1953

Negotiable Instruments

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Recommended Citation
Charles G. Thrash Jr., Negotiable Instruments, 7 Sw L.J. 379 (1953)
https://scholar.smu.edu/smulr/vol7/iss3/10

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Arkansas. The Arkansas Supreme Court recently considered the duty owed by a depositor to his bank.\(^1\) Two partners were in the construction business in Little Rock, and they alone were authorized to sign checks. The partners employed a part-time bookkeeper who had been recommended as competent and whom one of the partners had known in high school. On March 31, 1949, eight months after the bookkeeper’s employment, the books were audited and were found to be in balance.

Thereafter the bookkeeper contrived — through forgeries, alterations, destruction of cancelled checks, and substitution of fake checks — to obtain more than $10,000, which remained undiscovered until the next audit was made in April, 1950. This audit revealed that the bookkeeper had forged the name of the partners to 24 checks in the aggregate amount of $9,800. The bank had mailed cancelled checks and statements monthly, and the partners had looked them over to some degree but had not discovered anything amiss until the audit was made.

The company made demand for repayment of the total amount of the forged checks. The bank declined, taking the position that the loss must fall upon the company by reason of its failure for eleven months to examine the cancelled checks and bank statements with sufficient particularity to discover the fraud. The company then sued the bank for $9,800. The trial court overruled the bank’s motion for a directed verdict and, after submission to the jury, a verdict was reached for the company. Upon the ground that there had not been sufficient testimony to take the case to the jury the bank appealed.

The supreme court affirmed the trial court's judgment, following its earlier *Bank of Black Rock* case. In that decision it was stated that the bank is liable for payment on a forged check unless the depositor "is precluded from setting up the forgery or want of authority." Since the sole question on appeal was whether the trial court erred in refusing to grant the bank's motion for a directed verdict, the court concentrated its attention on whether or not the depositor's negligence was a question for the jury. The bank's theory was that (1) a strong case of depositor's negligence was made out and (2) the depositor had presented no evidence to negative such negligence. The bank contended that the court should not have allowed a question to go to the jury about which reasonable men could not have disagreed.

It is well settled that a bank on which a check is drawn is charged with knowledge of its depositor's signature and that it pays a forged check at its peril — payment in legal contemplation will be considered to have been made out of the bank's own funds so that it has no right to charge the depositor's account. However, it is equally well settled that the depositor, upon return by the bank of his cancelled checks for the preceding month along with a statement of his account for that period, is bound to do three things: (1) compare the vouchers returned by the bank with the stubs in his check book, (2) compare the balance entered in the statement or pass book with the balance in his check book, and (3) compare the returned vouchers with the list of checks entered in the statement or check list. The general principle has developed that the drawer, if he has failed to discharge his duty to the bank, may not be allowed to recover against the bank, at least to the extent that his fault has caused the bank to be damaged.

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3 Authorities are collected in 9 C. J. S., *Banks and Banking*, § 356a, p. 730.

4 *Id.* at 744, § 356d (1).
No quarrel can be had with the court's conclusion, based on its own earlier cases\(^5\) and those from other jurisdictions,\(^6\) that the depositor's negligence was a question for the jury. The case appears to be one of first impression in Arkansas on the facts presented, however. In comparing it with cases from other jurisdictions it appears that the one point vital to the determination of liability in such a case — that of agency — is the one which the court omitted discussing. If the partners are to be considered apart from their business relationship with the bookkeeper, their actual knowledge would be determinative. The bookkeeper, however, was their agent, and the effect of her knowledge should have been considered.

Where the duty of examining cancelled checks and statements has been given to an employee, a problem is created which has given the courts much difficulty. Where such agent has himself committed the forgeries, it is generally held that the depositor is not chargeable with the knowledge of the forgeries possessed by the agent. The majority of authorities do hold, however, that the depositor is chargeable with a knowledge of such facts as an honest agent would have acquired from an impartial examination.\(^7\)

The court did not mention whether knowledge of the agent would be chargeable to the company. None of the Arkansas cases cited by the court had dealt with the question and were used only in support of the proposition that the drawer's negligence was a question for the jury. One of the out-of-state cases,\(^8\) quoted extensively regarding the question of submission to the jury of the negligence issue, held that it was reversible error for the cir-

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\(^7\) Authorities are collected in 9 C. J. S., Banks and Banking, § 356d (2), p. 746.

cuit court to have refused the following instruction asked for by
the defendant:

No. 3. The jury are instructed that the plaintiff is charged with such
knowledge as Woodall had in making the examination of its bank
book and the inspection of returned checks and comparison of the
same with the stubs of plaintiff's check book.9

The court went further in order to distinguish between two
situations which have given the courts no little difficulty:

In the commission of a forgery the employee is not the agent of his
principal... But after the forged checks have been paid and returned
to the depositor as vouchers, with the bank account written up and
balanced... if the depositor assigns the duty of examining such
vouchers and account to this same clerk... then such employee in
the discharge of this duty is the agent of the depositor, and such de-
positor is chargeable with his agent's knowledge of the fraud.10

In the Leather Manufacturers National Bank case,11 which was
cited by the court and which the court described as "the leading
case in this country on the question", the Supreme Court of the
United States said, "Both causes of action are peculiarly for a
jury to determine, under such instructions as may be consistent
with the principles announced in this opinion." (Italics supplied.)
One of the principles which had been announced was:

... [W]hen, as in this case, the agent commits the forgeries... and,
therefore, has an interest in concealing the facts, the principal occupies
no better position than he would have done had no one been design-
nated by him to make the required examination — without, at least,
showing that he exercised reasonable diligence in supervising the con-
duct of the agent while the latter was discharging the trust committed
to him.12

The Arkansas court seems to have gone further in the direction
of relieving the depositor of all duty to the bank than any recent
case which has reached the appellate courts. The result is, in point

9 56 S. E. at 154.
10 Ibid.
12 Id. at 116.
of time, a retrogression in the direction of the extreme rule of the *Weisser* case,\(^\text{13}\) which went all the way in holding that the depositor is under no duty at all.

In the instant case the partners sometimes "looked through" the cancelled checks but were unable to find anything wrong. They employed a part-time bookkeeper whom one of them had known in high school and gave her almost complete control of their banking affairs. The Arkansas court expressly stated that it rejected the extreme rule of the *Weisser* case, but the decision — that there was evidence that the depositor had discharged his duty to the bank and that the jury was warranted in so finding — could only have been reached after the duty of the depositor had been reduced to minute proportions.

It should certainly be the partners' prerogative to have the books audited either once yearly or more often. It is understandable that the partners may have felt that the less often the better from the standpoint of economy. That the penalty for this managerial decision — to have only meager supervision — should fall upon the bank is less understandable. Of the two innocent parties the bank was the one which was in no position to protect itself after it had mailed the cancelled checks and statements. It is doubtful whether a fact question would have been in existence if the jury had been instructed that the partners were charged with the knowledge which an honest agent would have acquired from an impartial examination.

**"Time Price Differential"—Usury—Defense Against Holder In Due Course**

*Arkansas.* In *Hare v. General Contract Purchase Corp.*\(^\text{14}\) the buyer of a truck at a stated price of $1750 had paid $100 in cash and turned in to the seller a truck worth $500, leaving a balance


\(^{14}\) *Ark....*, 249 S. W. 2d 973 (1952).
due of $1150. To this the seller added a "Time Price Differential (Including any Insurance)" of $289.13, and the buyer executed a title-retaining contract and a note for the sum, $1,439.13, to be paid in 21 installments of $68.53 each. The seller transferred the contract and note to a holder in due course, the General Contract Purchase Corporation, without recourse, and received $1,150.00. After making several payments the buyer, Hare, filed suit under an Arkansas statute providing relief for debtors under a usurious contract. The chancery court refused Hare's plea of usury, and Hare appealed.

It was determined that the $289.13 "Time Price Differential" was made up of $148.24 for insurance and $140.89 for interest and service charge, the latter at an "effective rate" of 11.5%. The Supreme Court of Arkansas then stated that in a long line of cases it had "permitted the seller, under one guise or another, to do exactly what was done in the case at bar, and we have permitted the transferee of the paper to recover in just such a situation." It then affirmed the holding of the chancery court with the following statement: "... the parties dealt on the strength of the aforesaid holdings... and we must not overrule these cases retroactively. Therefore, insofar as the case at bar is concerned, it must be affirmed."16

The importance of the case lies in the "caveat" which the court then added:

... [T]he effect of transactions, such as in the case at bar, may impinge on the constitutional mandate against usury, and transactions entered into after this appeal becomes final, may be subjected to the taint of usury with the aforementioned decisions affording no protection.17

16 249 S. W. 2d at 977.
17 Ibid.
The court went back to the 1880 case of *Ford v. Hancock* to illustrate its earlier holdings. The court had there pointed out that it was not usurious to sell for a bona fide "credit price". If, however, the sale were really made on a cash estimate and an amount were assumed to be paid over a period of time which was greater than the cash price plus legal interest, then such agreement was usurious.

Also by way of illustration of its earlier holdings the court cited *Tillar v. Cleveland*, an 1885 case in which Cleveland had sought to borrow $270 from Tillar in order to buy some property. But Tillar insisted on taking title to the property and selling it to Cleveland for $360, and it was held that Tillar had used the deed and contract of sale to accomplish usury.

In the principal case the court observed that buying at a "credit price", as distinguished from a cash price, has largely disappeared in fact, but is being used as a cloak for usury in many cases by such words as "time price differential" or some other such language. After particularizing a number of situations which might be suspect, the court concluded:

We give this *caveat* prospectively, so as not to entrench on property rights acquired by reason of our previous opinions, and this *caveat* applies to all transactions entered into after this opinion becomes final.

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18 36 Ark. 248.
19 47 Ark. 287, 1 S. W. 516.
20 1 S. W. at 517. The court quoted from Scott v. Lloyd, 9 Pet. 418, 446, 447 (U. S. 1835), where Chief Justice Marshall said, "Yet it is apparent that if giving this form to the contract will afford a cover which conceals it from judicial investigation, the statute would become a dead letter. Courts, therefore, perceived the necessity of disregarding the form, and examining into the real nature of the transaction. If that be in fact a loan, no shift or device will protect it."

21 An interesting dissent by Griffin Smith, C. J., concurred in the spirit of the majority opinion but dissented on its application to the case at bar in the following words: "I do not understand that a vested property right in a violation of the constitution can be acquired, hence I would reverse the decree because of the overcharge." 249 S. W. 2d at 978. A question may be asked as to the incentive provided for a litigant in an attack on what he considers a bad rule of law if the only effect of a successful challenge will be that the bad rule will be changed for future litigants only. See von Moschzisker, *Stare Decisis in Courts of Last Resort*, 37 Harv. L. Rev. 426 (1924); Note, 85 A. L. R. 262 (1932).
In view of the fact that under the Arkansas Constitution a usurious contract is void and that a bona fide purchaser for value without notice can acquire no rights thereunder, it will behoove purchasers of commercial paper to see that full particulars are obtained on all such notes and that the "effective rate" of interest (which includes service or carrying charges) does not exceed 10 per cent.

The care with which all parties must proceed is indicated in the caveat:

If the seller . . . transfers the title documents . . . at a price which permits the transferee to obtain more than a return of 10% on its investment, then a question of fact arises as to whether the seller increased his cash price with the reasonable assurance that he could so discount the paper. . . . If that reasonable assurance existed, then the transaction is in substance a loan, and may be attacked for usury.

The court was determined to illuminate present day economic realities in their true relationship to constitutional inhibitions. If the two seem to be operating undesirably at cross purposes, then certainly the constitution can, in the prescribed manner, be amended. Too often constitutional restrictions are winked at. Often they are chuckled over as "outmoded" because they were written before current practices came into vogue. It appears that a commendable purpose was served by the court's reminder that, until changed, the constitution is the bedrock of the law of a state and that commercial usage must conform itself thereto.

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22 Art. 19, § 13.
23 German Bank v. DeShon, 41 Ark. 331 (1883).
24 249 S. W. 2d at 978.