**Who Can Bring Claims on a Negotiable Instrument**

Welcome to this podcast on Who Can Bring Claims on a Negotiable Instrument brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is the basics of who can bring which claims on a negotiable instrument and against whom. Why is this important? Oftentimes an examination question will simply ask who is liable. But in practice and sometimes on an examination you will have to answer as to the right of recovery of a specific party. You might also need to discuss which parties will ultimately get stuck with the loss. In this podcast we will look at claims that might be made by a drawer, maker, drawee bank (sometimes called a payor bank), depositary bank, transferee, and payee.

Let’s look at drawers. A drawer of a check as a signer of an instrument has liability if a check is dishonored. But, sometimes a drawer will actually be a claimant. Often, the claim is a request for recredit of an item that is not properly payable and is brought against a payor bank. The typical claim is made on the basis of an unauthorized signature, either a forgery of the drawer’s signature or a forgery of a required indorsement. Importantly, a drawer does not have a claim against other parties for indorsement liability, for breach of presentment or transfer warranties, or conversion. A drawer might have a claim in a proper case under the negligence rule of § 3-406. Most often, though, a drawer’s right of recovery will focus on a claim against the payor bank.

Let’s look at a hypothetical. Presume Darcy needed central air-conditioning and called, Kool It, Inc. for an in-home estimate. Steve Sneak went to Darcy’s home door and introduced himself as Kevin from Kool It. Darcy wrote out a check for $12,000 drawn on her bank, Payor Bank, and made it payable to Kool It, Inc. Steve cashed the check at Currency Exchange, specially indorsed to the top of the back of the check with the notation Pay to Currency Exchange. Before the worker put the check away Thief picked it up, who forged the indorsement of the Currency Exchange’s treasurer and deposited the check in his account at Depositary Bank. Ultimately Payor Bank paid the check.

If faced with the question of what right to recovery Darcy, as a drawer, might have, Darcy could make a claim for recredit against the Payor Bank due to the unauthorized signatures. Whether or not she’s successful will depend on any defenses made by Payor Bank. Darcy would not seem to have any claims that she could assert against the other parties, excepting possible negligence by Currency Exchange.

The same is true with respect to a maker of a note. With a note there is no claim for recredit because there’s no payor bank on the note. A maker of a forged note should simply dishonor it. A maker of a note might have a claim in a proper case under the negligence rule of § 3-406.

When faced with a claim by a drawer for recredit, a payor bank, the drawee, may have a defense against the drawer or claims against others. The payor bank might defend the drawer’s demand for recredit using one or more of the following four rules: (1) the imposter rule of § 3-404 which validates indorsements of an imposter posing as the payee who duped the issuer of the instrument; (2) the fictitious payee rule of § 3-404 which validates indorsements in the name of the payee; (3) the employer responsibility rule of § 3-405 which validates fraudulent indorsements made by employees given responsibility for an employer’s instruments; or (4) the negligence rule of § 3-406. The payor bank will rarely be able to successfully claim mistake under § 3-418 due to the rule of *Price v. Neal*.

Recall, Darcy might make a claim for recredit against the Payor Bank due to the unauthorized signatures. In this case, the Payor Bank could defend on the grounds of the imposter rule which would validate the indorsement made by Steve who duped Darcy into issuing the check. The later indorsement by Thief, though, is not validated by this rule and appears to be unauthorized. So, Payor Bank may still have liability.

Let’s look at claims that might be made by the payor bank for recovery against other parties in the chain of a negotiable instrument. The payor bank may be able to make a claim for a breach of a presentment warranty. The payee and all other parties in the chain through the depositary bank are called presenters and make a presentment warranty to the payor bank that makes payment or accepts the draft in good faith under §3-417 and §4-208. If the warranty is breached, then the presenter has liability to the payor bank. A payor bank does not have a claim for indorsement liability, transfer warranty or conversion.

Recall our hypothetical with Darcy. Steve, Thief, and the depositary bank would be presenters who each made a warranty to the Payor Bank, among other things, that they were a person entitled to enforce the instrument (a PETE) and to their knowledge all signatures were authentic. Due to the actions of Thief, none of these parties are a PETE and each breached the presentment warranty. The Payor Bank can bring a claim for breach of presentment warranty against any of them.

Sometimes, the payor bank which has paid an item may have a claim under the negligence rule of § 3-406. Look at the possibility of negligent behavior by a drawer, depositary bank or other party in the chain of a negotiable instrument. In our hypothetical with Darcy, the Payor Bank might be able to make a claim for negligence with respect to Currency Exchange if it failed to exercise ordinary care which substantially contributed to an alteration of an instrument or to the making of a forged signature.

The depositary bank and other parties in the chain of a negotiable instrument sometimes have claims for: (1) indorsement liability under the rule of § 3-415; and (2) breach of transfer warranty under § 3-416 and §4-207, which permits recovery by transferees against earlier transferees in the chain, whether or not they indorse the instrument. A claim for breach of transfer warranty cannot be made against the payor bank because they are not a transferor.

In our hypothetical, Steve and Thief indorsed the check, but there would be no indorsement liability because the check was not dishonored, a requirement of § 3-415. However, presume the Depositary Bank takes the loss, perhaps having to pay on a presentment warranty claim made by the Payor Bank. Then, the Depositary Bank could claim breach of transfer warranty against the earlier transferees, Steve and Thief, on the grounds that they were not a PETE. Currency Exchange would not be a transferee because it did not transfer the check. It is looking like the Depositary Bank might take this loss, but perhaps the Depositary Bank might claim negligence against the Currency Exchange if their actions substantially contributed to the theft by Thief.

So, where does the payee fit in all this? A payee that indorses, transfers or presents may have liability. A payee whose instrument is stolen, though, might have a claim for conversion against those who took the instrument by transfer, other than a negotiation, from a non-PETE or a bank that makes or obtains payment from a non-PETE. In some cases, a payee may even be able to claim PETE status with respect to enforcing an instrument that is lost, destroyed or stolen under § 3-309.

 Before we conclude, a word about the liability of representatives. Keep in mind that sometimes a representative of a business may be the signer and will bind the represented person under the rules of agency pursuant to § 3-402. The representative is not signing the instrument in their personal capacity and will not be liable on the instrument so long as the signature unambiguously indicates that it is made on behalf of the represented person. However, the representative could be liable as a signer of an instrument in their own capacity if the signature does not unambiguously indicate the representative capacity or the represented person is not identified in the instrument, unless the representative can prove that the original parties did not intend the representative to be liable on the instrument. That said, in cases of ambiguity, the representative will be liable to a holder in due course without notice of the representative capacity.

At this point, you should be able to describe who might have claims on an instrument and against which parties.

I hope you’ve enjoyed this podcast on Who Can Bring Claims on a Negotiable Instrument.

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