Tulsa Law Review

Volume 14 | Issue 1

1978

Federal Commercial Paper and the Federal Common Law

Stephen A. Becker

Follow this and additional works at: https://digitalcommons.law.utulsa.edu/tlr

 Part of the Law Commons

Recommended Citation
Stephen A. Becker, *Federal Commercial Paper and the Federal Common Law* , 14 Tulsa L. J. 208 (2013).

Available at: https://digitalcommons.law.utulsa.edu/tlr/vol14/iss1/8

This Casenote/Comment is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Law Review by an authorized editor of TU Law Digital Commons. For more information, please contact megan-donald@utulsa.edu.

FEDERAL COMMERCIAL PAPER AND THE FEDERAL COMMON LAW

I. INTRODUCTION

Justice Clark[1] in *Bank of America National Trust & Savings Association v. United States*[2] held that the United States, as the drawer-drawee, could not recover from the presenting bank the amount of a number of fraudulently issued drafts that were drawn on and paid by the United States prior to its knowledge that the drafts were fraudulently procured. The court held that the facts came under the imposter rule[3] which dictates that the drawer, here the United States, is liable for payment on the fraudulently issued drafts rather than holding the presenting bank liable on their stamped warranty of prior endorsements.[4] In a footnote to the opinion, Justice Clark made the following policy statement:

> The result we reach here is the same that would necessarily be reached by application of the Uniform Commercial Code, now in effect in all fifty states. Unfortunately, the U.C.C. has not yet been adopted for federal application by Congress, and the federal courts thus face the disturbing prospect of reaching on the same set of facts, different conclusions through the use of common law principles from that of states governed by the U.C.C. in commercial litigation.
>
> The commercial interests of our country would be better served if interested parties could expect uniformity in the fed-

1. Associate Justice Tom C. Clark, United States Supreme Court (Ret.), sitting by designation.

2. 552 F.2d 302 (9th Cir. 1977).

3. See U.C.C. § 3-405 and comments following. All citations to Uniform Commercial Code sections, comments, and tables refer to the 1972 Official Text and Comments of the Uniform Commercial Code. *See also* W. BRITTON, HANDBOOK OF THE LAW OF BILLS AND NOTES 715-25 (1943); F. BEUTEL, BRANNAN'S NEGOTIABLE INSTRUMENTS LAW 470-80 (7th ed. 1948).

4. The warranty is deemed to be made upon presentment.

> The presenting bank and the indorsers of a check presented to the Treasury for payment are deemed to guarantee to the Treasury that all prior indorsements are genuine, whether or not an express guaranty is placed on the check. When the first indorsement has been made by one other than the payee personally, the presenting bank and the indorsers are deemed to guarantee to the Treasury, in addition to other warranties, that the person who so endorsed had unqualified capacity and authority to indorse the check in behalf of the payee.

Treas. Reg. § 240.4 (1974).

Published by TU Law Digital Commons, 1978

> eral and state courts' application of commercial law. To this end, we would urge Congress to adopt, in the not too distant future, the U.C.C. for federal application, as our fifty states have already done for local application.[5]

Using Justice Clark's recommendation as a basis, this article will examine the origins and justifications of the federal common law in the area of federal commercial paper, a number of the conflicts between federal and state laws governing commercial paper, and the proposals for federal reform in dealing with federal commercial paper. Favor will be given to congressional enactment of the Uniform Commercial Code (U.C.C.), articles 3 and 4, for federal application.

II. FACTS

An examination of the facts of *Bank of America National Trust & Savings Association v. United States*[6] will bring the issues into focus. An unknown employee of the United States Air Corps Station Disbursing Office at El Toro, California, forged military pay orders, records, and drafts in favor of nonexistent servicemen and subsequently endorsed and cashed the fraudulently obtained drafts. The bank in turn presented the drafts to the Treasurer of the United States for payment with the bank's endorsement warranting prior endorsements.[7] The Treasurer paid the draft, and it was stipulated that all parties acted in good faith and without notice of the fraudulent scheme. Upon learning of the fraud, the United States sued to recover the amount paid out to the bank on the basis of the bank's endorsement warranty. The federal district court found in favor of the United States. The Court of Appeals for the Ninth Circuit reversed and found in favor of the bank on the grounds that the imposter rule governed the facts of the case. Justice Clark while discussing the imposter rule cited *Atlantic National Bank v. United States*:[8]

> In the process of fashioning a federal jurisprudence concerning the Government's own commercial paper [citation omitted] this Court . . . along with many others, has adopted the "imposter rule." Under it, when the drawer or issuer of a check intends that it shall go to the person falsely pretending to be another who is in fact nonexistent, the endorsement in

5. Bank of America Nat'l Trust & Sav. Ass'n v. United States, 552 F.2d 302, 303 n.1 (9th Cir. 1977).
6. *Id.* at 302.
7. Treas. Reg. § 240.4 (1974). See note 4 *supra*.
8. 250 F.2d 114 (5th Cir. 1957).

> the fictitious payee's name by the pretender is not a forgery and an endorser bank is not liable to the drawee-drawer on the traditional stamped endorsement "all prior endorsements guaranteed."[9]

Therefore, under the imposter rule the bank will not be liable on its guaranty of prior endorsements, whereas under the standard forged endorsement case it will be liable to the party to whom the warranty was given.[10] The conflict between the trial court's holding and the appellate court's opinion in the principal case illustrates the potential discrepancies between the state of the law under the U.C.C.[11] and the federal common law which has governed federal commercial paper since the United States Supreme Court's decision in *Clearfield Trust Co. v. United States*.[12]

III. BACKGROUND

The federal general common law flourished under the regime of *Swift v. Tyson*.[13] This period ended with the Supreme Court's opinion in *Erie R.R. v. Tompkins*[14] which interpreted section 34 of the Federal Judiciary Act:[15]

> Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There is no

9. *Id.* at 116 (footnote omitted).

10. In the normal forgery case the first solvent party to deal with the forger will usually have to absorb the loss, assuming the forger is not to be found or is insolvent. *See, e.g.*, National Metropolitan Bank v. United States, 323 U.S. 454 (1945); Clearfield Trust Co. v. United States, 318 U.S. 363 (1943); United States v. City Nat'l Bank & Trust Co., 491 F.2d 851 (8th Cir. 1974). *See also* U.C.C. §§ 3-419(1)(c), 3-419(3), 3-417, 4-207.

11. Louisiana is the only state in which the entire Code has not been enacted. *See* U.C.C., Table 1. On January 1, 1975, articles 1, 3, 4, and 5 became effective in Louisiana also. LA. REV. STAT. ANN. §§ 10:1-101 to 5-117 (West Supp. 1975).

12. 318 U.S. 363 (1943).

13. 41 U.S. (16 Pet.) 1 (1842). For a discussion and history of the *Swift* case, see Teton, *The Story of Swift v. Tyson*, 35 ILL. L. REV. 519 (1941).

14. 304 U.S. 64 (1938). *See generally* Boner, *Erie v. Tompkins: A Study in Judicial Precedent*, 40 TEX. L. REV. 509 (1962); Clark, *State Law in the Federal Courts; The Brooding Omnipresence of Erie v. Tompkins*, 55 YALE L.J. 267 (1946); Merrigan, *Erie to York to Regan: A Triple Play on the Federal Rules*, 3 VAND. L. REV. 711 (1950); Wright, *The Federal Courts and the Nature and Quality of State Law*, 13 WAYNE REV. 317 (1967).

15. Ch. 20, § 34, 1 Stat. 92 (1789) (current version at 28 U.S.C. § 1652 (1976)). "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply." 28 U.S.C. § 1652 (1976).

federal general common law.[16]

The principal justification for the holding in *Erie* was the absence of constitutional authority to fashion a federal general common law in a federal diversity suit. The forming of a federal general common law was seen as an unconstitutional invasion of the state's powers. Furthermore, as a policy matter the growth of the federal general common law fostered forum shopping and nonuniformity between state and federal courts concerned with the same issues. Accordingly, under *Erie* the federal courts must look to state substantive rules of law, both statutory and decisional, in diversity cases unless the Constitution, a treaty, or an Act of Congress otherwise provides,[17] or unless the state law simply does not apply to a particular transaction due to its federal character.[18]

Despite the apparent rejection of a federal general common law in *Erie*, the Supreme Court later made it clear that there remained an extensive area of "independent federal judicial decision" both within and without the constitutional realm.[19] Since the *Erie* decision, the federal courts have recognized that federal law will govern in such matters as apportionment of the water flowing in an interstate stream,[20] liability or immunity of a telegraph company for transmission of libelous messages,[21] public lands and Indian affairs,[22] bankruptcy cases,[23] and government contracts including transactions where the government is exercising a constitutional power.[24]

It was a facet of this last exception that enabled the Supreme Court to revitalize the federal common law in the area of federal com-

16. Erie R.R. v. Tomkins, 304 U.S. 64, 78 (1938). *But see* note 19 *infra* and accompanying text.

17. Where the Constitution, a federal treaty, or an Act of Congress dictates, federal law will govern by virtue of the supremacy clause. U.S. CONST. art. VI, cl. 2.

18. 28 U.S.C. § 1652 (1976). Note the language "in cases where they apply." *Id.*

19. United States v. Standard Oil Co., 332 U.S. 301, 308 (1947). *See also*, Monaghan, *Forward: Constitutional Common Law*, 89 HARV. L. REV. 1 (1975); Newman, *The Federal Common Law*, 26 DICTA 303 (1949); Note, *Federal Courts - Federal Common Law Determines Lessor's Duty to Convey Possession to Government Standing as Lessee*, 43 FORDHAM L. REV. 1078 (1975); Note, *Exceptions to Erie v. Tompkins: The Survival of Federal Common Law*, 59 HARV. L. REV. 966 (1946).

20. Hinderlinder v. La Plata River & Cherry Creek Ditch Co., 304 U.S. 92 (1938). This decision was handed down at the same time as *Erie* and was written by Justice Brandeis who was also the author of the *Erie* opinion.

21. O'Brien v. Western Union Tel. Co., 113 F.2d 539 (1st Cir. 1940).

22. United States v. Fullard-Leo, 331 U.S. 256 (1947); Board of County Comm'rs v. United States, 308 U.S. 343 (1939).

23. Heiser v. Woodruff, 327 U.S. 726 (1946); Wragg v. Federal Land Bank, 317 U.S. 325 (1943).

24. United States v. County of Allegheny, 322 U.S. 174 (1944).

mercial paper. *Clearfield Trust Co. v. United States*[25] held that "the rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law."[26] The Court, noting the lack of legislative regulation of federal commercial paper, determined that a federal common law should apply to the government's exercising of its constitutional function of disbursing funds for payment of debts.[27] The Court also perceived a need for uniformity in the law of federal commercial paper.[28] The Court believed that the application of state laws to federal commercial paper would impair its negotiability by subjecting the rights and duties of the United States to exceptional uncertainty.[29]

Once having determined that federal common law would govern the rights and duties emanating from federal commercial paper,[30] the *Clearfield* Court had to decide what the source of the federal common law would be. The Court was faced with the choice of drawing from state law or of forming a nation-wide rule. This latter alternative was selected based primarily on the need for uniformity in dealing with all government paper. In formulating such a rule of federal common law, the Court referred to the federal law merchant[31] developed throughout the century under *Swift v. Tyson*.[32] The Court's animosity towards state law appeared to stem from the lack of uniformity among the various states' laws governing commercial paper.[33]

Clearfield concerned a check drawn on the Treasurer of the United States to the order of Clair A. Barner and dated April 28, 1936. The check had been mailed but had never reached Barner. An unknown person had obtained the check and had presented it to the J.C. Penney Co. in Clearfield, Pennsylvania, claiming to be the named payee. The store cashed the check on his forged endorsement. Subsequently, the

25. 318 U.S. 363 (1943).
26. *Id.* at 366.
27. *Id.*
28. *Id.* at 367.
29. *Id.*
30. *See* Dumbauld, *The Clear Field of Clearfield*, 61 DICK. L. REV. 299 (1957); Friendly, *In Praise of Erie—And of the New Federal Common Law*, 39 N.Y.U.L. REV. 383, 410 (1964); Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. PA. L. REV. 797, 802-03 (1957).
31. 318 U.S. at 367.
32. 41 U.S. (16 Pet.) 1 (1842).
33. At the time of the *Clearfield* decision the Negotiable Instruments Law (N.I.L.) was in effect in all 50 states, the Canal Zone, District of Columbia, Phillippine Islands, Puerto Rico, and the Virgin Islands. However, there was a great deal of statutory and judicial variation among the jurisdictions. See F. BEUTEL, BRANNAN'S NEGOTIABLE INSTRUMENTS LAW 1353-83 (7th ed. 1948).

store endorsed the check over to the Clearfield Trust Co. who in turn put its endorsement on the check as follows: "Pay to the order of Federal Reserve Bank of Philadelphia, Prior Endorsements Guaranteed."[34] Clearfield then collected the full amount from the Federal Reserve Bank and paid it over to J.C. Penney Co. Neither Clearfield nor J.C. Penney Co. had any knowledge of the forgery. On May 10, 1936, Barner notified the appropriate government officials that he had not received the check, and on November 30, 1936, he executed an affidavit stating that the endorsement of his name on the check was a forgery. Clearfield was not given any notice of the forgery until January 12, 1937, and was not notified that the United States was seeking reimbursement until August 31, 1937.[35] The trial court found that the United States had unreasonably delayed in giving notice of the forgery to Clearfield and, therefore, that Pennsylvania law barred the United States from obtaining reimbursement from Clearfield. The Court of Appeals for the Third Circuit reversed,[36] and the Supreme Court affirmed, holding that Clearfield was required to show actual damages in order to bar the United States from reimbursement rather than merely a showing of unreasonable delay in notifying Clearfield of the forgery.[37] Not only was federal common law applied, as opposed to Pennsylvania law, but a showing of actual damages beyond the mere unreasonable delay was required by the federal law merchant[38] which served as the source for the federal common law. Hence, a separate body of law, the federal common law governing federal commercial paper, had survived the mandate of *Erie*.

Two years after *Clearfield*, the Supreme Court again asserted the maxim that the federal common law governed federal commercial paper in *National Metropolitan Bank v. United States*.[39] A civilian clerk in the Paymaster's office of the Marine Corps procured 144 government checks by forging pay and travel mileage vouchers in the names of living Marine Corps officers. He forged their endorsements, added his own second endorsement, and deposited or cashed the checks at Anacostia Bank which endorsed the checks and transmitted them to

34. See note 4 *supra*.

35. Clearfield Trust Co. v. United States, 318 U.S. 363, 364-65 (1943).

36. United States v. Clearfield Trust Co., 130 F.2d 93 (3rd Cir. 1942), *aff'd*, 318 U.S. 363 (1943).

37. 318 U.S. at 369.

38. *See, e.g.*, Ladd & Tilton Bank v. United States, 30 F.2d 334 (9th Cir. 1929); United States v. National Rockland Bank, 35 F. Supp. 912 (D. Mass. 1940); United States v. National City Bank, 28 F. Supp. 144 (S.D.N.Y. 1939). *Compare* U.C.C. § 4-406 (4).

39. 323 U.S. 454, 456 (1945).

National Metropolitan Bank. National Metropolitan Bank then presented the checks to the Government with the required guaranty of prior endorsements.[40] The Government paid the checks and, after their discovery of the fraud and forgeries, demanded reimbursement from National Metropolitan Bank based on a breach of its express warranty.[41] The bank's primary defense was that "the government's disbursing agencies neglected properly to supervise and examine the transactions both before and after the first and succeeding checks were issued, thereby delaying discovery of the fraud, and this neglect, not the bank's guaranty, caused the government's loss."[42] The district court granted the Government's motion for judgment on the pleadings, and the Court of Appeals for the District of Columbia affirmed.[43] The Supreme Court affirmed, holding that the "negligence of a drawer-drawee in failing to discover fraud prior to a guaranty of the genuineness of prior endorsements does not absolve the guarantor from liability in cases where the prior endorsements have been forged."[44]

Thus under *Clearfield* and *National Metropolitan*, the Supreme Court had established that federal common law governs federal commercial paper and that the federal law merchant rather than state law could be used as a source for federal common law. In addition these cases applied the federal common law and held that the presenting bank would be liable on its guaranty of prior endorsements regardless of the Government's negligence, as the drawer-drawee, in failing to discover the fraud prior to the bank's guaranty of the forged endorsements.

IV. ANALYSIS

The dispute in the *Bank of America National Trust & Savings Association v. United States*[45] involved the Government's contention that the rule in *National Metropolitan*[46] and its progeny[47] was controlling,

40. See note 4 *supra*.

41. The Government's complaint actually contained two counts, one for breach of express warranty and one for money paid under a mistake of fact. 323 U.S. at 455.

42. *Id.* The bank also set up two other defenses: that the endorsement did not amount to a guaranty of the payee's signature and that issuance of the checks by the government was a warranty that they were not "fictitious," but genuine and issued for valuable consideration, and this warranty was breached. *Id.*

43. National Metropolitan Bank v. United States, 142 F.2d 474 (D.C. Cir. 1944), *aff'd*, 323 U.S. 454 (1945).

44. 323 U.S. at 459. *Compare* U.C.C. § 3-406.

45. 552 F.2d 302 (9th Cir. 1977).

46. 323 U.S. at 454.

47. *See, e.g.*, United States v. City Nat'l Bank & Trust Co., 491 F.2d 851 (8th Cir. 1974);

and the bank's assertion that the imposter rule[48] was the controlling law. As stated earlier the Court of Appeals for the Ninth Circuit agreed with the bank's position.[49] The problem addressed in this section is not whether the court of appeals was correct in its decision to classify the principal case as an imposter case rather than a forgery case. This decision is not entirely consistent with the views of other federal courts on this issue, and indeed the Ninth Circuit itself has viewed the matter in several lights.[50]

How these conflicts are resolved factually is of little significance. The following analysis should serve to demonstrate instead that the use of the U.C.C. as the source of the federal common law would eliminate such conflicts. Such a rule would provide uniformity for federal courts, as well as to allow consistency between federal and state decisions on similar issues. This consistency would result as a matter of course in light of the adoption of articles 3 and 4 of the U.C.C. in all American jurisdictions.[51]

The U.C.C. represents the most modern and comprehensive statement of commercial law. The point to be drawn from the following discussion is that the desirable effects of its uniformity can be seriously undermined by its inapplicability to the federal government. The advantages of basing the federal common law of commercial paper on the U.C.C. can be illustrated by a comparison of the approaches of the U.C.C. and of the federal common law to the padded payroll exception to the imposter rule. The conflicts among the federal courts surrounding this concept are similar to the conflicts between state courts which were remedied by the adoption of the U.C.C.[52]

A. The Padded Payroll Exception Under the U.C.C.

The exception is codified in U.C.C. section 3-405(1)(c)[53] and cov-

United States v. Bank of America Nat'l Trust & Sav. Ass'n, 438 F.2d 1213 (9th Cir.), *cert. denied*, 404 U.S. 864 (1971).

48. *See* United States v. Bank of America Nat'l Trust & Sav. Ass'n, 274 F.2d 366 (9th Cir. 1959); Atlantic Nat'l Bank v. United States, 250 F.2d 114 (5th Cir. 1957). *See also* note 3 *supra* and accompanying text.

49. See notes 4-7 *supra* and accompanying text.

50. See notes 60-65 *supra* and accompanying text.

51. See note 11 *supra* and accompanying text.

52. See note 66 *infra* and accompanying text.

53. U.C.C. § 3-405 states:

(1) An indorsement by any person in the name of a named payee is effective if

. . . .

(c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.

ers situations in which an agent or employee of the maker or drawer provides him with the name of a payee while intending that the named payee have no interest nor receive any proceeds from the instrument. It is irrelevant whether the named payee is an existing person so long as the agent or employee procuring the instrument intended that the named payee have no interest in it.[54] Thereafter, an endorsement by any person in the name of the named payee is effective and is not a forged endorsement.[55] In the absence of a forged endorsement, there can be no breach of a collecting or presenting bank's warranty of prior endorsements.[56]

The policy behind the exception is that the loss in such a situation should fall on the drawer-employer as a risk of doing business rather than on a subsequent holder or drawee.[57] The policy is stated in the comments to the section:

> The reasons are that the employer is normally in a better position to prevent such forgeries by reasonable care in the selection or supervision of his employees, or if he is not, is at least in a better position to cover the loss by fidelity insurance; and that the cost of such insurance is properly an expense of his business rather than the business of the holder or drawee.[58]

If the allocation of the loss had been put upon the holder or drawee, such a holder could never be fully protected unless it could verify that the endorser was, in fact, the named payee. This burdensome procedure would definitely inhibit the transferability and negotiability of commercial paper. Furthermore, since it was the employer's negligence in hiring or failing to supervise properly his employees which caused the issuance of the fraudulent instrument, that negligent employer should bear the resulting loss. Therefore, under the U.C.C. the loss in a padded payroll situation is borne by the employer-drawer rather than by subsequent holders. This appears to be the most fair and commercially reasonable allocation of the risk and resultant loss.[59]

54. U.C.C. § 3-405, comment 1.

55. U.C.C. § 3-405(1). This will mean that the drawer can be held liable on his contract, U.C.C. § 3-413(2), rather than the holder or presenting bank's being liable under a particular warranty, U.C.C. §§ 3-417, 4-207.

56. U.C.C. §§ 3-417(1), 4-207(1).

57. U.C.C. § 3-405, comment 4.

58. *Id.*

59. For a discussion of the padded payroll exception under U.C.C. § 3-405, *see generally* Whaley & Yegerlehner, *Imposters, Insurance and the U.C.C.*, 5 CREIGHTON L. REV. 60 (1971) and Comment, *The Resolution of Padded Payroll Cases by the Uniform Commercial Code: A Pandora's Box*, 9 B.C. INDUS. & COM. L. REV. 379 (1968).

B. The Padded Payroll Exception Under the Federal Common Law

The exception does exist under the federal common law although its scope is substantially less than under the U.C.C. The Court of Appeals for the Ninth Circuit in *United States v. Bank of America National Trust & Savings Association* (1959)[60] rejected the exception as it is stated in section 3-405(1)(c) of the U.C.C. and which would have placed liability on the Government, holding instead that the *National Metropolitan* decision required that the bank be liable. The facts are as follows. Two enlisted men of the United States Navy were performing duties in the disbursing office of the U.S.S. *Coral Sea*. One of the men obtained a discharged shipmate's identification card and substituted his own photograph for that of the card's true owner. The two schemers then prepared and presented Treasury checks, payable to the discharged man, to the ship's disbursing officer who signed the checks. The defrauding seamen forged the endorsement of the named payee and through the use of the false identification card were able to cash the checks at a bank. The Government paid the checks and upon discovery of the fraud sought reimbursement from the bank on the basis of its guaranty of prior endorsements.[61] The court felt that the *National Metropolitan* decision absolved the Government from its negligence in failing to discover the fraud and did not preclude the Government's right to reimbursement from the bank. The court stated, "[W]e cannot find that the Supreme Court has itself, since 1945, written anything which might cause us to conclude with reasonable assurance that its *Metropolitan* decision is no longer viable. This being so, we think that *Metropolitan* must now control the disposition of this appeal."[62] The result was that, even though the bank had cashed a check on the basis of what appeared to be a valid *photographic* identification card, it nevertheless was held responsible for the loss.

In contrast, the padded payroll exception was found to be applicable in *Atlantic National Bank v. United States*.[63] In *Atlantic*, a tax collector prepared and filed income tax returns using *fictitious* names for the taxpayers and their employers, both on the returns and the attached statements of taxes withheld. All of these false returns requested re-

60. 438 F.2d 1213 (9th Cir. 1971), *cert. denied*, 404 U.S. 864 (1971).

61. *Id.*

62. *Id.* at 1214. For a criticism of the result in this case, see Comment, *Uniform Commercial Code—Applicability of Section 3-405 to Federal Commercial Paper—"Padded Payroll" Exception*—United States v. Bank of America Nat'l Trust and Savings Ass'n, 13 B.C. INDUS. & COM. L. REV. 586 (1972).

63. 250 F.2d 114 (5th Cir. 1957).

funds. The Treasury issued each of the checks on the basis of the returns alone without further verification. The tax collector obtained each of these checks and signed the names of the nonexistent payees as an endorsement and, except for three isolated checks, added a second endorsement in another fictitious name. The checks went through the banking channels and ultimately were presented to and paid by the Federal Reserve Bank of Atlanta.[64] Upon discovery of the fraud the Government sought to recover payment from the banks. The district court found in favor of the Government on the basis of the bank's breach of its warranty of endorsements. The Court of Appeals for the Fifth Circuit reversed:

> If through fraud practiced on the Government, either by outsiders or its own unfaithful servants, a check is delivered to one upon the mistaken belief that it is due such person, the endorsement of that imposter, whether in that name or in another, is not a forgery and the Government's loss is not that of a drawee who has been led to pay on the assumption that only the one authorized by the payee has made the endorsement. Rather, the Government's loss is that of one defrauded by a dishonest employee who set the scheme in motion. The necessity for unfettered circulation of the Government's negotiable paper not only does not require—it actually forbids—that such a loss should be visited on the collecting banks.[65]

Therefore, while the circumstances in both *Bank of America N.T.S.A.* (1959) and *Atlantic* involved a fraudulent scheme perpetrated on the Government by dishonest employees, the Government was absolved from liability in the former and had to assume liability in the latter.

The reason for this conflict among the federal courts as to when to apply the padded payroll exception parallels the conflict under the common law prior to the states' adoption of the U.C.C.[66] The padded payroll exception under the federal common law retains the requirement that the named payee be a fictitious or nonexistent person.[67] The

64. *Id.* at 116-17.

65. *Id.* at 118 (footnotes omitted).

66. *Compare* United States v. Bank of America Nat'l Trust & Sav. Ass'n, 274 F.2d 366 (9th Cir. 1959) *and* United States v. Continental-American Bank & Trust Co., 175 F.2d 271 (5th Cir. 1949) *with* United States v. City Nat'l Bank & Trust Co., 491 F.2d 851 (8th Cir. 1974) *and* United States v. Philadelphia Nat'l Bank, 304 F. Supp. 955 (E.D. Pa. 1969). *See also* Whaley & Yegerlehner, *Imposters, Insurance and the U.C.C.*, 5 CREIGHTON L. REV. 60, 61-67 (1971).

67. *See, e.g.*, Bank of America Nat'l Trust & Sav. Ass'n v. United States, 552 F.2d 302 (9th Cir. 1977) (non-existent servicemen); Bank of America Nat'l Trust & Sav. Ass'n v. United States, 438 F.2d 1213 (9th Cir. 1971), *cert. denied*, 404 U.S. 864 (1971) (discharged shipmate); Atlantic Nat'l Bank v. United States, 250 F.2d 114 (5th Cir. 1957) (fictitious names); United States v. Philadelphia National Bank, 304 F. Supp. 955 (E.D. Pa. 1969) (true persons).

U.C.C. dispenses with this requirement and stresses the defrauder's intent that the named payee have no interest in the instrument.[68] Whether the named payee is fictitious is irrelevant as long as the defrauding party intended to receive the entire proceeds himself to the exclusion of the named payee. Affixing the liability upon the intent of the defrauding party is a commercially more reasonable result than basing the determination upon whether the defrauding party uses a real or a fictitious person as the named drawer. As a result of retaining this latter standard for determining liability, the federal common law governing federal commercial paper is in a state of uncertainty with relation to the general commercial world. This situation is in direct opposition to the dictates of the Supreme Court in *Clearfield* and to the desire to have free and unrestricted negotiability of the Government's commercial paper.

V. PROPOSALS

Two possible solutions exist to resolve the conflict between the federal common law on federal paper and the rest of the commercial world operating under the U.C.C. The first and most comprehensive solution would be congressional enactment of the U.C.C., articles 3 and 4, into federal law. The U.C.C. was drafted to allow for some jurisdictional variations; therefore, any alterations that would be needed to bring the articles into conformity with federal treasury and banking regulations could certainly be provided.[69] Enacting the U.C.C. into federal law would bring certainty and uniformity into the law governing federal commercial paper. As the Supreme Court has stated, "The United States does business on business terms. . . . [It] is not excepted from the general rule by the largeness of its dealings and its having to employ agents to do what if done by a principal in person would leave no room for doubt."[70] And in the area of commercial paper the Court has said, "The United States as drawee of commercial paper stands in no different light than any other drawee."[71] Therefore, it would be preferable for Congress to bring the law governing federal commercial paper into conformity with the fifty states by enacting the U.C.C., articles 3 and 4, into federal law.

68. U.C.C. § 3-405, comment 1.

69. Care must be taken not to destroy the uniformity of the substantive policies expressed in the Code. *See, e.g.*, Minahan, *The Eroding Uniformity of the Uniform Commercial Code*, 65 KY. L.J. 799 (1977).

70. United States v. National Exch. Bank, 270 U.S. 527, 534-35 (1926).

71. Clearfield Trust Co. v. United States, 318 U.S. 363, 369 (1943).

A second solution would be an increased reliance on the U.C.C. as a source of determining what the federal common law should be. The problem with such an approach is the mandate of the supremacy clause of the United States Constitution[72] and the persuasiveness of stare decisis.[73] Nevertheless, the federal courts have looked upon the U.C.C. as a source for federal law in areas such as federal government contracts. Judge Henry J. Friendly in *United States v. Wegematic Corp.*[74] stated:

> We find persuasive the defendant's suggestions of looking to the Uniform Commercial Code as a source for the "federal" law of sales. . . . When the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disservice to insist on a different one for the segment of commerce, important but still small in relation to the total, consisting of transactions with the United States.[75]

Furthermore, former Chief Justice Roger J. Traynor of the Supreme Court of California has noted, "The Uniform Commercial Code has become a major influence on the development of common law in the federal courts to govern cases involving government contracts and other commercial transactions."[76] Considering the problem of the precedents in the *Clearfield* and *National Metropolitan* decisions, it would be most wise if the Supreme Court were to accept certiorari of an appropriate case and declare that the U.C.C. can be looked to as a source for determining the federal common law governing federal commercial paper. Such action would bring the law of federal commercial paper into conformity with that of private and state commercial paper.

VI. CONCLUSION

At the time of the *Clearfield* decision, it was clear that despite *Erie* the federal common law would govern rights and liabilities in relation

72. U.S. CONST. art. VI, cl. 2.

73. "We are reminded in this connection of the Court's recent expression of difficulty in comprehending how decisions by lower courts can ever undermine the authority of a decision of [the Supreme] Court." Federal Elec. Corp. v. United States, 486 F.2d 1377, 1382 (Ct. Cl. 1973) (quoting United States v. Mason, 412 U.S. 391, 396 (1973)).

74. 360 F.2d 674 (2nd Cir. 1966).

75. *Id.* at 676. *See also* United States v. First Nat'l Bank, 470 F.2d 944 (8th Cir. 1973) (U.C.C. as source for "federal law" governing FHA security interest); New York, N.H. & H.R. Co. v. Reconstruction Fin. Corp., 180 F.2d 241 (2d Cir. 1950) (use of the Negotiable Instruments Law as source of "federal law"); Comment, *Application of the Uniform Commercial Code to Federal Government Contracts: Doing Business on Business Terms*, 16 WM. & MARY L. REV. 395 (1974).

76. Traynor, *Statutes Revolving in Common Law Orbits*, 17 CATH. U.L. REV. 401, 422-23 (1968).

to federal commercial paper. This was appropriate in that no uniformity could be had by looking to the disparity of state laws governing commercial paper. Today, however, the federal common law of federal commercial paper has lost its uniformity through frequent clashes with the concepts of the U.C.C. as applied by the states. Although there is arguably a uniform federal rule governing federal commercial paper, that rule is certainly inconsistent with commercial reality in the fifty states.

It is time Congress acted to bring federal law into harmony with the commercial world. In the absence of congressional action, the federal judiciary should look upon the U.C.C. as a valid and persuasive source for determining the substance of the federal common law. In the words of Justice Clark, "The commercial interests of our country would be better served if interested parties could expect uniformity in the federal and state court's application of commercial law. To this end, we would urge Congress to adopt . . . the U.C.C. for federal application, as our fifty states have already done for local application."[77]

Stephen A. Becker

77. 552 F.2d 302, 303 n.1 (9th Cir. 1977).