

SECOND DIVISION

[G.R. No. 107382, January 31, 1996]

**ASSOCIATED BANK, PETITIONER, VS. HON. COURT OF APPEALS,
PROVINCE OF TARLAC AND PHILIPPINE NATIONAL BANK,
RESPONDENTS.**

D E C I S I O N

ROMERO, J.:

Where thirty checks bearing forged endorsements are paid, who bears the loss, the drawer, the drawee bank or the collecting bank?

This is the main issue in these consolidated petitions for review assailing the decision of the Court of Appeals in "Province of Tarlac v. Philippine National Bank v. Associated Bank v. Fausto Pangilinan, et. al." (CA-G.R. No. CV No. 17962).^[1]

The facts of the case are as follows:

The Province of Tarlac maintains a current account with the Philippine National Bank (PNB) Tarlac Branch where the provincial funds are deposited. Checks issued by the Province are signed by the Provincial Treasurer and countersigned by the Provincial Auditor or the Secretary of the Sangguniang Bayan.

A portion of the funds of the province is allocated to the Concepcion Emergency Hospital.^[2] The allotment checks for said government hospital are drawn to the order of "Concepcion. Emergency Hospital, Concepcion, Tarlac" or "The Chief, Concepcion Emergency Hospital, Concepcion, Tarlac." The checks are released by the Office of the Provincial Treasurer and received for the hospital by its administrative officer and cashier.

In January 1981, the books of account of the Provincial Treasurer were post-audited by the Provincial Auditor. It was then discovered that the hospital did not receive several allotment checks drawn by the Province.

On February 19, 1981, the Provincial Treasurer requested the manager of the PNB to return all of its cleared checks which were issued from 1977 to 1980 in order to verify the regularity of their encashment. After the checks were examined, the Provincial Treasurer learned that 30 checks amounting to P203,300.00 were encashed by one Fausto Pangilinan, with the Associated Bank acting as collecting bank.

It turned out that Fausto Pangilinan, who was the administrative officer and cashier of payee hospital until his retirement on February 28, 1978, collected the questioned checks from the office of the Provincial Treasurer. He claimed to be assisting or helping the hospital follow up the release of the checks and had official receipts.^[3]

Pangilinan sought to encash the first check^[4] with Associated Bank. However, the manager of Associated Bank refused and suggested that Pangilinan deposit the check in his personal savings account with the same bank. Pangilinan was able to withdraw the money when the check was cleared and paid by the drawee bank, PNB.

After forging the signature of Dr. Adena Canlas who was chief of the payee hospital, Pangilinan followed the same procedure for the second check, in the amount of P5,000.00 and dated April 20, 1978,^[5] as well as for twenty-eight other checks, of various amounts and on various dates. The last check negotiated by Pangilinan was for P8,000.00 and dated February 10, 1981.^[6] All the checks bore the stamp of Associated Bank which reads "All prior endorsements guaranteed ASSOCIATED BANK."

Jesus David, the manager of Associated Bank testified that Pangilinan made it appear that the checks were paid to him for certain projects with the hospital.^[7] He did not find as irregular the fact that the checks were not payable to Pangilinan but to the Concepcion Emergency Hospital. While he admitted that his wife and Pangilinan's wife are first cousins, the manager denied having given Pangilinan preferential treatment on this account.^[8]

On February 26, 1981, the Provincial Treasurer wrote the manager of the PNB seeking the restoration of the various amounts debited from the current account of the Province.^[9]

In turn, the PNB manager demanded reimbursement from the Associated Bank on May 15, 1981.^[10]

As both banks resisted payment, the Province of Tarlac brought suit against PNB which, in turn, impleaded Associated Bank as third-party defendant. The latter then filed a fourth-party complaint against Adena Canlas and Fausto Pangilinan.^[11]

After trial on the merits, the lower court rendered its decision on March 21, 1988, disposing as follows:

"WHEREFORE, in view of the foregoing, judgment is hereby rendered:

1. On the basic complaint, in favor of plaintiff Province of Tarlac and against defendant Philippine National Bank (PNB), ordering the latter to pay to the former, the sum of Two Hundred Three Thousand Three Hundred (P203,300.00) Pesos with legal interest thereon from March 20, 1981 until fully paid;
2. On the third-party complaint, in favor of defendant/third-party plaintiff Philippine National Bank (PNB) and against third-party defendant/fourth-party plaintiff Associated Bank ordering the latter to reimburse to the former the amount of Two Hundred Three Thousand Three Hundred (P203,300.00) Pesos with legal interests thereon from March 20, 1981 until fully paid;.

3. On the fourth-party complaint, the same is hereby ordered dismissed for lack of cause of action as against fourth-party defendant Adena Canlas and lack of jurisdiction over the person of fourth-party defendant Fausto Pangilinan as against the latter.

4. On the counterclaims on the complaint, third-party complaint and fourth-party complaint, the same are hereby ordered dismissed for lack of merit.

SO ORDERED.^[12]

PNB and Associated Bank appealed to the Court of Appeals.^[13] Respondent court affirmed the trial court's decision in toto on September 30, 1992.

Hence these consolidated petitions which seek a reversal of respondent appellate court's decision.

PNB assigned two errors. First, the bank contends that respondent court erred in exempting the Province of Tarlac from liability when, in fact, the latter was negligent because it delivered and released the questioned checks to Fausto Pangilinan who was then already retired as the hospital's cashier and administrative officer. PNB also maintains its innocence and alleges that as between two innocent persons, the one whose act was the cause of the loss, in this case the Province of Tarlac, bears the loss.

Next, PNB asserts that it was error for the court to order it to pay the province and then seek reimbursement from Associated Bank. According to petitioner bank, respondent appellate Court should have directed Associated Bank to pay the adjudged liability directly to the Province of Tarlac to avoid circuitry.^[14]

Associated Bank, on the other hand, argues that the order of liability should be totally reversed, with the drawee bank (PNB) solely and ultimately bearing the loss.

Respondent court allegedly erred in applying Section 23 of the Philippine Clearing House Rules instead of Central Bank Circular No. 580, which, being an administrative regulation issued pursuant to law, has the force and effect of law.^[15] The PCHC Rules are merely contractual stipulations among and between member-banks. As such, they cannot prevail over the aforesaid CB Circular.

It likewise contends that PNB, the drawee bank, is estopped from asserting the defense of guarantee of prior indorsements against Associated Bank, the collecting bank. In stamping the guarantee (for all prior indorsements), it merely followed a mandatory requirement for clearing and had no choice but to place the stamp of guarantee; otherwise, there would be no clearing. The bank will be in a "no-win" situation and will always bear the loss as against the drawee bank.^[16]

Associated Bank also claims that since PNB already cleared and paid the value of the forged checks in question, it is now estopped from asserting the defense that

Associated Bank guaranteed prior indorsements. The drawee bank allegedly has the primary duty to verify the genuineness of payee's indorsement before paying the check.^[17]

While both banks are innocent of the forgery, Associated Bank claims that PNB was at fault and should solely bear the loss because it cleared and paid the forged checks.

xxx

The case at bench concerns checks payable to the order of Concepcion Emergency Hospital or its Chief. They were properly issued and bear the genuine signatures of the drawer, the Province of Tarlac. The infirmity in the questioned checks lies in the payee's (Concepcion Emergency Hospital) indorsements which are forgeries. At the time of their indorsement, the checks were order instruments.

Checks having forged indorsements should be differentiated from forged checks or checks bearing the forged signature of the drawer.

Section 23 of the Negotiable Instruments Law (NIL) provides:

Sec. 23. FORGED SIGNATURE, EFFECT OF. - When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority.

A forged signature, whether it be that of the drawer or the payee, is wholly inoperative and no one can gain title to the instrument through it. A person whose signature to an instrument was forged was never a party and never consented to the contract which allegedly gave rise to such instrument.^[18] Section 23 does not avoid the instrument but only the forged signature.^[19] Thus, a forged indorsement does not operate as the payee's indorsement.

The exception to the general rule in Section 23 is where "a party against whom it is sought to enforce a right is precluded from setting up the forgery or want of authority. "Parties who warrant or admit the genuineness of the signature in question and those who, by their acts, silence or negligence are estopped from setting up the defense of forgery, are precluded from using this defense. Indorsers, persons negotiating by delivery and acceptors are warrantors of the genuineness of the signatures on the instrument.^[20]

In bearer instruments, the signature of the payee or holder is unnecessary to pass title to the instrument. Hence, when the indorsement is a forgery, only the person whose signature is forged can raise the defense of forgery against a holder in due

course.^[21]

The checks involved in this case are order instruments, hence, the following discussion is made with reference to the effects of a forged indorsement on an instrument payable to order.

Where the instrument is payable to order at the time of the forgery, such as the checks in this case, the signature of its rightful holder (here, the payee hospital) is essential to transfer title to the same instrument. When the holder's indorsement is forged, all parties prior to the forgery may raise the real defense of forgery against all parties subsequent thereto.^[22]

An indorser of an order instrument warrants "that the instrument is genuine and in all respects what it purports to be; that he has a good title to it; that all prior parties had capacity to contract; and that the instrument is at the time of his indorsement valid and subsisting."^[23] He cannot interpose the defense that signatures prior to him are forged.

A collecting bank where a check is deposited and which indorses the check upon presentment with the drawee bank, is such an indorser. So even if the indorsement on the check deposited by the bank's client is forged, the collecting bank is bound by his warranties as an indorser and cannot set up the defense of forgery as against the drawee bank.

The bank on which a check is drawn, known as the drawee bank, is under strict liability to pay the check to the order of the payee. The drawer's instructions are reflected on the face and by the terms of the check. Payment under a forged indorsement is not to the drawer's order. When the drawee bank pays a person other than the payee, it does not comply with the terms of the check and violates its duty to charge its customer's (the drawer) account only for properly payable items. Since the drawee bank did not pay a holder or other person entitled to receive payment, it has no right to reimbursement from the drawer.²⁴ The general rule then is that the drawee bank may not debit the drawer's account and is not entitled to indemnification from the drawer.^[25] The risk of loss must perforce fall on the drawee bank.

However, if the drawee bank can prove a failure by the customer/drawer to exercise ordinary care that substantially contributed to the making of the forged signature, the drawer is precluded from asserting the forgery.

If at the same time the drawee bank was also negligent to the point of substantially contributing to the loss, then such loss from the forgery can be apportioned between the negligent drawer and the negligent bank.^[26]

In cases involving a forged check, where the drawer's signature is forged, the drawer can recover from the drawee bank. No drawee bank has a right to pay a forged check. If it does, it shall have to recredit the amount of the check to the account of the drawer. The liability chain ends with the drawee bank whose responsibility it is to know the drawer's signature since the latter is its customer.^[27]

In cases involving checks with forged indorsements, such as the present petition,