14.
19. Id. § 4103(3).
20. Interview with W.F. VanHorn, Manager, Point Loma Branch of Bank of America, in San Diego, California, March 11, 1970.
21. Id.
of contract as well as for negligence. The bank had maintained that the check "was not ‘cashed’ in the sense that money was paid to the purported agent of the payee who presented the check, but rather was paid by means of a cashier’s check payable to the same payee." Even if the bank did not "cash" the check the fact remains that payment was made by a cashier’s check delivered to an imposter. California Commercial Code section 4401 clearly states that a drawee bank may charge to the customer’s account only those items properly payable from that account. The bank’s failure to meet this contractual obligation is obvious when it is considered that the bank was ordered to make payment to March Construction Company, not to an imposter claiming to be the payee’s agent. As was stated in Pacific Indemnity:

"The entire problem arises because of the heavy burden placed upon depository banks by their contractual agreement not to pay out their depositor’s funds except in strict accordance with his instructions. Where a depositor issues a check instructing the drawee bank to make a payment from his funds on deposit to a specified person, his account may not be charged for this amount unless this person actually endorses and negotiates this check."

The bank was under a clear duty to make payment only as ordered by the drawer, and its responsibility to fulfill this contractual obligation is rigid.

The appellate court dealt with this case solely on the basis of whether the facts alleged could constitute negligence. In this regard the court failed to apply the proper standard of care as expressed in section 4103. However, the correct result was probably reached because the bank’s conduct was apparently contrary to standard banking practices.

But more importantly, the court never came to the realization that the respondent bank violated its contractual duty when it failed to pay funds according to the strict order of Wright. In so failing this duty, the Bank of California is clearly liable under section 4401. It would have been more appropriate if the court’s decision had been based on the clear violation of this contractual duty rather than the alleged negligent conduct.

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24. 248 Cal. App. 2d at 87, 56 Cal. Rptr. at 150 (emphasis added).