

1965

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Repository Citation

Fairfax Leary Jr., *Check Handling Under Article 4 of the Uniform Commerical Code*, 49 Marq. L. Rev. 331 (1965).

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CHECK HANDLING UNDER ARTICLE FOUR OF THE UNIFORM COMMERCIAL CODE

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In any system of jurisprudence based on precedent, it is too easy for the law to get out of harmony with the practices of business. It is also true that judges under our system face two tasks in every case. The first and primary task is to resolve in a fair and decent fashion the dispute between the parties before the Court. The second task is to fit the decision into the pattern of the law as it appears to be evolving from the cases and statutes available to the judge. Often the two tasks appear to conflict. While it is difficult to articulate, most people have an innate sense of fairness against which they evaluate the choices, or decisions, that they must make. Judges are people and have, inevitably, the same sense of fairness and decency.

On analysis, however, the sense of fairness and decency reacts to the facts¹ of a given situation only as those facts are presented and understood. In an adversary legal system, the facts of the situation come from only two sources: those presented by the litigants, and those known to the decision makers² from prior experience, or ascertained by independent research.

When the decision is made in a given case, its place in the facade of the law will largely depend upon community reaction,³ and this in turn is derived from what the decision says it is deciding and the knowledge and experience of the community.

In the case of the decision itself, and in the case of the community's evaluation thereof, there is often a considerable difference between the actual decision, based on the totality of all the facts, those stated and urged upon the decision makers, and those felt or unconsciously assumed, and the effect of the decision as precedent, based on the quality of the written opinion and the subsequent evaluation of it as used in other judicial decision making.

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The Final Draft of Article 4 was not prepared by the author.

¹ The word is here used in a broad sense to include prior concepts as to the applicable rules of law, and general understandings as to the way business is conducted, whether or not made a part of the record.

² "Decision makers" include both judge and, where used, jury, in the exercise of their specific functions.

³ The word "community" is used in the limited sense of the lawyers, judges and others concerned with the effect of the particular case. In the civil rights area the community is, of course, very large. In commercial matters, the community is very small.

In the field of commercial law, the inability to present and have full consideration given to a complete picture of the effect of alternate resolutions of a given dispute upon the course of business as a whole, has resulted in much bad law, as the judicial sense of fairness and decency has evolved decisions with respect to the particular cases to be decided, without too great an appreciation of the possible effect of the enunciated ruling on the course of business as a whole.

The trouble is inherent in our system of jurisprudence. Commercial cases often involve small amounts of money. The businessman is interested primarily in his particular situation, usually his only question on one side is whether he does or does not have to pay, and on the other how much money will he get. Lawyers' fees are to be kept within a reasonable relationship to the sums involved. Hence, except where true professional zeal is involved, the lawyer keeps his hours spent on the case in some sort of relation to the fee, and the judge does not have the benefit of exhaustive briefs or an unhurried trial.

All of the foregoing presses toward a statutory treatment of commercial subjects, and in particular in the field of bank collections, where a Code treatment with Official Comments affords a unique opportunity to present the decision makers with background material and to show the interplay of the various over-all factors that should affect a decision that is to have precedential value.

What then are the policy considerations that should bear upon the decision-making process in the field of the collection of checks through banking channels? A businessman, the author believes, now regards a check not as a credit device, but as a "payment" device. It is the medium we have worked out for paying for goods and services in the vast and an ever increasing majority of cases.⁴ The function of a check is to effect the transfer of "immediately available" funds from the Buyer's account in his bank to the Seller's account in his bank in the sales transaction. The function is the same in a myriad of other transactions, including payment of salaries, repayment of loans, payment of taxes or any other transaction calling for a payment from A to B.

Here we face the first of the situations in which the law has, perhaps, not kept pace with business practice, and yet perhaps it has. No rule of law compels a businessman to accept a check or to deal through the banking system at all. No rule of law compels the holder of a check

⁴ The increasing use of the check is probably more concentrated in urban and industrial areas. Many corporations now use checks to pay all employees, including weekly wage earners. "Special" checking accounts and other "ten cents a check" plans make checks available to the many who cannot afford to maintain minimum balances. All of this is not to deny a tremendous volume of "cash" transactions. Even in the "cash and carry" supermarkets, however, managers are cashing checks in substantial volume to enable the housewife to pay at the "check-out" counter.

to deposit it in his own bank account, or even to have a bank account.⁵ Yet no bank today could remain open if every check or item presented to it on that day was required to be paid over-the-counter in cash. The bankers just do not keep sums of that magnitude available in currency. The banking community is oriented to operating largely on the principle of the set-off of mutual claims.

Ideally, if all transactions were local ones, and there was only one bank in the community, each person having an account would give the bank a list of the transfers to be made from his or her account to the accounts of other customers, and "payment" would be effected when the bank posted the transfers to the indicated accounts. Even if there were two or more banks, if everyone knew the bank of deposit of each person to whom a payment had to be made, the list method could be used, but, in general, these facts are not known.

Custom and the absence of necessary knowledge have, however, decreed the use of the customary oblong pieces of paper as the mechanical means of effecting the necessary transfers. And these are used in truly astonishing numbers.⁶ In addition, studies have shown that checks issued in recent years have almost unanimously been good. The area of risk appears to be about one eighth of one per cent.⁷ From these facts we can deduce two principles that have guided the selection of the statutory rules governing a law of check collections. One is that

⁵ Many payroll checks are cashed at local markets or at a bar-and-grill by the weekly wage employees who perhaps only bank "savings." However, practically no businesses today operate without a bank account.

⁶ In 1963 the Federal Reserve System handled 4,700,000,000 items for collection, the Fed. of Chicago alone handled 700,000,000. But these are "inter-city" items, and the local clearing house items must be added. Conservative estimates by knowledgeable bankers place the total, country wide at 50,000,000 a day, and 13,000,000,000 a year. One study made some years ago by the author showed that banks with deposits of \$5,000,000 or less averaged from 1,000 to 3,000 items a day. The figures relate to items, not to "handlings," which will vary from bank to bank, and, on an average, the figures should probably be multiplied by 7 to equal total "handlings" by all banks concerned. For a description of the mechanics of check handling in 1949 see Leary, *Deferred Posting and Delayed Returns—The Current Check Collection Problem*, 62 HARV. L. REV. 905 (1949).

⁷ Studies made by the Federal Reserve Banks yield a figure of about 99½% by number and 99¾ by dollar value for those paid in due course. A further examination of the initially dishonored items indicate that about half of these are paid upon a re-presentment. These statistics are the basis for two provisions in the Uniform Commercial Code (hereinafter called the "Code"). One, in Section 3-507, refers to a "term in a draft or an endorsement thereof allowing a stated time for re-presentment" in the case of certain dishonors, which in the case of a check would be dishonor by non payment. The second is in Section 4-108 permitting extensions of time by a collecting bank for "specific items" of up to an additional "banking day" in a good faith effort to secure payment. This last must be done on an item-by-item basis, and banks should note that while the "midnight deadline" [UNIFORM COMMERCIAL CODE 4-104 (h)] is the usual cut off hour, the extension is only to the close of a "banking day" [UNIFORM COMMERCIAL CODE §4-104 (c)] which ends when the bank closes its doors "to the public for the carrying of substantially all of its banking functions." Thus evening hours, when the bank is open for the receipt of deposits and cashing of checks, will not be a part of the "banking day."

the rules must be suitable for a bulk processing of large numbers of checks at little cost. The second, which is a corollary of the first, is that rules to ensure a proper allocation of losses incurred in the area of the one eighth of one percent of bad items should not be so restrictive as to clog the free flow and smooth handling of the almost unanimous number of *good checks, collections in bulk, and deferred posting*.

With regard to checks, the point to be made is that banks do not collect a check. They collect bulk loads of checks. The process is not an individualized one, it has become a highly mechanized, fast moving procedure currently moving rapidly into an electronically computerized operation where checks are sorted and proved at utterly fantastic speeds.⁸ And still the ever increasing volume moves ahead of the facilities provided for its handling. Thus, the third principle can be distilled; the collection rules should foster speed in the transfer of bank credits, but only to the extent consistent with efficient operation of a bulk processing system.

The rash of so-called "deferred posting" statutes in the post World War II period emphasized the application of these principles.⁹ The adjective "so-called" is properly applied because the statutes nowhere use the term "deferred-posting," but by extending the time within which a bank may return an item as not properly payable, the statutes gave the banks sufficient time in which to provide for the orderly processing of the demand items¹⁰ (primarily checks) referred to in the statutes. Statutory treatment of the problem was necessary because two common-law rules had over-emphasized speedy action. The first was the rule that entry of credit in a depositor's passbook constituted a "final payment" of all deposited items drawn on the bank.¹¹ The second was the so-called "next day" rule whereby it was considered negligence if

⁸ In banks using electronic systems, the "fine sorting" machines sort at the rate of 1,600 items a minute or 96,000 items an hour! A "bookkeeping" section (usually two girls as a team) handles 4,500 regular checking accounts or 10,000 "special checking" accounts. The work load of a substantial Philadelphia bank is about 800,000 items a day. The number of accounts handled by a particular team will vary with the activity of the accounts, of course. Management has given the author the above figures as averages. Each check is visually inspected at the "sections" for date, correspondence of amount between "words" and "figures" and signature. The average daily work load of a section is in the neighborhood of 7,500 items for about seven hours of actual working time, which includes balancing with the clearings, checking for stop orders and other legals, overdrafts, and drawing against uncollected funds.

⁹ The statutes up to 1949 are collected in the Article cited *supra* n. 6 at p. 924-928.

¹⁰ Article 4 uses the term "item" [UNIFORM COMMERCIAL CODE §4-104 (g)] to include any instrument, whether or not negotiable, calling for the payment of money. The term does not include money itself. Bankers divide collections into "cash items" and "non cash items," the latter usually covering items requiring some special handling that excludes them from the bulk channel. The excluded items are not the same in all sections of the country.

¹¹ See, *e.g.*, *Kirkham v. Bank of America*, 165 N.Y. 132, 58 N.E. 753 (1900).

any person receiving a check drawn and payable in the "same town" did not present it for payment on the next banking day, or if payable in a "different town" did not start it on its way through collection channels by the next banking day.¹² When these concepts were coupled with the rule that a payor bank's retention of an item payable by it beyond 24 hours rendered the bank liable on the item,¹³ and that dishonor in such case related back to the day of presentment, trouble was bound to follow as volume increased.

One solution adopted by the Code was already in effect in most situations as a result of sporadic legislation and deposit agreements or legends on deposit slips, most of which had also been adopted and used in Wisconsin prior to its adoption of the Code. Hence the Code's solution will not be new. The concepts can be called the "settle now investigate later" ideas. When a bundle of checks are presented to a payor bank either by mail or through a clearing house, or deposited by a customer,¹⁴ the credit, given immediately for the full amount thereof, is called "provisional," and the bank is afforded additional time in which to locate and return the few "not good" items or to revoke the credit if any item forwarded to another bank is returned unpaid. The same concept applies between banks. The forwarding bank receives a "provisional" credit or remittance at once, and the bank receiving the bundle of checks may revoke, at a later time, that minor portion of the total credit which may be required to cover the small number of "not good" items.

The time selected for the completion of the necessary processing is called, in the Code, the "midnight deadline." This, by definition, means midnight of the next banking day following the later of (a) the banking day on which the bank receives the item or (b) the banking day from which the time for taking action commences to run.¹⁵ Thus, if items are received, at 10:30 a.m. in the morning clearing house exchanges, the bank will have the balance of the day and all of its next banking day in which to sort and post the items.

Prior to the adoption of the so-called deferred posting statutes, items

¹² See, e.g., *Wendkos v. Scranton Life Insurance Co.*, 340 Pa. 550, 17 A. 2d 895 (1941); *Seager v. Dauphinee*, 284 Mass. 96, 187 N.E. 94 (1933); *Gordon v. Levine*, 194 Mass. 418, 80 N.E. 505 (1907); *Lloyd v. Osborne*, 92 Wis. 93, 65 N.W. 859 (1896).

¹³ See, e.g., *Wisner v. First National Bank of Gallitzen*, 220 Pa. 21, 68 Atl. 955 (1908); *Notes* 63 A.L.R. 1138 (1929), 68 A.L.R. 862 (1930).

¹⁴ Bulk handling of checks by business firms is not unusual. The author has seen a single deposit by *Sears Roebuck & Co.*, and by a gas company that covered the entire top of a fair-sized table. Indeed, to speed the collection process, banks have arranged with such bulk customers for the application, *by the customer*, of all necessary bank endorsements (including a Federal Reserve Bank stamp) and for sorting in accordance with the collection routing.

¹⁵ *UNIFORM COMMERCIAL CODE* §4-104 (h) defines "midnight deadline." The second part of the definition, [the b] is made necessary in part by §4-107 permitting banks to establish a 2:00 p.m. cut-off hour after which items will be deemed received at the opening of business on the following day.

received in the morning had to be reconciled, sorted, posted, and "not good" items sorted for return before the close of business on the day of receipt. As a practical matter, this meant that "not good" items had to be ready for a 3:00 p.m. "return clearing." As volume increased, this meant, for most bank clerks engaged in this work, a lunch hour starting at 2:30 p.m. or a little before. The turn-over in personnel resulting from this, plus the cost of increasing staff to handle the work load in a span of about four to five hours required that more time be allowed.¹⁶

Coupled with the "provisional" credit concept, it did not seem too great a risk to extend for an additional banking day the time allowed for internal posting and operation. Banks were thus enabled to organize the work flow on a more rational basis, sorting the items to the indicated account classifications on the day of receipt, and posting them the following morning. Returns could be proofed, sorted and effected the second day.

The additional time did not, however, delay the transfer of bank credit, at least as between collecting and payor banks. Where settlement is effected in the clearing house situation by mutual debits and credits to reserve accounts at, say, the appropriate Federal Reserve Bank, this has been done. The reserved right of charge back is limited to that small percentage of "not good" items. Where settlement is effected by debits and credits to mutual accounts, this has been done with the same minor reservation. Where settlement is effected by means of a remittance draft, (i.e. a draft on a third bank sent to collecting bank by a payor bank) it will have been started on its way for collection.

Thus, the extended time has not extended the risk of loss through bank failure. It must, however, be admitted that this particular risk, in recent times, is about the least of the risks encountered in the collection

¹⁶ Another problem was that until incoming items were sorted, there was little work for the bookkeepers at the deposit ledgers. Yet in order to cover items cashed "over-the-counter" etc., the posts had to be manned. Special problems are also created in the case of large metropolitan banks where the volume of items has required three shift round-the-clock operations in the "proofing," "sorting," and "posting" operations. "Proofing" covers the verification of totals, checking to see that all items on the tape are in fact included in the bundles, and reconciling the totals of the sorted items with the totals of the items to be sorted. Special machines have been devised for the sort and proof operations. Some run 25 adding machine tapes simultaneously, one for each of 24 "sorts" and a master proof tape covering the totals. The text has discussed the "incoming" items from other banks or from a clearing house. Deposited items, of course, go through a similar process, being sorted first as between "on us" and other items. The "on us" then join and swell the incoming stream. The outward items are then sorted to the appropriate correspondent to which they will be forwarded.

Electronic bookkeeping has added one other process for the first bank using such equipment, and that is the "encoding" whereby the amount of the check is typed on the item in magnetic ink "readable" by the various machines. Proper arrangements have been made with practically all check printers so that the numbers indicating the bank of deposit and the customer's account are already printed with magnetic ink.

process. Bank closings have not been significant in number or economic impact, in recent years.

What has been extended by the deferred posting concept, however, is the risk against "competing" items, namely the attaching creditor, the stop order, the bank's own right of set-off, and the insolvency of the drawer, or his carelessness in overdrawing his account. Here a decision had to be made on the basis of the conflicting thrusts of differing policies. To the extent that the risk on non-payment is extended, the equivalency of payment by check to payment by cash is defeated. This can be readily understood. Initially the author, and certain banker friends, felt that it would be possible to have a "day blockage" of items, and have Monday's items take precedence over Tuesday's stop payment orders, attachments and the like.¹⁷ However, several practical difficulties stand in the way of such a rule. One is the continuous processing of items on a three shift basis by the large banks. Another is the problem of the item paid over the counter. This is a service customers expect and so, too, do other members of the public. Where an item is presented for payment over the counter on Tuesday, it is just not practical to hold up the payment until the state of the customer's account after the posting of the Monday items can be ascertained. Then, too, the bank's determination of whether or not to exercise a right of set-off, sometimes depends upon the nature and amount of the items presented for payment.¹⁸ This, too, could not be ascertained until Tuesday, when, under the "day-blockage" rule, it would be too late.

The resolution of these conflicting policy interests was viewed in the light of the very small percentage, one-eighth of one percent in dollar amount, of "not good" items, and the added cost to all depositors, of installing the necessary mechanical operations to ensure that all banks would be able to ascertain, in the few situations of contest, the facts on which the determination of various claims to the funds on deposit would depend.¹⁹

It is all very well for advocates of "distributive justice" to suggest that the risk of loss should be borne by the banks as a cost of doing business. But things do not happen that way. The risk-loss goes into the cost of doing business, and, in the long run is passed on to the customers

¹⁷ The earlier drafts discussed by the author in *Deferred Posting and Delayed Returns—The Current Check Collection Problem*, 62 HARV. L. REV. 905, 946 ff (1949), were drafted on this theory, which, at the time, seemed to the author to have a certain fairness to all parties.

¹⁸ Particularly where the bank desires equal repayment with other creditors, or has restricted repayment of subordinated debt, etc.

¹⁹ It is submitted that Dean Beutel in *The Proposed Uniform (?) Commercial Code Should Not be Adopted*, 61 YALE L. J. 334 (1952), overlooks these practical considerations, and the cardinal fact of the very small area of risk, when he criticizes the bank collection article as being a sellout to the bankers. As early as 1954 the author pointed out that the "day blockage" rule appeared to be impractical. Leary, *Bank Deposits and Collections under the Uniform Commercial Code*, 15. U. PITT. L. REV. 565, 574 (1954).

of the bank in increased service charges, increased interest costs and the like. Thus, in all such cases, the real issue is whether the risk, or the cost of installing procedures to avoid the risk, should be borne by the community or by the person dealing with the issuer of the check that was found to be "not good."

The foregoing, it is believed, justifies the decision to extend the time area in which the risk of non-payment operates, as an application of the principle that the need for a speedy transfer of bank credits should give way to the need for efficient operations and a subsidiary principle that the vast majority of good transactions should not be rendered more expensive and reduced in speed for the benefit of the relatively few "not good" items.

Against the background of these principles then, let us trace the progress of a check given in payment for goods or services through the various sections of the Code applicable thereto, disgressing now and again to fill in the story with appropriate discussion of the various rules. To do this we will have to poach, from time to time, on the territory of those who would explain Article 3, as the rules relating to negotiable instruments also apply to checks, except as the provisions of Article 4 conflict with or supersede those of Article 3.²⁰

RESPONSIBILITY OF PAYEE TO INSTITUTE COLLECTION

In our supposed case, the check has been issued to the payee. What rules govern what action he must take? Reference has already been made to the "same town" and "different town" rules at common law.²¹ The penalty for delay in starting a check through bank collection channels was, at common law, the absolute discharge of any indorsers, and the discharge of the drawer "to the extent of the loss" caused by the delay.²² One problem in the drawer situation was how such loss could be proven. Obviously, the drawer only suffered loss to the extent that he lost a deposit credit at his bank; that is, the area of the loss is the area of bank insolvency. Often the percentage to be recovered by depositors was not known, and could not be known until the closed bank was liquidated. A second problem was that such speed in rushing to one's bank did not fit into the customs of the people on two scores. In the large business with monthly bills, the volume of checks received at certain times precluded a deposit on the day following receipt.²³ Many

²⁰ UNIFORM COMMERCIAL CODE §4-102.

²¹ *Supra* p. at note-calls 11 and 12.

²² See UNIFORM NEGOTIABLE INSTRUMENTS LAW §186. Case law discharged the indorser absolutely. See *e.g.* *Nuzum v. Sheppard*, 87 W. Va. 243, 104 S.E. 587 (1920); Note, 11 A.L.R. 1028 (1921). A similar rule was applied to the remitter. *Commercial Inv. Trust v. Lundgren - Wittensten Co.*, 173 Minn. 83, 216 N.W. 531 (1927).

²³ This is particularly true of utilities, stores, etc. The Code was being drafted in 1949-1951. Cyclical billing by utilities, department stores, etc. had not been adopted to any widespread extent. Even where it has, customers still have the habit of paying once a month, and often at or near the first part of the month, probably coinciding with the receipt of the monthly and semi-monthly pay

people in rural areas do not engage in daily banking. Despite the rules, many people do not immediately bank checks as they are received. As at common law, it was felt that the drawer should stand behind his check for a greater time than the indorser.

Consequently, the Code adopts a rule discharging the indorser if bank collection is not instituted within seven days after the date of the indorsement, and the drawer thirty days after date of issue whichever is later.²⁴ This rule applies only to an *uncertified* check drawn and payable within the United States, and which is not a draft drawn by a bank. The specified time limits are stated in terms of a "presumed" reasonable time,²⁵ and are to be considered in the context of the general rule that presentment, in order to charge secondary parties, must be made within a reasonable time after such party became liable thereon.²⁶ The Code eliminates problems of proof of loss in the drawer's situation by providing for his discharge only if he assigns to the holder the "cover" maintained at his bank for the check.²⁷ As partial assignments are generally recognized, this provision should cause no procedural difficulty. In many cases, however, a drawer will not be able to prove that he was deprived of any funds by reason of the insolvency of the payor bank. This is because Federal Deposit Insurance will cover, in full, all deposit accounts up to \$10,000. While this will cover a substantial majority of all outstanding deposit accounts, the occasional account with a balance exceeding \$10,000 will present interesting questions. Will the recovery from deposit insurance have to be pro-rated with the holder who delayed instituting bank collection?²⁸ It would seem so, as the issue

check. To paraphrase "The law does not change habits, and habits change but slowly with the law."

²⁴ UNIFORM COMMERCIAL CODE §3-503 (2). Indorsements, except bank indorsements, usually are not dated. In the vast majority of cases, however, an indorsee is a business and will bank its checks within 7 days of receipt.

²⁵ "Presumed" is a defined term [UNIFORM COMMERCIAL CODE §1-201 (31)] and means, in this context that the trier of fact must find 30 days to be a reasonable time with respect to the liability of a drawer unless and until evidence is introduced which would support a finding that 30 days is an unreasonable time. Such evidence could, the author assumes, be introduced either to shorten or to lengthen the "presumed" reasonable time.

²⁶ UNIFORM COMMERCIAL CODE §3-503 (1) (e). Section 3-503 (2) of the Uniform Commercial Code provides that a reasonable time for presentment is determined by the nature of the instrument, any usage of banking or trade and the facts of the particular case. Section 1-205 (2) of the Uniform Commercial Code defines a usage of trade as "any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question." Thus a general practice of depositing promptly could be shown to reduce the 30 day period. What will be the effect of attempting to fix a shorter reasonable time by agreement under Sections 4-103 and 1-204 of the Uniform Commercial Code in view of the specific tests for determining a reasonable time? Such an agreement would be one of the facts of the particular case, and in the author's opinion would be upheld if the time specified were not manifestly unreasonable.

²⁷ UNIFORM COMMERCIAL CODE §3-502 (1) (b).

²⁸ There is some question as to how the assignment will operate in this situation. Assume an account of \$31,000, and a dividend of 66 2/3% from the closed

under the Code is the extent to which the drawer is deprived of funds. On the other hand, the assignment is only to be of the depositor's rights against the drawee or payor bank. Since the rights to deposit insurance arise by reason of the funds maintained on deposit, it does not seem to be too great a stretch of the interpretive process to believe that the insurance recovery should also be pro-rated. This result also flows from the fact that the concept of the assignment was designed to avoid the difficulties inherent in proving loss to the drawer where his bank was not yet liquidated. Hence the phrase "rights against the drawee or payor bank" should include all rights derived from the existence of the deposit, including deposit insurance.

RIGHTS ON DEPOSIT OF CHECK

Returning now to the main thread of the collection of a check and assuming a timely deposit, what rights and duties are then created? As we have seen, the credit given the depositor, in the absence of "agreement otherwise" is provisional merely, dependent upon the check proving to be a good item. Two main issues then arise: (1) when can the depositor utilize his provisional credit in his own business, and (2) when does the right of the "depository bank"²⁹ to revoke the provisional credit expire. This first question divides into two subquestions, one is when will the depositor's checks not be returned "N.S.F." (not sufficient funds), and when will the depositor, by legal action, be able to compel the payor bank to account to him as a debtor.

If the deposit is made in money, then the credit is final when made, but in order to protect the bank against claims for wrongful dishonor, etc., the deposit does not become available for withdrawal "as of right" until "the opening of the bank's next banking day following receipt of the deposit."³⁰ Here, perhaps, a digression should be made to flag one possibility. The phrase "next banking day following receipt of the deposit" should be read as if it said "next banking day following the day of receipt of the deposit." This rendering is required by Section 4-107 which provides that banks may fix an afternoon hour of 2:00 P.M. or later as a cut-off hour for the handling of "money or items" and may treat receipts of items or money arriving after such a cut-off hour as having been "received at the opening of the next banking day."³¹ Thus, if such an hour has been fixed, and appropriate public notice thereof has been given, or

bank. The depositor, if no delayed check were involved, would receive \$24,000, composed of \$110,000 of insurance and \$14,000, being a two-thirds recovery on the remaining \$21,000. The holder of the delayed check must, therefore, obtain by the assignment 24/31sts of the face amount of his check. Or, will the rule be that the delaying holder is to be limited to the claim against the uninsured overplus, on the theory that it is the excess over insurance only that was the "cover" for his unrepresented check?

²⁹ Defined as the first bank taking an item for collection. UNIFORM COMMERCIAL CODE §4-105 (a).

³⁰ UNIFORM COMMERCIAL CODE §4-213 (5).

³¹ UNIFORM COMMERCIAL CODE §4-107.

agreement thereon reached with depositors,³² money deposited after 2:00 P.M. on Monday will not be available for withdrawal "as of right" until the opening of business on Wednesday. This follows from the fact that it is the deposit slip, not the money itself, that results in the posting of credit to the depositor's account. Both money and checks are entered on the same slip, and it must take its place in the flow of papers being processed.

If the item deposited is a check on the depository bank, the availability for withdrawal as of right follows the "deferred posting" rule that we discussed above,³³ and occurs at the opening of the bank's second business day following the day of receipt of the item, and is expressly made to depend upon the final payment of the item.³⁴ Thus availability as of right occurs at the opening of the next business day following the expiration of the "midnight deadline" for processing and sending for return of not good items. A question might arise under the "additional day" rule of Section 4-108 which permits a "collecting bank," on its own authority, to grant an additional day in a good faith effort to secure payment. A collecting bank is defined as any bank in the collection chain "except the payor bank."³⁵ The definition does not, as does the definition of a depository bank, include a bank acting as a collecting bank even though it is also the payor bank. In view of the dual position of a bank acting as both depository and payor bank, both depositor and drawee being customers, it would seem that the power to extend for an additional day should not be automatically extended to the "on us" check. Yet, in view of the fact that over half of the "not good" items are paid on a second presentment, the matter should, perhaps, be covered by agreement between the depository bank and its depositing customer.

VARIATION OF CODE RULES BY AGREEMENT

A digression here to discuss, briefly, the limits upon agreements varying the provisions of Article 4 seems appropriate, as it can be done

³² Some commentators have raised a question of how a bank "may fix" a cut-off hour. See *e.g.* Clarke, Bailey and Young, *Bank Deposits and Collections*, 24-25 (1959). How does a bank fix any rule binding on its depositors? By public announcement or by legend on its deposit slips or deposit agreements, as in the past. In this case, the notice should be given in the same manner as notice is given of the hours the bank's doors will be open—by a posted sign. Similarly another commentator has raised an issue as to the effect of Daylight Saving Time unless the particular state has a statute permitting the use of some other time during the year. Funk, *Banks and the Uniform Commercial Code*, 133 (1962). Such a restrictive interpretation, it seems to the author, does not give due consideration to the "commercial" purposes of the Code. The purpose of the "cut-off hour" is to close off the time earlier than the usual hour for closing the bank's doors. Consequently the "commercial" time generally used in the community on the particular day is what was intended. If a bank usually opens its doors at 9:00 A.M., when Daylight Saving Time is effective, the doors usually open at 9:00 Daylight Saving Time, not at 10:00 A.M. Daylight Time.

³³ *Supra* p.

³⁴ UNIFORM COMMERCIAL CODE §4-213 (4) (b).

³⁵ UNIFORM COMMERCIAL CODE §4-105 (d).

to some extent in the light of the proposed agreement just mentioned. Here we find some degree of parallelism and some degree of difference between the general provisions of Section 1-102 (3) applicable to the Uniform Commercial Code as a whole and Section 1-103 (1) which is limited to Article 4.

The general section provides, to paraphrase, that, unless otherwise specifically stipulated in the Act, the provisions of the Code may be varied by agreement,

except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement, but the parties may, by agreement, determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

The specific section in Article 4 states that all provisions of that Article may be varied by agreement

except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack of failure; but the parties may, by agreement, determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

Thus on comparison, it would seem that in the area of bank collections, the bank may contract out of duties of diligence and reasonableness to the extent that such duties are not comprehended in the concept of "ordinary care."

One trouble to be faced in drafting any bank collection agreements will be found in the verbal formulation of the Code's rules governing the actions required of banks in the collection process. Under Section 4-202 the entire Article is apparently framed in the context of a duty of ordinary care.³⁶ Absent a specific regulation of a specific situation in some subsequent section of the Article, all common law rules of the particular jurisdiction, which were also framed in a verbal formulation of "ordinary care" can be deemed incorporated in the Code. To the extent that specific sections and time limitations are set forth in other sections of Article 4, they could be interpreted as being formulations of particular manifestations of ordinary care designed to change the effect of certain prior common law decisions, leaving all else unchanged.

The author attempted, unsuccessfully, to induce the banking and legal fraternities to adopt some other formulation in place of "ordinary care" to avoid the problem and to have bank collections law as it relates to checks considered as it really should be, a unique status where all

³⁶ UNIFORM COMMERCIAL CODE §4-202 (1) provides "A collecting bank must use ordinary care in. . . ." There then follow subdivisions (a) through (e) which cover the gamut of the collection process from sending for presentment, sending notice of dishonor or non payment, returning the item, settling for the item, protesting if necessary, and giving notice of loss or delay in transit.

rules must be geared to the needs of a low cost, bulk handling operation for the benefit of the community as a whole. It is to be hoped that courts interpreting the law will consider the real factual situation, and not transfer to the interstices of the Code a mortar of outmoded concepts and rules relating to a simpler day when negotiable instruments were presented over the counter for cash by an agent working only for one principal and handling one item. In interpreting the ban against contracting out of the duty of "ordinary care" the courts should, the author believes, limit "ordinary care" to a meaning of good and accepted banking practice; or the care ordinarily used in the situation by a banker. This interpretation is practically required by the provisions of Section 1-102 of the Code in any event.³⁷

It seems clear that a collecting bank may, by agreement with its customer, extend its time for taking action.³⁸ And, under the "chain of command" theory, all "intermediary banks" will be protected if acting in accordance with the instructions of the immediate transferor.³⁹

With respect to payor banks, different considerations come into play. On the policy side, the drawer of the check is the customer of the payor bank, and it would have a tendency, possibly, to favor its customer. It is true that in many instances the forwarding bank is also a customer, but action with respect to an occasional check would probably not disrupt that relationship. Where the payor bank is also the depository bank, it

³⁷ This Section provides that the Code shall be liberally construed to promote its underlying purposes and policies one of which specifically set forth in Section 1-102 (2) (b) is to permit the continued expansion of commercial practices through custom, usage and agreement of the parties. An interpretation of "ordinary care" which would prohibit any departure from the specific sections of Article 4 would not be a construction promoting the underlying purposes and policies of the Code. Compare the refusal of the N.Y. Court of Appeals to impose on a collecting bank any duty not to collect its own debt so long as no bad faith was involved. *Hydro Carbon Processing Corp. v. Chemical Bank New York Trust Co.*, 16 N.Y. (2d) 147, (1965).

³⁸ At least to time limits the way seems open to almost any agreement since Section 4-202 (2), immediately following the duty of "ordinary care" in taking all indicated *types* of action, provides that a collecting bank acts "seasonably" if it acts by its "midnight deadline" following receipt of the item. Hence it follows that the Code equates "ordinary care" with "seasonably" when the issue is one of the *time* of taking action. See UNIFORM COMMERCIAL CODE §4-202 Comment 3. "Seasonably" is a defined term [UNIFORM COMMERCIAL CODE §1-204 (3)] meaning acting "at or within the time agreed, or if no time is agreed, at or within a reasonable time." The bank does, however, have the burden of establishing that a reasonably longer time than its midnight deadline is "seasonable." Where there is an agreed time, this last provision can only mean that the bank has the burden of establishing the agreement, and, probably, that its terms are not manifestly unreasonable. See Section 1-204 (3). Where the bank has no agreement, then under the guidelines of depending upon "the nature, purposes and circumstances of the action," the bank would be subject to the risk of non persuasion of the trier of fact [UNIFORM COMMERCIAL CODE §1-201 (8) definition of burden of establishing] that its time of acting was reasonable.

³⁹ UNIFORM COMMERCIAL CODE §4-203. A collecting bank [which term includes all intermediary banks, UNIFORM COMMERCIAL CODE §4-105 (c)] is not liable to prior parties for any action taken pursuant to instructions or in accordance with any agreement with its transferor.

would have conflicting loyalties. On the technical side, while *time* limits for a collecting bank are stated in terms of "seasonable" action, including, therefore, by definition, agreement upon time limits, the time limits applicable to a payor bank are not so stated. The applicable Code sections merely use the term "midnight deadline."⁴⁰ On the other hand, the term "ordinary care" is not specifically applied by the Code to the duties of a payor bank.

The conclusion, therefore, must be that the time limits applicable to a payor bank may be varied by an appropriate agreement. The policy considerations outlined above precluded any extension to the payor bank of the unilateral freedom to extend time limits, but an agreement by the customer satisfies the policy. There are, in most instances, however, almost insuperable practical difficulties which limit the ability of a payor bank to obtain an effective agreement, including the problem of consensually binding remote parties.⁴¹

Returning from the digression to the case at hand, an agreement with its depositor that the depository bank (whether or not also a payor bank) may, in a good faith effort to obtain payment from its customer, extend time limits, seems not in conflict with the Code. The depositing customer may or may not be able to bind prior endorsers. If this is a risk, he can take it voluntarily. The bank taking such action would not appear to be assuming any liability to a party with whom it has no contract, and the agreement would protect its right against its customer. As to rights of recourse against others, it too would voluntarily take the risk, if any.⁴² The extension being an extension of the time in which to pay, dishonor will not occur until the end of the extended time.⁴³ If

⁴⁰ Part 3 of Article 4 covers the collection duties of a payor bank, and has but three Sections, none of which use the term "ordinary care."

⁴¹ See Malcolm, *Article 4-A Battle with Complexity*, 1952 WIS. L. REV. 265 at 278 ff. On the other hand, some help may be found in Section 4-103 (2) providing that "Federal Reserve regulations, and operating letters, clearing house rules, and the like" are effective as agreements, even if specific assent is not obtained. Such agreements are still subject to the limitation that a bank may not relieve itself by contract from its obligation of "honesty" (UNIFORM COMMERCIAL CODE §1-203) and "ordinary care." Agreements may fix "standards" for determining "ordinary care" if such standards are not manifestly unreasonable.

⁴² Notice of dishonor is necessary to charge an indorser [UNIFORM COMMERCIAL CODE §3-501 (2) (a)]. It is due from a bank by its midnight deadline and from any other person before midnight of the third business day "after dishonor or receipt of notice of dishonor." [UNIFORM COMMERCIAL CODE §3-508 (2)] Presumably the time runs from dishonor only against a person in whose hands the instrument is dishonored, and as to all others the time runs from receipt of notice of dishonor. A point to watch is that notice of dishonor may be *oral*, given in any reasonable manner. [UNIFORM COMMERCIAL CODE §3-508 (3)]. It must however be given by or on behalf of the holder or a party to the instrument who can be compelled to pay it, or a party who has himself received notice. [UNIFORM COMMERCIAL CODE §3-508 (1)].

⁴³ This follows from the definition of dishonor in Section 3-507 (1) that an instrument is dishonored when a necessary or optional presentment is duly made "and payment cannot be obtained within the prescribed time." A change in time of payment could be effected by contract. Such a contract would not

the dishonor should be held to have occurred by the midnight deadline, a prompt giving of notice of dishonor by the bank's customer will preserve his rights of recourse in any event.⁴⁴

Having discussed the "on us" item where the depositary bank is also the payor bank, the situation of the check drawn on another bank remains to be considered. Here the depositor's credit availability depends upon receipt of a final settlement by the depositary bank and the lapse of "a reasonable time to learn that the settlement is final."⁴⁵ Actually, in banking practice, the depositary bank does not, in the absence of special instructions, learn that a settlement is final. What happens is that the depositary bank learns that an item is not paid when the item is returned to it. It never, or almost never, gets advice of a payment. In practice no particular restrictions are placed upon the drawings of most customers. Only a few accounts are set up so as to prevent the drawing against uncollected funds, and as to these accounts, there are so-called "availability schedules" that are followed.⁴⁶ How are the availability schedules constructed?

Each check, today, carries a fraction somewhere, usually in the upper right hand portion. The numerator consists of digits to the right and left of a dash. The left hand digits indicate the city or state in which the bank is located, and the right hand figures indicate the particular bank. For example, 1-8 indicates The First National City Bank of New York, and 3-3 indicates Philadelphia's Girard Trust Bank.⁴⁷ Denominators are of two sorts, three digit and four digit numbers. The first digit of a three digit denominator, and the first two of the four digit indicate the Federal Reserve district in which the drawee bank is located, the next to the last digit indicates the Federal Reserve Bank or branch which is closest, for collection purposes, to the drawee bank, and the final digit gives the number of days after arrival at the indicated Federal Reserve

contain a prohibited "disclaimer" of an obligation of diligence, etc. prohibited by Section 1-102 (3). Indeed since a check is a demand item, and needs only to be presented within a reasonable time after date or issue, an advance agreement to extend the payor bank's time for payment, in effect would make the initial delivery only a notice that presentment is to be considered as made in a timely manner so that the time to pay expires at the end of the extended time. A secondary prior party could not claim any right to an earlier presentment.

⁴⁴ His time to give notice of dishonor expires on the third business day after he himself receives notice of dishonor.

⁴⁵ UNIFORM COMMERCIAL CODE §4-213 (4) (a).

⁴⁶ When electronic computers are used, the availability schedules can be programmed into the machines, and drawing against uncollected funds more rigidly controlled.

⁴⁷ Under the National Numerical System of the American Bankers Association, the numbers 1 to 49 were assigned to cities ranked according to financial importance at the time, and numbers from 50 to 999 were assigned to states and territories.

The fractional numbers here discussed should be distinguished from the numbers at the bottom of the check, usually near the left, which are used in electronic check processing and are discussed *infra* at p.

Bank or branch required for the availability of credit in that institution. For example, 212 indicates a payor bank in the second reserve district closest to the Federal Reserve Bank in New York City, with credit available two days after the check reaches New York City. 310 means a bank in the City of Philadelphia with credit on the day of arrival at the Federal Reserve Bank in that Third District. Knowing how long it will take for its "cash letter"⁴⁸ to reach the "Fed" in New York, the depository bank can compute when in normal course it will receive the check returned unpaid, if that should be the fate of the check. From this information it can fix the time when its depositor will be permitted to draw against his provisional or tentative deposit credit with a minimum of risk. As stated above, the rule of the Code is phrased in terms of reasonable time for learning of final payment, and the time, of course, varies depending on the location of the drawee or payor bank.

What happens if the depositor makes withdrawals against uncollected funds? To start with, the Code makes it very clear that the depository bank is its customers' agent, even if funds the withdrawn.⁴⁹ The depositing bank has a statutory perfected security interest in all deposited checks and the proceeds thereof.⁵⁰ It has a right to charge any unpaid check back to its customer's account, unless it has received a final settlement for the item.⁵¹ The charge-back is automatic, but does not relieve any bank from liability for its failure to use ordinary care.⁵² If the payor bank makes a late return, a charge-back by the depository bank will not discharge it of its accountability for the check, in the author's opinion. The Code itself has no express provision on the precise point.

In addition, as a collecting bank, the depository bank has received from its customer certain statutory warranties.⁵³ These cover his title or authority to obtain payment, the genuineness of all signatures, absence of material alteration, the fact that no party to the check has a

⁴⁸ This is the name given by banks to the form accompanying a bundle of checks forwarded for collection. It used to list and describe each included check. It is no longer practical, due to increased volume, to do more than enclose an adding machine tape showing amounts and total. The cash letter shows the sending bank, the receiving bank, the date of sending and the total enclosed.

⁴⁹ UNIFORM COMMERCIAL CODE §4-201 (1). Whether the bank was a "purchaser" occasioned much trouble in the past. The Section makes it clear that, even if, despite a contrary presumption, a "purchase" relationship is found in the facts, it is a term of the purchase contract that the purchasing bank will forward the check in accordance with the rules of the Code.

⁵⁰ UNIFORM COMMERCIAL CODE §4-208. Subsection (4) provides that no security agreement is necessary, no filing is required, and the interest has priority over conflicting perfected security interests in the check, but that otherwise the security interest is subject to the provisions of Article 9.

⁵¹ UNIFORM COMMERCIAL CODE §4-212.

⁵² UNIFORM COMMERCIAL CODE §4-212 (4) provides as follows:—

"(4) The right of chargeback is not affected by:

(a) Prior use of the credit given for the item; or

(b) failure by any bank to exercise ordinary care with respect to the item but any bank so failing remains liable."

⁵³ UNIFORM COMMERCIAL CODE §4-207.

defense good as against him, and the fact that he has no knowledge of any insolvency proceedings against the drawer. In addition, the customer, if he has received settlement or other consideration, engages that upon dishonor and upon the giving of any necessary notice of dishonor and protest, he will, as the Code phrases it, "take up the item." Then the next subsection, while calling this engagement an engagement to honor the item, provides that damages for a breach of the engagement to honor shall not exceed the consideration received by the customer "plus finance charges and expenses related to the item, if any."⁵⁴ It would seem that the theory of this provision is to place the bank in the position it would have been in had it not handled the item. The Official Comment indicates that the term "expenses" was intended to cover not only collection expenses, but "in appropriate cases could also include such expenses as attorney's fees."⁵⁵ As an example of finance charges, the situation where the collecting bank charges interest on its advance during the period necessary to effect collection is cited by the Comment. This is all very well in the case of a foreign collection. There is usually no such charge in the check collection process, and perhaps interest is not recoverable for the customer's use of the advance during the normal check collection interval.⁵⁶

If, however, the recovery for breach of the collection warranty is not effected except after protracted litigation over whether the customer knew, for example, of pending insolvency proceedings, it is the author's opinion that interest will be recoverable on the amount of the damages, but that the interest will run from the date the customer should have responded to the claim, even though no interest was charged on the amount of the depository bank's advance during the period of collection.

In a recent case the Georgia Court of Appeals had occasion to apply these principles where a depositor had withdrawn the credit given for a deposited check of \$49,600 which was returned unpaid four days after the deposit because the drawer had stopped payment. The bank sued the drawer, not its depositor, claiming holder in due course status, and recovered.⁵⁷

As in most of the cases under the Code the result was what one would expect from reading the Code. For present purposes the case is

⁵⁴ In this the bank collection warranties differ from the general negotiable instrument warranties of Article 3 where no measure of damages is specified and the engagement is to pay the instrument. See UNIFORM COMMERCIAL CODE §§3-417 and 3-414.

⁵⁵ See Official Comment 5 to UNIFORM COMMERCIAL CODE §4-207.

⁵⁶ Where the customer draws against uncollected funds he is borrowing from the bank against the "float." Interest is usually not charged on a *de minimis* basis as compared to the entire operation of the bank. Such a charge could, of course, be provided for in the deposit contract. It is another story if the amount is outstanding during litigation, especially if the customer has moved his account to another bank.

⁵⁷ *Pazol v. Citizens Bank of Sandy Springs*, 138 S.E. (2d) 442 (Ga. Ct. App. Div. No. 1, 1964).

interesting for the number of arguments that the drawer raised and on which he lost.

His first contention was that Article 4 made the depositary bank the agent of the depositing payee, and therefore its rights could rise no higher than those of its principal. While admitting that Section 4-201 created an agency status, the Court quite correctly pointed out that the purpose of the section was to make it clear that credits given a depositor were provisional and that risk of loss remained upon the depositor. Even though an agent, the depositary bank also became a holder of the check.

As to the plaintiff bank's status as a holder, the allegation was that the payee delivered the check to the bank and "caused the same to be endorsed for deposit." The court ruled that even if the plaintiff bank itself had put the "for deposit" indorsement on the check, it was still a holder. Article 3's definition of an indorsement requires that it be written "by or on behalf of a holder,"⁵⁸ and Section 4-205 (1), (one of the innovations of the Code) authorizes a depositary bank to supply an indorsement of the customer which is necessary to title "unless the item contains the words 'payee's indorsement required' or the like."⁵⁹ As the item did not contain such a term, the indorsement was an authorized indorsement of the payee, constituting the bank a holder.

Holder in due course status, of course, requires more than being a mere holder. The additional requirements are (1) value, (2) no notice that instrument is overdue, (3) no notice of a claim or defense, and (4) good faith.⁶⁰ The Court pointed out that Section 4-209 specifically provides that for purposes of determining its holder in due course status, "a bank has given value to the extent that it has a security interest in an item." Turning to Section 4-208 (1) the Court found that it specifically provided that the bank is given a security interest in deposited items to the extent that credit given for an item has been withdrawn or applied.⁶¹

⁵⁸ UNIFORM COMMERCIAL CODE §3-302 (2).

⁵⁹ The drawer sought to limit the effect of Section 4-205 by reference to the Official Comments where the purpose of the Section was stated to be "to speed up collections by eliminating any necessity to return to a *non-bank* depositor any items he may have failed to indorse." (UNIFORM COMMERCIAL CODE §4-205, Comment 1). The Court summarily rejected the argument that the section was thus limited to items deposited in something other than a bank. Both the Official Comment and the Court overlooked the definition of a "customer" [UNIFORM COMMERCIAL CODE §4-104 (1) (e)] which specifically includes a bank maintaining a deposit account with another. Normally a second bank would not be a depositary bank (i.e. first bank in the collection process). But if checks were issued or indorsed to it, not for collection, but in payment of interest due on loans, various fees and charges, etc., then the first bank to which it sent the items would be the depositary bank (as to those items) and authorized to supply its customer's (the first bank's) indorsement. The Comment cannot limit the text, and should be read as referring to the usual situation of one who forgets to indorse, the depositor who is not a bank.

⁶⁰ UNIFORM COMMERCIAL CODE §3-302(1).

⁶¹ To round out the discussion of the bank's security interest in the "float,"

Our Georgia case is useful in that one further point was raised. The deposit was made on January 9, 1964. The petition alleged that the check was dated January 4, 1964, but the copy of the check attached to the petition showed that it was dated January 4, 1963. On demurrer, the drawer urged that this showed the bank was on notice that the check was overdue when deposited. The Court said the allegation as to dating would permit the introduction of parol evidence to show the true date.⁶² Under the Code, a more apt allegation in this case would have been that the check was *issued* on January 4, 1964. The Code, with respect to notice of overdue status of a check, counts time from "its issue," not its date, and uses a 30-day presumption.⁶³

COLLECTION RULES BETWEEN BANKS

Having covered, to some extent, the relations between the depositor and his depository bank, the next phase in the course of a check's progress to presentment and final payment, will relate to transactions between banks occurring in the process of forwarding and presentment.

Certain mechanical rules may, perhaps, be noted at the outset. Section 201 (2), in effect, locks a check in banking channels, once it has been indorsed, "with the words 'pay any bank' or the like." Only a bank may thereafter acquire the rights of a holder until the check is returned to the depositor initiating collection, or until it has been specially indorsed by a bank to a non-bank. The avowed purpose is to protect the ownership rights of the customer initiating collection if the item is subsequently acquired improperly by a person not a bank, so

attention is also directed to Section 4-208 (2) providing that where credit is given for several items deposited at one time and is withdrawn or applied in part, the security interest remains on *all* of the items. Thus, as in the present case, the bank could sue the drawer of any one or more of the items.

The last sentence of the subsection adopts the "First-in-first-out" method of determining which credits are withdrawn. This follows the holding in *First National Bank v. Court*, 183 Wis. 203, 197 N.W. 798 (1924) where, although the opinion seems to go on a theory that the collecting bank "owned" the items, really gave the bank no more than a security interest, as does the Code.

⁶² Pointing out that, under Section 3-114 (3) the dating of an instrument is only presumed to be correct and citing *Mutual Fertilizer Co. v. Henderson*, 18 Ga. App. 495 (1), 89 S.E. 602 (); and *Wiggins v. First Mutual Building & Loan Assn.*, 179 Ga. 618, 176 S.E. 636 ().

⁶³ UNIFORM COMMERCIAL CODE §3-304 (3) (c). The retention of "time after issue" from N.I.L. §53 may seem unfortunate with respect to subsequent takers of a post dated check. But the holder is denied holder in due course status by the Section only if he has "reason to know" [not a defined term but used in the definition of "notice" UNIFORM COMMERCIAL CODE §1-201 (25)]. The author has pointed out elsewhere that "reason to know" smacks of an objective standard. See "*Commercial Paper*," Uniform Commercial Code Handbook (A.B.A., 1964) p. 110, et seq. For purposes of time for presentment, the Code, in Section 4-503 (2) (a) uses "date or issue, whichever is later" in the context of a 30 day presumption. The difference appears to be intentional. One who deals with a check which he has "reason to know" was post-dated may well lose the right to take free of defenses at an earlier date than that at which the drawer could claim a partial discharge by reason of a late presentment, especially when, by dating his check ahead, the drawer has prevented earlier presentment.

the Official Comment states.⁶⁴ It is submitted that in connection with Section 4-206 (eliminating any requirement of indorsement for transfers between banks) the purpose is to avoid problems of whether an indorsement is "special" or "in blank," if the check should be picked up by a non-bank holder. Consequently, the phrase "and the like" should not be narrowly construed to cover only the tired, old rubber stamp type of indorsement, "Pay any bank, banker or trust company," but should cover any situation of an indicated transfer to a bank by special indorsement naming a particular bank, or by any language indicating a purpose to transfer to a bank.⁶⁵ Since a collection system cannot depend on whether a proper indorsement has been made by a customer, who sometimes doesn't indorse at all, the depository bank must indorse with the words "Pay any bank," in all probability.

As just indicated, Section 4-206 provides that any agreed method which identifies the transferor bank is sufficient for the further transfer to another bank. This immediately raises the issue of identifying an item "for what purpose." If the identification is solely for the purpose of securing credit for the package of checks forwarded for collection, the "cash letter" would of itself do all the identifying needed in the case of checks, and there would be no need for any bank to stamp anything on the back of a check.

But, as the discussion of the Georgia case has indicated, it may be important for a bank in the chain of collection to qualify as a holder in due course. Banks are not apt to change present operating methods unless assured that, as to negotiable items in the collection process, each bank can, with respect to any value given by it, qualify as a holder in due course, even though the occasions when this is important may be relatively infrequent.

Section 4-209 covering when a bank gives value for the purpose of holding in due course specifically requires the bank otherwise to comply with the requirements of Section 3-302 on what constitutes a holder in due course. One of these requirements is that the bank be a "holder." This is a defined term in Article 1, and requires that the check be "issued or *indorsed* to him, or to his order, or to bearer, or in blank."⁶⁶ Section 4-206 is, perhaps, lacking in complete effectiveness in that by

⁶⁴ Such indorsements are classified as restrictive. UNIFORM COMMERCIAL CODE §§3-205 and 3-206. Discussion of the effect of the Code on restrictive indorsements is beyond the scope of this Article, except to state that such indorsements, except by an immediately prior party, have no effect on intermediary banks or payor banks. They can conclusively assume that the depository bank has performed its duty of applying value consistently with the indorsement.

⁶⁵ As a practical matter, the words "For deposit" might be construed as sufficient. Most state banking laws define the banking business as that of receiving money on deposit, and thus the words should sufficiently indicate a purpose to transfer to a bank.

⁶⁶ UNIFORM COMMERCIAL CODE §1-201(20).

virtue of the section, the agreed method, only makes the receiving bank a "transferee," and Article 3 makes a great distinction between a "transfer" and a "negotiation,"⁶⁷ the latter also requiring that the transferee become a holder. For banks to operate with the greatest freedom under Section 4-206, it will be necessary for the depositary bank either to take under a blank indorsement, or itself indorse the checks "in blank."

What then is an indorsement "in blank"? By definition it is one which specifies no particular indorsee and may consist of a mere signature,"⁶⁸ but it must be written by or on behalf of the holder and on the instrument or a paper so firmly affixed thereto as to become a part thereof."⁶⁹ While "signature" is not a defined term, "signed" is, and governs, in the author's opinion, what constitutes a signature. "Signed" means "any symbol executed or adopted by a party with present intention to authenticate a writing."⁷⁰ Hence the stamping of the back of the check with a bank's bank transit number under a resolution of the bank's board of directors that this is the depositary bank's signature should suffice to make all other banks "holders" when they take a check so stamped. Notice could be given to other banks through clearing house rules of Federal Reserve operating letters or correspondent bank letters.

Need any other bank also stamp the check? Certainly not for qualifying itself as a holder, nor as indicated hereinafter, is such action necessary for creating rights or imposing liabilities. Does this dispose of the matter? Unfortunately not. There is still the $\frac{1}{2}$ of 1% of the items that must be "returned" unpaid. Under customary procedures of giving a "provisional" settlement or credit for checks received for collection, a bank expects to be able to revoke the credit or obtain refund from the forwarding bank with which it dealt, and, presumably, with whose credit for the occasional refund, it is satisfied. At the moment, therefore, each bank handling an item in the chain of collection must identify itself *on the item*.

Anyone who has examined a welter of bank stamped indorsements on the back of his returned checks knows the almost impossible problem facing the "return-item" teller in a collection department. The Code will eliminate, when adopted in all U.S. jurisdictions, the need for all the wording about "all prior indorsements guaranteed, etc." If proofing and sorting machines can sufficiently vary the location where the transit number will be stamped, so that each bank does not superimpose its number over all the others, a great gain will have been made.

⁶⁷ UNIFORM COMMERCIAL CODE §§3-301 and 3-302.

⁶⁸ UNIFORM COMMERCIAL CODE §3-204(2). Cf. UNIFORM COMMERCIAL CODE §3-401(1) which states "No person shall be liable on an instrument unless his signature appears thereon."

⁶⁹ UNIFORM COMMERCIAL CODE §3-302(2).

⁷⁰ UNIFORM COMMERCIAL CODE §1-201(39).

DIRECT RETURNS

The Code, in optional Section 4-212(2), which has been omitted in the Wisconsin enactment,⁷¹ has opened the way to another solution. This is the practice of "direct returns." Under this practice, instead of returning any unpaid item to its forwarding bank, the returning bank, be it payor bank, or presenting bank, or an intermediary bank, encloses the return item in an envelope of approximately the same size, fills out a draft on the depository bank on the form already printed on the envelope for the amount of the unpaid item and sends it off in its next cash letter. Provisional credits or settlements given by prior banks stand, and a new set come into existence, firming up when the depository bank pays the envelope draft and charges the amount back to its customer. Simple?

Except for the one risk of insolvency of the depository bank, this system should work perfectly. The "envelope draft" will reach the depository bank at the same time, or sooner than the normal return item, so that the depository bank is in the same position vis-a-vis its customer as it would have been had the tentative credit been revoked by the intermediary bank to which it sent the item. Under direct returns, however, the self-help of a revocation of the provisional settlement would not be available. In good times, and as to most depository banks, this presents no problem.⁷² It must be noted that the Code Section is only an optional one, and need not be used except where the bank making the "direct return" is satisfied that it is not taking any risk.⁷³ Another debit entry in the "direct return" ledger is that the amount of the returned item remains in the "float," and until settled for finally, the returning bank does not receive the amount thereof in actually and finally collected

⁷¹ Cf. WIS. STATS. §404.212. A number of other jurisdictions have also omitted the Section.

⁷² This might be an area for "agreement otherwise" among banks even in states where the optional subsection has been omitted. The bank using the "direct returns" system, in the absence of such an agreement, would be doing no more than making a call upon a prior indorser to take up the item pursuant to the contract made upon its indorsement, or calling upon a prior warrantor under Section 4-207. The limitation of damages in Section 4-207(3), last sentence, would not, in the case of "cash items," limit the recovery of the "direct-returning" bank since it will have received a provisional settlement for the face amount of the check. The bank making the direct return will have "firmed up" its provisional settlement, and, by virtue of the "zinger" Section 4-213(3) discussed *infra* p. 00, all prior credits will be final. Should the depository bank refuse or be unable to pay the envelope draft, each bank handling the item could agree to remain liable and take over the claim against the depository bank, as if the item had been returned through it. There is still a risk element as the first intermediary bank would not receive notice until several days later than otherwise it would. The "Agreement" could suspend the use of direct returns in time of financial stress.

⁷³ The effect of this $\frac{1}{8}$ of 1% on bank earnings should be balanced in part against the savings in handling costs occasioned by not having to check out and find the proper return channel.

funds. Under the present method, final funds are received almost forthwith upon a return.⁷⁴

The exact language of the Code appears to contemplate a direct mailing of the return item to the depositary bank and a separate mailing of a collection draft. This is an unworkable and improper interpretation, not giving full consideration to the *qui facit per alium facit per se* principle. The contrast is between a return as a direct collection and a return that must seek out and follow its particular forwarding channel. If a small country bank takes all its incoming items from a particular intermediary bank, return items sent back to that bank should under the system of "direct returns" follow the same channels as presentment of an item drawn on that bank.

Should the practice become universal, there would be no need for any but the depositary bank to "indorse" items. In passing, it should be noted that our British cousins have, ever since 1957, also abolished the requirement for indorsements, on their "cheques,"⁷⁵ and, as far as the writer is informed, without any particular ensuing difficulties.

RULES FOR FORWARDING AND PRESENTING

The discussion has already covered the sending of checks through banking channels for collection and the return of the item if unpaid. In each instance the assumption has been that the item was forwarded in a "cash letter" to a bank in which the forwarding bank had an account, and that provisional settlement was effected by credit to the account. This is certainly the usual method to a point. The discussion now must turn to the rules governing methods of forwarding, presenting and settling, still against the factual pattern of collecting checks.

The basic job of the collecting bank is to cause the item to be presented promptly. On the other hand, due to the volume of items, some concessions had to be made to the practicalities of bulk handling and to the availability of mail transport. A bank west of Milwaukee receiving the deposit of a check payable by a San Francisco bank may, due to airmail schedules, effect a faster collection by routing the check through Chicago where fast, direct nonstop jet airmail service is available than by sending the check westward by railroad mail. A small suburban bank may save considerably on costs by sending all deposited checks to its central city correspondent, even though some are drawn on a bank in an adjoining suburb or a bank to which faster presentment could be made by use of another correspondent. Thus the Code, on the problem of "routing" could do no more than set forth guide lines and considerations. The sending must be by a "reasonably prompt method"

⁷⁵ CHEQUES ACT, 1957; Cf. 204 H.L. Deb. (5th Ser.) 667-692; Negrah, Cheques Act, 1957, 78 J. INST. BANKERS 254 (1957).

taking into consideration the depositors special instructions,⁷⁶ the number of checks on hand, the cost involved in alternative methods, and the usual practices of the depository and similarly located banks.⁷⁷ Obviously, deliberate "circuitous routing" is still a violation of the basic duty of "ordinary care" in sending for presentment.⁷⁸ The multitude of possible situations, however, made unworkable any attempt at greater specificity.

Presentment by mailing directly to the payor bank is specifically permitted.⁷⁹ This follows much prior statutory law needed to overcome the common law and N.I.L. concept that presentment had to be made by someone other than the person to pay, and that the presenter only released the instrument against receipt of legal tender.⁸⁰ Thus "cash letters", if the volume and state of reciprocal accounts makes it economical to do so, may be sent directly to the payor bank. Often, of course, presentment is effected through a clearing house,⁸¹ and even more recently presentment is effected by delivery to so-called "off-premises" centralized bookkeeping centers.⁸² Under earlier drafts of the Code this latter practice occasioned some disquietude for some cautious bank lawyers.⁸³ The addition of a special subsection in the 1962

⁷⁶ Generally an item forwarded with "special instructions" becomes a "non-cash" item, and the collection process differs somewhat, including far more "individual" handling, than a check. Certain particular instructions such as "protest waived" or "wire fate" do not have this effect everywhere.

⁷⁷ UNIFORM COMMERCIAL CODE §4-204(1).

⁷⁸ Prior case law would, therefore, be still applicable except as changed by the general guide lines mentioned in Section 4-204(1).

⁷⁹ UNIFORM COMMERCIAL CODE §4-201(2) (a).

⁸⁰ This was reiterated in *Federal Reserve Bank v. Malloy*, 264 U.S. 160 (1924), as the rule applicable in the absence of agreement, or proof of a custom or usage of trade existing in such a manner as to be binding on the customer. Cf. *Slone v. First National Bank*, 260 S.W. 948 (1924). Prior to the Code, statutes existed changing the common law rule of *Malloy* and allied cases in some 36 American jurisdictions. On this score (mail presentment) the provisions of Article 4 may be *more restrictive* than Article 3 which permits presentment by mail to any payor, UNIFORM COMMERCIAL CODE §3-504(2) (a). It is not clear, however, that Article 3 permits an "agent to present" to mail the instrument to the payor. Article 3 treats any demand upon the payor for payment, no matter where made, as a presentment, and then lists requirements which the payor may make "without dishonor." One of these is exhibition of the instrument from which it could be inferred that in the mail presentment referred to in Article 3 the presenter retains the instrument and, if an agent, should not surrender it. On such an interpretation, Article 4 enlarges upon what is permitted under Article 3.

⁸¹ Article 4 makes no mention of presentment through a clearing house. It is specifically covered by Section 3-504(2) (b). To the extent that the "item" in Article 4 covers broader territory than "instrument" as used in Article 3, the validity of a clearing house presentment lies in "agreement" found from clearing house rules under Section 4-103(2).

⁸² These may often be at another bank. The cost of the electronic processing machines is so great that some banks, to keep their machines fully occupied, and to reduce unit costs of operation, have undertaken the check posting for others. In some areas groups of banks have pooled resources to pay for electronic machines.

⁸³ The arguments are presented in Clarke, *Electronic Brains for Banks*, 17 Bus. Law, 532, at 539 (1962); Funk, *Presentment under The Uniform Commercial*

Official Edition of the Code has eliminated this *quaere*. The new subsection provides that presentment may be made by a presenting bank at any place where the payor bank has requested it to be made.⁸⁴ This subsection, taken in connection with Article 3's new concept of presentment as any demand for payment anywhere,⁸⁵ should put at rest any question as to the validity of a presentment made by delivery to an electronic processing center, provided that the delivery properly identifies, to those in charge of the facility, the proper payor bank to be charged with the items.

Two further sections also are most clearly made necessary by the bulk processing of checks. One is that which provides that no bank except a depository bank, including one which is also the payor bank, is in any way affected by the restrictive indorsement of any person other than its immediate transferor.⁸⁶ The other adopts, for all practical purposes, the "chain of command" theory of bank collections, namely that only a bank's immediate transferor can give it instructions, or put it on notice with respect to an item handled for collection.⁸⁷ Quite apart from the utter impossibility of any one bank's identifying a particular check, should it receive a notice or order from the "depositor-owner" of the item, the bank would have no way of knowing whether or not a prior intermediary or even the depository bank had made advances and so acquired an interest in the check described in the notice. These rules are practical applications of the principle that the speedy movement of the vast majority of good items must not be clogged or made more expensive by procedures designed to afford undue protection for the owners of the small number of not-good items.

As had become the law, or was thought to be the rule by contract or custom almost everywhere, long prior to the drafting of the Code, no bank is liable for the act or omission of a correspondent selected with due care.⁸⁸ Earlier unapproved drafts had contained provisions

Code—A Reply to Mr. Clarke, id at 548. See also *The Law of Presentment of Checks for Payment*, 78 BANKING L.J. 663-666 (1961); Leary, *Commercial Paper*, in Uniform Commercial Code Handbook (1964) 87 at p. 122-125.

⁸⁴ UNIFORM COMMERCIAL CODE §4-204(3).

⁸⁵ UNIFORM COMMERCIAL CODE §3-504(1). The trouble arises from the preamble to subsection (2) of this Section which reads "Presentment may be made," and then lists three specifics. If interpreted as an *exclusive* listing, then presentment anywhere else is not valid. Prior drafts more clearly indicate the original draftsman's intent. After defining presentment as any demand for payment, Dean Prosser's subsection (2) had as its preamble "Presentment may also be made." This, to the author, more clearly indicated the more exclusive nature of the listings. In the final drafting, the permissible "may" perhaps is overworked in using it to convey the idea of a non-exclusive listing, except as considered in the light of this full argument made by Funk, et al, note 79, *supra*.

⁸⁶ UNIFORM COMMERCIAL CODE §4-205(2).

⁸⁷ UNIFORM COMMERCIAL CODE §4-203.

⁸⁸ UNIFORM COMMERCIAL CODE §4-202(3).

designed to reinstate the so-called New York rule on the theory that the present regulation of banks had so minimized the risk of bank failure, that such liability might not be unduly opposed in view of other provisions of the Code. The sponsoring organizations, however, felt otherwise, and such a provision did not receive final approval. The very consideration urged for the adoption of such a rule, the diminished risk of bank failure, also indicated that there was no substantial risk to the depositor-owner of the item in continuing the Massachusetts rule of non liability for correspondent's action. The only debit is that of inconvenience of forum.⁸⁹ Again, the principle of not increasing the cost for the handling of a great bulk of good items by spreading a cost of litigation in a foreign forum over all items indicates that this cost, infinitesimal though it may be, be borne by the owner of the item that was mishandled, rather than that it be a cost of the banking system as a whole.

PROCESS OF PAYMENT

So far the course of a check through the depositary bank and up to its presentment to the payor bank has been traced in rough outline. There remain to be considered the processes of payment and the means of getting the drawer's final credit transferred to final credit in the account of the depositor.

The prior discussion has been based upon the common practice of forwarding a cash letter to an intermediary or payor bank with which the forwarding bank has an account. The process in each such instance is exactly the same as that by the holder-depositor and his bank, i.e. a tentative credit is given subject to *pro tanto* revocation or charge-back of the amount of the "not good" items in the cash letter.

The credit in an account is only one method whereby banks settle for items. The term "settle," as used in the Code, covers, by definition, delivery of cash, a clearing house settlement, credit in an account of the presenting bank maintained with the payor, an authorization to charge an account of the settling bank held by the presenting bank, delivery of a check on a third bank for collection, or in any other manner permitted by instructions.⁹⁰ This definition of "settle" is narrower, and covers less than the list of what a collecting bank may (but not must) take in settlement of a cash letter. Yet there is a reason for the seeming difference which permits a collecting bank to take a cashier's check or similar primary obligation of a remitting bank, but only if the remitting bank is a member of or clears through a member of the same clearing house or group as the collecting bank.⁹¹ The initial reaction to this by many people is that it is wrong to permit a payor bank, for example, to substitute its promise to pay for an actual transfer of funds, and, so it

⁸⁹ This, of course, only applies in the case of the interstate collection item.

⁹⁰ UNIFORM COMMERCIAL CODE §4-104(1)(j).

⁹¹ UNIFORM COMMERCIAL CODE §4-211(1)(b.)

would be if the Section were that broadly worded. The limitation to membership in the same clearing house, or group clearing arrangement is the saving grace. Actually, where there is a clearing house or a group clearing arrangement, settlement for checks will usually be made through the clearings. But suppose for some reason, perhaps special instructions, a check or special group is presented over the counter out of ordinary channels. The payor bank gives its cashier's check to the messenger who takes it back to his bank. Suppose further that taking a primary obligation of the payor bank was held to be lack of ordinary care. The presenting bank is now faced with a dilemma if it refuses the cashier's check and sends back for the items so as to treat them as dishonored, it will probably take until the next day to send out notices of dishonor. In any event, a return of the cashier's checks may result in the tender of a check on a third bank which will have to be collected or else refused on the ground that the prior action constituted dishonor.⁹² On the other hand, if the cashier's check is promptly sent through the clearing, the transfer of bank credits will have been effected almost as promptly as if the cashier's check had been returned. If the collecting or presenting bank and the payor bank use the same daily clearing arrangements, this will be especially true where the initial presentment was by mail, and the cashiers' check was returned by mail. Stress must also be placed upon the permissive nature of the preamble of the subsection authorizing this procedure. Obviously, if a payor bank regularly and continuously uses such a practice, or uses it for the first time in a period of cash stringency known to the collecting bank, a blind acceptance of the cashiers' checks, in extreme cases, may raise questions as to whether such acceptance constituted the exercise of "ordinary care."⁹³

The discussion has covered the concept of a "provisional" settlement made pending determination of whether all of the presented checks are properly payable. How is it determined whether a settlement is or is not provisional? Here the general clue is found, as it was at common-law, in the concept of "final payment". Provisional settlements for checks become firm *pro tanto* upon final payment of each item in

⁹² Section 3-506(2) provides that payment may be "*deferred*" without dishonor pending reasonable examination to determine whether it is properly payable. By giving its own obligation for the item, the payor bank has made this determination, unless, of course, it reserved a right of charge-back or otherwise.

⁹³ Section 4-103(3) provides that "Action or non-action approved by this Article or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care . . ." The permissive nature of the listing in Section 4-211(1), however, may permit a court to rule, in strong cases, that the discretion granted should have been negatively exercised. However, the permissive blessing in the great majority of situations (absent "bad faith") should be construed as a sufficient approval to grant immunity to a charge of lack of ordinary care.

the group of presented checks. Where a settlement is made for an item, this constitutes a "final payment" unless the settling bank reserves the right to revoke the settlement *and* has the right to make such reservation under statute, clearing house rule or agreement.⁹⁴ Consequently, banks desiring to make provisional settlements should be sure that their forms contain the necessary reservation of a right to revoke *and* that authority to do so exists. The statutory authority, under the Code, in the usual check collection case is found in the section on deferred posting.⁹⁵ The section is limited to demand items other than documentary drafts. The requirement is an "authorized settlement" before midnight of the day of receipt. In such case a revocation before final payment and before the midnight deadline is authorized. It is the "before final payment" cut-off that must be watched, because unless the right to revoke the settlement is reserved, the settlement itself constitutes final payment.

The circuitry here is more apparent than real. Settlement constitutes final payment. When it is intended that a settlement be provisional, i.e., subject to later revocation, that intent must be manifested by a reservation of the right to revoke, for example by agreement among banks, by statements in remittance letters or the like.

Final payment also occurs when a check is paid over the counter,⁹⁶ but this is the relatively rare case compared with the vast multitude of checks handled otherwise. Final payment also occurs when, having made a provisional settlement, the payor bank fails to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.⁹⁷

The remaining step constituting final payment is when the payor bank completes the process of posting the check to the indicated account of the drawer.⁹⁸

The Code uses the verbal formula of "final payment" found in the common-law cases, but unlike the welter of conflicting decisions at common law,⁹⁹ selects, in the main, specific points of time at which final payment occurs. Some writers have allocated the common-law cases to

⁹⁴ UNIFORM COMMERCIAL CODE §4-213(1)(b). The dual requirement of (1), a reservation of the right, and (2) authority to make the reservation was intentional, as otherwise the provisions of Section 3-506(2) could be readily avoided by unilateral action of the payor bank. Settlement will be "final payment" if, despite authority to revoke, no right to do so is reserved.

⁹⁵ UNIFORM COMMERCIAL CODE §4-301(1).

⁹⁶ UNIFORM COMMERCIAL CODE §4-213(1)(a).

⁹⁷ UNIFORM COMMERCIAL CODE §4-213(1)(d).

⁹⁸ UNIFORM COMMERCIAL CODE §4-213(1)(c).

⁹⁹ See UNIFORM COMMERCIAL CODE §4-213, Comment 2 referring to cases fixing the time of payment in remittances as

(1) when the remittance draft is accepted by the presenting bank;

(2) when the remittance draft was finally paid; or

(3) at the election of the collecting bank under Section 11 of the Bank Collection Code recommended by the American Banker's Association if actual and finally collected funds are not received.

one of three rules, one called the "intention to pay" rule, a second called the "posting to the account" rule, and the third called the "recapture" rule.¹⁰⁰ Even if so classified, the cases within each rule selected different points of time at which either the intention to pay was manifested or the power to recapture was lost. An extreme case under the power to recapture rule arose in the Supreme Court of Minnesota where the ruling was, apparently, that a check was not "paid" until the payor bank settling by remittance draft, could no longer recapture the remittance draft from the mails.¹⁰¹ The bank having made no effort to recapture, the ruling was that it had dishonored a timely stop order. Thus, where the issue is the accountability of the payor bank for the proceeds of the item, the Minnesota case is not, in a strict sense, a precedent.

In a modern check situation, the principal area of vagueness under the Code will center around the phrase "completed the process of posting." A fairly recent addition to the Code is Section 4-109 which defines the "process of posting."¹⁰² As can be seen from a reading of the text, the "process of posting" is a combination of two diverse elements. One is the element of judgment in determining whether or not to pay, and the other is the mechanical element of recording the debit of the amount of the item on the customer's account. The judgment portion of the "process of posting" includes verification of signatures, inspection of the check for obvious alterations and any other relevant action based on judgment.

The recording element, in today's mechanics, using computers and electronic processing, often precedes the judgment element. Normally

¹⁰⁰ See, e.g. Huggins and Phemister, *Bank Deposits and Collections, Uniform Commercial Code Handbook*, 129 at 138 (1964) dividing the cases into the "intention" and "recapture" theories. Malcolm, *Article 4—A Battle With Complexity*, 1952 Wis. L. Rev. 263 (1952), advocated the "posting" theory.

¹⁰¹ *Bohling v. First National Bank*, 233 Minn. 523, 48 N.W. (2d) 445 (1951).

¹⁰² The Section was added in the 1962 Official Text. While it may not have been intended to make any substantive change, in the meaning of "completing the process of posting," as pointed out *infra*, the wording may have done so. The section reads

"The 'process of posting' means the usual procedure followed by a payor bank in determining to pay an item and in recording the payment including one or more of the following steps as determined by the bank:

- (a) verification of any signature;
- (b) ascertaining that sufficient funds are available;
- (c) affixing a paid or other stamp;
- (d) entering a charge or other entry to a customer's account;
- (e) correcting or reversing an entry or erroneous action with respect to the item." (Emphasis supplied)

The problem arises from the placement of the word "erroneous" only in front of "action." Thus the reversal of any entry, even for reasons other than that it was made in error, constitutes a part of the process of posting. In *Gibbs v. Gerberich*, v Ohio App. (2d) 93, 203 N.E. (2d) 851 (1964), the court recognized the dual nature of the process of posting and held that final payment had not occurred since the judgment element had not been exercised prior to the service of the restraining order.

in the payor bank, the process of posting involves three parts. The first is called "encoding", and this involves seeing to it that the drawer's account number and the amount of the item are imprinted on the check in the proper magnetic ink. In the case of most payor banks today, the account number is already printed in magnetic ink when the check book is printed for the customer. If the check has been forwarded from or through a fairly large correspondent bank, the amount of the check will already be encoded. Generally banks know which of their correspondents will have "encoded" and which will not and can route incoming cash letters accordingly. As a part of the encoding process, in at least one large Eastern bank, the "on us" items are sorted between "regular" checking accounts and the "special" checking accounts, and they are fed into the computers on different "runs."

After "encoding", the batches of checks are placed into the electronic machines where they are read, posted and sorted at simply incredible speeds.¹⁰³ The sorted checks, now broken down by account numbers, are then delivered to the signature control clerks for verification and checking. It is here that the judgment element of the determination to pay or not to pay will be made.

For purposes of when secondary parties are discharged and the liability of the payor bank on its provisional settlements becomes irrevocable, the cut-off time might be fixed at this final point. But human error, and sometimes even machine error, can creep in. And so one of the included steps in the process of posting includes the correction of errors and the reversal of entries.¹⁰⁴ It would seem to follow, then, that the subdivision of Section 4-213(1) based on "completion of the process of posting" would not be satisfied, until the time within which entries could be reversed had expired. So long as time remains in which entries could be reversed, it would, in view of the enumeration of "reversal of entries" as one of the steps included in the "process of posting", be difficult for a court to say that the "process of posting" had been completed. Normally, in the non-clearings-cash-letter-for-credit-in-an-account situation this means that the process of posting is not completed until the expiration of the midnight deadline where the bank is working three shifts in its processing of checks, otherwise at the close of operations next preceding the midnight deadline.

Once "final payment" has occurred, the payor bank becomes "ac-

¹⁰³ See note 8 *supra*.

¹⁰⁴ Example 3 given in the Official Comment to the Section, relates only to an entry made on a forged signature, and then adds "or that the item should not be paid for some other reason," which might include anything. The thrust of the Comment, however, is that a determination to pay or not to pay once made completes the process of posting. This may not necessarily be so, as the signature clerk's decision may be changed by higher authority.

countable" for the item.¹⁰⁵ A case decided under the Code has correctly equated the word "accountable", as used in this context, with the phrase "liable for the amount of the item."¹⁰⁶ Also, in the usual cash letter situation, once the item has been finally paid, the accountability will be instantaneously released, under the provisions of the "zinger" section which provides that when provisional credit given by the payor bank becomes firm—"zing"—all prior provisional credits are instantaneously made firm.¹⁰⁷ In some situations, however, final payment will have been made, and the payor bank will remain "accountable" for the amount of the item for an appreciable period of time. An example, rare though it may be today in the case of checks, is where a payor bank has remitted to the collecting bank making a mail presentment, by the payor bank's draft on a third bank, and final payment by the payor bank occurs prior to the final payment on the remittance draft. But during this period, secondary parties on the check have been discharged by final payment. By virtue of Section 3-802(1)(b) the discharge also covers, unless otherwise agreed, liability upon the obligation underlying the instrument.¹⁰⁸

What then, has been substituted for the discharged liability? In the case of payors which are national banks, quite frankly, only the liability of the payor bank, buttressed as it is by Federal Deposit Insurance treating the owner-depositor of the check as a depositor in the payor bank.¹⁰⁹ In the case of state chartered banks, the owner-depositor has a preferred claim.¹¹⁰ Again, in a situation probably only binding on state chartered banks, a suspension of payments by a payor bank which has not made a final settlement for an item does not prevent certain provisional settlements from becoming final, and presumably from firming-up all prior provisional settlements in the chain of title.¹¹¹

EFFECT OF STOPS AND LEGAL PROCESS

At this point another digression is in order. The concept of payment was used at common law to govern the results in several situations, and considerations applicable to one situation led to results that were not applicable to other situations. The concept of "payment" was used to

¹⁰⁵ UNIFORM COMMERCIAL CODE §4-109(e).

¹⁰⁶ *Rock Island Auction Sales, Inc. v. Empire Packing Co., Inc. et al.* (Illinois National Bank and Trust Company of Rockford, Illinois, Appellee) Ill. Ct. App. Docket No. 38745—Agenda 19—November 1964.

¹⁰⁷ UNIFORM COMMERCIAL CODE §4-213(2).

¹⁰⁸ The Section provides "... discharge of the underlying obligor on the instrument also discharges him on the obligation." While Section 3-603 speaks only in terms of the discharge of a party by "his" payment, obviously payment by or on behalf of a drawer discharges indorsers in that their engagement that such payment will be made has been fulfilled.

¹⁰⁹ 12 C.F.R. Ch. III §330.1.

¹¹⁰ UNIFORM COMMERCIAL CODE §4-214(2).

¹¹¹ UNIFORM COMMERCIAL CODE §4-214(3), but see the discussion of this subsection, *infra*.

govern the shift of rights from drawer to payor bank, and from payor bank to the holder owner. The concept of "payment" was also used at common law to rule the issue of the priority of competing claims to be the balance in drawer's account.¹¹² These competing claims, sometimes called for four "legals," arise from the receipt by the payor bank of (1) notices or knowledge, as for example of death or an adjudication of incompetence of the drawer, (2) attachments, injunctions or other legal process affecting the account, (3) stop orders of the drawer and (4) a prior right of set-off of the payor bank itself.

If the law were to be the result of a symmetrical series of syllogisms, then obviously "payment" would always occur at the same point in the collection process, regardless of the issue involved. A proper answer, perhaps, lies somewhere between the extreme "functional" approach which would select different points of time for each issue, including each of the legals, and the extreme "conceptual" approach which would have a single point fixed to determine payment in all cases. Operating simplicity and convenience dictates some departure from extreme functionalism in this area. The Code adopts one rule for the case of final payment when the issues are those arising in the collection process, and this is the rule we have been discussing heretofore. It adopts a somewhat different rule, at least in certain respects, for determining the point in time when the claim of the depositor-owner of the item takes precedence over the four legals. This we now proceed to discuss.

Originally in the drafting of the Code, it was felt that the extended time granted for deferred posting should not operate to extend the depositor-owner's risk of being defeated by one of the four legals. Consequently early drafts of the Article provided that when the check had been presented to the payor bank, all legals thereafter arriving at the bank came too late to defeat the check. The stop-order, attachment, or other of the legals is such an unusual item and is usually first received by a responsible employee, so that the time of service or receipt is noted thereon, or can be reconstructed with substantial accuracy. In some banks this can be done with checks, as the "batch numbers" of the proofing department are used in sequence. From the proof department's batch number, the time of the initial step in the process can be determined. As to stop-payments the Texas legislature also adopted the time of presentment as the time at which a stop-payment order came too late.¹¹³ Many banks, however, felt that the time of receipt or of pre-

¹¹² Possibly one touchstone in the confusing welter of "payment" cases would be to analyze them in accordance with whether the issue is liability of the payor bank or a question of priority over a competing claim.

¹¹³ See TEX. CIV. STAT. (Vernon 1948) Art. 342-712 as amended by Acts 1957, 55th Leg. ch. 434. Art. 342-704 uses the time of presentment as the point of time for determining whether the drawee bank was authorized or obligated to pay the item. An exception is made for a time item in favor of the due

sentment could not be fixed with sufficient accuracy to be determinative. Obviously, due to the volume of items handled, time stamping each incoming check was not practical. The rule of payment was again chosen, but with two additional elements not considered in determining final payment.

One such additional element is acceptance or certification. After a check has been certified, legals directed against the drawer should be considered as coming too late. The obligation of the payor bank has been substituted for the drawer's direction to pay, and under banking practice, the drawer's account has been debited with the amount of the check and an account covering certified checks outstanding has been credited. If certification was procured by a holder, all prior parties, including the drawer, have been discharged.¹¹⁴ If certification was procured by the drawer, he is not discharged, but the bank's primary obligation should not, with one exception, be varied by the risks of the drawer's fortunes. This exception is the stop-payment order of the drawer¹¹⁵ who is still liable. But the Code does not draw this distinction, and provides that a stop order comes too late if the bank has certified the item.

The other additional element listed in the priorities section, Section 4-303(1), is stated alternatively with the "completed the process of posting" in the same subsection, by adding thereto "or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item."¹¹⁶ It seems to the author that the added language may serve two functions. First, it will cover the practice of "sight posting" whereby a bank indicates that a particular check is to be paid out of the usual order, places a "hold" on the account for it and then allows the check to come through in the usual way. But more im-

date. Presumably this means only if the item was received before the due date.

¹¹⁴ UNIFORM COMMERCIAL CODE §3-411(1). By negative implication the old rule of liability remaining where the drawer procures certification remains unchanged. An innovation is found in Section 3-411(3) permitting a payor bank to certify a check before returning it for proper indorsement. Note that supplying its customers indorsement may only be done by a depository bank (UNIFORM COMMERCIAL CODE §4-205) and not then in the case of certain U.S. Government Checks and insurance company drafts containing a term requiring the payee's indorsement. Cf. the British practice n. 71 *supra*.

¹¹⁵ Section 4-403(1) provides that the customer may stop payment of any item "payable for his account." Where the drawer has procured certification he is still liable, and perhaps the check so certified is still payable *for* his account. Significantly the section does not say payable *from* his account. Yet Section 4-303(1) covers stop orders and requires that they be received prior to certification. As pointed out, *infra*, this may leave it to the discretion of a bank to honor or not honor a request to stop payment on a check certified at the drawer's request. This is as it should be since the holder has become liable on the item of a holder prior to presentment for payment, and should have a discretionary voice in determining whether to refuse to honor its certification.

¹¹⁶ UNIFORM COMMERCIAL CODE §4-303(1)(d).

portantly, the phrase should also eliminate, with respect to the four legals, the extension of time given, in final payment cases, by the inclusion in the definition of the "process of posting" of the concept of reversal of entries. But even if the process of posting may be said to remain incomplete until time for reversal of entries has expired, a bank which has done everything except reverse entries has certainly indicated by examination of the item and by action its decision to pay, and thereafter the legals come too late.

The distinction is as it should be. The termination of the owner's risk of defeat by legals should occur at the moment of the final posting. That additional time is allowed the payor bank for its own purposes, and that the drawer's liability is continued a bit longer, should not give any of the "legals" the right to compel a reversal of entries, if no such reversal should otherwise occur.

One of the four "legals" is the set-off exercised by the payor bank. Here, again, then is some justification for terminating the bank's power to obtain priority for its own debt sooner than the power to correct oversights such as drawing against uncollected funds is ended. With both the drawer's power to stop and the bank's power to set-off ended, the longer time available before final payment may be considered made in the case of the ending of collection, will be of practical importance in only two or possibly three instances. These are first in the situation of an error in the process of posting, either human or mechanical, and second in the relatively rare case of bank insolvency occurring after mechanical posting is completed but before the expiration of time for the reversal of entries.¹¹⁷

The third instance is a possibility, and that is that the differences between the section on "final payment" before the payor bank becomes "accountable for the item,"¹¹⁸ and the time when the notice or stop comes too late, may give the payor bank a discretionary area in which to operate. It is axiomatic law that, at least until final payment has occurred, a payor bank is under no liability to the holder of a check.¹¹⁹ The Code specifies the point in time when the bank becomes liable, and gives no indication of imposing any obligation at an earlier date. Section 4-303(1) speaks in terms of suspending the payor bank's "right or duty" to pay an item. To whom would such a duty be owed? Absent

¹¹⁷ In the latter case, of course, the owner-depositor of the item has a preferred claim against state chartered banks. *UNIFORM COMMERCIAL CODE* §4-214(2).

¹¹⁸ *UNIFORM COMMERCIAL CODE* §4-213(1). This, of course, depends on the interpretation of "completed the process of posting" in item (c) as compared with item (d) of Section 4-303(1).

¹¹⁹ The whole thrust of the postamble to Section 4-213(1) is that the payor bank is not liable until after final payment. Its contract is only with the drawer. In the case of items mailed to it, some cases called the payor bank an "agent to present itself" but this seems mere semantics.

some clear indication in the Code, only to its customer, the drawer of a check. The right to pay is personal to the bank. Hence, if the theory just advanced is correct, the payor bank may reverse entries and honor a stop order, or notice of adjudicated insolvency,¹²⁰ or other legal without liability to the owner-depositor of the check, provided it has the acquiescence of its customer, the only one to whom, at this point in time, a duty to pay is owed.

What about reversing entries to effect a set-off? Assuming that the customer drawer does not acquiesce, has he any rights in the situation? He owes both debts, the one represented by his note at the bank, and the other which he sought to pay by the check. Both being due, interest runs on both, presumably at the same rate so that no damages would ensue on that score. However, under the Code the liability of a bank wrongfully dishonoring a check through mistake, is limited to actual damages proved.¹²¹ Consequential damages are recoverable, if determined as a fact to have been proximately caused.¹²² A bank, therefore, may be taking some risk in taking a set-off in the period available for a reversal of entries.

INSOLVENCY OF PAYOR BANK

What happens in the event of the insolvency of the payor bank? At the outset, the Official Comments expressly recognize that in view of the U.S. Supreme Court's decision in *Jennings v. United States Fidelity & Guaranty Co.*¹²³ the rules do not apply to national banks. This express recognition should avoid decisions similar to that of the Illinois Supreme Court which invalidated the Bank Collection Code because not applicable to national banks.¹²⁴

Upon the insolvency of the payor bank pursuant to the first subsection of the applicable Section 4-214, items which have not been finally paid are to be returned to the presenting bank.¹²⁵ Again, in view of

¹²⁰ As pointed out *supra* n. 97, the reversal of an entry, language in the definition of "process of posting" is not limited to reversal of an entry erroneous when made.

¹²¹ UNIFORM COMMERCIAL CODE §4-402.

¹²² "Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case." UNIFORM COMMERCIAL CODE §4-402 last sentence. Most of the cases are concerned with arrest and prosecution under bad check laws. See Official Comment No. 5.

¹²³ 294 U.S. 216, 55 S. Ct. 394, 79 L. Ed. 869 (1935).

¹²⁴ See *People ex. rel. Barrett v. Union Bank & Trust Co.*, 362 Ill. 164, 199 N.E. 272 (1935). Under the Code a similar argument has been rejected in *Illinois. Rock Island Auction Sales, Inc. v. Empire Packing Co., Inc. et al.* (Illinois National Bank and Trust Company of Rockford, Illinois, Appellee) Ill. Ct. App. Docket No. 38745—Agenda 19 November 1964.

¹²⁵ Actually the section uses the term "suspends payments" defined to include any official takeover or failure to make payments in ordinary course. UNIFORM COMMERCIAL CODE §4-104(h). Section 4-108 on delays caused by events over which the bank has no control, includes suspension of payments, so that items may be returned even beyond the midnight deadline. *Quaere*, however, if the "reversal of entries" phrase in the definition of process of posting would be coupled with excused delays to extend the time for

the inclusion of reversal of entries in the definition of "process of posting," this will require the return of all items as to which the time for returns has not expired. Thus, if the bank suspends payments on Tuesday at the close of business, all items received on Monday, on Tuesday and thereafter, must be returned unless, as to Monday's items, the clearing house rules, or other applicable agreements, stipulate an earlier time by which returns must be made than the midnight deadline, and such earlier time has expired. In the case of checks, provisional settlement will normally have been made for these items, and the closed bank will receive a refund or recredit in respect thereof.¹²⁶

A further subsection provides that if a payor bank has given a provisional settlement and thereafter suspends payments, the suspension does not prevent or interfere with the settlement becoming final, "if such finality occurs automatically upon the lapse of certain time or the happening of certain events. . . ."¹²⁷ The language certainly seems, at first blush, to be inconsistent with the duty to return items not "finally paid." All provisional settlements by a payor bank become final if, after making such a settlement, the payor bank does nothing. That the subsection apparently was not intended to have this meaning is indicated by the cross-reference items in the statutory text immediately following the quoted language. The references are to Sections 4-211(3), 4-213(1)(d); 4-213(2) and 4-213(3). These sections, however, all refer to situations in which final payment of an item has occurred, and relate to subsequent firming up of provisional credits. Thus, where a payor bank suspends payments at or after final payment, such suspension does not interfere with the automatic firming up of the provisional credits in the chain of collection.¹²⁸ If the suspension occurs *before* final payment *i.e.*, before the time for reversal of entries has expired, the items are to be returned unpaid.

The Code does establish a preference for the depositor-owner of an item in two situations, neither of which will occur with any frequency in the collection of checks. The first is where the payer bank makes final payment, and then suspends payments without making a settlement that is or becomes final. We can suppose that the payor bank has settled for a cash letter by mailing to the presenting bank on the day it receives its cash letter a draft on a third bank. The draft is received by the presenting bank on the next day and is forwarded by it for collection the following day. The payor bank makes final

making returns to revoke a provisional settlement. UNIFORM COMMERCIAL CODE §4-213(1)(d), which is governed by UNIFORM COMMERCIAL CODE §4-214(3). Hence in the case supposed in the text, there would have to be prompt action before the midnight deadline to revoke the settlement.

¹²⁶ Assuming, of course, that a timely return has been made.

¹²⁷ UNIFORM COMMERCIAL CODE §4-214(3).

¹²⁸ By virtue of UNIFORM COMMERCIAL CODE §4-213(2).

payment by its midnight deadline, but obviously before its remittance draft is presented, and then suspends payments, on the day the remittance draft is presented. The third bank dishonors the remittance draft, and so the settlement has not become final. The owner-depositor has the accountability of the payor bank under the postamble to Section 4-213(1), and a preferred claim therefor under Section 4-214(2). A similar preference is given where a collecting bank receives a final settlement and suspends payments before its settlement with its customer becomes final.¹²⁹

CONCLUSION

Some seven sections of Part 4 of Article 4 cover some aspects of the relationship of the payor bank and its customer with respect to checks. Detailed discussion of these must be reserved for another time.¹³⁰ One, however, deserves brief mention. Where a payer bank pays a check contrary to a valid stop-order, or otherwise under circumstances giving a basis for objection by the drawer, the bank is given a statutory right of subrogation to the rights of the person paid against the drawer, and of the drawer against the payee or holder with respect to the transaction out of which the item arose.¹³¹ The right is limited to the amount necessary to prevent loss to the bank, and the obvious justification is the prevention of unjust enrichment at the expense of the payor bank who may be deemed to have paid out its own funds.

Limitations of space and the patience of the reader have precluded this discussion from being more than a cursory examination of the provisions of Article 4 relating to the collection of checks. Changes in prior law, or at least in what was thought to be the prior law have not been fundamental. The principal benefit to the law from this codification, aside from the clarifications made in areas where precedent was muddy, will probably lie in the use of the Official Comments to bring to the decision making process, the business background and the relation of the fact situation to the general business pattern in a way not heretofore generally done except in cases involving substantial

¹²⁹ UNIFORM COMMERCIAL CODE §4-214(4).

¹³⁰ These sections deal with when the bank may charge its customer's account (UNIFORM COMMERCIAL CODE §4-402); liability for wrongful dishonor (UNIFORM COMMERCIAL CODE §4-402); the customer's right to stop payment (UNIFORM COMMERCIAL CODE §4-403); no obligation to pay a check more than six months old (UNIFORM COMMERCIAL CODE §4-404); effect of death or incompetence of a customer, including the privilege to pay checks drawn before death for ten days after the date of death (UNIFORM COMMERCIAL CODE §4-405) and the customer's duty to examine returned items and promptly report any irregularities (UNIFORM COMMERCIAL CODE §4-406).

¹³¹ UNIFORM COMMERCIAL CODE §4-407. The Section was drafted to reject decisions such as *Chase National Bank v. Battat*, 297 N.Y. 185, 78 N.E. 2d 465 (1948); *Hunsberger v. Bank of Schwenksville*, 38 Pa. D. & C. 323 (C.P. Mont. 1940).

amounts of money. In addition, the Code states clear principles in areas where the decisional law was far from clear and uniform. Naturally the Code is not perfect,¹³² but the net result is a great step forward toward the realization of the objectives of flexibility, modern growth and uniformity in the many fields of commercial law covered by the Code, including the law relating to the collection of checks.

¹³² Gilmore, Book Review (Coogan, *et al.*, Secured Transactions under the Commercial Code) 73 YALE L. J. 1303 at 1305 (1964), points out the need for careful and thorough consideration of the Code and the development of some thoughtful and carefully developed amendatory process.