South Carolina Law Review

Volume 18 | Issue 1 Article 9

1966

Commercial Transactions

Robert W. Foster
University of South Carolina

COMMERCIAL TRANSACTIONS

ROBERT W. FOSTER*

A. Commercial Paper

Three cases raising questions of liability on checks involved acts of a malefactor in receiving payment from a drawee bank after making alterations or forging indorsements on the checks. *Citizens & So. Nat'l Bank v. State Budget & Control Bd.*[1] presented the court with the question of when the statute of limitations begins to run on the depositor's cause of action against his bank to remove the debit of the account for a check paid bearing a forged indorsement.[2] The plaintiff-drawer argued for the rule followed in a few states that his cause of action against the bank did not accrue until discovery of the forgery,[3] but the court rejected this and adopted the more widely accepted view that the statute starts to run as of the date the bank renders to the depositor its statement showing the charging of the check to the depositor's account.[4] In reaching this result, the court approved of the technical rationale expressed in *Kansas City Title & Trust Co. v. Fourth Nat'l Bank*[5] that the return of the check to the depositor bearing a forged indorsement with a statement showing the charge of the amount of the check to the depositor's account is a denial of liability, thus dispensing with the requirement of the depositor's demand to recover the amount of the check. On broader policy grounds, the court was apparently influenced by the underlying purpose of the statute of limitations as a statute of repose.

While this rule may work a hardship on a person who does not learn of his cause of action until after the statute has run, it is "necessarily incident to a law arbitrarily making legal

* Professor of Law, University of South Carolina.

1. 246 S.C. 140, 142 S.E.2d 874 (1965).

2. The rule is well settled that the drawer has a cause of action to remove the debit of his account where the drawee pays an order check on a forged indorsement since no interest in the instrument passes and the drawee has not paid the payee or holder as directed by the drawer. UNIFORM NEGOTIABLE INSTRUMENTS LAW § 23; UNIFORM COMMERCIAL CODE § 3-404; See Singletary & Son, Inc. v. Lake City State Bank, 243 S.C. 180, 133 S.E.2d 118 (1963); Bourne v. Maryland Cas. Co., 185 S.C. 1, 192 S.E. 605 (1937); Yarborough v. Peoples Nat'l Bank, 162 S.C. 332, 160 S.E. 844 (1931).

3. Miami Beach First Nat'l Bank v. Edgerly, 121 So. 2d 417, (Fla. 1960); New York v. Fidelity Trust Co., 243 App. Div. 46, 276 N.Y. Supp. 341 (1934).

4. For a collection of the authorities see, Annot., 82 A.L.R.2d 933 (1962).

5. 135 Kan. 414, 10 P.2d 896 (1932).

remedies contingent on mere lapse of time"[6] so that parties to a transaction may consider the matter closed at some definitely designated point in time.[7]

The Uniform Commercial Code adopts the view of the *Citizens & So. Nat'l Bank* case by providing that the drawer is precluded from asserting an unauthorized indorsement if he does not report it to his bank within three years after the statement and check are made available to him. Since the Commercial Code has been enacted in forty-four jurisdictions, including those which had applied the minority view, this rule is probably now unanimous.[8]

Acts of a wrongdoer in forging indorsements and receiving payment on checks raised the issue of liability between the presenting bank which had cashed the checks and the drawee which had paid them in *County Bank v. South Carolina Nat'l Bank.*[9] The checks in question were sent by the drawers to the personnel manager of a plant for delivery to employees named as payees, who forged the signature of the payees, added his indorsement and cashed the checks at the defendant bank. The defendant bank then forwarded them to the plaintiff-drawee bank with indorsements guaranteed. The plaintiff paid the checks and charged the amounts to the account of the drawer. Upon discovery of the forged indorsement of this order instrument, the drawer could clearly compel the removal of the debit of his account by the drawee.[10] The drawee could then recover from the presenting bank, alternatively on the theory that payment was made under a mistake of fact giving rise to the right of restitution,[11] or for breach of the express warranty of all in-

6. 34 AM. JUR. *Limitation of Actions* § 230 (1938).

7. See Livingston v. Sims, 197 S.C. 458, 15 S.E.2d 770 (1941).

8. UNIFORM COMMERCIAL CODE § 4-406(4).

9. 244 S.C. 327, 137 S.E.2d 281 (1964).

10. See note 2, *supra.*

11. As analyzed by Professor Britton, this result is not based on the theory of breach of implied warranty of title under the UNIFORM NEGOTIABLE INSTRUMENTS LAW §§ 65-66 which prescribe the liability of an indorser as a warrantor since the holder upon presenting the check for payment does not negotiate or sell it and the drawee does not become a holder. The theory of recovery is the drawee's common law quasi-contracted action. BRITTON, BILLS AND NOTES § 139 (2d ed. 1961). The UNIFORM COMMERCIAL CODE § 3-417(1)(a) creates an implied warranty of the genuineness of indorsements so that the presenting party would be liable to the drawee in the amount of payment received under a forged indorsement similar to the implied warranty theory under existing law as between indorsers.

dorsements guaranteed.[12] This case did not fit into this pattern of established law, however. The drawer did not seek to remove the debit of his account since he was reimbursed by the employer of the forger with funds from its insurer under a policy of insurance covering loss from forgeries. Finding that the plaintiff had suffered no loss, the court affirmed the lower court's judgment for the defendant.

Where a drawer has insurance covering losses resulting from forged checks, the usual practice is for the insurer to advance the amount of coverage and take back a loan receipt by which the insured agrees to repay the "loan" if recovery is made from the bank. This device has been generally held effective to permit the insured to recover from the bank free of the defense of payment and the amount recovered will then be paid over to the insurer.[13] In the instant case, the court referred to the plaintiff's contention that a loan receipt had been executed thereby preserving its rights against the defendant. The court dismissed this contention without going further into the circumstances surrounding the loan receipt. It is therefore impossible to determine from the reported case the court's disposition of this aspect of the decision.

Defalcations of an employee in forging and altering a number of checks over a two year period again raised the issue of risk of loss in *United States Fid. & Guar. Co. v. First Nat'l Bank.*[14] The plaintiff was a surety company which had paid the employer under a fidelity bond and sought to recover from the drawee bank by way of subrogation. After a review of the evidence in the record, the court found that it was sufficient to support the finding of fact below that the drawer was negligent in its internal procedures in the preparation, issuance and handling of the checks and that such negligence was the proximate cause of the losses. The court also concluded that despite some indication on the face of some of the checks that they had been altered, the finding below that defendant was free of negligence in paying the checks under these circumstances was not without evidentiary support. From these facts the court applied the

12. Life Ins. Co. of Va. v. Edisto Nat'l Bank, 166 S.C. 505, 165 S.E. 178 (1932); Newberry Sav. Bank v. Bank of Columbia, 91 S.C. 294, 74 S.E. 615 (1911).

13. Luchenbach v. W. J. McCahun Sugar Ref. Co., 248 U.S. 139 (1918); Singletary & Son, Inc. v. Lake City State Bank, 243 S.C. 180, 133 S.E.2d 118 (1963).

14. 244 S.C. 436, 137 S.E.2d 582 (1964).

general rule of estoppel against the drawer, and thus the plaintiff-surety, to assert the alterations and forged indorsements as a basis for recovering the debits against the account.

The leading case establishing this principle is the English decision of *Young v. Grote*,[15] which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. This rule was not expressly written into the Uniform Negotiable Instruments Law but is generally followed as common law.[16]

The Uniform Commercial Code would dictate a similar result by the provision:

> The customer is precluded from asserting against the bank an unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank after the first item and statement was available to the customer for a reasonable period not exceeding fourteen calendar days and before the bank receives notification from the customer of any such unauthorized signature or alteration.[17]

This statutory coverage removes the difficulty of the factual finding of negligence and is based on the theory that the customer's failure to report the first forgery or alteration presents the opportunity to the wrongdoer to repeat his misdeeds. The Commercial Code would also continue the rule recognized by the court that the estoppel against the customer would not apply if he can establish lack of ordinary care on the part of the bank in paying the item.[18]

B. Chattel Security

In *First Nat'l Bank v. Wade*[19] the plaintiff had instituted an action in claim and delivery to recover on a past due note and chattel mortgage on a car executed by the defendant to the seller of the car and subsequently assigned to the plaintiff bank. The lower court directed a verdict for the plaintiff for possession of

15. 4 Bing. 253 (1827).

16. Hair v. Winnsboro Bank, 103 S.C. 343, 88 S.E. 26 (1915). This rule is codified in the UNIFORM COMMERCIAL CODE §§ 3-406, 4-406; See Annot., 42 A.L.R.2d 1071 (1955).

17. UNIFORM COMMERCIAL CODE § 4-406(2)(b).

18. UNIFORM COMMERCIAL CODE § 4-406(3).

19. 245 S.C. 426, 141 S.E.2d 102 (1965).

the collateral and damages for the unlawful detention. The defendant appealed on the ground that the assertion of breach of warranty in the sale of the car required a jury determination on this issue; held, affirmed as to the possession of the automobile since defendant could not defeat plaintiff's right of possession by asserting that he was entitled to an offset for partial failure of consideration. As to the damages for wrongful detention of the automobile, however, their assessment is a fact question which must be determined by the jury upon remand for a new trial.

The perennial problem of measuring the propriety in the conduct of a mortgage liquidation sale[20] was again before the court in *Callicutt v. Brown.*[21] The defendant had purchased an automobile from the plaintiff executing a conditional sales contract for the unpaid balance which was assigned to a finance company. After making three payments, the defendant defaulted and the finance company took possession of the vehicle and sold it at public auction to the plaintiff, the only bidder, for less than one-fourth of the original purchase price. The plaintiff repurchased the conditional sale contract from the finance company and brought action for the remaining indebtedness due. In affirming a directed verdict for the plaintiff, the court held that there was no evidence of impropriety in the liquidation sale and no question as to liability or the amount due, and therefore no issue to submit to the jury.

In approving the liquidation sale the court presumably was satisfied that the payment of one-fourth of the initial selling price of the automobile was not so inadequate as to raise a presumption of fraud,[22] even though the facts could be viewed as though the mortgagee had purchased, in which case the adequacy of the price will be more closely scrutinized by the court.[23]

Commercial Credit Corp. v. Webb[24] involved a contest between the holder of a chattel mortgage on an automobile and the claim of the state which seized it under a statute which provides: "Every vehicle . . . used in hunting of deer at night is hereby

20. See, *e.g.*, Castell v. Stephenson Fin. Co., 244 S.C. 45, 135 S.E.2d 311 (1964); Johnson Cotton Co. v. Cannon, 242 S.C. 42, 129 S.E.2d 750 (1963).

21. 244 S.C. 164, 135 S.E.2d 852 (1964).

22. See Henry v. Blakely, 216 S.C. 13, 56 S.E.2d 581 (1949); Poole v. Jefferson Standard Life Ins. Co., 174 S.C. 150, 177 S.E. 24 (1934).

23. Black v. Hair, 2 Hill's Eq. 622 (S.C. 1837).

24. 245 S.C. 53, 138 S.E.2d 647 (1964).

declared forfeited to the State . . . ."[25] While this precise issue was one of first impression in this state, the court reasoned by analogy from the cases which have protected the interest of an innocent chattel mortgagee of an automobile against the claims of the state under a statute which calls for the confiscation of the vehicle when used illegally to transport liquor.[26] It was argued that this line of cases is distinguishable on the ground that the statute involved in the instant case at the time of its initial enactment provided—"used with the knowledge or consent of the owner thereof or of the agent of such owner in charge of such vehicle . . . ." and this language was deleted by the South Carolina General Assembly in 1952. Since the legislature removed the protection accorded innocent owners of vehicles used in night deer hunting, it was argued that it was the legislative purpose to remove the protection of other innocent parties, such as the holder of a security interest in the vehicle, from the claims of the state. The court failed to find any such legislative intent to deprive an innocent holder of a security interest of his claim in a motor vehicle from the fact that the present statute does not protect the owner.

In dismissing an action for damages for an alleged unlawful repossession of chattel, the court in *Bing v. General Motors Acceptance Corp.*[27] affirmed the familiar principle that upon default in the payment of a promissory note secured by a security interest in chattel, title to the chattel vests in the secured party with right to possession and the right to enter peaceably on the debtor's premises to make seizure.[28]

In dismissing an action by the plaintiff to assert a "purchase money lien" against property sold to one defendant and mortgaged to the other defendant in the amount of the unpaid purchase price, the federal court in *Seneca Grape Juice Corp. v. Palmetto Grape Marketing Ass'n*,[29] had occasion to apply the

25. S.C. CODE ANN. §§ 28-457 to -458 (1962).

26. General Motors Acceptance Corp. v. Chestnut, 158 S.C. 42, 155 S.E. 231 (1930); Manufacturer's Fin. Acceptance Corp. v. Bramlett, 157 S.C. 419, 154 S.E. 410 (1930); Ward v. Greer, 155 S.C. 426, 152 S.E. 678 (1930); Seignious v. Limehouse, 107 S.C. 545, 93 S.E. 193 (1917); Moody v. McKinney, 73 S.C. 438, 53 S.E. 543 (1905).

27. 237 F. Supp. 911 (E.D.S.C. 1965).

28. Mishoe v. General Motors Acceptance Corp., 234 S.C. 182, 107 S.E.2d 43 (1959); Soulios v. Mills Novelty Co., 198 S.C. 355, 17 S.E.2d 869 (1941); Justin v. Universal Credit Co., 189 S.C. 487, 1 S.E.2d 508 (1939).

29. 234 F. Supp. 939 (W.D.S.C. 1964).

established principle of South Carolina law that a vendor of personal property has no lien for the unpaid purchase price unless he takes a purchase money mortgage, or complies with the attachment law, in acquiring a lien.[30]

C. Sales

In *McManus v. Midland Valley Lumber Co.*[31] the court awarded the plaintiff-buyer damages for breach of contract to sell logs based on an amount of profits lost by an expected resale, less the cost he would have incurred in handling. This result is an application of the modern principle that the party breaching a sales contract is liable for consequential damages which naturally flow from the breach, including such profits as could be reasonably anticipated had the contract been performed.[32]

Earlier common law decisions usually excluded profits as an element of recovery in actions for breach of contract under a rigid application of the "foreseeability" rule announced in the leading English case of *Hadley v. Baxendale*[33] conditioning liability on a showing that the seller had knowledge of the buyer's particular resale contract and the profit contemplated by it. Another obstacle to the recovery of such special damages was the tendency of the courts to conclude that the alleged loss of profits is too speculative to be considered, requiring almost mathematical precision in the proof of loss.[34] Over the past half-century there has been a gradual erosion of this attitude of restrictive damages. The certainty rule has become a more flexible standard of "reasonable certainty"[35] and the foreseeability requirement of *Hadley v. Baxendale* is usually presumed, especially where the breaching party knows that he is dealing with a merchant and thus should assume that the breach will result in lost profits.[36] The modern attitude which rejects the

30. Ross v. Eddins, 187 S.C. 29, 196 S.E. 375 (1938); Maxwell v. Greene, 171 S.C. 253, 172 S.E. 146 (1933).

31. 232 F. Supp. 885 (E.D.S.C. 1964).

32. South Carolina Fin. Corp. v. West Side Fin. Co., 236 S.C. 109, 113 S.E.2d 329 (1960); W. T. Rawleigh Co. v. Wilson, 141 S.C. 182, 139 S.E. 395 (1927).

33. 9 Ex. 341, 156 Eng. Rep. 154 (1854).

34. See, *e.g.*, Standard Supply Co. v. Canter & Harris, 81 S.C. 181, 62 S.E. 150 (1908).

35. See, *e.g.*, Charles v. Texas Co., 199 S.C. 156, 18 S.E.2d 719 (1942).

36. See generally *Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery*, 65 YALE L.J. 992 (1956).

nineteenth century tendency to minimize the damages recoverable on breach is expressed generally in the Uniform Commercial Code in the following language: "The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . ."[37] The *McManus* decision is in the mainstream of this current development.

In *W. R. Grace Co. v. LaMunion*[38] the court reversed a judgment for the defendant-buyer of fertilizer on a counter-claim for damages resulting from a breach of express warranty that it contained a pesticide which would effectively protect his cucumber crop from nematodes on the ground that the trial judge committed error in failing to instruct the jury that they must take into account the expense which the defendant would have had in harvesting and processing the crop that would not have been lost without the breach. While the aggrieved party to a sales contract is entitled to be "put in as good a position as if the other party had fully performed,"[39] if the jury fails to take into account the cost which he would have incurred in handling the crop, the result would be a windfall benefit in this amount.

D. Legislation

A most significant action by the South Carolina General Assembly in the field of commercial transactions in the 1965 session was the step taken toward enactment of the Uniform Commercial Code. This comprehensive codification of the great bulk of commercial law passed the house of representatives, was favorably reported out of the senate judiciary committee but failed to come up for a vote on the crucial second reading in the senate before adjournment. With the additional year for consideration of the Code, the 1966 session of the South Carolina Senate should be in the position to come to a decision as to whether this state will join the other forty-four jurisdictions which have stated the law of commercial transactions in terms of contemporary commercial needs by the enactment of the Uniform Commercial Code.[40]

37. UNIFORM COMMERCIAL CODE § 1-106(1).
38. 245 S.C. 1, 138 S.E.2d 337 (1964).
39. UNIFORM COMMERCIAL CODE § 1-106(1).
40. See, Foster, *The Proposed Uniform Commercial Code: A New Bottle for Old and New Wines,* 15 S.C.L. REV. 623 (1963).