

Report on Article 4 of the Uniform Commercial Code Entitled "Bank Deposits and Collections"

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Article 4 of the proposed Uniform Commercial Code is drafted and presented on the theory that the country-wide nature of the bank collection processes require uniformity in the law. It is pointed out that individual Federal Reserve banks process as many as one million items a day and many large metropolitan banks average three hundred thousand items per day. The entire banking system probably clears as many as twenty-five million items on a normal day and the volume of business keeps on increasing. Due to this constant and voluminous flow of collection items across state lines, an ideal situation exists for the development of realistic uniform rules that will define the rights of the various parties to each transaction in such manner that the flow will be implemented, rather than impeded. Such is the purpose of Article 4.

At the present time The American Bankers Association Bank Collection Code has been enacted in at least 18 states, but Ohio is not one of these. More recently many states, including Ohio, have enacted so-called Deferred Posting Statutes¹ which tend to create new rules of law relative to the collection of checks and other cash items. Many states, however, have only court decisions and a few scattered statutory provisions governing bank deposits and collections, and I would place Ohio in this category.

Article 4 adopts many of the rules of The American Bankers Association Bank Collection Code, the principles and rules of Deferred Posting, and certain rules established by court decisions. It establishes well defined patterns and processes that exist in fact although not previously covered by statute, principally those found in the Regulations of the Federal Reserve system relating to check collections.²

Without presuming to digest or outline Article 4 in its entirety, the purpose of this paper will be to point out in the briefest possible manner a few of the highlights of the Article which will suffice to illustrate the general nature of the subject matter covered and the manner of its treatment.

Before proceeding further, it may be well to have in mind a typical collection process such as the following: A lawyer in Cleve-

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¹ OHIO REV. CODE § 1105.13 (710-133a).

² Regulation J issued by the Board of Governors of the Federal Reserve System.

land receives a check for \$1,000 in payment of fees. The check is drawn on a bank located in Red Gap, California, which we will assume is a small town located about 80 miles inland from San Francisco. The lawyer has a commercial account at a Cleveland bank where he deposits the check and in so doing uses a bank deposit slip which plainly states that the check is accepted for collection subject to the rules and regulations of the bank relating to such matters.³ The Cleveland bank sorts the check into a batch with

³ Rules and Regulations of a large commercial bank in Ohio.

RULES AND REGULATIONS FOR
COMMERCIAL ACCOUNTS

1. The Bank, in receiving checks and other items for deposit or for collection, acts only as the collecting agent of the depositor and assumes no responsibility beyond the exercise of due care. The Bank will not be liable for default or negligence of any correspondent or for losses in transit, and each correspondent shall have no liability except for its own negligence. The Bank or any correspondent may send checks and other items directly or indirectly to any bank, including the payor, and accept its draft, check or credit as conditional payment in lieu of cash; it may charge back to the depositor any check or other item at any time before final payment, whether returned or not, and should any collecting agent convert the proceeds of any item so forwarded for collection, the amount thereof will be charged back to the depositor. Unpaid checks and other items may be returned by mail at depositor's risk.

2. Deposits received during regular banking hours at one office of the Bank for credit at another will be entered on the books of the Bank to the credit of the depositor before the Bank opens for business on the second following legal banking day, and deposits received during regular banking hours at the office at which the account is carried will be entered on the books of the Bank to the credit of the depositor before the Bank opens for business on the following legal banking day; provided, however, that if any office of the Bank maintains regular banking hours on Saturday or after 4:30 o'clock P. M. on Friday, deposits received in such office on Saturday and after 4:30 o'clock P. M. on Friday shall be treated as if received on the first legal banking day following the day of actual receipt. The Bank shall not incur any liability to the depositor or to any other person for failure to pay checks or other items unless drawn against the actual cash balance and collected funds credited, on the books of the Bank at the opening of business on the day of presentation, to the account on which such checks or other items are drawn. Checks or other items may be paid without inquiry as to the circumstances of issue or application of proceeds.

3. Checks and all other items, including those drawn on any office of this Bank, will be cashed, accepted or credited conditionally and if not found good will be charged back to the depositor.

4. All checks or other items drawn by the depositor must bear the name of the office of the Bank at which the account of the depositor is carried.

5. In case the Bank is requested to stop payment on any item or items the depositor agrees to hold the Bank harmless from all expenses and costs incurred by the Bank on account of refusing payment of any such item. No stop-payment request, renewal or revocation shall be valid unless in writing and served on the Bank.

6. Each depositor shall be subject to such service charges, including charges for activity, stop-payment orders, the return of checks because of insufficient funds, uncollected funds, or post-dating, as may now or hereafter be established by the Bank or by Clearing House, State or Federal authorities with respect to commercial accounts. Such charges may be deducted from depositor's account and the Bank shall not be liable for dishonoring checks or other items because of insufficient funds resulting from the deduction of such charges.

7. The Bank reserves the right at any time to terminate any depositor's account or to refuse to accept deposits or credits thereto.

8. In consideration of the surrender of cancelled checks and other data by the Bank, depositors agree to verify their accounts and report forgeries, alterations or errors to Bank's auditor within 10 days from the time such can-

other checks going to California and decides, from experience, how this check and others in the same batch shall be dispatched to reach California in the shortest possible time. This course could very easily begin with an overnight train trip to a Chicago bank which acts as correspondent for the Cleveland bank. Upon arrival at the Chicago bank the check will be placed with others going to California and will probably be flown to a bank in San Francisco to reach there in the late afternoon or evening of the first day after being deposited in Cleveland. The San Francisco bank may have a night transit department which will, on the same night, place the check in the mails in time to reach the bank on which it is drawn before noon of the next day. The drawee bank will either pay the check and remit the proceeds or refuse payment and return the check through the same collection channel. The bank in Cleveland, the banks in Chicago and San Francisco, and the drawee bank in Red Gap, California, as well as the depositor in Cleveland, all have certain rights and duties growing out of the transaction, and it is primarily with these rights and duties that Article 4 is intended to deal.

In the very beginning, the Code lays down the rule that the liability of a bank for action taken by it in the course of collection is governed by the law of the place where the bank is located. Section 4-102 (2). If the action is taken by a branch and the branch is located in a different place than the main office, the law of the place where the branch is located governs the transaction. If all states were to adopt the Uniform Commercial Code, it seems fairly obvious that the law of all places would be the same (unless differences should later develop by Court decisions) but until this result is obtained it is quite desirable to know which law controls a given situation.

Section 4-103 states that the law itself may be varied by agreement of the parties but a bank is not permitted, even by agreement,

celled checks and other data are made available to the depositor by mailing to the last address furnished by the depositor in writing, or by such other method of delivery as may have been established. Failure so to do will exempt the Bank from liability to the depositor on account of any such forgery, alteration or error.

9. In the case of joint accounts in the names of two or more depositors, the Bank may treat each of such depositors as the agent of each of the others, with authority to deposit or endorse for deposit in said account checks or other items payable to any one or more of such depositors, and the Bank is authorized to receive and credit to any such account checks or other items payable to any one or more of said depositors which may not be endorsed, and may supply absent endorsements.

10. The above Rules and Regulations are subject to change, and the Bank may from time to time adopt new Rules and Regulations. Said changes and new Rules and Regulations shall be binding upon the depositor after notice thereof has been posted in the lobby of the Bank or after such notice has been mailed to the depositor to the last address furnished by him in writing or after such notice has been enclosed with the cancelled checks of the depositor and such checks made available to the depositor in accordance with Rule No. 8 hereof.

to disclaim responsibility or limit the measure of damages for its own lack of good faith or failure to exercise ordinary care. The same section provides that Federal Reserve collection rules, Clearing House rules and the like have the effect of agreements, whether or not assented to by the parties and compliance therewith constitutes the exercise of ordinary care. This, you see, allows the banks in each city to make their own rules covering exchange of checks, time within which to return items not found good, and other similar matters. Thus, the lawyer in our hypothetical case who deposited his check in the Cleveland bank became bound by the Clearing House rules in San Francisco (if they have any), even though he did not know of such rules and did not suspect that his check would be sent to a bank in San Francisco. This is not greatly different from the present rule in Ohio, the principal case being that of *Akron Scrap Iron Company v. Guardian Savings & Trust Company*,⁴ wherein it was decided that one who deposited a check for collection in an Akron bank was bound by the rules and regulations of the Cleveland Clearing House, that being the location of the bank on which the check was drawn, even though such depositor was not actually aware of such rules at the time of making the deposit.

To allow banks time to process items they are given the right to fix an afternoon hour of 2 P. M. or later as a "cut-off time" and to treat all items received after such time as being received at the opening of business on the next banking day. Section 4-107. It will be noted that the rules and regulations of the bank previously mentioned⁵ make similar provisions, particularly for deposits received after regular banking hours on Fridays. Banks are also permitted without the approval of any person involved to modify or extend by not more than one day any time limit specified in the law, all without discharge of persons secondarily liable and without liability to the transferor or any other prior party. Section 4-108.

Another Section (4-106) which is intended to eliminate confusion in those cases where a bank has numerous branches provides that each branch or separate office of a bank maintaining its own deposit ledgers is a separate bank for purposes of computing the time within which and the place at or to which action may be taken or notices given. In actual practice it is not uncommon to have the deposit ledgers of several branches combined and carried at one branch only and it occurs to the writer that this Section may create rather than eliminate confusion, especially when it is remembered that the bank's liability is governed by the law of the

⁴ 120 Ohio St. 120, 165 N.E. 715 (1929); *Hilsinger v. Trickett*, 86 Ohio St. 286 (1892).

⁵ Paragraph 2 of Bank Rules and Regulations, *supra*, note 3.

place where the branch or separate office is located and the "place" of giving notice is governed by the place where deposit ledgers are kept. The Courts may be called upon to interpret this provision, particularly in its application to situations arising in some of our western states where branch banking sometimes transcends state lines.

The old question of whether the bank of deposit has accepted a check for collection or has become the owner thereof is put to rest by Section 4-201 which definitely states that unless a contrary intent clearly appears, the check has been taken for collection even though credit for the item is subject to immediate withdrawal as a matter of right. The law in Ohio has not always been too clear on this point and the student will find difficulty in reconciling some of our Ohio decisions.⁶ Many of our cases in Ohio involve banks in liquidation and the Courts could frequently be accused of a departure from sound reasoning in an effort to avoid creating preferences or trusts against property in the hands of the Superintendent of Banks. Having the law thus definitely stated will probably make it unnecessary in the future for banks to cover this point in their rules and regulations as most of them now do.⁷

A bank which uses ordinary care in presenting an item or in sending it for presentment will not be liable for the insolvency, neglect, misconduct or default of another bank. Section 4-202. According to the applicable comments, this provision constitutes the adoption of the Massachusetts rule rather than the New York rule which held the initial bank liable for the actions of subsequent banks in the collection chain. Ohio apparently follows the New York rule as set forth in the early case of *Reeves v. State Bank*. The federal district court in the case of *Taylor & Bournique Co. v. National Bank of Ashtabula* was called upon to decide whether the New York rule or the Massachusetts rule should govern a collection which originated in Wisconsin (a Massachusetts rule state) and ended in Ohio (a New York rule state). Judge Westenhaver, who wrote the opinion, said that under those circumstances the federal court was not required to follow the law in either state but could decide the controversy on the general law based on all authorities. The result was that the New York rule was followed and the Wisconsin bank was held to be liable for the negli-

⁶ Squire, *Superintendent of Banks v. Goulder*, 131 Ohio St. 106, 2 N.E. 2d 2 (1936); *Jones v. Kilbreth*, 49 Ohio St. 401 (1892). *Close v. Fulton*, Superintendent of Banks, 44 Ohio App. 165, 184 N.E. 22 (1932). *Smith and Setron Printing Co. v. Fulton*, Superintendent of Banks, 40 Ohio App. 32, 178 N.E. 211 (1931).

⁷ Paragraph 1 of Bank Rules and Regulations, *supra*, note 3.

gence of the bank in Ohio.⁸ The same section authorizes a bank to send a check for payment directly to the bank on which it is drawn. Although frowned upon by some of the earlier decisions, this practice is now almost uniform and speeds up collection to a considerable degree. Most banks cover this point in their rules and regulations and in Ohio we have a statute specifically authorizing this procedure.⁹ It is also provided for in Regulation "J" of the Federal Reserve System.

Generally speaking, the customer depositing a check in his bank is said to warrant to such bank, to each bank in the collection chain and to the payor bank that he has title to the check; that it has not been materially altered; that he has no knowledge that the signature of the maker or drawer is unauthorized, and that he knows of no effective stop payment order relating to the check. Additional warranties exist where the transferee of an item other than the payor has given consideration therefore, in which case the transferor agrees that upon dishonor and the giving of any necessary notices thereof he will pay the amount of the item to the transferee or to any subsequent holder who takes it up. Section 4-207.

The Code is specific in defining the media of payment which may be accepted by a collecting bank in settlement of an item without being responsible if such form of remittance is itself not paid. Section 4-211. This is no different than the present law in Ohio which is governed by the statute previously referred to relating to direct sending.¹⁰ The new Code is more explicit, however, and states in detail the various forms of remittance which a sending bank may accept in settlement of an item, among which are a cashier's check of the remitting bank, authority to charge the account of the remitting bank and several others.

Provision is also made in Section 4-212 for a collecting bank (as distinguished from a drawee bank) to make conditional payment to its customer for a deposited item and still have the right to charge the item back to the customer if it later turns out not to be "good". There is nothing new in this provision since it is common practice for banks to so provide in their own rules and regulations and the point is also specifically covered by paragraph 9 of Regulation J of the Federal Reserve System.

In controversial cases it is often important to know when a check is paid with finality by the bank upon which it is drawn

⁸ *Reeves v. State Bank*, 8 Ohio St. 466 (1858); *Taylor and Bournique Co. v. National Bank of Ashtabula*, 262 Fed. 168 (N.D. Ohio 1919); Comment to Section 4-202.

⁹ OHIO REV. CODE § 1105.12 (710-133).

¹⁰ *Id.*

and this is stated unequivocally to be the time when the drawee bank "has paid the item in cash or has completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith, whichever happens first". Section 4-213. The Courts have frequently had difficulty with this problem and the decisions in Ohio and elsewhere lack uniformity. The test in Ohio is apparently one of intention which is not always easily ascertainable.¹¹ The rule laid down by the Code should therefore be helpful.

Deferred Posting, previously mentioned in this report, is authorized by Section 4-301 and it is also authorized by an existing Ohio Statute¹² which was adopted in 1949. This practice may be defined briefly as a procedure whereby the drawee bank pays a check immediately upon presentation but does not post the item to the customer's account until the following day. Under these circumstances the bank has no idea whether the check is good at the time of payment and is allowed until midnight of the next business day after presentment to return the item or give notice of dishonor and may, of course, recover the amount paid on the day of presentment. This practice is adopted for the purpose of producing an even flow of items through payor banks on a day-by-day basis in a manner which permits them to be processed without abnormal peak loads, night work and other objectionable practices. Many states have similar statutes authorizing this procedure but their operation is not uniform. The necessity for this procedure is emphasized by paragraph 4 of Regulation J of the Federal Reserve System, which incorporates a similar provision. A further necessity arises on account of OHIO REV. CODE § 1305.11 (8241) which allows a drawee only twenty-four hours to decide whether or not he will accept a bill of exchange. If this section is also applicable to a check no bank could safely use a Deferred Posting system without special statutory authority.

Another important section defines the various priorities of stop-payment orders, legal process and the bank's right of setoff. Section 4-303. A bank is also made liable to its customer for wrongful dishonor of an item but where such dishonor occurs through mistake (as it almost always does) such liability is limited to the actual damage done, including damage for arrest and prosecution of the customer. Section 4-402. We have a similar statute at the present time in Ohio¹³ which was probably adopted as a result of a case in which the Court held a bank liable for the arrest and im-

¹¹ Akron Scrap Iron Company v. Guardian Savings & Trust Co., *supra*, note 4.

¹² *supra*, note 1.

¹³ OHIO REV. CODE § 1105.11 (710-132).

prisonment of a depositor because of the nonpayment through mistake of a check which should have been paid, even though such action on the part of the bank was found not to be malicious.¹⁴

The customer's right to stop payment of a check is preserved by Section 4-403 if the order is given in such time and manner as to afford the bank a reasonable opportunity to act thereon. An oral stop-payment order is binding only until a written order can be furnished and a written order is effective for six months. The burden of establishing the fact and amount of loss suffered by the customer as a result of a bank's failure to observe a valid stop-payment order, is placed upon the customer. This I believe to be the present law in Ohio.¹⁵

Death or incompetence of a customer does not, under Section 4-405, revoke the right of the bank to pay or collect items until the bank has actually received notice of his death or adjudication of incompetency. Even after such notice a bank may, for ten days after date of death, pay or certify checks drawn prior to that date unless otherwise ordered by a person claiming an interest in the account. This is an entirely new idea for Ohio¹⁶ and is of course adopted with the idea of permitting persons who receive checks shortly before the death of the drawer to collect their money without the necessity of filing a claim in the Probate Court.

Section 4-406 is intended to operate as a statute of limitations but seems unduly complicated by the manner in which it is drafted. Without reference to the comments its meaning is not always clear. The intention is to place a 90-day limitation on a customer's right to assert a claim against his bank by reason of a check bearing the forged or unauthorized signature of the maker, or which has been raised or otherwise materially altered. The time begins to run against the customer when the bank has sent him his statement or has otherwise made it available to him. To provide for the customer who may be ill, absent or for any good cause unable to examine his statement, such customer has an additional 30 days to report irregularities after such good cause ceases to operate, but in every case claims based on forged endorsements must be made within three years and within one year on material alterations and on account of forgeries of the maker's signature. We now have

¹⁴ *Mouse v. Central Savings & Trust Co.*, 120 Ohio St. 599, 167 N.E. 868 (1929).

¹⁵ *Speroff v. First-Central Trust Co.*, 149 Ohio St. 415, 79 N.E. 2d 119 (1948).
Central National Bank v. International Sales, Inc., 87 Ohio App. 207, 91 N.E. 2d 532 (1950).

¹⁶ *Haefner, Admr. v. First National Bank of Elmwood Place*, 70 Ohio App. 293, 44 N.E. 2d 489 (1942).

similar statutes in Ohio limiting the periods to two years and one year respectively.¹⁷

Only a few of the provisions of Article 4 seem to depart from prevailing collection practices and for the most part these departures attempt to clarify situations which are now shrouded in uncertainty and conflict. If uniformly adopted, the writer is of the opinion that Article 4 would constitute an improvement over the presently existing situation. However, this report is not intended to constitute a recommendation that Article 4 be adopted in Ohio, but is submitted for the primary purpose of stimulating further inquiry and study by those interested in bank collections.

¹⁷ OHIO REV. CODE §§ 1307.09 (11225-2) and 1307.08 (11225-1).