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Notes & Comments

Sun 'n Sand, Inc. v. United California Bank: A New Approach to the Problem of Drawer v. Collecting Bank

By Jonathan Paul Williams*

Introduction

A problem which has arisen persistently in litigation dealing with commercial paper is whether to allow the drawer1 of a forged or materially altered check2 to bring an action to recover the amount of the check from a collecting bank which has received a settlement for the item. Articles Three and Four of the Uniform Commercial Code (U.C.C. or Code), drafted against a background of common law decisions, state and federal statutes, and banking rules and customs,3 were intended to provide a system of rules for governing transactions involv-

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1. The term "drawer" refers to the party who writes (draws) a check. The check serves as an order to the "drawee bank" to pay a specified sum to the order of the "payee" named on the check and to charge the amount of the check against the drawer's account. The payee may cash or deposit the check with a bank other than the drawee bank; such a bank acts as a "collecting bank" which transmits the check, either directly or through one or more other collecting banks, to the drawee bank which pays the item.

2. U.C.C. § 1-201(43) defines an unauthorized signature or indorsement as "one made without actual, implied or apparent authority" and as including a forgery. In the case of a check the unauthorized signature may be that of the drawer, the payee, or other indorser.

ing negotiable instruments. Working within the context of an almost infinite number of combinations of parties and factual situations, the drafters of Articles Three and Four unfortunately failed to deal expressly with the remedies available to the drawer against a collecting bank. In a recent case, Sun 'n Sand, Inc. v. United California Bank, the California Supreme Court held that the warranties on presentment found in sections 3-417 and 4-207 of the California Commercial Code,
normally available in an action by the drawee bank against a collecting bank, are also available to the drawer of a check whose account is charged by its bank with the amount of the check. This holding allows the drawer to maintain a direct action against a collecting bank to recover the amount of a forged or materially altered instrument. The court in *Sun 'n Sand* also acknowledged the drawer’s right, under the particular circumstances presented by the case, to proceed directly against the collecting bank upon theories of negligence and mistake of fact. The major import of the court’s decision, however, is the holding that the Code authorizes an action by the drawer based upon warranty, not only because of the limitation of the other theories of recovery to certain factual situations, but also because the availability of the warranty cause of action creates the possibility of liability without fault on the part of the collecting bank.

To hold that the drawer of a check is a “payor” or “person who in good faith pays” a check within the language creating the presentment warranties, the court was forced to distort the concept of “payment” as it is generally understood in the banking community. This Note analyzes the supreme court’s construction of the language of the Code as well as the various policy considerations which reflect on the soundness of its holding. Analysis shows that not only is the court’s stated objective of avoiding a multiplicity of suits adequately met by presently available procedural alternatives to the direct action, the court’s holding actually may result in an increased volume of commercial paper litigation. Furthermore, the protection which the court’s holding affords drawee banks, by allowing the drawer to bypass the drawee and directly sue the collecting bank, is more than offset by the resulting impairment of the substantive rights of collecting banks.

(iii) To an acceptor of an item if the holder in due course took the item after the acceptance or obtained the acceptance without knowledge that the drawer’s signature was unauthorized; and

(e) The item has not been materially altered, except that this warranty is not given by any customer or collecting bank that is a holder in due course and acts in good faith

(i) To the maker of a note; or

(ii) To the drawer of a draft whether or not the drawer is also the drawee; or

(iii) To the acceptor of an item with respect to an alteration made prior to the acceptance if the holder in due course took the item after the acceptance, even though the acceptance provided ‘payable as originally drawn’ or equivalent terms; or

(iv) To the acceptor of an item with respect to an alteration made after the acceptance.” *Cal. Com. Code § 4207(1)* (West 1964).

Sections 3417 and 4207 of the California Commercial Code adopted without change §§ 3-417 and 4-207 of the Uniform Commercial Code (U.C.C.). For convenience, this Note will use the U.C.C. system of notation.
History of the Direct Action Controversy

The Traditional Loss Allocation Scheme

The allocation of loss on a forged or altered instrument generally has involved a series of lawsuits.8 The right of the drawer to force the drawee bank to recredit its account, based on the drawee's contractual obligation to pay only in accordance with its depositor's orders, is well established both under the common law9 and the U.C.C.10 Equally well established is the right of the drawee bank, in the case of a forged endorsement or a material alteration of the instrument, to shift the loss to the collecting bank as the party dealing directly with the forger.11 The net result in cases involving a forged endorsement or a material alteration is that the ultimate loss is placed on the collecting bank. Under the doctrine of Price v. Neal,12 however, a different result obtains where the drawer's signature is forged, as the drawee generally must shoulder the loss without recourse against the collecting bank.13

11. H. Bailey, supra note 5, at 439-40, 485; W. Britton, supra note 9, at 392-93, 399. Recovery at common law generally was based upon a theory of mutual mistake of fact. Id.; H. Bailey, supra note 5, at 439, 484; J. Clarke, H. Bailey & R. Young, Bank Deposits and Collections 132 (4th ed. 1972). In the case of forged indorsements recovery also was based upon a collecting bank's guarantee of prior indorsements. Id.; H. Bailey, supra note 5, at 485.

Recovery under the U.C.C. is based upon warranty theory; the general result accords with prior law. H. Bailey, supra note 5, at 441, 487; J. Clarke, H. Bailey & R. Young, supra, at 132. U.C.C. § 3-418 reads: "Except for recovery of bank payments as provided in the article on bank deposits and collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section [§ 3-417], payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment." The warranties of subsections 3-417(1)(a) and 3-417(1)(c) and the parallel warranties of subsections 4-207(1)(a) and 4-207(1)(c) permit recovery by the drawee for a breach of the warranty of good title—which applies to forged indorsements—and the warranty against material alteration.
13. The difference in treatment afforded different types of forgeries has been justified on a number of grounds. W. Britton, supra note 9, at 377-78; Ames, The Doctrine of Price v. Neal, 4 Harv. L. Rev. 297, 298-300 (1891). The reason most often given is that the drawee is in a position to verify the drawer's signature in the case of a forged check, while the collecting bank has a better opportunity, because it deals directly with the forger to
Direct Suit by the Drawer Prior to the U.C.C.

Prior to the widespread adoption of the U.C.C., there was a split of authority among courts which had addressed the issue of a direct suit by a drawer against a collecting bank. The majority of jurisdictions allowed the direct action; however, the theories of recovery often differed, sometimes based on quasi-contract for money had and received and sometimes based on tort for conversion. In contrast, recovery generally was denied when the cause of action was based upon the collecting bank’s warranty of prior endorsements. Since warranty liability is grounded on contractual principles, and because there is no privity of contract between a drawer and a collecting bank, common law courts held that the warranty theory was not available to a drawer.

The California Supreme Court first faced the problem of whether to allow the direct suit in 1950, in California Mill Supply Corp. v. Bank...
of America. The plaintiff, California Mill Supply, was the drawer of a series of checks issued to fictitious payees upon the fraudulent representations of one of its employees. The employee forged the endorsements and cashed the checks at the defendant collecting bank. The defendant endorsed the checks and obtained a settlement from the drawee bank which debited plaintiff's account. Because the plaintiff was precluded by the statute of limitations from maintaining an action against the drawee bank, the court was squarely confronted with the issue of the right of direct action. Observing that the authorities were hopelessly in conflict on the question, the court decided to follow the reasoning of an earlier California Court of Appeal case which had denied recovery under similar circumstances, and consequently adopted the rule that the drawer has no right of direct action against the collecting bank for loss on a check bearing a forged indorsement.

Direct Suit Under the U.C.C. in California

After the adoption of the U.C.C. in 1963, the first California decision to address the direct suit issue was Allied Concord Financial Corp. v. Bank of America. The case involved a check drawn by plaintiff Allied Concord which was intercepted by the brother of the payee, who forged his brother's signature and obtained payment from the defendant collecting bank. The defendant, in turn, forwarded the check through normal banking channels to the drawee bank which charged plaintiff's account. Although both the plaintiff drawer and the drawee bank were located in New York, the plaintiff chose to sue the collecting

20. California Code of Civil Procedure § 340(3) provides for a one year statute of limitations in actions "by a depositor against a bank for the payment of a forged or raised check, or a check that bears a forged or unauthorized endorsement . . . ." CAL. CIV. PROC. CODE § 340(3) (West 1979) (emphasis added). Because the plaintiff was not a depositor of the collecting bank, presumably the longer statutes of limitations applicable to actions for conversion, breach of warranty of prior indorsements, or money had and received did not preclude the direct action. See CAL. CIV. PROC. CODE §§ 338(3); 339(1) (West 1979).
21. 36 Cal. 2d at 341, 223 P.2d at 853.
22. Metropolitan Life Ins. Co. v. San Francisco Bank, 58 Cal. App. 2d 528, 136 P.2d 853 (1943), also involved checks payable to a fictitious payee. The court of appeal held that the collecting bank's guarantee of prior indorsements was "addressed to the drawee bank and subsequent holders in due course" rather than to the drawer. Id. at 532, 136 P.2d at 855. The court further held that the money paid by the drawee to the collecting bank was the drawee bank's money rather than the drawer's; therefore, the collecting bank held nothing of value belonging to the drawer which could form the basis of an action for conversion. Id. at 533-34, 136 P.2d at 855-56. The court distinguished earlier California decisions cited by the plaintiff, which had allowed recovery by the drawer, on the grounds that the drawer in one case was also the drawee and in the other case was the trustee of the payee. Id. at 531-32, 136 P.2d at 854-55.
23. 36 Cal. 2d at 341, 223 P.2d at 853.
bank located in California.  

Justice Fleming, writing for the court in Allied Concord, noted that the supreme court's ruling in California Mill Supply tended to promote circuity of action, which the modern trend of procedure disfavored.  

To avoid this result the court held that the benefit of the warranties of sections 3-417 and 4-207 of the Code should extend to the drawer of a check under traditional third party beneficiary principles, thus allowing the direct suit against the collecting bank. The court also held, however, that because the drawer's rights against the collecting bank under third party beneficiary principles derive from the drawee's rights, the collecting bank should have the benefit of any defenses which would be available to the drawee bank in an action by the drawer, including the applicable statute of limitations. Because the statute of limitations barred an action by the drawer, the court's holding regarding the availability of the warranties was a fruitless victory for the plaintiff.

The court's resolution of the direct suit question on the basis of third party beneficiary principles does not withstand critical analysis.

25. The plaintiff was heavily indebted to the drawee bank and was afraid that it might be called upon to pay its loans if it demanded that the bank recredit its account.  

26. 275 Cal. App. 2d at 3, 80 Cal. Rptr. at 624.  

27. Id. at 5-7, 80 Cal. Rptr. at 624-26. The court based its holding upon subsections (4) and (5) of U.C.C. § 4-406. Subsection (4) requires a customer to report unauthorized signatures or alterations to the drawee bank within absolute time limits or be precluded from asserting a claim against the bank. Subsection (5) provides in effect that the drawee bank may not waive a defense based upon the customer's laches and pass the loss on to the collecting bank. See text accompanying notes 54-55 infra. California Commercial Code § 4406, Comment 7, states that the effect of subsection (5) "is to extend the protection of subdivision (4) to collecting banks." CAL. COM. CODE § 4406, Comment 7 (West 1954). The court reasoned that "[i]n allowing direct suit by the drawer against . . . collecting banks, we would be emasculating [§ 4-406] if we did not also make available to . . . collecting banks defenses available to the drawee bank." 275 Cal. App. 2d at 6, 80 Cal. Rptr. at 626. The court therefore concluded that the defenses available to the drawee bank under § 4-406(4) are also available to collecting banks. Id. at 7, 80 Cal. Rptr. at 626.

28. U.C.C. § 4-406(4) establishes a three year time limit within which the drawer must discover and report a forged indorsement to the drawee bank or be precluded from asserting a claim against the bank. This subsection was modified in California to provide for a one year time limit similar to that of California Code of Civil Procedure § 340(3). CAL. COM. CODE § 4406, Comment 8 (West 1964). The court in Allied Concord stated: "Since Allied is barred from recovery in California against the drawee bank by section 4406, subdivision (4), it cannot recover from [the collecting bank] on a third-party beneficiary warranty after a period of one year." 275 Cal. App. 2d at 7, 80 Cal. Rptr. at 626. The drawee bank in this case, however, was located in New York. If the court had looked to the New York version of the Code, presumably a different result would have been reached, since New York retains the original three year time limit for actions based on forged indorsements. N.Y. U.C.C. § 4-406(4) (McKinney 1964). See E. FARNSWORTH & J. HONNOLD, CASES AND MATERIALS ON COMMERCIAL LAW 331 n.3 (3d ed. 1976).
Third party beneficiary doctrine focuses on the intentions of the individual parties to a contract. In the context of a statutory warranty, however, the intentions of the parties are not controlling; rather, the intention of the drafters defines the scope of the warranty. If the drafters of the Code had intended the drawer to benefit from the presentment warranties, in all likelihood they would have expressly extended those warranties to the drawer instead of leaving it for the courts to do so by construction. Rather, it would appear clear that the warranties in question were created for the benefit of the drawee bank so that it could recover from the collecting bank in the event that it was required to recredit the drawer's account after payment on a forged indorsement or on a materially altered check. Therefore, it cannot properly be said that the drawer, as an intended beneficiary, can utilize the warranties of sections 3-417 and 4-207 based on third party beneficiary principles. In spite of the lack of a sound theoretical foundation, the holding in Allied Concord remained the only basis for a direct action in California until the supreme court undertook to establish a more defensible justification for allowing the drawer to utilize the Code's presentment warranties.

**Sun 'n Sand**

The Factual Setting

In 1978, Sun 'n Sand, Inc. v. United California Bank presented the California Supreme Court with the opportunity to reexamine the rule it had established in California Mill Supply in light of California's adoption of the U.C.C. and the court of appeal decision in Allied Concord. The controversy in Sun 'n Sand arose out of a scheme by a Sun 'n Sand employee to embezzle funds through the manipulation of company checks.

As part of her duties at Sun 'n Sand, Eloise Morales prepared checks to be signed by a corporate officer. Over a three year period Ms. Morales prepared nine checks, each for a relatively small amount, payable to defendant United California Bank (UCB). She obtained authorized signatures on each of the checks from a Sun 'n Sand officer who believed the sums represented were owed by Sun 'n Sand to defendant. In fact, no such debts were owed. Morales then altered the checks, in each case increasing the amount by several thousand dollars, and presented them to UCB. Although UCB was the named payee, the

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29. See Restatement (Second) of Contracts §§ 133, 135, 147 (1973), which provide that only an intended beneficiary may enforce an agreement to which he or she is not a party.
30. See Direct Suit, supra note 14, at 114. Under the doctrine of Price v. Neal, the drawee bank bears the loss in cases where the drawer's signature is forged. See notes 12-13 & accompanying text supra.
bank, upon Morales' request, credited the amounts to her personal account. UCB indorsed the checks and presented them to Union Bank, where Sun 'n Sand maintained its account. Union Bank paid the checks and charged Sun 'n Sand for the face amounts. Because Morales concealed her actions by manipulating company records, Sun 'n Sand did not discover the scheme until three months after the ninth transaction.

Sun 'n Sand brought an action against UCB and Union Bank to recover the total amount of the nine checks based on alternative theories of mistake of fact, fraudulent misrepresentation, negligence, breach of warranty against material alteration, and breach of warranty of good title. The trial court sustained UCB's demurrer on the grounds that Sun 'n Sand had failed to state facts sufficient to constitute a cause of action, that some or all of the counts were barred by the statute of limitations, and that UCB, as payee, owed no duty to Sun 'n Sand. The court ordered the case against UCB dismissed and Sun 'n Sand appealed that order.

The Drawer's Right to Utilize the Code's Warranties on Presentment

The first issue addressed by the supreme court was Sun 'n Sand's right, as the drawer of the checks in question, to invoke the warranty provisions of California Commercial Code sections 3-417 and 4-207. Like the court in Allied Concord, the supreme court initially noted that the rule of California Mill Supply, denying a drawer the right of direct action against a collecting bank, "conflict[ed] with the objective of avoiding multiple suits." The court, however, found it "unneces-

32. The facts as set forth in the opinion in Sun 'n Sand offer no explanation for what would seem to be highly questionable behavior on the part of the bank. Indeed, the court held that the transaction as alleged was so irregular that Sun 'n Sand had stated a valid cause of action for negligence. See text accompanying notes 69-70 infra.

33. 21 Cal. 3d at 679, 582 P.2d at 926, 148 Cal. Rptr. at 335.

34. Sun 'n Sand invoked § 3-417 on the basis of UCB's status as named payee on the checks and predicated liability under § 4-207 on the bank's activity as a collecting bank. 21 Cal. 3d at 680, 582 P.2d at 926-27, 148 Cal. Rptr. at 335-36. As a practical matter, both sections are applicable to most transfers in the bank collection process. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 512 n.40 (1972). [hereinafter cited as J. WHITE & R. SUMMERS].

35. See note 26 & accompanying text supra.

36. 21 Cal. 3d at 681, 582 P.2d at 927, 148 Cal. Rptr. at 336. The court noted: "In determining whether the drawer of a check is among those to whom the statutory warranties of [§§ 3-417 and 4-207] were intended to be extended, we are guided by our observation in Cooper v. Union Bank [9 Cal. 3d 371, 381-82, 507 P.2d 609, 617, 107 Cal. Rptr. 1, 9 (1973)]: "Requiring cumbersome and uneconomical circuity of action to achieve an identical result would obviously run contra the code's explicit underlying purposes "to simplify, clarify and modernize the law governing commercial transactions." ([§ 1-102(2)(a)).'" 21 Cal. 3d at 681, 582 P.2d at 927, 148 Cal. Rptr. at 336.
sary" to rely on third party beneficiary principles as a means of extending the benefits of the presentment warranties to the drawer. Instead it interpreted the language of the Code itself to authorize drawer utilization of those warranties.

The court's analysis of the Code centered on section 4-207(1), which provides that a collecting bank makes certain warranties to the "payor bank or other payor who in good faith pays or accepts [an] item." To make the warranties available to the drawer, the court was forced to fit the drawer within the "other payor" language of this provision. The court recognized that the term "payor" generally refers to the drawee rather than the drawer of a check, but refused to limit the term to a narrow, technical meaning. The term is not defined in the Code, and therefore the court concluded that it should not be regarded as a term of art. Analyzing the matter as a layperson might view it, the court found that, in fact, the drawer does ultimately "pay," in the Code sense of the term, when the drawee bank charges his or her account in the amount of a check. Based on this simplistic reasoning the court concluded that the drawer should be considered an "other payor" for the purpose of invoking the presentment warranties of section 4-207.

The court supported its conclusion that the drawer is an "other payor" by referring to the structure of section 4-207 and certain language in the official comments. The warranties of subsections (1)(b) and (1)(c) of section 4-207 are subject to a number of exceptions which operate in favor of a holder in due course who acts in good faith. Specifically, the holder in due course does not make these warranties to the drawer of a check, "whether or not the drawer is also the drawee." The court in *Sun 'n Sand* reasoned, "by negative implication," that the warranties are given to the drawer by a collecting bank which is not a holder in due course or which does not act in good faith. Because the exception applies "whether or not the drawer is also the drawee," the court concluded that its holding was applicable to drawers in general and not just in the situation where a bank draws a check on itself and is thus both the drawer and the drawee (payor) bank.

Apparently convinced that its construction of the payor concept rested on solid footing in regard to subsections (1)(b) and (1)(c), the court summarily concluded that the warranty of section 4-207(1)(a), which is not subject to a comparable exception, is also available to the

37. 21 Cal. 3d at 681, 582 P.2d at 928, 148 Cal. Rptr. at 337.
38. CAL. COM. CODE § 4207(1) (West 1964); U.C.C. § 4-207(1).
39. 21 Cal. 3d at 682, 582 P.2d at 928, 148 Cal. Rptr. at 337.
40. Id. at 682-83, 582 P.2d at 928, 148 Cal. Rptr. at 337.
41. U.C.C. §§ 3-417(1)(b)(ii), (1)(c)(ii); 4-207(1)(b)(ii), (1)(c)(ii).
42. 21 Cal. 3d at 682, 582 P.2d at 928, 148 Cal. Rptr. at 337.
43. U.C.C. § 4-207(1)(b)(ii), (1)(c)(ii).
44. 21 Cal. 3d at 682, 582 P.2d at 928, 148 Cal. Rptr. at 337.
drawer.45

In further support of its holding, the court cited the following language from the official comment to the Code: "[U]nder subparagraph (ii) a drawer of a draft is presumed to know his own signature and if he fails to detect a forgery of his signature and pays a draft he may not recover that payment from a holder in due course acting in good faith."46 The court interpreted this comment as the drafters’ implicit recognition that the drawer “pays” when his or her account is debited in the amount of a check and therefore should benefit from the presentment warranties set forth in the Code.47

Without further discussion, the court also found that the drawer of a check is a “person who in good faith pays” within the purview of section 3-417.48 Thus, the warranties of that section, virtually identical to those of section 4-207,49 were held applicable in an action against the person obtaining payment on a check.

The Availability of Defenses to the Collecting Bank

Having determined that the drawer may proceed directly against the collecting bank, the supreme court realized, like the court of appeal in Allied Concord, that the collecting bank must, in fairness, be afforded the protection of the defenses which normally would be available to the drawee bank in an action by the drawer.50

The two major defenses normally available to the drawee bank are set forth in sections 3-406 and 4-406 of the Code. Section 3-406 excludes a party whose negligence substantially contributed to a forgery or material alteration from asserting a claim against a “holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee’s or payor’s business.”51 Noting the absence of any suggestion in the Code that the same defense should not be available to the collecting bank, and again stressing that the term “payor” was not to be construed narrowly, the court held that a collecting bank is an “other payor” for the purposes of section 3-406.52 The collecting bank

45. Id.
46. Id. (quoting from U.C.C. § 3-417, Comment 4) (emphasis added). The official comment to § 3-417 applies to § 4-207. U.C.C. § 4-207, Comments 1, 4.
47. 21 Cal. 3d at 682-83, 582 P.2d at 928, 148 Cal. Rptr. at 337.
48. Id. at 683, 582 P.2d at 928, 148 Cal. Rptr. at 337.
49. See note 7 supra.
50. 21 Cal. 3d at 683-84, 582 P.2d at 929, 148 Cal. Rptr. at 338. See note 27 & accompanying text supra.
51. U.C.C. § 3-406.
52. 21 Cal. 3d at 683, 582 P.2d at 929, 148 Cal. Rptr. at 338. The bank would not qualify as a holder in due course for the purposes of U.C.C. § 3-406 because, in the case of a forged indorsement, the unauthorized signature would be ineffective for purposes of negoti-
would therefore be able to raise the drawer's negligence as a bar to recovery in a direct action.

Section 4-406 of the Code involves the customer's duty to examine his or her account statement and cancelled checks and to report any unauthorized signatures or alterations.53 Under certain circumstances, the customer's failure to comply with this duty precludes him or her from asserting a claim against the drawee bank.54 Subsection (5) of section 4-406 provides that if the drawee bank "waives or fails upon request to assert" a valid defense against the drawer under that section it cannot assert a claim against the collecting bank based on the same forgery or alteration that was the basis of the drawer's claim. The supreme court inferred from this provision that the defenses of section 4-406 are available to a collecting bank in a direct action by the drawer.55

Application of the New Warranty Rules to Sun 'n Sand's Cause of Action

Having concluded that a drawer could invoke the warranties of sections 3-417 and 4-207, the court addressed the question of whether Sun 'n Sand had alleged facts sufficient to constitute a breach of those

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53. U.C.C. § 4-406(1) reads: "When a bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries or holds the statement and items pursuant to a request or instructions of its customer or otherwise in a reasonable manner makes the statement and items available to the customer, the customer must exercise reasonable care and promptness to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof."

54. U.C.C. § 4-406(2)(a) provides: "If the bank establishes that the customer failed with respect to an item to comply with the duties imposed on the customer by subsection (1) the customer is precluded from asserting against the bank . . . his unauthorized signature or any alteration on the item if the bank also establishes that it suffered a loss by reason of such failure . . . ." U.C.C. § 4-406(3), however, limits the scope of this subsection by providing that "[t]he preclusion under subsection (2) does not apply if the customer establishes lack of ordinary care on the part of the bank in paying the item(s)." U.C.C. § 4-406(4) establishes absolute time limits within which the drawer must report forgeries and alterations: "Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration." This subsection is modified in California to provide for a one year time limit in the case of forged indorsements as well as forgeries of the drawer's signature and alterations. CAL. COM. CODE § 4406(4) (West 1964).

55. 21 Cal. 3d at 684, 582 P.2d at 929, 148 Cal. Rptr. at 338. The supreme court cited with approval the appellate court's analysis of § 4-406 in Allied Concord. See note 27 & accompanying text supra.
In September 1979, Sun 'n Sand alleged a breach of the good title warranties of sections 3-417(1)(a) and 4-207(1)(a). Following the weight of authority, the court held that the warranties of those sections deal only with the validity of the chain of necessary indorsements. Because the checks in question were made payable to UCB, the transaction between Morales and the bank involved no question of forged indorsements. Accordingly, the court upheld the dismissal of the counts based on the good title warranties.

In addition to the warranty of good title, Sun 'n Sand alleged a breach of the warranties against material alteration found in California Commercial Code sections 3-417(1)(c) and 4-207(1)(c). As noted above, these warranties are subject to an exception which precludes the drawer of a check from asserting a material alteration against a holder in due course who acts in good faith. Section 3-302 of the Code sets forth the qualifications of a holder in due course. One requirement is that the holder take the instrument "without notice . . . of any defense against or claim to it on the part of any person." The court found that the transfer by Morales of the checks payable to UCB was sufficiently irregular as to create "an ambiguity as to the proper disbursement of the funds represented by the checks." This ambiguity precluded UCB from relying on the holder in due course exception. The court concluded that Sun 'n Sand had stated a valid cause of action to recover the difference between the raised amount and the original amount of the checks.

57. 21 Cal. 3d at 687, 582 P.2d at 931, 148 Cal. Rptr. at 340.
58. Id. at 687, 582 P.2d at 931-32, 148 Cal. Rptr. at 340-41.
59. See text accompanying notes 41-45 supra.
60. U.C.C. § 3-302(1) reads: “A holder in due course is a holder who takes the instrument (a) for value; and (b) in good faith; and (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.”
61. U.C.C. § 3-302(1)(c).
62. 21 Cal. 3d at 690, 582 P.2d at 933, 148 Cal. Rptr. at 342.
63. Id. Analysis of the supreme court’s treatment of UCB’s status as a holder in due course is beyond the scope of this Note. For an introduction to the complexities of the holder in due course problem see H. BAILEY, supra note 5, at 113-47; W. BRITTON, supra note 9, at 210-327; J. WHITE & R. SUMMERS, supra note 34, at 456-91.
64. 21 Cal. 3d at 690-91, 582 P.2d at 933-34, 148 Cal. Rptr. at 342-43. U.C.C. § 4-401(2)(a) provides that “[a] bank which in good faith makes payment to a holder may charge the indicated account of its customer according to . . . the original tenor of his altered item . . . .” Accordingly, the court concluded that “[t]he wrong for which [Sun ‘n Sand] seeks to recover under this cause of action is negotiation by UCB in an excessive amount . . . .” 21 Cal. 3d at 690, 582 P.2d at 934, 148 Cal. Rptr. at 343. Recovery on a number of the checks
Other Theories of Recovery

After considering the counts based on warranties, the supreme court addressed the remaining counts set forth in Sun 'n Sand's complaint. In doing so the court did not reexamine the direct suit issue in conjunction with each proposed theory of recovery. Because of its dissatisfaction with the rule of California Mill Supply, and in light of its general objective in allowing the direct action—that of avoiding a multiplicity of suits the court apparently felt it had eliminated any objections to maintaining a direct suit per se. As the following discussion indicates, however, the availability of additional theories as the basis for a direct action is of minimal importance because of limitations inherent in the nature of the actions and because of other restrictions imposed by the court.

In addition to its allegation that UCB breached the warranties on presentment, Sun 'n Sand alleged that UCB was negligent in allowing Morales to deposit checks made payable to the bank in her personal account. In response UCB contended that the Code provided an exclusive remedy and that it owed no duty to Sun 'n Sand to make inquiries before giving Morales credit for the checks. The court responded to UCB's first claim by referring to section 1-103, which provides that the Code is supplemented by traditional principles of law and equity unless such principles are displaced by the application of particular Code sections. The court found that none of the provisions of the Code were directly applicable to the circumstances of the case and that therefore the Code did not preclude Sun 'n Sand's action based on negligence. The court responded to UCB's claim that it owed no duty by

was barred by the statute of limitations. Id. at 691-92, 582 P.2d at 934-35, 148 Cal. Rptr. at 343-44.

65. See note 36 & accompanying text supra.
66. 21 Cal. 3d at 696, 582 P.2d at 937, 148 Cal. Rptr. at 346.
67. Id. at 693, 582 P.2d at 935, 148 Cal. Rptr. at 344.
68. U.C.C. § 3-405(1)(c) provides that "[a]n indorsement by any person in the name of a named payee is effective if . . . an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no . . . interest [in the instrument]." The supreme court held that this provision was not applicable where, as in the instant case, the checks were actually presented to the named payee. 21 Cal. 3d at 696, 582 P.2d at 937, 148 Cal. Rptr. at 346.

U.C.C. § 3-418 provides that, subject to the possibility of recovery for a breach of the warranties on presentment, payment of an item is final in favor of a holder in due course or one who changes his or her position in reliance on such payment. See note 11 supra. Because the court had already determined that UCB, under the facts alleged, had taken the checks with notice, see notes 59-63 & accompanying text supra, it dispensed with the claim that the bank, as a holder in due course, took free of a common law action for negligence. 21 Cal. 3d at 696-97, 528 P.2d at 937-38, 148 Cal. Rptr. at 346-47. But see Fireman's Fund Ins. Co. v. Security Pac. Nat'l Bank, 85 Cal. App. 3d 797, 149 Cal. Rptr. 883 (1978), where the Court of Appeal for the Second District held that § 3-418 of the Code precluded plaintiff
citing previous California cases in which a bank named as the payee of a check had been held negligent for failing to investigate before allowing a dishonest agent to divert the proceeds of the check to his or her personal account. After observing that foreseeability of harm is the main consideration in finding a duty to use due care, the court concluded that Sun 'n Sand's loss was reasonably foreseeable in light of the irregularity in the transfer of the checks. The court, however, was careful to limit narrowly the scope of the bank's duty:

[I]t is activated only when checks, not insignificant in amount, are drawn payable to the order of a bank and are presented to the payee bank by a third party seeking to negotiate the checks for his own benefit. . . . There must be objective indicia from which the bank could reasonably conclude that the party presenting the check is authorized to transact in the manner proposed. In the absence of such indicia the bank pays at its peril.

Because no “objective indicia” appeared from the facts as alleged, Sun 'n Sand was held to have stated a valid cause of action for negligence.

drawer from maintaining a common law action for negligence against the defendant collecting bank. The Sun 'n Sand decision was distinguished on two grounds: (1) in Sun 'n Sand the collecting bank was also the named payee of the checks; and (2) in Fireman's Fund the drawer's signature was forged, bringing into play the doctrine of Price v. Neal as codified in § 3-418. 85 Cal. App. 3d at 813-14, 149 Cal. Rptr. at 895.

69. 21 Cal. 3d at 693-94, 582 P.2d at 935-36, 148 Cal. Rptr. at 344-45. The court cited Pacific Fin. Corp. v. Bank of Yolo, 215 Cal. 357, 10 P.2d 68 (1932), and Pacific Indem. Co. v. Security First Nat'l Bank, 248 Cal. App. 2d 75, 56 Cal. Rptr. 142 (1967). In each of these cases the checks bore a notation as to the intended use of the proceeds. 215 Cal. at 358-59, 10 P.2d at 69-70; 248 Cal. App. 2d at 79-80, 56 Cal. Rptr. at 145. The cases are therefore factually distinguishable from Sun 'n Sand, where nothing on the face of the instruments suggested that the transfer by Morales was irregular. The supreme court did not address this factual distinction.

It is also interesting to note that the direct suit issue did not arise in the Bank of Yolo and Pacific Indemnity cases. The courts in those cases did not treat the defendants as collecting banks, although their positions in the underlying transactions were similar to that of UCB in Sun 'n Sand. Presumably, this was because liability was premised on the banks' status as named payees on the checks in question. UCB itself contended that it was not a collecting bank and therefore could not be liable for breach of the presentment warranties. 21 Cal. 3d at 680 n.5, 582 P.2d at 927, 148 Cal. Rptr. at 336. U.C.C. § 4-105, Comment 1, indicates that the definition of a collecting bank does not include a bank to which an item is issued. However, such exclusion is not applicable where “the item is issued to a payee for collection.” U.C.C. § 4-105, Comment 1. The supreme court stated: “The facts alleged herein, if true, establish that UCB treated the checks as though it was merely a nominal payee, named as such to facilitate collection. Thus, it may not successfully demur on the ground that it was not a collecting bank.” 21 Cal. 3d at 680 n.5, 582 P.2d at 927, 148 Cal. Rptr. at 336.

70. 21 Cal. 3d at 695, 582 P.2d at 937, 148 Cal. Rptr. at 346.

71. Id. at 695-96, 582 P.2d at 937, 148 Cal. Rptr. at 346.

72. Recovery on some of the checks was barred by the statute of limitations. Analysis of the court's holding that neither California Commercial Code § 4406(4) nor California Code of Civil Procedure § 340 applies to an action in negligence is beyond the scope of this Note.
The court also determined that Sun ’n Sand had alleged a viable claim for equitable relief based on restitution of money paid under a mistake of fact, subject to UCB’s right to show that it had changed its position upon payment thereby making it unjust to require it to refund the money. Finally, Sun ’n Sand’s cause of action based on fraudulent misrepresentation was deemed defective due to a failure to allege adequately either knowledge on the part of UCB that Morales lacked the right to negotiate the checks or the intent to deceive Sun ’n Sand by failing to advise it of the irregularities in the transaction.

In summary, Sun ’n Sand, as the drawer of the checks, was held entitled to maintain an action against UCB, as the collecting bank and named payee on the checks, based upon breach of the warranties on presentment, negligence, and mistake of fact. UCB, in turn, was held entitled to raise any defenses normally available to the drawee bank in an action by the drawer. The most significant of the holdings with respect to the general problem of direct suit by a drawer against a collecting bank relates to the drawer’s utilization of the warranties on presentment. In contrast to the limited applicability of the other theories of recovery, the availability of the presentment warranties allows the drawer to maintain an action against a collecting bank in the relatively common case in which the bank cashes a check bearing a forged indorsement. Equally important is the fact that an action based on warranty principles is virtually the same as a strict liability action—the drawer need not establish fault on the part of the collecting bank to

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73. 21 Cal. 3d at 700-01, 582 P.2d at 940-41, 148 Cal. Rptr. at 349-50. The supreme court held that Sun ’n Sand’s failure to notify the bank of the alterations within a reasonable time did not amount to a “neglect of legal duty” such as to preclude recovery based on mistake of fact, as defined in California Civil Code § 1577. 21 Cal. 3d at 700-01, 582 P.2d at 940, 148 Cal. Rptr. at 349. However, the court held that the statute of limitations ran from the date that an honest agent would have discovered the alterations. Id. at 701-02, 582 P.2d at 941, 148 Cal. Rptr. at 350. Morales’ destruction and manipulation of company records, therefore, did not toll the running of the statute, and recovery on a theory of mistake of fact was barred for three of the nine checks. Id.

74. 21 Cal. 3d at 702-03, 582 P.2d at 941-42, 148 Cal. Rptr. at 350-51.

75. The court was very careful to limit the scope of a bank’s duty, in the context of a common law action for negligence, to encompass only those cases in which the bank is the named payee on a check and a third party attempts to divert the proceeds to his own purposes. See text accompanying note 71 supra. U.C.C. § 3-405 governs other fictitious payee situations such that a common law action for negligence will be precluded. See note 68 & accompanying text supra.

Similarly, a cause of action to recover money paid under a mistake of fact probably will be limited to those cases where the drawer makes a check payable to a bank, as did Sun ’n Sand, under the mistaken belief that it represents payment of a debt owed to the bank, and the check is actually presented to the named payee bank.

76. Subsections (1)(b)(ii) and (1)(c)(ii) of both U.C.C. §§ 3-417 and 4-207 preclude the drawer from asserting a forgery of his or her own signature or a material alteration where the collecting bank is a holder in due course.
recovery.  

**Critique of the Court’s Warranty Rulings**

The following sections of this Note focus on the holding in *Sun ’n Sand* that the Code authorizes utilization by the drawer of the presentment warranties. Analysis of the supreme court’s interpretation of the Code’s “payor” concept demonstrates that the court distorted the concept of “payment” as used by the drafters and as generally understood in the banking community. Furthermore, an examination of the various policy considerations in favor of allowing or disallowing a direct warranty action indicates that the court’s misapprehension of the procedural value of the direct suit resulted in its placing upon collecting banks the unfair burden of establishing defenses based on information known only to drawee banks.

**The Drawer as an “Other Payor”**

The holding in *Sun ’n Sand* that the drawer of a check is an “other payor” who may utilize the warranties on presentment to maintain a direct action against a collecting bank finds little support in the decisions of other jurisdictions or in commentaries on the direct suit question. Only three other courts have directly addressed the question, and although one court arrived at the same conclusion as the court in *Sun ’n Sand*, it relied solely upon the rationale that when a check is paid the amount of the check is ultimately charged to the drawer’s account. In most discussions of who should bear the loss in the case of a forged or materially altered check, there has been an implicit assumption that it is the drawee bank which pays an item. The Code itself incorporates

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77. The supreme court in *Sun ’n Sand* recognized the absolute nature of warranty liability. 21 Cal. 3d at 698, 582 P.2d at 939, 148 Cal. Rptr. at 348. See W. PROSSER, HANDBOOK OF THE LAW OF TORTS 636 (4th ed. 1971).


80. See, e.g., Griffith, Final Payment and Warranties on Presentment Under the Uniform Commercial Code—Some Aspects, 23 DRAKE L. REV. 34, 34-41 (1973). See also W. BRITTON, supra note 9, at 638-41. Commentators have devoted little attention to the question of whether the drawer might be considered an “other payor” for the purposes of utilizing the presentment warranties—perhaps an indication in itself that such a characterization conflicts with the general understanding of who pays a check. Professors White and Summers have criticized such a characterization. J. WHITE & R. SUMMERS, supra note 34, at 514. One proponent of the direct suit has offered an analysis of the “payor” concept virtually identical with that adopted by the supreme court in *Sun ’n Sand*. Direct Suit, supra note 14, at 115-17.
this assumption into its rules dealing with finality of payment.\textsuperscript{81}

The question therefore arises as to why the drafters of the Code included the “other payor” language in section 4-207(1).\textsuperscript{82} The absence of an adequate explanation for this language might well lend support to the court's conclusion in \textit{Sun 'n Sand}. One possible explanation is that the language refers to parties who pay drafts through banks, as in the case of insurance claim drafts. The person seeking payment of such a draft presents it at a designated bank which in turn presents the draft to the drawer for payment—thus making the drawer the payor.\textsuperscript{83} Certainly the drawer who pays such a draft should be entitled to assume that any indorsements on the instrument are genuine, and the person obtaining payment should be held to warrant the same.\textsuperscript{84} In such a case, however, the drawer of the draft is also the drawee. As noted above,\textsuperscript{85} the exceptions in subsections 4-207(1)(b)(ii) and (1)(c)(ii), upon which the court in \textit{Sun 'n Sand} relied in inferring that the warranties of those subsections are available to the drawer, refer to the “drawer, whether or not the drawer is also the drawee.” Furthermore, Comment 4 to section 3-417, which also is applicable to section 4-207,\textsuperscript{86} notes, in discussing the exceptions based upon the \textit{Price v. Neal} doctrine:

\[
\text{[U]nder subparagraph (ii) a drawer of a draft is presumed to know his own signature and if he fails to detect a forgery of his signature and pays a draft he may not recover that payment from a holder in due course acting in good faith. This rule applies if the drawer pays the instrument as drawer and also if he pays the instrument as drawee in a case where he is both drawer and drawee.}\textsuperscript{87}
\]

The emphasized language, which the court in \textit{Sun 'n Sand} failed to acknowledge, might appear to lend considerable support to the conclusion that the drawer of a check is an “other payor.” It is more likely, however, that the reference to payment by the drawer was not intended to describe the usual case in which the drawee bank pays a check and debits the drawer-depositor's account in the amount of the item. Otherwise the result is that two different parties “pay” the same check,

\begin{itemize}
  \item \textsuperscript{81} For example, U.C.C. § 4-213(1) begins: “An item is finally paid by a payor bank . . .”
  \item \textsuperscript{82} The Code itself is silent on the matter. The original version of § 4-207(1) referred only to the “payor.” U.C.C. § 4-207(1) (1952 version). In the 1955 Supplement to the 1952 Official Draft, in which the “payor bank or other payor” language first appears, no reason is given for the change.
  \item \textsuperscript{83} The comment to U.C.C. § 3-120 notes the common use of “payable through” drafts in the case of insurance, dividend and payroll checks. The comment further explains that the bank to which the item is presented acts merely as a collecting bank.
  \item \textsuperscript{84} See C. Weber, \textit{Commercial Paper in a Nutshell} 208-09 (2d ed. 1975).
  \item \textsuperscript{85} See text accompanying note 41 \textsuperscript{supra}.
  \item \textsuperscript{86} See U.C.C. § 4-207, Comments 1, 4.
  \item \textsuperscript{87} U.C.C. § 3-417, Comment 4 (emphasis added).
\end{itemize}
which is contrary to the concept behind the Code's system of rules dealing with finality of payment.88

An alternative explanation for the reference to payment by a non-drawee drawer lies in those situations in which the drawer of a check is required to pay an item after it has been dishonored by the drawee bank.89 In such a case the drawer, no less than the drawer-drawee of an insurance claim draft, should be entitled to the benefit of a warranty by the person obtaining payment that any signatures on the instrument are genuine.90 This is illustrated in the following hypothetical situation in which the drawer who pays a check bearing a forged indorsement should be allowed to recover from the party receiving payment based on the Code warranty of good title: (1) DER draws a check on DEE bank payable to PEE; (2) T steals the check, forges PEE's signature, and submits the check to CB (collecting bank) and obtains cash (3) CB presents the check to DEE, but DEE, for whatever reason (e.g., insufficient funds), refuses to pay; (4) CB gives notice of dishonor to DER who, ignorant of the forgery, pays because of his secondary liability under section 3-413(2);91 (5) PEE then sues DER, on a theory of conversion under section 3-419(1)(c),92 and recovers. CB warranted that it had good title to the check when it obtained payment from DER. Therefore, DER ought to recover from CB, as an "other payor" or "person who in good faith pays," based on the warranties of sections 4-207(1)(a) and 3-417(1)(a). In contrast, if the facts were the same except that DER's signature was forged, DER would not be able to recover from CB because presumed to know his or her own signature—the exception in subsection (1)(b)(ii) of the presentment warranty sections. The same would be true with respect to a material alteration because of the exception found in subsection (1)(c)(ii).

The foregoing explanation of the meaning of the Code's "other payor" language admittedly finds no direct support in the cases and commentaries dealing with commercial paper. This is not surprising in view of the scant attention devoted to the problem. Regardless of whether the proposed explanation accords with the design of the drafters, however, the interpretation adopted in Sun 'n Sand is most certainly at odds with the concept of "payment" as used in the Code, in commentaries on commercial paper problems, and in the banking community in general. When a check is presented to the drawee bank it is

88. See notes 80-81 & accompanying text supra.
89. U.C.C. § 3-413(2) provides: "The drawer engages that upon dishonor of the draft and any necessary notice of dishonor or protest he will pay the amount of the draft to the holder or to any indorser who takes it up . . . ."
90. See C. WEBER, COMMERCIAL PAPER IN A NUTSHELL 208-09 (2d ed. 1975).
91. See note 89 supra.
92. U.C.C. § 3-419(1)(c) provides: "An instrument is converted when . . . it is paid on a forged indorsement."
paid by the bank. To say that the drawer then "pays" the check when his or her account is charged by the bank is a complete distortion of the meaning of "payment."

The Collecting Bank as an "Other Payor"

Not content with making the concept of "payor" do double duty, the court in Sun 'n Sand also held that the collecting bank is an "other payor" for the purpose of making available the defense of section 3-406. This holding leads to the anomalous result that the drawer may bring an action as the payor of a check and the collecting bank, also as a payor, may assert the drawer's negligence as a bar to that action. In such a scheme the concept of payment loses all meaning.

The idea of treating the collecting bank as a payor under section 3-406 has been suggested by more than one commentator on the theory that a court which decides to allow a direct action by the drawer against the collecting bank also must make available those defenses which would have been available to the drawee bank. Such a construction of the "payor" language has been recognized, however, as a definite misinterpretation of the term as it is used in the Code.

There is general agreement that fairness requires that the defenses of section 4-406 be made available to the collecting bank in an action by the drawer. Indeed, the California Code Comments to section 4-406 indicate that the effect of subsection 4-406(5) "is to extend the protection of [subsection] (4) to collecting banks." This language, however, should not be interpreted as implying support for the direct action. Rather, the language more properly applies to a situation in which the drawee bank, perhaps to placate its customer, chooses to waive defenses otherwise available under the section, to admit liability to the drawer-customer, and to pass the ultimate loss on to the collecting bank.

The preceding analysis of the substantive basis for a direct warranty action by the drawer of a check against a collecting bank leaves no doubt that the supreme court misinterpreted the warranty provisions of the U.C.C. Perhaps the decision can be explained as an example of judicial inventiveness on the part of the court to effect what it felt was a

93. See text accompanying note 52 supra.
94. J. White & R. Summers, supra note 34, at 540 n.42; Direct Suit, supra note 14, at 109-10. See also O'Malley, supra note 5, at 260.
95. Professors White and Summers state: "It is quite unclear how a court is to arrive at . . . the only sensible solution, namely the application of [§] 3-406 . . . to collecting . . . banks . . . . One solution is simply to bend the devil out of the 'payor' language and so make it include . . . collecting banks." J. White & R. Summers, supra note 34, at 540 n.42.
96. See, e.g., id.; Direct Suit, supra note 14, at 110-11.
needed change in the law of California. Were the result found to be beneficial to all parties involved the court might be entitled to praise. The final section of this Note, however, demands the conclusion that the court not only used unsound reasoning but also arrived at an unsound result.

Policy Considerations

The remainder of this Note examines the possible advantages as well as the detrimental effects of bypassing the drawee bank in the process of allocating losses on forged or materially altered instruments. This analysis demonstrates that the Sun 'n Sand decision has the unfortunate effect of impairing the substantive rights of collecting banks without providing a material offsetting benefit to the other parties involved or the judicial system in general.

The drawer of a check might want to proceed directly against a collecting bank for one of two reasons. The first is to avoid disturbing an otherwise harmonious relationship with its own bank. An existing mutually satisfactory relationship might be damaged by subjecting the bank to the nuisance and expense of two lawsuits—first in the defense of the drawer's action and subsequently seeking recovery from the collecting bank.\textsuperscript{98} In practice, bringing all the parties together in a single action lessens the burden on the drawee bank.\textsuperscript{99} Nevertheless, the drawer's interest in keeping its bank out of the litigation altogether is outweighed by the unfair burden this would place upon the collecting bank.\textsuperscript{100} This is directly related to the second reason why the drawer might wish to maintain a direct suit—to circumvent a defense known only to the drawee bank. As will be demonstrated more fully hereinafter,\textsuperscript{101} circumvention of an existing defense may be possible, for even though the collecting bank is allowed to assert any defenses which would be available to the drawee bank, as a practical matter it will be at a great disadvantage in establishing such defenses.

The reason most often advanced for allowing the direct suit by a drawer—avoiding a multiplicity of suits—is of immediate benefit only to the drawee bank, which avoids being sued, although of course the entire judicial system benefits by economizing judicial resources.\textsuperscript{102} This desire to avoid multiple suits and the belief that a direct action

\textsuperscript{98} O'Malley, \textit{supra} note 5, at 233-34; \textit{Direct Suit, supra} note 14, at 108. See note 25 & accompanying text \textit{supra}.

\textsuperscript{99} See text accompanying notes 106-07 \textit{infra}.

\textsuperscript{100} See text accompanying notes 108-19 \textit{infra}.

\textsuperscript{101} See notes 109-22 & accompanying text \textit{infra}.

\textsuperscript{102} The drawer might also benefit in a case where there was one collecting bank but a number of drawee banks, as in National Bank & Trust Co. of Cent. Pa. v. Commonwealth, 9 Pa. Commw. Ct. 358, 305 A.2d 769 (1973) (drawee banks assigned their rights to drawer).
merely expedites the inevitable were what motivated the court in Sun 'n Sand to allow the direct action based on warranty principles. Most sources generally agree that, in the case of a forged indorsement or a material alteration, the ultimate liability rests on the collecting bank as the party which dealt directly with the wrongdoer. Supporters of the direct action argue, therefore, that as long as the collecting bank is going to be held liable there is no reason to require the drawer to proceed initially against the drawee.

While the desirability of economizing judicial resources and preventing unnecessary litigation is beyond question, an examination of the available alternatives to the direct action indicates that the spectre of multiple lawsuits and “circuity of action” is more imaginary than real. A variety of means exist to join in a single action all the parties which dealt with a particular check. The collecting bank, when notified by the drawee bank of pending litigation by the drawer, may make a voluntary appearance in anticipation of a later action by the drawee. Indeed, the Code has provided the drawee with a method of encouraging the collecting bank to appear, namely section 3-803, which codifies the common law doctrine of “vouching in.” This procedure requires that the collecting bank, once notified by the drawee that the drawer has instituted an action, either come in and defend or be bound in a future action by the drawee by any determination of fact common to the two actions. Moreover, in California, if the collecting bank decides not to accept this invitation, the drawee may file a cross-complaint against the collecting bank as a third-party defendant, seeking declaratory relief for indemnification.

The drawee bank thus may avoid the necessity of appearing in two separate lawsuits. In view of the loss allocation scheme outlined
above, one might question, however, why the drawee bank's presence in the suit is required at all. The answer is that the drawee is in the best position to assert available defenses to the drawer's recovery. This argument was raised in the first case to consider the direct suit problem under the U.C.C., Stone & Webster Engineering Corp. v. First National Bank & Trust Co. of Greenfield. The court in Stone & Webster, after noting that the authorities were divided on the issue, decided that the better view was that no direct action should be allowed. The court feared that the collecting bank would not be in a position to effectively assert against the drawer the defenses that would be available to the drawee bank under the Code, particularly those set forth in sections 3-406 and 4-406, dealing with the drawer's negligence and laches.

The concern over the collecting bank's disadvantage in defending an action against the drawer led proponents of the direct suit to seek an interpretation of the Code which would allow the collecting bank to utilize the defenses of sections 3-406 and 4-406. The court in Sun 'n Sand presents such an interpretation and apparently considers this sufficient to dispense with the objection to the direct action. There is another aspect to the problem, however, which is completely ignored by the court—the collecting bank's practical difficulty in obtaining the information necessary to effectively plead and establish a valid defense.

To prove the drawer's negligence or laches, and thus preclude recovery on a forged or materially altered check, requires knowledge of when the cancelled check was returned to the drawer and whether or not the drawer timely notified the drawee of the forgery or alteration. This information is solely within the control of the drawee bank and is therefore not readily available to the collecting bank. Similarly, knowledge of the drawer's general business practices, which may have facilitated the forgery or the making of the material alteration, would be valuable. Again, clearly the drawee bank, because of its continuing relationship with its customer, is much more likely to have access to such information than is the collecting bank. The col-
lecting bank’s inability to obtain this information readily may enable the drawer to circumvent an otherwise effective bar to recovery. Although modern discovery procedures might make any such information available to the collecting bank, the burden of obtaining this information would, by comparison, be much greater if placed upon the collecting bank rather than upon the drawee bank itself. Moreover, the drawee, in all probability, would not cooperate voluntarily in making available any records which would establish its customer’s negligence. Of course, the collecting bank can subpoena such records, but this process is likely to prove costly, and if the drawee bank is located in another state, obtaining the necessary information may prove virtually impossible.

Ironically, allowing the direct action may create more litigation rather than avoid multiple suits. If the drawer is required to proceed against the drawee, the bank may be able to assert effectively a defense which precludes recovery by the drawer without extended litigation and without ever involving the collecting bank. Even where there is no effective defense available against the drawer, there is reason to doubt that the drafters of the Code intended to place on the collecting bank the burden of subpoenaing the drawee’s records and investigating the business practices of a party with whom it has had no prior dealings in order to determine whether or not such a defense actually exists. As the court in Stone & Webster recognized, “[t]he possibilities of such a result would tend to compel resort to litigation in every case involving a forgery of commercial paper. It is a result to be avoided.”

Although the court in Sun ‘n Sand dealt with sections 3-406 and 4-406, it completely ignored the defense in section 4-207(4), which is available to a collecting bank in an action by the drawee bank, but which is entirely lost if the drawer is allowed to maintain a direct action. The effect of this subsection is that the drawee bank must make a claim for a breach of one of the presentment warranties within a reasonable time after it learns of the breach or else the collecting bank’s liability is discharged to the extent of any loss caused by the delay. Thus, there could arise a situation in which the drawer would be allowed to recover from the drawee bank but the drawee bank would be precluded from asserting a claim against the collecting bank. If the

119. For example, in Allied Concord Financial Corp. v. Bank of America, 275 Cal. App. 2d 1, 80 Cal. Rptr. 622 (1969), the drawer and drawee were both located in New York, while the collecting bank was located in California. See note 25 & accompanying text supra.

120. 345 Mass. at 10, 184 N.E.2d at 363.

121. U.C.C. § 4-207(4) reads: “Unless a claim for breach of warranty under this section is made within a reasonable time after the person claiming learns of the breach, the person liable is discharged to the extent of any loss caused by the delay in making claim.”
drawer were allowed to proceed directly against the collecting bank this defense to the bank’s liability would be completely circumvented.

The Code does not envision such a disparity in results based on the drawer’s decision as to which party to sue. Rather, the Code establishes an orderly scheme in which the drawer may recover from the drawee bank on the basis of section 4-401, subject to defenses available to the drawee bank under sections 3-406 and 4-406, and the drawee bank may recover from the collecting bank based on the presentment warranties of sections 3-417 and 4-207, subject to defenses available to the collecting bank under sections 4-207(4) and 4-406(5).122 By allowing the drawer to utilize the presentment warranties in an action against the collecting bank, the court in *Sun 'n Sand* departed from this intended method of allocating losses on forged or altered instruments. As a result, the court not only seriously prejudiced the rights of the collecting bank but also created the possibility of unnecessary litigation, directly contrary to its stated objective of avoiding multiple suits.

**Conclusion**

This Note has attempted to show how the Supreme Court of California, in *Sun 'n Sand, Inc. v. United California Bank*, distorted the concept of payment of an instrument in order to extend the benefit of the presentment warranties of the California Commercial Code to the drawer of a check, and in so doing seriously prejudiced the rights of the collecting bank by placing upon it the burden of establishing defenses known only to the drawee bank.

Fortunately for collecting banks, in most instances the drawer and its bank will be so situated that it will be simpler for the drawer to seek his or her remedy against that bank rather than against the collecting bank. Nevertheless, in the relatively common case of forged indorsements the collecting bank is now open to virtually absolute liability to the drawer without the full benefit of defenses based on either the drawer’s negligence or laches.

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