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Article

Contracting Around Finality: Transforming *Price v. Neal* from Dictate to Default

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INTRODUCTION

"Arguably the most important and problematic area within the entire field of negotiable instruments law is the law relating to forgery, especially the allocation of losses that result from forgery."[1] Forgery is central to negotiable instrument law because a signature typically authenticates the orders and promises to pay on which the entire system is based.[2] Unfortunately, forgery continues to cause substantial losses to American banks and the national economy.[3] "Despite the significance of this problem, many of the legal doctrines governing forgery loss allocation remain quite problematic, even after nearly three centuries of development."[4] To combat the problem of negotiable instrument fraud, this Article argues that the time-honored doctrine of finality, as embodied in the case of *Price v. Neal* and § 3-418(c) of the Revised Uniform Commercial Code (RUCC) should be transformed from a rigid, per se dictate into a default rule. This transformation would constitute a signifi-

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1. Steven B. Dow, *The Doctrine of* Price v. Neal *in English and American Forgery Law: A Comparative Analysis*, 6. TUL. J. INT'L & COMP. L. 113, 116–17 (1998).
2. *Id.*
3. *See infra* notes 30–33 and accompanying text.
4. Dow, *supra* note 1, at 117–18.

cant change in Anglo-American commercial paper law. The goal of this transformation is to allow presenters of negotiable drafts and payor banks to better allocate the losses of forgery to the party who is most willing to bear that burden. This ability to allocate losses, in turn, is designed to reduce the costs of forgery and improve the efficiency of the American commercial paper system.

I. THE PROBLEM OF FORGERY

The autobiography of Frank Abagnale—perhaps the most notorious forger in modern American history and subject of the movie *Catch Me If You Can* starring Leonardo DiCaprio—vividly illustrates the process and potential ease of forging a negotiable instrument,[5] such as a draft[6] check.[7] Abagnale describes the process of forging a check:

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5. *See* U.C.C. § 3-104(a) (2003):

> Except as provided in subsections (c) and (d), "negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:
>
> (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
>
> (2) is payable on demand or at a definite time; and
>
> (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

Id. "'Promise' means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgement of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation." *Id.* § 3-103(a)(12). Section 3-103(a)(8) states:

> "Order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

Id. § 3-103(a)(12).

6. *See id.* § 3-104(e) ("An instrument is a 'note' if it is a promise and is a 'draft' if it is an order. If an instrument falls within the definition of both 'note' and 'draft,' a person entitled to enforce the instrument may treat it as either.").

7. *See id.* § 3-104(f) ("'Check' means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier's check or teller's check. An instrument may be a check even though it is described on its face by another term, such as 'money order.'").

> [I] needed a sweeter type of check . . . Like a Pan Am payroll check . . . I obtained a book of blank counter checks from a stationary store . . . I then rented an IBM electric typewriter with several different typeface spheres, including script, and some extra ribbon cartridges in various carbon densities. I located a hobby shop that handled models of Pan Am's jets and bought several kits in the smaller sizes. I made a final stop at an art store and purchased a quantity of press-on magnetic-tape numerals and letters . . . I took one of the blank counter checks and across the top affixed a PAN AMERICAN WORLD AIRWAYS decal from one of the kits . . . [I] typed in the words "EXPENSE CHECK" . . . I made myself, "Frank Williams," the payee, of course, in the amount of $568.70, a sum that seemed reasonable to me. In the lower left-hand corner I typed in "CHASE MANHATTAN BANK" . . . [I] laid down a series of numbers with magnetic tape . . . I drove to the nearest bank [and asked the teller to] cash this check.[8]

Four parties are involved in any payment on a draft: (1) the presenter[9] of the draft; (2) the depositary bank[10] that first takes the draft;[11] (3) the payor bank that pays on the draft;[12] and (4) the drawer or account holder.[13] Potentially, the payor bank and the depositary bank could be the same entity if the presenter and the account holder use the same bank, or if the presenter simply happens to attempt to present the instrument directly to the payor bank. Usually, however, the payor and depositary banks will be different institutions.

Problems relating to the allocation of loss from a forged draft occur when a party presents[14] a forged or altered[15] check[16]

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8. FRANK ABAGNALE, CATCH ME IF YOU CAN 118–20 (Broadway Books 2000) (1980).

9. Abagnale in the above example.

10. The bank where Abagnale took the check to have it cashed in the above example. *See* U.C.C. § 4-105(2) ("'Depositary bank' means the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter.").

11. *See id.* § 3-104(e).

12. *See id.* § 4-105(3) ("'Payor bank' means a bank that is the drawee of a draft.").

13. Pan Am is the account holder in the above example. *See id.* § 4-104(a)(1) ("'Account' means any deposit or credit account with a bank . . . .").

14. U.C.C. § 3-501(a) defines "presentment":

> "Presentment" means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, or (ii) to accept a draft made to the drawee.

Id.; *see also id.* § 3-501(b)(1)–(4).

15. *Id.* § 3-407(a) ("'Alteration' means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.").

or other draft to a bank for payment.[17] Presentment, as in the example above, can be made to a bank either directly or, as is often the case in modern times, through an established check collection system. Upon presentment by a presenter, the depositary bank forwards the draft through a collection system to the payor bank. If the payor bank, to which the instrument is presented, does not detect the forgery, it will typically immediately pay the amount of the item[18] to the presenting party and accept[19] the item.

The check is then routed through a check collection system to the payor bank, which holds the relevant account. The payor bank will usually charge the account of the customer[20] who is the account holder[21] whom the forgery is attributed to, ostensibly its drawer,[22] for the amount of the item.

When the payor bank forwards funds to cover the check to the depositary bank, the payor bank withdraws money from the account of its account holder. Once the account holder discovers the loss, the presenter is long gone and recovery of the funds is unlikely. Thus, the forgery is complete and the problem of allocating the burden of draft forgery detection—and the losses therefrom—is introduced. At this point, the parties seek their attorneys to decide who bears the burden of the forgery.

The Anglo-American laws governing commercial paper, including the laws of negotiable instruments, are rooted in four-

16. *Id.* § 3-104(f) ("'Check' means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier's check or teller's check. An instrument may be a check even though it is described on its face by another term, such as 'money order.'"); *see also id.* § 3-104(g) (defining "cashier's check"); *id.* § 3-104(h) (defining "teller's check"); *id.* § 3-104(i) (defining "traveler's check").

17. *See id.* § 3-602(a)–(e); Dow, *supra* note 1, at 119–20.

18. U.C.C. § 4-104(a)(9) ("'Item' means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip.").

19. *See id.* § 3-103(a). "'Acceptor' means a drawee who has accepted a draft." *Id.* § 3-103(a)(1).

20. *Id.* § 4-104(a)(5) ("'Customer' means a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank.").

21. For purposes of clarity, this Article will refer to a "customer" as defined in U.C.C. § 4-104(a)(5) as an "account holder" to differentiate a code-defined "customer" from an ordinary consumer of bank services.

22. *Id.* § 3-103(a)(5) ("'Drawer' means a person who signs or is identified in a draft as a person ordering payment.").

teenth century England.[23] There, the negotiable instruments doctrines evolved so that, by the second half of the seventeenth century,[24] "[a]t common law, mistaken payments could sometimes be recovered through an action for money had and received, a form of *indebitatus assumpsit*."[25] This equitable doctrine was repudiated by English judges, but was later revived by the House of Lords in 1943.[26] In the meantime, though, the doctrine created in the case of *Price v. Neal*[27] limited restitution by limiting a payor bank's[28] ability to recover on a forged drawer's signature, and "greatly unsettled"[29] the allocation of losses from forged instruments. Although the doctrine of *Price v. Neal* has been steadily eroded in England, this rule, in contrast, was quickly incorporated into the American commercial paper law system, where it remains an essential fixture.

Despite the fact that, under the doctrine of *Price v. Neal*, payor banks have an economic incentive to prevent forgery, losses to the American economy resulting solely from forged checks were estimated at an annual $60 million–$1 billion two decades ago.[30] These losses appear only to have continued to grow.[31] In 1995 the Federal Reserve estimated banking losses from check fraud, including forgeries, at $475–$875 million, annually.[32] The Federal Reserve estimated the resulting an-

23. *See* Dow, *supra* note 1, at 114.

24. *Id.* at 121.

25. Steven B. Dow, *Restitution of Payments on Cheques with Forged Drawers' Signatures: Loss Allocation Under English Law*, 4 RESTITUTION L. REV. 27, 28 (1996).

> Beginning in the early sixteenth century, assumpsit, which is the Latin word for undertaking, developed into an action to enforce bargained-for promises. It was first limited to express promises, but by the early seventeenth century, assumpsit would lie in the case of a promise implied (in fact) from the conduct of the parties.

Dow, *supra* note 1, at 122 n.27 (citations omitted).

26. Dow, *supra* note 1, at 123.

27. 97 Eng. Rep. 871 (K.B. 1762).

28. *See* U.C.C. § 4-105(1) (2003) ("'Bank' means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company."); *see also id.* § 4-105(3) ("'Payor bank' means a bank that is the drawee of a draft.").

29. Dow, *supra* note 1, at 125.

30. *Id.* at 117; Steven B. Dow & Nan S. Ellis, *The Proposed Uniform New Payments Code: Allocation of Losses Resulting from Forged Drawers' Signatures*, 22 HARV. J. ON LEGIS. 399, 400 (1985).

31. Dow, *supra* note 1, at 117.

32. *Id. See generally* BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON FUNDS AVAILABILITY SCHEDULES AND CHECK FRAUD AT DEPOSITORY INSTITUTIONS 5–7 (1996), *available at* http://www.

nual losses to the national economy as a whole at $10–$60 billion.[33]

II. *PRICE V. NEAL* AND ITS AMERICAN PROGENY

A. *PRICE V. NEAL*

1. The Case of *Price v. Neal*

The 1762 case of *Price v. Neal*,[34] decided in the King's Bench of England and delivered by Lord Mansfield, is as celebrated as any other commercial paper case in Anglo-American legal history.

The case features five important individuals. Benjamin Sutton had deposited money with one John Price. Thus, Price is the drawee.[35] Sutton, then, is the account holder here, who would otherwise have been a drawer if he had drafted the bills himself.[36] Edward Neale is the presenter who took the bill from Rogers Ruding, an indorser.[37] Lee is the forger who signed Sutton's name to the bill of exchange.[38]

Price paid out on one of the bills when it was due but without acceptance.[39] The other bill was properly accepted, and Price paid it when it matured.[40] The drawer's handwriting, however, was a forgery.[41] Once Price discovered the forgery, he brought an action as plaintiff against defendant Neale to recover the money that he paid. [42]

The first bill in question was drawn as:

> Leicester, 22d November 1760. Sir, six weeks after date pay Mr. Rogers Ruding or order forty pounds, value received for Mr. Thomas Ploughfor; as advised by, sir, your humble servant Benjamin Sutton.

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federalreserve.gov/boarddocs/rptcongress/chkfraud.pdf (last visited Sept. 1, 2004) (discussing the losses suffered to the banking industry from check fraud and possible solutions).

33. Dow, *supra* note 1, at 117. *See generally* BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 32, at 5–7.

34. 97 Eng. Rep. 871 (K.B. 1762).

35. *See id.*; *see also* U.C.C. § 4-104(a)(8) (2003) ("'Drawee' means a person ordered in a draft to make payment.").

36. *See Price*, 97 Eng. Rep. at 871.

37. *See id.*

38. *See id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

To Mr. John Price in Bush-Lane Cannon-Street, London; [indorsed by] R. Ruding, Anthony Topham, Hammond and Laroche. Received the contents, James Watson and Son: witness Edward Neale.[43]

"[T]his bill was indorsed to the defendant" Neale "for a valuable consideration."[44] Neale properly gave notice of the bill to Price on its due date. Price then sent his servant to take the bill from Neale.[45]

Another bill was drawn as follows:

Leicester, 1st February 1761. Sir, six weeks after date pay Mr. Rogers Ruding or order forty pounds, value received for Mr. Thomas Ploughfor; as advised by, sir, your humble servant Benjamin Sutton. To Mr. John Price in Bush-Lane, Cannon-Street, London. . . . [Indorsed by] R. Ruding, Thomas Watson and Son. Witness for Smith, Right and Co. . . . Accepted [by] John Price.[46]

The second bill was indorsed to defendant Neale for valuable consideration and left at his bankers for payment.[47] This bill was paid to the order of Price, and it was also taken.[48]

A significant amount of time passed after Price paid the bills of exchange before he discovered that they were forged.[49] Subsequently, Price discovered that "[b]oth these bills were forged by one Lee, who has been since hanged for forgery,"[50] as was the custom in England at that time. Despite this skullduggery, the King's Bench of England held that the "defendant Neale acted innocently and bona fide, without the least privity or suspicion of the said forgeries or of either of them; and paid the whole value of those bills."[51]

Thus, for the King's Bench the issue was "[w]hether the plaintiff . . . can recover back, from the defendant, the money he paid on the said bills, or either of them."[52] Plaintiff Price argued that he ought to recover his money from Neale because "it was paid by him by mistake only," while Price was acting under the assumption that the bills were genuine.[53] Defendant Neale argued that Plaintiff Price was not entitled to recover money

43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*

back.[54] Neale insisted that the burden should fall "to the negligence of the plaintiff" who should have endeavored to find out "whether the bill was really drawn upon him by Sutton, or not."[55]

The King's Bench reiterated Neale's lack of fraud and payment of value for the bills as important factors in holding in his favor.[56] Presaging the American Uniform Commercial Code (UCC), and its revision, it then laid down its time-honored rule: "[I]t can never be thought unconscientious in the defendant, to retain this money, when he has once received it upon a bill of exchange indorsed to him for a fair and valuable consideration, which he had bona fide paid, without the least privity or suspicion of any forgery."[57] The King's Bench added, "it was not incumbent upon the defendant, to inquire into it."[58]

Tying its rule together with rationale, the court expanded:

> Here was notice given by the defendant to the plaintiff of a bill drawn upon him: and he sends his servant to pay it and take it up. The other bill, he actually accepts; after which acceptance, the defendant innocently and bona fide discounts it. The plaintiff lies by, for a considerable time after he has paid these bills; and then found out "that they were forged:" and the forger comes to be hanged. He made no objection to them, at the time of paying them. Whatever neglect there was, was on his side. The defendant had actual encouragement from the plaintiff himself, for negotiating the second bill, from the plaintiff's having without any scruple or hesitation paid the first: and he paid the whole value, bona fide. It is a misfortune which has happened without the defendant's fault or neglect. [Even i]f there was no neglect in the plaintiff, yet there is no reason to throw off the loss from one innocent man upon another innocent man . . . [I]f there was any fault or negligence in any one, it certainly was in the plaintiff, and not in the defendant.[59]

With that, the King's Bench entered judgment for Neale.[60]

2. Historical Justification

The most cited historical justification for the result of *Price v. Neal* is that Price was—or should have been—in a superior position to detect the forgery.[61] Neale took the forged note

54. *Id.* at 872.
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.*
61. This justification is prevalent in American courts that relied on the

without fault and paid value.[62] He had no reason to believe that the note was a forgery and could not be expected to make such an examination.[63] Presumably, according to the King's Bench, if Price would have taken the time to compare the forged bills with the actual signature of the true drawer and account holder Sutton, Price would have discovered the fact that the bills were unauthorized, and the forgery would have become readily apparent to him.[64] Therefore, Price, as a drawee, was in the best position to prevent the forgery. If he accepted or paid on an instrument bearing a forged signature of one of his account holders, then he is bound by that acceptance.[65] As a result, a drawee, like Price, cannot recover payment from a person who takes without fault and for value. Thus, the holding provides a rule of strict liability for the drawee.[66] Even if Price had endeavored to make such a comparison, but had reasonably failed to detect the forgery, the doctrine would still foreclose recovery.[67]

Another common, and related, justification for the holding of *Price v. Neal* is that the decision supports the policy of finality in commercial transactions.[68] Commonly, the holding of *Price v. Neal* is referred to as the "finality rule."[69] Under the finality rule, a payor or acceptor who pays or accepts an instrument bearing a forged drawer's signature is bound by that acceptance.[70] Essentially, certainty is obtained because the process of collecting drafts finally comes to a definite end, lay-

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Price v. Neal doctrine. *See* Bank of the United States v. Bank of Ga., 23 U.S. (10 Wheat.) 333, 349 (1825); Morgan Guar. Trust Co. v. Am. Sav. & Loan Ass'n, 804 F.2d 1487, 1495 (9th Cir. 1986); Bank of Glen Burnie v. Loyola Fed. Sav. Bank, 648 A.2d 453, 455 (Md. 1994); *see also* Perini Corp. v. First Nat'l Bank, 553 F.2d 398, 405 (5th Cir. 1977) ("Reaffirming *Price v. Neal* in the final payment rule of § 3-418, the [U.C.C.] drafters recognized that the case's appraisal of relative opportunity to scrutinize drawer signatures was somewhat unrealistic [but] they nevertheless insisted that its conclusion survives.").

62. *Price*, 97 Eng. Rep. at 871.

63. *See id.*

64. *See* WILLIAM D. HAWKLAND, COMMERCIAL PAPER AND BANKING 347–48 (1995).

65. *See id.*

66. *See* CLAYTON P. GILLETTE ET AL., PAYMENT SYSTEMS AND CREDIT INSTRUMENTS 343 (1996).

67. *See* HAWKLAND, *supra* note 64, at 348.

68. *See* 3 GEORGE E. PALMER, THE LAW OF RESTITUTION 291 (1978).

69. *See* Dow, *supra* note 1, at 147.

70. *See* PALMER, *supra* note 68, at 290–91.

ing the liability on the drawee.[71] Such finality encourages the free transfer of commercial paper.

For some observers, though, these rationales for the decision remain "problematic."[72] According to these commentators, "By failing to make clear the justification of the decision and, at the same time, suggesting an array of potentially conflicting possibilities, Lord Mansfield invited confusion and conflict over the doctrine."[73] Despite the apparent confusion, "it is clear that the *Price* doctrine was well-established by 1829" in English law.[74] It was not, however, extended to forged indorsements or material alterations during the nineteenth century in Great Britain.[75]

B. AMERICAN PROGENY

1. Pre-Uniform Commercial Code

Price v. Neal was adopted wholeheartedly in the nineteenth century in almost all American jurisdictions in commercial paper cases.[76] This ubiquity held well into the twentieth

71. Steven B. Dow & Nan S. Ellis, *The Payor Bank's Right to Recover Mistaken Payments: Survival of Common Law Restitution Under Proposed Revisions to Uniform Commercial Code Articles 3 and 4*, 65 IND. L.J. 779, 789 n.45 (1990) ("Promoting certainty in commercial transactions requires an end to the process of check collections at some point.").

72. Dow, *supra* note 1, at 129.

73. *See, e.g., id.* at 129–30. For more than half a century after *Price v. Neal*, courts continued to question the justification for the rule in the case. *See, e.g.*, Smith v. Mercer, 128 Eng. Rep. 961, 964 (P.C. 1815) (Chambre, J., dissenting) ("A great part of the doctrine of *Price v. Neal* seems . . . to be wholly repudiated by the Court.").

74. Dow, *supra* note 1, at 133.

75. *Id.* at 134 (citing Robinson v. Yarrow, 129 Eng. Rep. 183 (C.P. 1817) (for forged indorsements) and Jones v. Ride, 128 Eng. Rep. 779 (C.P. 1814) (for material alterations)).

76. Dow, *supra* note 1, at 134. *See, e.g.*, Bank of the United States v. Bank of Ga., 23 U.S. (10 Wheat.) 333, 349 (1825). After a lengthy summary of *Price v. Neal*, the Supreme Court said, "the case of *Price v. Neal* has never since been departed from; and . . . it has had the uniform support of the court, and has been deemed a satisfactory authority." *Id.* at 349–50; *see also* Cooke v. United States, 91 U.S. 389 (1875). In *Cooke*, the Court explained, justifying the rule:

> It is, undoubtedly, also true, as a general rule of commercial law, that where one accepts forged paper purporting to be his own, and pays it to a holder for value, he cannot recall the payment. The operative fact in this rule is the acceptance, or more properly, perhaps, the adoption, of the paper as genuine by its apparent maker. Often the bare receipt of the paper accompanied by payment is equivalent to an

century.[77] Like *Price v. Neal*, however, the prohibition on a drawee's right to recover was generally limited to holders who paid for value, acted in good faith, and were not negligent.[78] "[T]hese restrictions were no different from . . . the early nineteenth century English cases" or from *Price v. Neal* itself.[79] Early American courts were reluctant to expand the doctrine beyond the circumstances that gave rise to *Price v. Neal*.[80]

> adoption within the meaning of the rule; because, as every man is presumed to know his own signature, and ought to detect its forgery by simple inspection, the examination which he can give when the demand upon him is made is all that the law considers necessary for his protection. He must repudiate as soon as he *ought* to have discovered the forgery, otherwise he will be regarded as accepting the paper. Unnecessary delay under such circumstances is unreasonable; and unreasonable delay is negligence, which throws the burden of the loss upon him who is guilty of it, rather than upon one who is not. The rule is thus well stated in *Gloucester Bank v. Salem Bank*, 17 Mass. [33, 45 (1820)]: "The party receiving such notes must examine them as soon as he has opportunity, and return them immediately: if he does not, he is negligent; and negligence will defeat his action."

Id. at 396–97.

77. *See, e.g.*, Commercial & Sav. Bank Co. v. Citizens Nat'l Bank, 120 N.E. 670, 672 (Ind. App. Ct. 1918). In 1918, the Indiana Court of Appeals held that:

> Where a check purporting to have been drawn by one of [the payor bank's] depositors is presented to the bank by a bona fide holder thereof for value, and is paid by the bank, the latter cannot compel such holder to whom payment has been so made to repay the amount to it, if it subsequently discovers the check to have been forged.

Id. In 1920, the Supreme Court again favorably cited *Price v. Neal's* doctrine of finality, incorporating directly much of *Bank of the United States v. Bank of Georgia*. United States v. Chase Nat'l Bank, 252 U.S. 485, 494 (1920).

78. Dow, *supra* note 1, at 135–36; *see Bank of Ga.*, 23 U.S. at 348 ("[N]o recovery could be had, unless it be against conscience for the defendant to retain it, and that it could not be affirmed, that it was unconscientious for the defendant to retain it, he having paid a fair and valuable consideration for the bills, said 'Here was no fraud, no wrong.'" (internal citation omitted)); United States v. Nat'l Exch. Bank, 214 U.S. 302, 311 (1909) (applying *Bank of Ga.*, 23 U.S. (10 Wheat.) 333); Hoffman v. Bank of Milwaukee, 79 U.S. 181, 192 (1870)); *see also* Leather Mfrs. Bank v. Morgan, 117 U.S. 96, 109 (1886).

79. Dow, *supra* note 1, at 136.

80. *See* Dow & Ellis, *supra* note 71, at 791 n.51 (stating that much like English courts, American courts refused to extend *Price v. Neal* in other cases that involved mistaken payment, including the payment of a draft containing a forged indorsement or a material alteration); *see also* Nat'l Metro. Bank v. United States, 323 U.S. 454, 458 (1945) (affirming the "general rule under which one who presents and collects a valid commercial instrument with a forged [i]ndorsement can be compelled to repay"); ABN Amro Bank N.V. v. United States, 34 Fed. Cl. 126, 129 (1995). The Court of Claims noted:

> The common law evolved differently for checks involving solely forged indorsements. In such cases, rather than placing responsibility for the loss with the [payor] bank, the courts placed liability on the

However, some limited exceptions were made for cases of mistaken payment of insufficient funds[81] and no-account checks.[82]

The 1896 Uniform Negotiable Instruments Law (NIL) did not explicitly recognize the rule of *Price v. Neal*.[83] This omission is, perhaps, due to the fact that almost the entirety of the NIL was taken "paragraph by paragraph from the English Bills of Exchange Act of 1882," which was characterized by a similar omission.[84] Nonetheless, the doctrine of finality became and remained "firmly established" and "nearly universal" in American commercial paper law before the UCC.[85]

2. Original Uniform Commercial Code

The holding of *Price v. Neal* was adopted into the original UCC, and remained largely unaffected until the adoption of the RUCC.[86] The drafters cited as the justifications for adopting

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> depositary bank. Although the allocation of loss for the two types of forgery cases is different, the reasoning that underlies the results is essentially the same. In *Price* and its progeny, the courts allocated the loss to the [payor] bank because the [payor] bank is in a better position than the depositary bank to detect a forgery of the drawer's signature. Analogously, for forged indorsements, the depositary bank typically is in a better position than the [payor] bank to detect a forgery because the depositary bank is either familiar with the indorser's signature or in a position to secure proof of the indorser's identity.

Id. (internal citation omitted).

81. *See* Dow & Ellis, *supra* note 71, at 791 n.51 (discussing cases of mistaken payment of insufficient funds).

82. *Id.* at 792 n.52 and accompanying text (discussing the expansion of the doctrine in cases of insufficient funds and no-account checks); *see* Dow, *supra* note 1, at 136–37. In the case of no-account checks, "payment was final and could not be recovered by the bank so long as the holder was in good faith, not negligent, and had taken the item for value." *Id.* at 137.

83. Dow, *supra* note 1, at 141.

84. *Id.* The NIL "was closely modeled on the British Bills of Exchange Act of 1882 . . . ." Robert L. Jordan & William D. Warren, *Introduction* to Symposium, *Revised U.C.C. Articles 3 & 4 and New Article 4A*, 42 ALA. L. REV. 373, 385 (1991).

85. Dow, *supra* note 1, at 144–45.

86. U.C.C. § 3-418 cmts. 1–2 (1978) state:

> [U.C.C. § 3-418] follows the rule of Price v. Neal, 3 Burr. 1354 (1762), under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover back his payment. Although the original Act is silent as to payment, the common law rule has been applied to it by all but a very few jurisdictions . . . . [U.C.C. § 3-418] follows the decisions under the original Act applying the rule of Price v. Neal to the payment of overdrafts, or any other payment made in error as to the state of the drawer's account. The same argument for finality applies, with the additional reason that the drawee is responsible for knowing

the doctrine both the finality rule and the concept that the drawee is in a superior position to detect the forgery.[87]

Section 3-418 of the original UCC read, in relevant part, "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."[88] The drafters, however, pointed out that "[t]he rule as stated in the section is not limited to drawees, but applies equally to the maker of a note or to any other party who pays an instrument."[89] Notably, § 3-418 included the equivalent *Price v. Neal* requirements of "good faith"[90] and "takes . . . for value," incorporated through § 3-302's definition of "holder in due course."[91] Moreover, § 3-418

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the state of the account before he accepts or pays.

Id.; Dow, *supra* note 1, at 145–46; *see, e.g.*, N. Trust Co. v. Chase Manhattan Bank, N.A., 582 F. Supp. 1380 (S.D.N.Y. 1984) (applying U.C.C. § 3-418 and holding that when an indorser was holder in due course, the drawee could not recover the monies or its proceeds from the forged check because the final payment rule barred the action), *aff'd* 748 F.2d 803 (1984) (per curium).

87. U.C.C. § 3-418 cmt. 1 (1978). Of these two justifications, the drafters found that the benefits of finality were more important and realistic:

> The traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker's signature and is expected to know and compare it; a less fictional rationalization is that it is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered.

Id.

88. *Id.* § 3-418.

89. *Id.* § 3-418 cmt. 1.

90. *Id.* § 3-418.

91. *Id.* § 3-302. The original U.C.C. definition of "holder in due course" read in relevant part:

> (1) 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.

Id. U.C.C. § 3-418 cmt. 3 states:

> [U.C.C. § 3-418 makes] payment or acceptance final only in favor of a holder in due course, or a transferee who has the rights of a holder in due course under the shelter principle. If no value has been given for the instrument the holder loses nothing by the recovery of the payment or the avoidance of the acceptance, and is not entitled to profit at the expense of the drawee; and if he has given only an executory promise or credit he is not compelled to perform it after the forgery or other reason for recovery is discovered. If he has taken the instrument in bad faith or with notice he has no equities as against the drawee.

Id. § 3-418 cmt. 3; *see also, e.g.*, G.F.D. Enters., Inc. v. Nye, 525 N.E.2d 10, 11 allowed recovery "for breach of warranty on presentment"[92] under § 3-417,[93] parallel to the common law.[94]

The rule allowing a drawee to recover based on negligence by the presenter was also adopted via the good faith requirement.[95] In a nod to the common law, the drafters maintained *Price v. Neal* "in essentially its pre-Code form,"[96] allowing recovery for insufficient funds and no-account items.[97] Up to the creation of the RUCC, the principle "obstacle" a plaintiff-drawee had to clear to recover against a presenter remained "the final payment rule which has its roots in the 18th century case of *Price v. Neal*."[98]

3. Revised Uniform Commercial Code

The RUCC made "relatively minor"[99] changes to the UCC and the *Price v. Neal* doctrine. While RUCC § 3-418(a) and (b) appear to give the drawee hope of recovering funds paid over a forged drawer's signature,[100] RUCC § 3-418(c) quickly steals this optimism for recovery from the drawee.[101]

(Ohio 1988) (applying U.C.C. § 3-418 and holding, as a result of the final payment rule, the payment of a negotiable instrument by the "payor bank is final" when the payment is made in favor of a holder in due course, rendering the "payor bank primarily liable on the instrument").

92. U.C.C. § 3-418 (1978). The warranty on presentment included, in most cases, that the person obtaining good faith payment or acceptance had "no knowledge that the signature of the maker or drawer [was] unauthorized," *Id.* § 3-417(1)(b). This provision was carried into the RUCC. *See* U.C.C. § 3-417 (2003).

93. U.C.C. § 3-418 (1978).

94. Dow, *supra* note 1, at 147–48.

95. *Id.* at 148.

96. *Id.* at 151.

97. *Id.*

98. *See, e.g.*, Payroll Check Cashing v. New Palestine Bank, 401 N.E.2d 752 (Ind. Ct. App. 1980). In this case, the Indiana Court of Appeals reiterated the rationale of *Price v. Neal*. *Id.* at 755. New Palestine Bank (NPB) inspected and paid three checks, but was subsequently informed that they were forgeries. *Id.* at 754. NPB then commenced an action against Payroll Check Cashing to recover. *Id.* The court recounted the finality rule and applied it to the case at hand. *Id.* at 755. The court noted that: "[t]he rule of *Price v. Neal* . . . is maintained in the Code . . . . [P]ayment 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." *Id.* "[*Price v. Neal*] held that a drawee who pays an instrument bearing a forged drawer's signature is bound on his acceptance and cannot recover back his payment." *Id.*

99. Dow, *supra* note 1, at 154.

100. *See* U.C.C. § 3-418(a)–(b) (2003).

101. *See id.* § 3-418(c).

RUCC § 3-418(a) codifies the drawee's right to recover for payment on an instrument if the drawee mistakenly believed that a stop payment order[102] had not been issued or if a forged drawer's signature appeared on the draft.[103] Further, § 3-418(b) codifies the right of a drawee to recover payment or revoke acceptance for other mistaken payments, like insufficient funds, under the common law of mistake and restitution.[104] The rule of *Price v. Neal*, however, is itself incorporated in § 3-418(c).[105] It reads, in relevant part, "[t]he remedies provided by subsection (a) or (b) *may not* be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance."[106] Thus, in most circumstances, § 3-418(c) swallows § 3-418(a) and (b).[107]

Moreover, under the RUCC, the drawer still provides certain presentment warranties to the drawee.[108] When the pre-

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102. *See id.* § 4-403.

103. *Id.* § 3-418(a) reads:

> Except as provided in (c), if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to Section 4-403 or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

Id.

104. *Id.* § 3-418(b) reads:

> Except as provided in subsection (c), if an instrument has been paid or accepted by mistake and the case is not covered by subsection (a), the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

Id.

105. *See id.* § 3-418(c) cmt. 1.

106. *Id.* (emphasis added).

107. *Id.* § 3-418 cmt. 1:

> [I]n each case [(a) and (b)], by virtue of subsection (c), the drawee loses the remedy if the person . . . who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance . . . . The result in the two cases covered by subsection (a) is that the drawee in most cases will not have a remedy against the person paid because there is usually a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance.

Id.

108. *See id.* § 3-417.

senter presents an instrument to a payor bank for payment who in turn pays it, the presenter warrants that at the time he presented the instrument, he believes in "good faith" that (1) the presenter received the instrument "from a person entitled to enforce it;" (2) the instrument was not altered; (3) the presenter "has no knowledge that the signature of the drawer of the draft is unauthorized;" and (4) "with respect to any remotely-created consumer item[s], that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn."[109] The first three presentment warranties do not alter the *Price v. Neal* doctrine, however, because, by definition under the RUCC, the presenter needs only believe in "good faith"[110] that the instrument was not doctored and was transferred by a person entitled to enforce it. Such a clean heart is also a requirement under *Price v. Neal*. In fact, the third warranty is, itself, a codification of the *Price v. Neal* rule.[111] However, the fourth presentment warranty, added in 2002, provides a limited exception to the *Price v. Neal* doctrine for specific instruments.[112] This amendment possibly indicates a shift in the drafters' mentality towards erosion of the *Price v. Neal* doctrine.

Negligence by the drawer has also been incorporated as a ground for absolving the payor bank from liability under § 3-406(a).[113] Under § 3-406, a drawer may be precluded from recovering from the payor bank "to the extent to which the failure . . . to exercise ordinary care [by the drawer] contributed to the loss," a comparative allocation.[114] As provided by § 3-406(c),

109. *Id.* § 3-417(a)(1)–(4).

110. *See id.* § 3-417.

111. *Id.* § 3-417 cmt. 3, provides:

> [S]ubsection (a)(3) retains the rule of Price v. Neal, 3 Burr. 1354 (1762), that the drawee takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized. Under subsection (a)(3) the warranty of no knowledge that the drawer's signature is unauthorized is also given by prior transferors of the draft.

Id.

112. *See id.* § 3-416 cmt. 8, app. XIX.

113. *Id.* § 3-406(a) reads:

> A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

Id.

114. *Id.* § 3-406(b) reads:

"[u]nder subsection (a), the burden of proving failure to exercise ordinary care is on the person *asserting the preclusion*."[115] Lastly, § 3-406(c) provides "[u]nder subsection (b), the burden of proving failure to exercise ordinary care is on the person *precluded*."[116]

4. Exceptions or Erosion?

Despite a "remarkable continuity"[117] in the doctrine of *Price v. Neal* throughout American commercial paper law, some observers continue to question its usefulness. Some observers would like to add exceptions to the rule of finality. For example, by 2000, the California Bankers Clearing Association and California Uniform Commercial Code had implemented non-uniform exceptions.[118] The effects of these provisions are "to place the loss flowing from unauthorized demand drafts on the depositary bank."[119] Thus, their result is to "create[ ] a limited exception to the venerable rule of *Price v. Neal* . . . by relieving the drawee, in that context, of the ultimate economic responsibility for the unauthorized signature of its customer."[120] Whether such a movement will ultimately yield only narrowly carved-out exceptions to the rule of finality, or will spell a

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> Under subsection (a), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

Id.

115. *Id.* § 3-406(c) (emphasis added).

116. *Id.* (emphasis added).

117. Dow, *supra* note 1, at 157.

118. Fred H. Miller, *Modernizing the UCC for the New Millenium: Introduction to a Collection on the New UCC*, 25 OKLA. CITY U. L. REV. 189, 207–08 (2000).

119. *Id.* at 207. Importantly:

> In recent years, the use of "demand drafts" as a payment mechanism and, in some cases, a collection mechanism, has grown. Demand drafts appear very much like traditional checks, except that they are prepared by the payee and bear a legend such as "signature on file," "no signature required," or "authorized by customer." When actually authorized by the named drawer, a demand draft can be an efficient mechanism to process payments. The possibilities for fraud and misuse are obvious, though, especially in connection with telemarketing activities, and have led to the federal Telemarketing and Consumer Fraud and Abuse Prevention Act.

Id.

120. *Id.* at 208.

wholesale erosion of it, remains to be seen. In either case, this debate indicates that the rule of *Price v. Neal* is not entirely without controversy.

5. Modern Justification

In contemporary banking, many payor banks do not actually take the time to compare the signature on an instrument to a verifying signature card.[121] The typical exception is made for unusually large checks. Still, three principal rationales are made for maintaining the historical final payment rule.

First, the payor bank is presumed to have extensive information concerning fraud rates, the types and amounts of checks most typically used, and effective prevention measures. Thus to the extent that these facts hold true, the payor banks are in a good position to undertake prevention in many, if not most, situations.[122] A payor bank will match the marginal cost of acquiring or investing in technologies that deter or prevent check fraud with the marginal loss that results from the possibility that any particular check is a forgery.[123]

Second, adding the imposition of strict liability to the bank's ostensible informational reservoir creates an even stronger incentive for payor banks to acquire or invest in technologies that detect or deter check fraud.[124] Third, the doctrine continues to encourage finality in commercial paper transactions.[125]

Nonetheless, some commentators believe that "[t]he overwhelming support for the basic doctrine in American law was accompanied by a general failure to firmly settle on a satisfactory justification for it."[126] This position is maintained, despite the fact that "this process was not as pronounced . . . as in the English courts."[127]

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121. *See* Am. Bankers Ass'n, *Results of ABA DAFC Survey on Unauthorized Unsigned Drafts*, *at* http://www.aba.com/Compliance/DAFCsurveyjuly2002.htm (July 2002) (last visited Sept. 1, 2004) [hereinafter ABA Survey].

122. *See* GILLETTE ET AL., *supra* note 66, at 344.

123. *See id.* at 345.

124. *Cf. id.* ("[U]nder each liability regime, negligence and strict liability, banks will invest in precautions until the marginal cost of examination equals the marginal gain in fraud detection.").

125. *See generally* PALMER, *supra* note 68 (discussing the doctrine of finality).

126. Dow, *supra* note 1, at 138–39.

127. *Id.* at 139.

C. COMPARATIVE ANALYSIS: THE PATCHWORK FATE OF *PRICE V. NEAL* IN ENGLISH LAW

Despite the English courts' acceptance of the doctrine of *Price v. Neal* in the late eighteenth and early nineteenth centuries, English judges began undermining the doctrine in 1841.[128] During this period of time, English judges routinely selected a "single factor from the *Price v. Neal* opinion as *the* justification for that decision . . ."[129] These judges would then hinge their opinion on the stated justification while they rejected, explicitly or implicitly, some of the other foundations of the doctrine.[130] Not surprisingly, such jurisprudence began to lead to inconsistent results and the erosion of the prevalence of the *Price v. Neal* rule in England.

Many English judges saw negligence as one of the basic justifications for the *Price v. Neal* Doctrine.[131] However, the 1841 case of *Kelly v. Solari*[132] held that even when a party making a mistaken payment is negligent, that fact would not preclude recovery by that party.[133] The effect of this decision was to undermine one of the key rationales supporting *Price v. Neal*.[134]

In the latter years of the nineteenth century, English courts partially withdrew another of the proposed justifications for *Price v. Neal*.[135] A series of cases held that the defense of estoppel against the drawee would be limited to situations where the negligent party owed a specific duty either to "the person asserting the estoppel or to the general public."[136] Later, English courts determined that a party that had mistakenly received payment on a forged check had no special relationship with the payor bank that gave rise to a duty on the part of the

128. *Id.* at 158–59.

129. *Id.* at 132 (citing Dow, *supra* note 25, at 33–34).

130. *See* Dow, *supra* note 1, at 132.

131. *See id.* at 158–59.

132. 152 Eng. Rep. 24 (Ex. 1841); Dow, *supra* note 1, at 159.

133. *See* 152 Eng. Rep. 24; Dow, *supra* note 1, at 159. Under *Kelly*, the signature cards that a payor bank maintains do not provide the payor bank with actual knowledge; they simply provide a means to acquire knowledge of the forgery. *See* Dow, *supra* note 1, at 159 n.234.

134. *See* Dow, *supra* note 1, at 159.

135. *See id.*

136. *Id.* (citing Lewes Sanitary Steam Laundry Co. v. Barclay & Co., 95 L.T.R. 444 (K.B. 1906); Patent Safety Gun Cotton Co. v. Wilson, 49 L.J.R. 713 (C.A. C.P.D. 1880); Arnold v. Cheque Bank, 1 C.P. 578 (1876)).

bank to the mistaken payee.[137] As such, the bank was "not estopped from denying the validity of the signature."[138]

Similarly, the potential use of the change-in-position justification was substantially limited in a number of *Price v. Neal*-type cases.[139] One of the explanations for the *Price v. Neal* doctrine was that a presenter may have relied on the mistaken payment or acceptance by the drawee and acted on the assumption that the drawee had correctly paid on the draft.[140] The presenter is said to have undergone a change in position to his detriment in reliance on the failure of the drawee to detect the forgery and to have mistakenly paid or accepted the instrument.[141] As such, it would be unfair to punish the presenter for the failure of the drawee to detect the forgery by requiring repayment of the draft.

In bill of exchange cases, some judges were unwilling to presume a change in position.[142] However, in the latter half of the nineteenth century, courts began to limit the applicability of the change-in-position defense to instances where an agent received payment and then paid funds over to another party, relying on the validity of the initial payment.[143] Elsewhere, the change-in-position defense was limited to situations where the plaintiff breached a duty arising from a mutual relationship.[144] This approach eventually undermined *Price v. Neal* in the first decades of the twentieth century.[145] In time, English courts ceased to recognize a legal duty between the presenting party

137. *See* Dow, *supra* note 1, at 159.

138. *Id.*

139. *See id.* at 160–61.

140. *See id.* For example, in *Cocks v. Masterman*, 109 Eng. Rep. 335 (K.B. 1829), the King's Bench held that "the holder of a bill is entitled to know, on the day when it becomes due, whether it is an honoured or dishonoured bill, and that, if he receive[s] the money and is suffered to retain it during the whole of that day, the parties who paid it cannot recover it back." *Id.* at 338. Because the presenter had rights against "former parties on their signatures," the court assumed that the drawee had a duty to the presenter to identify whether the instrument was to be paid or dishonored on the day when the instrument was presented. *Id.* The failure of the drawee to explain to the presenter that the instrument was forged limited the power of the presenter to pursue these former parties. *See id.* As such, the presenter had undergone a change of position to his detriment because of the drawee's failure to detect a forgery. *Id.*

141. *See* Dow, *supra* note 1, at 160–61.

142. *See id.* at 160.

143. *See id.* at 161.

144. *See id.* at 160.

145. *See id.*

and the drawee.[146]

The 1903 case of *Imperial Bank v. Bank of Hamilton*[147] crippled the *Price v. Neal* doctrine even further. In this case, the Privy Council held that a drawee making payment who had the ability to discover a mistake but did not do so, could still recover money paid under a mistake of fact.[148] In addition, "the 'sham' doctrine,[149] which emerged in the [middle of the nineteenth] century, eventually narrowed the *Price* rule" by making "a *valid* drawer's signature . . . an essential requirement of a valid bill of exchange."[150] Thus, the lack of a valid (i.e., not forged) drawer signature prevented liability under both contract, via the bills of exchange law, and criminal forgery law.[151] Although the sham doctrine appeared to have little impact in the nineteenth century,[152] it resurfaced in 1927 in the Supreme Court of Ceylon.[153] Even then, the doctrine was largely ignored[154] by English courts and commentators until it was adopted in the 1974 case of *National Westminster Bank Ltd. v. Barclays Bank International Ltd.*[155] There, Justice Kerr held that items with a forged drawer's signature were not negotiable instruments and therefore, *Price* did not govern those types of cases.[156]

Thus, "in modern English law . . . while the doctrine [of *Price v. Neal*] has not been overturned, its justifications have been largely undermined and its scope considerably limited so that outside of a few specific situations there is very little left of it in English law."[157] This patchwork erosion stands in stark contrast to its essentially wholesale adoption in the American

146. *Id.*

147. 1 App. Cas. 49 (P.C. 1903); Dow, *supra* note 1, at 166.

148. *See Imperial Bank*, 1 App. Cas. 49; Dow, *supra* note 1, at 166.

149. The instrument is a "sham" because it was never a negotiable instrument in the first place. *See* Dow, *supra* note 1, at 163 (citing 1 JOSEPH CHITTY, A PRACTICAL TREATISE ON BILLS OF EXCHANGE, PROMISSORY NOTES, AND BANKER'S CHECKS 9 (1834)).

150. Dow, *supra* note 1, at 163 (emphasis added) (citing *Ex parte* Hayward, 6 L.R. ch. 546 (Ch. App. 1871); M'Call v. Taylor, 34 L.J.R.N.S. 365 (C.P. 1865); Stoessiger v. S. E. Ry., 118 Eng. Rep. 1248 (Q.B. 1854)).

151. *See* Dow, *supra* note 1, at 163.

152. *See id.* at 165–66.

153. *See id.* at 167–68 (citing Imperial Bank v. Abeyesinghe, 29 N.L.R. 257 (Ceylon 1927)).

154. *See* Dow, *supra* note 1, at 167 n.281.

155. 3 All E.R. 834 (Q.B. 1974); Dow, *supra* note 1, at 167 n.281.

156. *See* Dow, *supra* note 1, at 168.

157. *Id.* at 173.

commercial paper system.[158] This differentiation is all the more peculiar given the otherwise similar evolution of English and American payments law.[159]

III. FROM DICTATE TO DEFAULT

A. THE COST OF *PRICE V. NEAL*

As noted above, whatever the underlying rationale, the principal effect of *Price v. Neal* is to prompt American payor banks to compile extensive information concerning fraud rates, types and amounts of checks used, and effective prevention measures.[160] Assembling these mechanisms to collect information and utilize it has a substantial price tag.[161] To be effective, banks must make tangible investments in data compilation and information systems technology.[162] Payor banks likely will and do inevitably burden customers with much or all of the cost of matching the marginal cost of these investments to the marginal losses resulting from forgery.[163] This cost to consumers can manifest itself in the form of higher fees, lower interest payments to customers, or the curtailment of customer services.

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158. *See supra* Part II.B.

159. *See* Dow, *supra* note 1, at 173–74.

160. *See supra* Part II.B.5.

161. According to the American Bankers Association:

> One in five money center banks spent more than $20 million each in check fraud-related operating expense (not including actual losses). The median expense per bank fell in the range of $5 million to $20 million for money center banks, between $250,000 and $1 million for regional banks, from $10,000 to $50,000 for mid-size banks and less than $5,000 for community banks.

Am. Bankers Ass'n, News Release 2002, *Attempted Check Fraud Doubles to $4.3 Billion According to ABA Survey* (Nov. 13, 2002), *at* http://www.aba.com/press+room/111302checkfraud.htm (last visited Sept. 1, 2004) [hereinafter ABA News Release 2002].

162. *See id.*; *see also* CORP. FOR AM. BANKING, FRAUD REDUCTION SOFTWARE SOLUTION CARREKER, *at* http://www.aba.com/CAB/CAB_carreker_fraud.htm (last visited Sept. 1, 2004) (describing an ABA recommended banking software program available to banks that allow them to detect and prevent check fraud); Am. Bankers Ass'n, News Release 2001, *ABA Endorses Carreker Products for Preventing Fraud and Improving Cash, Reserve Efficiency* (Oct. 16 2001), *at* http://www.aba.com/CAB/CAB_carrekerpressrel.htm (last visited Sept. 1, 2004).

163. *See* Bryan D. Hull, *Common Law Negligence and Check Fraud Loss Allocation: Has Common Law Supplemented or Supplanted the U.C.C.?*, 51 OHIO ST. L.J. 605, 613 (1990).

B. WHAT DO PAYOR BANKS DO IN THE REAL WORLD?

Despite these substantial investments in fraud-detection technology and the specter of strict liability, most payor banks do not take the time to compare the signature on an instrument to a verifying signature card except for unusually large checks.[164] Although there is a dearth of empirical evidence on this point, anecdote serves a useful purpose. "Time is money," as the saying goes. Despite the compilation of extensive databases for verifying signature cards, the transaction costs for a bank employee to actually utilize a database will likely outweigh the monetary benefits of fraud detection in many circumstances, especially during peak processing periods. The apparent failure of banks in many instances to use all available means of fraud detection is troublesome given the fact that attempted and successful check fraud continues to rise.[165]

The payor bank's theoretical incentive to detect fraud is further complicated by the fact that even if a presenter or account holder is well educated on his legal rights under commercial paper law, and points to RUCC § 3-418(c) in a *Price v. Neal* situation, a payor bank can simply refuse to credit the presenter's account or decline to restore the account holder's balance. Moreover, a payor bank may simply misrepresent to an uninformed account holder or presenter that he bears the burden of loss.

In either case, the cost of litigation effectively precludes the proper crediting of a presenter's account or restoring the account holder's balance in the instance of a small check.[166] It is

164. *See* ABA Survey, *supra* note 121 (indicating that banks do not physically inspect all of the nearly fifty billion checks processed each year). See also John M. Norwood, *Bank Negligence and the Forgery Doctrine*, 115 BANKING L.J. 254, 256–61 (1998) and cases discussed therein.

165. *See* ABA News Release 2002, *supra* note 161. According to the 1999 ABA Deposit Account Fraud Survey Report, $2.2 billion in fraudulent checks were presented to U.S. banks that year, resulting in actual bank losses of $679 million. *Id.* That amounts to a success rate of almost thirty-one percent.

A recent survey indicates that banks have become far more proficient at detecting fraudulent checks. *Id.* Of the $4.3 billion attempted to be obtained by fraudulent checks in 2001, only $698 million was actually obtained. *Id.* While this is almost $20 million more in actual losses than in 1999, it is only about half of the loss as a matter of percentage of actual loss to attempted fraud. Just over sixteen percent of the attempted fraud resulted in actual loss to the banks in 2001. *See also* AM. BANKERS ASS'N, DEPOSIT ACCOUNT FRAUD, *at* http://aba.com/Compliance/DAFC_overview.htm (last visited Sept. 1, 2004).

166. *See* Edward Rubin, *Efficiency, Equity and the Proposed Revision of Articles 3 and 4*, 42 ALA. L. REV. 551, 569–70 (1991).

only in the case of a relatively large check that the marginal benefit of recovery would equal or be greater than the marginal cost of litigation.[167]

Of course, a payor bank would still have "the burden of proving failure to exercise ordinary care"[168] as "the person asserting the preclusion"[169] in the course of bona fide litigation. Nonetheless, the payor bank could, with no immediate cost to itself, perfunctorily claim its belief that the presenter or account holder must have been negligent. By taking such a stance, the payor bank can force the adverse party to make a difficult decision.[170] The presenter or account holder at this point has to weigh the costs of a lawsuit against the payor bank and the likelihood of success against the value of payment on the instrument.[171]

The resulting, strong-form conclusion is that, "consumers can virtually never enforce their rights against a bank because it will simply be too expensive to do so."[172] Thus, despite the substantially strong de jure adherence to the rule of *Price v. Neal*, the American litigation system's high transaction costs almost certainly cause a substantial de facto misallocation of forgery costs to be imposed on legally innocent presenters or account holders.

C. A COASEIAN CONFLUENCE AND THE HAYEKIAN DECENTRALIZED NATURE OF KNOWLEDGE

The nature of payor bank firms' usual information-processing competence does not, by itself, supply an adequate rationale for uniformly imposing strict liability on them in *all instances*. It is economically efficient for a payor bank to pursue fraud detection only to the extent that its internal cost is less

167. *See id.*
168. U.C.C. § 3-406(c) (2003).
169. *Id.* § 3-406(b).
170. *See* Rubin, *supra* note 166, at 569.
171. *See id.* at 569–70.
172. *Id.* at 569. Rubin points out that such a system is highly inefficient. *Id.* With the RUCC applying a comparative negligence rule, the parties are prone to squabble over each and every aspect of a case, thus driving up the cost of any potential litigation. *Id.* Because the precise allocation of negligence is vital, every fact has particular significance. *Id.* This causes increased costs of discovery and can cause trials to be dragged out. *Id.* As the cost of the litigation increases, the actual benefit of any outcome decreases. *Id.* It is only in the very large cases that the amount at issue will be greater than the amount spent determining the fault of the parties. *See id.* at 569–70.

than the corresponding external cost. Allowing parties to reallocate fraud risk more efficiently based on their particularized knowledge would reduce social costs, including consumer costs.

1. The Nature of the Firm and the Commercial Paper System

a. The Nature of the Firm

To understand what a "firm" *is*, one must first understand the fundamental reason a firm exists, which is to reduce transaction costs among human beings engaged in economic exchange intended to create mutual value.[173] Transaction cost economics finds its beginnings with Nobel Economics Laureate Ronald Coase's famous 1937 article *The Nature of the Firm.*[174] A firm mitigates or avoids many transaction costs by producing some production inputs for itself internally (in-house).[175] As a result, a firm expands its operations until the marginal cost of producing an input internally equals the external (market) price of that input.[176] When the internal cost becomes greater than the market price, a firm will no longer engage in that activity, leaving it for external parties to perform more cheaply.[177] When external transaction costs are high, internal firm organization is efficient (if only by comparison).[178] In contrast, when external transaction costs are low, autonomous, arm's-length market relations will proliferate.[179] A firm also exists in legal terms as a nexus of contracts that helps to reduce agency costs by preventing employees from enriching them-

173. *See generally* R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 393 (1937) (providing a working definition of the term "firm" to be used in economic theory).

174. *Id.*

175. *See id.* at 394–96. The entrepreneurial model as described by Coase states that obtaining goods in the market is not costless in that there is a cost to the operation of the market itself. *See id.* The entrepreneur therefore must direct a firm and the available resources at a cost that is less to the firm than the market can provide, essentially suppressing the price mechanism as it relates to the firm. *See id.*

176. *See id.*

177. *See id.*

178. *See* Oliver E. Williamson, *The Economics of Organization: The Transaction Cost Approach*, 87 AM. J. SOC. 548, 558–59 (1981).

179. *See id.* This is simply the converse of the previous sentence in that it is another way of saying that firms will look to the market to provide them with the materials they need if the costs of doing so are lower than creating the material internally.

selves at the expense of owners.[180] This nexus, in turn, reduces internal transaction costs.[181]

A firm evolves these transaction-cost boundaries out to the edge of its core competencies and capabilities.[182] Essentially, this boundary marks what the firm is good at in terms of its specific information capital or know-how for solving economic problems.[183] A firm may have more than one core competence, but attempts to fuse disparate competencies together rarely yield benefits, as firms will tend to spend more time on what they are "less good" at than on their strengths, reducing their competitiveness, efficiency, and—ultimately—the value they create for their stakeholders.[184]

Together, then, a firm can be defined as a group of heterogeneous resources organized into one or more core competence(s) and capabilities to reduce the transaction costs of human exchange by creating production inputs internally to the extent that the marginal cost of doing so is less than or equal to an input's external market price.[185]

b. *The Firm and the Commercial Paper System*

All financial institutions function as an information matrix

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180. Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976). Jensen & Meckling define agency costs as follows:

> (1) the costs of creating and structuring contracts between the principle and the agent (both explicit and implicit contracts)
>
> (2) the monitoring expenditures by the principle (measuring or observing the behavior of the agent as well as efforts to control the behavior of the agent through budget restrictions, compensation policies, operating rules and the like)
>
> (3) the bonding expenditures of the agent, and
>
> (4) the residual loss.

Id. at 308 nn.9–10, 309.

181. *See id.* at 310.

182. *See* C.K. Prahalad & Gary Hamel, *The Core Competence of the Corporation*, HARV. BUS. REV., May–June 1990, at 79, 81; *see also* George Stalk et al., *Competing on Capabilities: The New Rules of Corporate Strategy*, HARV. BUS REV., Mar.–Apr. 1992, at 57, 66 (describing the similarities and differences between core competencies and core capabilities and likening their combination to the "grand unifying theory" in the field of physics).

183. *See* Prahalad & Hamel, *supra* note 182, at 81–83.

184. *See* Coase, *supra* note 173, at 394–95 (stating that through excessive expansion, a firm will at some point fail "to make the best use of the factors of production").

185. *Id.* at 393 (stating that a firm "consists of the system of relationships which come into existence when the direction of resources is dependent on an entrepreneur").

that is designed to align a kaleidoscope of consumer financial wants with a variegated array of available financial products.[186] Thus, every financial institution possesses some type of financial information processing core competence.[187] Similarly, to obtain in the first instance and thereafter retain customers, all financial institutions have a capability in "customer-centricity" that aids the targeting of particular products to particular consumers.[188]

On some level, payor banks also possess core information-processing competence and capability.[189] Thus, the nature of a payor bank as a firm provides support for the thesis that a payor bank can accumulate information on fraud and the ability to prevent it.[190] Although a payor bank may often be in the best position to compile a financial fraud matrix, it does not necessarily follow from this fact alone that a payor bank is, per se, in *the best position in all circumstances* to vigorously act on that information to prevent fraud.[191] It is economically efficient

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186. *See* Stalk et al., *supra* note 182, at 68–69. Stalk and company examine and compare the core capabilities of two fast growing regional banks: Wachovia and Banc One. The authors' basic premise is that each bank has developed a set of core capabilities that enables each to deliver flexible customer service from two very different perspectives. *See id.* Wachovia focuses on providing customers throughout the regions with a superior level of individualized customer service much like a corporate client would receive. *See id.* at 68. Banc One on the other hand, focuses on serving the particular needs of specific communities by giving its local branches a high level of autonomy so that they may adapt to the specific needs of the community. *See id.* at 68–69.

187. *See, e.g.*, *id.* As Stalk points out, the core competence of Wachovia is its ability to treat the individual customer with a great deal of personal service. *See id.* at 68. This personal attention to the individual customer results in Wachovia's having "the highest 'cross-sell ratio'—the average number of products per customer—of any bank in the country." *Id.* at 68. To perform these services, Wachovia has developed a specialized support system that integrates customer information and allows the personalized bankers to respond to customer requests by the end of the day in many cases. *See id.* Banc One, by focusing on local needs, has allowed its branches to develop community roots. *See id.* However, unlike most local banks, Banc One has a highly centralized informational system that allows each branch manager to learn from the practice of other Banc One branches. *See id.* at 68–69.

188. *See, e.g.*, *id.*

189. *See, e.g.*, *id.*

190. *See supra* Part III.B; *see also* CORP. FOR AM. BANKING, *supra* note 162 (discussing a system that can be used by banks to detect counterfeit and forged checks and evaluate deposit fraud); ABA News Release 2002, *supra* note 161 (crediting banks' check fraud prevention systems with keeping actual fraud losses significantly lower than the number of fraud attempts in 2001).

191. *Cf. supra* Part II.B.5 (discussing the modern justification for the finality rule imposing liability on the payor bank).

for a payor bank to attempt to detect fraud only to the extent that the internal transaction cost of doing so is less than the corresponding external cost.[192]

2. Hayek's Decentralized Nature of Knowledge and the Efficient Management of Fraud

Price v. Neal is essentially a case about allocating the burden of fraud to the "innocent" party that had the most knowledge to stop the fraud prior to payment.[193] Thus, the party that could have verified the signature against a signature card is the party that bears the burden of the risk of loss. Although the modern rationale for the rule of finality in *Price v. Neal* dovetails with the realities of knowledge acquisition in some instances, it is not necessarily true that it does so *in all instances.* As Nobel Economics Laureate F. A. Hayek observed in his seminal 1945 article *The Use of Knowledge in Society*, knowledge is typically decentralized and diffuse, and is often only tacitly held.[194] Although knowledge can be gathered and assembled into various forms for human manipulation, the more decentralized, diffuse, and tacit knowledge is, the higher the cost of its assembly and manipulation. When legal rules further limit the ability to use knowledge, the impediments to efficient

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192. *See* Coase, *supra* note 173, at 394–96. *See generally* ABA News Release 2002, *supra* note 161 (noting that in 2001 the external cost, in the form of actual losses, to banks from check fraud was $698 million).

193. *See supra* Part II.

194. *See* F.A. Hayek, *The Use of Knowledge in Society*, AM. ECON. REV., XXXV, No. 4 (Sept. 1945), 519–30, *reprinted in* INDIVIDUALISM AND ECONOMIC ORDER 77 (The Univ. of Chi. Press 1957) (1948). Hayek states:

> [T]he "data" from which the economic calculus starts are never for the whole society "given" to a single mind which could work out the implications and can never be so given.
>
> The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess. The economic problem of society is thus not merely a problem of how to allocate "given" resources—if "given" is taken to mean given to a single mind which deliberately solves the problem set by these "data." It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge which is not given to anyone in its totality.

Id. at 77–78; *see also* THOMAS SOWELL, KNOWLEDGE AND DECISIONS 3–20 (Basic Books 1980).

use of this knowledge are further increased. This is especially true when the cost of gathering a particular type of knowledge is high.

The efficiency of the commercial paper system depends critically on how freely transaction costs are allowed to converge at their lowest levels, and thus transmit knowledge pertaining to fraud at the lowest cost to human beings. To the extent that the external transaction cost of assembling information on commercial paper fraud and managing the potential loss therefrom is less than the corresponding internal cost for a payor bank, it is more economically efficient to allow an external party[195] to bear that cost. This result, of course, is presently disallowed in the American system.

Thus, in the name of preserving finality[196] and laboring under the mistaken assumption that a payor bank is always best positioned to detect fraud,[197] *Price v. Neal* presses the commercial paper system into a scheme where transaction costs are not necessarily allowed to converge at their lowest levels. Instead, payor banks must spend significant amounts of time at suboptimum efficiency levels performing fraud-management tasks for which they are often unsuited. The result is an inefficient, and therefore more costly, allocation of the burden of fraud.

This inefficient result is especially strange considering the obvious fact that a payor bank typically has no direct involvement in the highly decentralized acts of issuing and negotiating a draft. Therefore, the cost of compiling fraud management to a payor bank is high. By contrast, for persons directly involved with the issuance and negotiation of a draft, knowledge is more readily available. Therefore, the cost associated with manage-

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195. An external party is any party that is not the payor bank.

196. Subcomm. on Payments, Unif. Commercial Code Comm. Of the Am. Bar Ass'n's Section of Bus. Law, *Deterring Check Fraud: The Model Positive Pay Services Agreement and Commentary*, 54 BUS. LAW. 637, 642 n.29 (1999) [hereinafter Subcomm. on Payments].

197. *See* Alvin C. Harrell, *Impact of Revised UCC Articles 3 and 4 on Forgery and Alteration Scenarios*, 51 CONSUMER FIN. L.Q. REP. 232, 235 (1997) (arguing that *Price v. Neal* is based on the theory that the bank is in the best position to determine if fraud exists and thus should be the one to bear the burden). The assertion that a bank is in a position to determine one aspect of fraud ignores the fact that the cost to determine such fraud may be unbearably high (considering banks generally do not actually check signature cards). Also, Harrell's assertion ignores the possibility of others being in a better position to prevent the fraud from occurring in the first place, determine that fraud has occurred, or bear the burden of the fraud.

ment of fraud to such persons should typically be significantly lower.

3. The Problem of Social Cost and Transforming Dictate to Default

a. The Coase Theorem

In another famous article, *The Problem of Social Cost*,[198] Ronald Coase pointed out that as long as parties can make and enforce contracts in their mutual interest, direct regulation beyond an initial assignment of property rights is unnecessary where there are no transaction costs.[199] That is, when transaction costs are zero, if an agreement is made that mutually benefits both concerned parties, then any individual definition of property rights leads to an efficient outcome.[200] This postulate is generally referred to as the Coase Theorem.

b. The Social Cost of Fraud

As noted above, the costs from fraud in the commercial paper system are enormous and are ultimately borne by consumers, despite the widespread adoption of *Price v. Neal*. Ironically, despite being an ostensibly pro-presenter/pro-account holder rubric,[201] it is precisely the rigidity of the application of *Price v.*

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198. Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1–44 (1960).

199. *Id.*

200. *Id.*; *see also* DAVID D. FRIEDMAN, LAW'S ORDER, WHAT ECONOMICS HAS TO DO WITH LAW AND WHY IT MATTERS 41–42 (2000). Some economists have dismissed the Coase Theorem as a mere intellectual curiosity, because transaction costs are often greater than zero in the real world. *Id.* The theorem, however, does have some very important real world applications that have been verified. *Id.*

For example, bees graze on the flowers of various, but particular, crops. *Id.* But bees do not respect property rights. *Id.* Without property rights or the ability to make contracts, a farmer who grows such crops can receive none of the benefits himself if the bees are owned by another person. *Id.* Thus, the farmer would have a low incentive to grow nectar-rich crops. *Id.* In a real world with property rights and contracts, however, the following occurs:

> [C]ontracts between beekeepers and farmers have been common practice in the industry at least since early in this century. When the crops were producing nectar and did not need pollination, beekeepers paid farmers for permission to put their hives in the farmers' fields. When the crops were producing little nectar but needed pollination (which increases yields), farmers paid beekeepers.

Id.

201. *See* Brian Patrick Perryman, *Checking Checks:* American Airlines

Neal that prevents the reduction of costs or the offering of incentives to bank customers, including presenters.

Take, for example, the common situation where a presenter knows firsthand the identity of a maker[202] of a draft indorsed over to him and can, therefore, directly verify the draft's authenticity. The presenter (and others similarly situated) will still unnecessarily bear a portion of the cost of fraud prevention, as incurred initially by a payor bank and then passed to the presenter himself. Notably, this situation results even though the presenter does not bear any direct liability on the instrument, as the bank has no right to charge him for an unauthorized check.[203] The same is true for other presenters similarly situated. The knowledgeable presenter ultimately bears the cost of the indiscriminate presenter. Moreover, an account holder who diligently protects access to his checks or other instruments nonetheless still currently bears a proportion of the costs of more careless account holders.

This malevolent result is the direct outcome of the inability to opt out of the *Price v. Neal* rule. As indicated by the Coase Theorem, the ability to reassign property rights in a zero-transaction-cost world would yield a more efficient outcome in the American commercial paper system. Such efficiency, however, requires two things: (1) the ability to assign such rights and (2) zero, or at least low, transaction costs. Removing the handcuffs of the *Price v. Neal* rule will allow the transaction costs to settle to their most efficient level and will also allow the parties to freely assign their rights as they choose.

c. *Moving From a Dictate to a Default Rule*

First, to encourage the parties to take actions to best allocate the burdens associated with draft forgery, an initial assignment of that burden must be determined. Given the already strong position of a payor bank vis á vis an innocent presenter or account holder due to de facto litigation costs, it makes little sense from an efficiency standpoint to further strengthen that position by reassigning the initial burden of

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Employees Federal Credit Union v. Martin *and the Amenability of Common Law Waiver to Deposit Agreement Cutdown Provisions*, 10 GEO. MASON L. REV. 551, 552 n.7 (2002).

202. *See* U.C.C. § 3-103(7) (2003) ("'Maker' means a person who signs or is identified in a note as a person undertaking to pay.").

203. *See* Maurice Portley, *Forged Checks: An Analysis of Civil Liability Under the Uniform Commercial Code*, 28 ARIZ. ST. L.J. 927, 931 (1996).

forgery detection to the presenter or account holder. Instead, to achieve an efficient outcome by encouraging parties to come to agreements to allocate risk, the initial assignment should be that a payor bank continues to bear the loss of forgery. Thus, the dictate of *Price v. Neal* is correct insofar as it initially assigns the risk of loss from a forged draft to the payor bank.

From that point onward, however, parties should be allowed to allocate the burden of draft forgery detection as they see fit. Therefore, the rule assigning the risk of loss should be transformed from a per se dictate to a default provision, subject to the commercial reasonableness requirement of RUCC § 4-103(a).[204] If another party agrees to assume the risk of loss from forgery, a payor bank should be allowed to opt out of the *Price v. Neal* strict liability regime and assign that burden to a presenter, depositary bank, or account holder.

With much foresight, the "UCC was designed with 'expansion joints' so that amendment would be necessary only at infrequent intervals."[205] As noted in § 1-103 of the RUCC, "[This act] must be liberally construed and applied to promote its underlying purposes and policies."[206] These "underlying purposes and polices,"[207] in turn, are "to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties."[208] Therefore, "[t]he effect of the provisions . . . may be varied by agreement . . . ."[209] The flexibility of the UCC, however, does have limits. Amendment, therefore, will sometimes be necessary to cover substantially new forms of transactions or place new boundaries on commercial activities.[210]

This burden falls on legislatures of the individual states to implement such changes. These legislatures have the power to change the present rules to the more efficient rules suggested

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204. U.C.C. § 4-103(a) reads:

> The effect of the provisions of this Article may be varied by agreement, but the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.

Id.

205. Miller, *supra* note 118, at 192.

206. U.C.C. § 1-103(a).

207. *Id.*

208. *Id.* § 1-103(a)(2).

209. *Id.* § 4-103(a).

210. *See* Miller, *supra* note 118, at 203.

here, and some are already moving in that direction.[211] In this instance, allowing a payor bank to contract out of RUCC § 3-418 requires such an amendment.

Second, although perfectly frictionless transaction costs do not exist in the real world, they are often close enough to zero to substantially satisfy the Coase Theorem. The power of the Coase Theorem is, of course, the insight it provides into real world transactions. When spread over numerous transactions, a payor bank could, for a sufficiently low cost, hire attorneys to draft standardized agreements that would allow a party, *if the party so chooses*, to assume the risk of loss from a forged drawer's signature or to compensate parties for their decision to accept the risks of loss.

A payor bank will have many ways to contractually induce another party into accepting this burden. Principally, such inducements may include payment of a percentage based on the value of the draft presented, or a flat fee payment. Drawees may also provide premium services, better interest rates, or other superior treatment to a party who shifts a significant risk of fraud detection to itself, especially when the party does so on a repeated basis or on large sum drafts.

Some might question the reality of such inducements based on a lack of bargaining power on the part of noninstitutional, individual parties to draft payments.[212] However, there is no inherent reason to expect that such a noninstitutional individual would shift the risk of loss to himself without appropriate compensation. Instead, payor banks would have significant financial incentives to offer reasonable contractual terms and the best possible array of compensatory options to persons who could aid them in reducing their fraud detection costs.

Moreover, when considered in the aggregate, the bargaining power of such individuals is, in fact, great. Thus, for instance, vigorous competition for the business of individual account holders would guard against the possibility that payor banks might attempt to establish uniform customer contracts

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211. *Id.* at 208.

212. *See, e.g.*, Kerry Lynn Macintosh, *Liberty, Trade, and the Uniform Commercial Code: When Should Default Rules Be Based on Business Practices?*, 38 WM. & MARY L. REV. 1465, 1470 (1997). Macintosh argues, "[c]onsumers lack the knowledge and power to bargain effectively with banks, and have few alternative payment mechanisms available to them. Unfortunately, this lack of meaningful choice within a significant segment of the market makes it hard to justify the codification of checking account practices on liberty grounds." *Id.*

that attempted to automatically shift the burden to an individual account holder. Any such attempt to manipulate a de jure default rule into a de facto dictate where the account holder automatically bears the loss would inevitably result in mass defections to more consumer-friendly banks or customer-owned credit unions that would be eager to differentiate themselves to gain business.[213]

4. Contracting for the Most Efficient Allocation of Draft Forgery Detection

Given the choice to opt out of the *Price v. Neal* structure, a payor bank could negotiate with any of the three other parties to a draft or check payment to shift the burden of loss. Each of these results is consistent with the fundamental tenant of commercial paper law that the burden of loss from an instrument should be placed on the person who dealt with the wrongdoer.[214]

a. Contracting to Allow the Presenter to Assume the Risk of Draft Forgery Detection

If a presenter agrees to assume the burden of draft forgery detection, a payor bank should be allowed to opt out of *Price v. Neal* by contract. Such a contract could take one of two forms.

One form of contract would be an agreement on the presentment of an individual draft, using a standardized contract. Such a standardized contract could be made available to a presenter in the same way that bank deposit slips, travelers checks, or other services are commonly made available to presenters in a bank lobby. By signing such a standardized contract, the presenter would warranty to the payor bank that the specified drafts do not bear a forged drawer signature.

A second form of contract would be a continuous blanket contract. Such a contract could be signed when the soon-to-be presenter initially opens an account with the depositary bank, or at some point thereafter when the account holder begins

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213. Free checking is a good example of banks becoming more consumer-friendly to win business, despite the relatively weak bargaining power of an individual account holder as compared to the bank.

214. *See* Harrell, *supra* note 197, at 233–37. The common element in much of the commercial paper system is to look up the chain of title placing the burden on the person closest to the forger, by a series of warranties granted with the passage of title. *Id.* The passage of title to the payor bank does not include such warranties. *Id.*

presenting drafts. By signing such a blanket contract with the depositary bank, the presenter would warrant to *all* potential payor banks that *all* such presented drafts will not bear any forged drawer or indorser's signatures, and that they accept the risk of fraud therefrom.

With either type of contract, a presenter who chooses to assume the risk of draft forgery detection in exchange for compensation from the payor bank thus has an incentive to monitor the identity and trustworthiness of the persons it deals with in draft transactions. This is particularly realistic in the common situation where a presenter knows firsthand the identity of a maker of a draft indorsed to him and can, therefore, directly verify the draft's authenticity.

Importantly, in either case, a presenter would retain complete control over the shifting of such a burden, alleviating any fear of lack of bargaining power or legal unconscionability.[215] Furthermore, if the presented draft bears a forged drawer signature and the presenter, therefore, is called on to assume the burden of that fraud, the presenter is not without recourse. The presenter may still proceed against the draft's former indorsers and transferees by enforcing the presentment[216] and transfer warranties[217] made by those persons.

b. Contracting to Allow the Depositary Bank to Assume the Risk of Draft Forgery Detection

A payor bank may seek to escape its liability on forged drafts imposed by the *Price v. Neal* doctrine by attempting to contract that liability to the depositary bank. The payor bank would need to provide some incentive for the depositary bank to agree to assume liability for forged drafts. The depository bank without any incentive, like an account holder similarly situated, would not agree to assume liability for forgeries that would otherwise automatically fall on the payor bank.

By shifting the burden of draft forgery detection to the depositary bank in some cases, overall efficiency in the check collection system would be increased. In cases where the depositary bank has some type of special relationship with the presenter, it is in a better position than the payor bank to detect forged drafts.

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215. *See, e.g.*, Macintosh, *supra* note 212.
216. *See* U.C.C. § 3-417 (2003).
217. *See id.* § 3-416.

A recent amendment to RUCC § 3-417(a) added a fourth presentment warranty.[218] This addition demonstrates the Code drafter's willingness to create exceptions to the *Price v. Neal* doctrine in cases where the payor bank is not in the best position to detect forged drafts. As a result of the new amendment, the payor bank is automatically relieved of liability on forged drafts in certain cases.[219]

Allowing a depositary bank to assume the burden of forged draft detection and placing that burden farther up the chain of transactions, closer to where such forgery might occur, is particularly appealing. It reinforces an underlying tenant of the American commercial paper system, by holding liable the party who deals with the wrongdoer. The depositary bank may have actually dealt with the forger and thus should be held liable.

The depositary bank could then try to shift its potential liability to the person presenting the draft. As described earlier, the depositary bank would have to provide an incentive to the presenter to entice them to accept liability for potentially forged drafts. This type of arrangement with the presenter to further allocate the risk of loss would place the burden even closer to the person who dealt with the wrongdoer.

Notwithstanding, in the case of a presenter who agrees to assume the burden of draft fraud protection, if a depositary bank pays on a forged draft it would retain its rights to enforce presentment,[220] if they are also the payor bank, and transfer warranties.[221]

c. Contracting to Allow the Account Holder to Assume the Risk of Draft Forgery Detection

Another party to whom the payor bank may attempt to contract away its liability imposed under the *Price v. Neal* doctrine is the account holder. Once again the payor bank would need to offer an incentive to the account holder in exchange for their agreement to accept liability on forged drafts.

Likewise, if an account holder agrees to assume the burden of draft forgery prevention for drafts which are (1) approved for use by the payor bank, and (2) are within the account holder's

218. *See id.* § 3-417(a).

219. *See, e.g.*, Guardian Life Ins. Co. v. Weisman, 223 F.3d 229 (3d Cir. 2000).

220. *See* U.C.C. § 3-417.

221. *See id.* § 3-416.

control, a payor bank should once more be allowed to opt out of *Price v. Neal* by contract. In many, if not most, instances, payor banks are in the best position to *detect* forgery, but they are certainly not in the best position to *prevent* it from occurring in the first place.[222]

The King's Bench in *Price v. Neal* was concerned with placing the burden of fraud detection on an otherwise innocent party.[223] However, since the account holder has significant power to forestall forgery on the payor bank-approved drafts within its control, the account holder is not necessarily—as the presenter Neale likely was—any more innocent than a payor bank.[224]

Under RUCC § 4-401, an account holder is presently only liable on a check that he signs.[225] However, allowing an account holder to contract to accept the burden of draft fraud detection would thus align that burden with a party who has a significant amount of power to prevent draft forgery in the first place. Ultimately, the account holder has as much, if not more, potential to prevent draft forgery than any other party because the account holder controls unwritten checks, as well as access to them by others.

By accepting this burden the account holder would then have a significant incentive to take greater care of drafts within his control. Individuals would have greater motivation to keep their checkbook in a safe place, rather than in their glove compartment. Businesses would have greater incentives to restrict employee access to checks and more closely monitor the actions of employees with access to them.

Modern mass retailers and credit card companies rarely hesitate to sell their customers insurance for their financial products.[226] Payor banks could do the same for their account holders. While contracting away his RUCC § 3-418(c) right to recover on a forged draft, an account holder could simultane-

222. *See supra* Part III.C.1.b (discussing payor banks' ability to detect forgery but not prevent it).

223. *See* Price v. Neal, 97 Eng. Rep. 871 (K.B. 1762).

224. *See* Alvin C. Harrell, *NCCUSL Articles 3, 4, and 4A Drafting Committee Highlights Current Payment System and Negotiable Instrument Issues*, 54 CONSUMER FIN. L.Q. REP. 351, 363 (2000).

225. *See* U.C.C. § 4-401. Thus, an "item containing a forged drawer's signature or forged indorsement is not properly payable" from the account holder to the drawee. *Id.* § 4-401 cmt. 1.

226. *See, e.g.*, A.J. Mistretta, *Credit Insurance Criticized as Unnecessary Expense*, NEW ORLEANS CITYBUSINESS, July 15, 2002, at 30.

ously contract back with his payor bank to purchase various levels of forgery protection at various prices. This could also be done at some later date if the account holder so chooses. Allowing an account holder to assume the burden of draft forgery detection for drafts within his control would also permit the account holder to self-determine and more precisely calibrate his own desired level of exposure to the risk of draft forgery.

An account holder could require the payor bank to verify all of his checks, or none of them. The payor bank, in turn, could calculate a blanket or per-check charge for such verification, instead of passing the cost on to all customers. Or, to achieve a more precise allocation of the burden of draft forgery detection, a payor bank and its account holder could contract to require the payor bank to verify some signatures deemed sufficiently risky by the account holder. In such a contract, the payor bank could be required to verify the signatures and continue to assume the typical *Price v. Neal*-type risk of drawer forgery on drafts above a certain agreed upon dollar amount. At the same time, the burden of forgery detection for drafts below the agreed upon dollar amount would remain with the account holder, having contracted away his RUCC § 3-418 right to recover payment on a forged draft.

Additionally, the payor bank and account holder could contract to allow the account holder to designate certain presenters from which the customer will accept the burden of draft forgery detection. Account holders who frequently send a limited number of checks to certain trustworthy persons, or who send checks to the very same persons frequently, would find this arrangement attractive. The account holder could create a list of presenters for which the burden automatically shifts to him, while the bank would continue to bear the burden of loss for any presenter not specified on the list.

Importantly, though, in order to be rational and efficient,[227] any rule allowing an account holder to contractually assume the burden of draft forgery detection must limit that assumption to those drafts (1) approved for use by the payor bank and (2) actually placed into the account holder's control by the payor bank. Otherwise, an account holder would be at the mercy of both ingenious draft forgers[228] and ultimately its own

227. *See supra* Part III.C.3 (addressing more efficient rules based on the Coase Theorem).

228. *E.g.*, ABAGNALE, *supra* note 8.

payor bank. Without this limitation, a forger would have every incentive to devise ever-more convincing forgeries.

In contrast, a payor bank would have no incentive to do anything other than indiscriminately pay out on any passable draft bearing the account holder's name, which it could do with total impunity. Thus, the payor bank would still have a de minimus fraud monitoring function in that it would be obliged to examine a draft to verify that the underlying physical draft was created or approved for use by the payor bank itself and first given into the account holder's control. Thus, a payor bank can only shift liability to its account holder for approved drafts on which they are identified as the drawee.

The payor bank has a recurring relationship with only one of the other three parties to payment on a draft: the account holder. Given this relationship, it is probable that the payor bank will likely contract with this party to allocate the risk. Shifting the burden to the account holder is potentially the most promising way to reduce both forgery and transaction costs.

5. Benefits

The result of transforming *Price v. Neal* from dictate to default is that the cost of detecting draft forgery to a payor bank, its account holders, and other bank customers would be more efficiently allocated to the parties best able to bear that burden.[229]

In may instances, payor banks would not have to take the time or other associated expense to verify a signature card or conduct a further investigation. Payor banks would need to spend less on overhead costs associated with gathering information to prevent forgery. These costs would not be passed on to other bank customers, as they are presently. Such saved costs could then be returned to bank customers and/or split with the party who accepts the burden of draft forgery detection.

Presenters, of course, would receive a monetary premium for actively monitoring draft forgery. While likely insubstantial in the individual instance of a small value draft, aggregate premiums would be tangible in instances of repeated present-

229. An ounce of prevention is, of course, worth a pound of cure. This is the main theme of allowing burden shifting to someone who can prevent the forgery from occurring in the first place.

ment or presentment of large-value drafts. Similarly, depositary banks and account holders would receive compensation for actively monitoring draft forgery.

Thus, allowing the costs of draft forgery detection to settle on the party most willing to bear them and best able to prevent the forgery would reduce the overall costs of banking. Although the precise effect is difficult to estimate, together, the economic benefits from such a transformation could easily amount to many millions of dollars annually.

Finally, the argument for the perpetuation of *Price v. Neal* that has prevailed over time is that it creates finality because the drawee is not able to reverse a series of transactions after discovery of the forgery.[230] Importantly, allowing payor banks to bargain with the other parties to payment on a draft will not lead to an unraveling of the transaction. As in the case where the burden is shifted to an account holder, the funds will be withdrawn from the account holder's account and paid to the presenter as if the check were genuine. The bank would not pursue the presenter[231] for the funds and the certainty and finality remain.

CONCLUSION

To combat the problem of draft forgery, this Article argues that the doctrine of finality, as embodied in the case of *Price v. Neal* and § 3-418(c) of the RUCC should be transformed from a rigid, per se dictate into a default rule. Importantly, the elegance of this solution both relieves the doctrinal pressures of the strict form of *Price v. Neal* and avoids the sort of undesirable patchwork erosion of the rule of finality that has taken place in English courts. This transformation should allow parties to payment on a draft to better allocate the burden of draft forgery detection to the party who is best able to bear the burden. This ability to allocate losses, in turn, should substantially improve the efficiency of the American commercial paper system.

230. *See* Subcomm. on Payments, *supra* note 196, at 642 n.29.

231. *Cf.* Price v. Neal, 97 Eng. Rep. 871 (K.B. 1762). Contrast this scenario of a bank not pursuing a presenter with *Price v. Neal*. In that case, Price, the drawee pursued Neale, the presenter for the funds. *See id.* If Price had prevailed, Neale would have had to return the funds to Price. However, if the change is made that this article suggests, in the most likely case of a payor bank allocating the burden with the account holder, the presenter does not have to return the funds, and the transaction remains *final*.