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ARTICLE 4: BANK DEPOSITS AND COLLECTIONS

F. GARLAND RUSSELL, JR.*

Bank advertisements frequently inform the public of the advantages of a checking account. Paying by check is more convenient than making the rounds to distribute cash among one's creditors, it is safer than sending currency through the mails, and the cancelled checks provide the drawer with a convincing proof of payment. When a person opens a checking account, he expects his bank to pay the checks he writes which have been properly indorsed by the recipients, to sift out and reject checks on his account which have been forged or materially altered, and to cash the checks which he receives from others by paying him currency or by converting these checks into credit in his own bank account. These expectations outline the subject matter treated in Article 4 of the Uniform Commercial Code.

While checks account for the bulk of instruments which are collected through the banking system, the rules established by Article 4 must be sufficiently broad to cover the great variety of both negotiable and non-negotiable documents¹ which are continuously handled, and sufficiently flexible to apply to new types of financial paper which may gain currency during the half century or more the Uniform Commercial Code is expected to be in effect. These rules must be drafted to provide guidance for large banks where check clearing and posting operations are handled by high speed electronic equipment and for small banks where these tasks may still be performed manually. Aside from necessary definitions and preliminary matters covered in Part 1 and the specialized rules on the collection of documentary drafts in Part 5 (which in the present paper must fall victim to the limitations of space), Article 4 is devoted to the interrelated problems of (1) how instruments for the payment of money are collected through the banking system, (2) when a payor bank becomes accountable for the amount of an instrument to the party making presentment, and (3) what rights the payor bank has to reimburse itself through charging the account of its depositor for amounts which it has paid. Due to space

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1. Such instruments include maturing notes, acceptances, bankers' acceptances, certificates of deposits, bills of exchange, drafts with documents attached, maturing bonds and coupons, state and municipal warrants and special or general obligations of states and their political subdivisions; 12 C.F.R. § 207.1 (1963).

limitations, this paper will only review the law as it applies to checks in the light of the recently enacted Uniform Commercial Code, at the expense of slighting rules designed specifically for handling other types of commercial paper.³

The exposition contained in Article 4 for the solution of problems concerning the collection and payment by banks of financial paper is neither exclusive nor revolutionary. Many of a bank's responsibilities with regard to a negotiable instrument arise from the nature of the instrument and not from the circumstance that one party happens to be a bank. The duty to protest a dishonored foreign instrument and send prompt notice of dishonor in order to hold parties secondarily liable arises under the law of negotiable instruments (Article 3 of the Code) and applies with equal force to any party making presentment. Questions concerning the transfer of bonds may require resort to the law of investment securities, Article 8.³ The province of Article 4 is to provide rules to deal with those aspects of the collection and payment which are particularly relevant to the banking system.

The draftsmen of the bank collections and deposits rules in Article 4 did not write on a clean slate. The bank collection system, as it has evolved through usage and the principles of contracts, agency, and trusts, is capable of handling checks in astronomical numbers in a routine which operates smoothly. New rules which would disturb established practices would likely bring practical chaos far in excess of their theoretical or demonstrable advantages. Thus the authors of Article 4 directed their energies toward providing a more satisfactory framework in which to conduct the collection process. They sought a framework which would remove variations in the rules of different states for handling what is essentially a multistate operation and which could be adapted to the needs of changing business conditions.⁴

2. Perhaps the most significant provision which has no application to checks is § 400.4-210, RSMo 1963 Supp., which allows a bank to make presentment to non-bank payors by written notice. This section recognizes what has become an accepted, if legally questionable practice. *Batchelder v. Granite Trust Co.*, 339 Mass. 224, 157 N.E.2d 540 (1959).

3. In the event of conflict, the provisions of Article 4 take precedence over those of Article 3 but not over those of Article 8. 400.4-102(1), RSMo 1963 Supp.

4. "With items flowing in great volume not only in and around metropolitan and smaller centers but also continuously across state lines and back and forth across the entire country, a proper situation exists for uniform rules that will state in modern concepts at least some of the rights of the parties and in addition aid this flow and not interfere with its progress." Comment to UCC § 4-101 (1962).

In states where bank collections have been governed primarily by case law, Article 4 may make some important changes. However, in Missouri provisions of Article 4 parallel the Bank Collection Code, adopted in 1929, which will be superseded by the Uniform Commercial Code on July 1, 1965.⁵ In considering the provisions of Article 4 just before it became effective in Massachusetts, one court said that reference to the new law was appropriate because the Uniform Commercial Code was regarded "less as a novel enactment than as largely a restatement and clarification of existing law which has the approval of American scholars."⁶ The impact of Article 4 on Missouri law could be similarly described.

I. BANKS AND THE COLLECTION OF CHECKS

The presentment of a check or other financial instrument to the designated payee is a matter of varying complexity depending upon the facts of each case. When a buyer of goods gives a check to a seller who lives in the same locality and carries his account at the same bank, presentment for payment can be quickly accomplished by the payee himself. Where the buyer and seller have different banks in the same city, presentment may be made by the seller's bank acting through the local clearing house. But where the buyer and seller are located on opposite sides of the country or where a promissory note is payable at a distance from the holder's residence, the intervention of additional parties to move the instrument to the place of payment, make a proper presentment, and return the proceeds to the owner becomes necessary. If a substantial distance is

An example of the need for uniformity can be seen in the career of a raised check which is handled by collecting banks in several states. Under §§ 400.4-207(1)(c) and 400.4-207(2)(c), RSMo 1963 Supp., each collecting bank warrants to the payor bank and each subsequent collecting bank that the check has not been materially altered. This warranty is not made by a collecting bank in a state having the Uniform Negotiable Instruments Law and is probably not covered by the guaranty of prior indorsements, 8 ZOLLMANN, BANKS AND BANKING § 5635 (1936). *Contra*, New York Produce Exch. Bank v. Twelfth Ward Bank, 135 App. Div. 52, 119 N.Y.S. 988 (1909). Consequently, a collecting bank in a Code state may find itself making warranties to subsequent parties, yet receiving no analogous warranties from its transferor in a non-Code state. See 12 C.F.R. § 210.5(5) (1963).

5. The Uniform Commercial Code specifically repeals Chapter 402, RSMo 1959, entitled "Bank Collection Code," as well as Chapter 401, RSMo 1959, entitled "Negotiable Instruments," which contains provisions applicable to banks and their depositors; Mo. Laws 1963, at 637, § 10-102. Some provisions concerning bank-customer relations, e.g., §§ 362.365, 363.300, RSMo 1959, on stop payment orders, and §§ 362.370, 363.610, RSMo 1959, on payment of stale checks, are left to the implicit repeal of all inconsistent legislation in Mo. Laws 1963, at 638, § 10-103.

6. *Universal CIT Credit Corp. v. Guaranty Bank & Trust Co.*, 161 F. Supp. 790, 792 (D. Mass. 1958).

involved, the collection process is likely to include not only the bank of deposit and the bank to make payment, but a number of intermediary banks, either Federal Reserve Banks or large commercial banks, which regularly exchange bundles of checks referred to as "cash letters" with each other and with the depositary or payor bank. Much of the acceptability of financial paper depends upon the existence of an organized system which can accomplish collection for the holder at a price which will not vary appreciably with the distances or number of intermediate parties involved and which will not materially reduce the value of his instrument. To meet this need a bank collection system must be able to handle many more than 25,000,000 checks daily at a low per item cost.⁷

A. *Collecting Banks—From Agency to Statute*

In the vast majority of cases the check collection operation completes its task without incident or cause for second thoughts on the part of the depositor. The aberrational instances where the courts have been called upon to examine the theory of bank collections have generally arisen where the check has disappeared in the course of collection or where the collecting process fails to make the contemplated remittance to a depositor because of the insolvency of one or more of the banks. The ultimate determination as to whether the bank of deposit or its depositor must bear the loss, under Missouri case law, turned on whether the bank took the particular check as an agent of the holder for the purpose of making collection or whether the bank purchased it from its depositor and had itself become the owner.⁸

If the check was accepted by the bank as the depositor's agent, it might revoke or recover any credit it had allowed the depositor⁹ and leave him, as owner, to pursue his claim against any intermediary bank whose

7. A high degree of uniformity in the material handled is a characteristic of today's check collection process which has made electronic processing possible. Whatever functions drafts may have served in the past to provide a type of supplementary money for the merchant community which could pass from one holder to another in satisfaction of obligations, today's check is normally an instrument drawn on standard bank-supplied forms for the purpose of transferring credits from the account of one bank depositor to that of another.

8. Under the code when a check is dishonored upon presentment, the consequences for the depositor and the bank of deposit are much the same regardless of whether the bank is treated as agent of the depositor or as owner of the check. If the dishonor is not attributable to negligence by the bank, *e.g.*, undue delay in making presentment, the bank can recover from the depositor either as an agent entitled to reimbursement from its principal or on the warranties given on transfer of the item, § 400.3-414(1), RSMo 1963 Supp. If the bank's negligence was the cause of the dishonor, it cannot recover from the depositor under either theory.

9. *Pollack v. National Bank of Commerce*, 168 Mo. App. 368, 151 S.W. 774 (St. L. Ct. App. 1912) (credit given is presumed to be provisional).

negligence caused the collection attempt to miscarry or to seek the proceeds among the remaining assets of the payor or intermediary collecting bank which had gone insolvent.¹⁰ The capacity in which a bank received an item was a matter to be settled by examining the intention of the parties.¹¹ Customarily indorsements, bank collection agreements, deposit

10. In the event of the depository bank's insolvency, the customary roles may be reversed and the depositor may seek to maintain the bank's agency. In *Thomson v. Bank of Syracuse*, 220 Mo. App. 805, 278 S.W. 810 (K.C. Ct. App. 1926), the depositor wished to establish the agency of the insolvent depository bank in order to claim the proceeds of the collection as the beneficiary of a trust rather than being limited to a claim as a general depositor of the bank. See also, *Farmers' Exch. Bank v. Farm & Home Sav. & Loan Ass'n*, 332 Mo. 1041, 61 S.W.2d 717 (1933) (payment stopped at request of payee-depositor of failed bank); *May v. Bank of Hughesville*, 291 S.W. 170 (K.C. Mo. App. 1927).

The rights of an owner of the proceeds of a paid item to a preferred claim on the assets of an insolvent bank which was holding the proceeds at the time of insolvency are treated in § 400.4-214, RSMo 1963 Supp. Briefly, they are:

- (1) If a collecting or payor bank suspends payments, the unpaid checks in its possession should be returned to the presenting bank or to the closed bank's customer;
- (2) If the payor bank fails after having finally paid a check but without having made a settlement which is or becomes final, the owner of the check (now the proceeds) has a preferred claim against the payor bank;
- (3) If a collecting bank fails after it has received a final settlement for an item but before it has made a final settlement with its transferor, the owner has a preferred claim against the assets of the collecting bank.

These rules parallel those under the Bank Collection Code, § 402.110, RSMo 1959, and the position developed in Missouri decisions: *Federal Reserve Bank v. Millspaugh*, 314 Mo. 1, 282 S.W. 706 (1926) (failed payor bank); *Bank of Poplar Bluff v. Millspaugh*, 313 Mo. 412, 281 S.W. 733 (1926); *Schreier v. Joplin State Bank*, 63 S.W.2d 179 (Spr. Mo. App. 1933); *Aurora Farmers' Exch. v. Bank of Aurora*, 227 Mo. App. 1030, 62 S.W.2d 562 (Spr. Ct. App. 1933) (failed depository bank); *Federal Reserve Bank v. Quigley*, 284 S.W. 164 (K.C. Mo. App. 1926).

Without amendment to the National Bank Act's provisions concerning distribution of assets on liquidation, 13 Stat. 114, 12 U.S.C. § 194, the preference provisions of § 400.4-214, RSMo 1963 Supp., cannot apply to national banks: *Jennings v. United States Fid. & Guar. Co.*, 294 U.S. 216 (1935).

In Illinois, the Bank Collection Code was held unconstitutional on the grounds that the legislature had exceeded its powers in attempting to pass insolvency rules which would be applicable to national banks and that the insolvency provisions were inseparable from the remainder of the statute, *People ex rel. Barrett v. Union Bank & Trust Co.*, 362 Ill. 164, 199 N.E. 272 (1935). These infirmities could scarcely apply to the Uniform Commercial Code since the draftsmen are explicit in confining their efforts to state chartered banks. Comment 3 to UCC § 4-214 (1962).

In Missouri, the constitutionality of the preference provisions of the Bank Collection Code was upheld against a claim that an unreasonable classification was involved: *Mississippi Valley Trust Co. v. West St. Louis Trust Co.*, 232 Mo. App. 281, 103 S.W.2d 529 (St. L. Ct. App. 1937). A similar result was reached in Illinois, *People ex rel. Nelson v. Dennhardt*, 354 Ill. 450, 188 N.E. 464 (1933).

11. *National City Bank v. Macon Creamery Co.*, 329 Mo. 639, 46 S.W.2d 127 (1932); *Robinson v. Gentry*, 106 S.W.2d 913 (St. L. Mo. App. 1937); *Townsend Wholesale Grocery Co. v. Chamberlain Canning Co.*, 277 S.W. 958 (K.C.

slips and general banking customs spelled out the bank's agency,¹² but conflicting actions, such as permitting the depositor to withdraw credit given for the deposited instrument, or even giving him credit subject to the right of withdrawal, were taken as showing that ownership had been transferred.¹³ The Bank Collection Code continued to make the question of whether a bank was an agent or owner paramount in the determination of rights and liabilities, but defined many of the terms of the agency and established a strong presumption of the bank's agency which would require a particular factual situation to be judged differently than before.¹⁴

Under section 400.4-201 the rule that a bank accepts an instrument as the collection agent of the owner is retained largely from a desire to provide guidance for disputes in areas not covered by specific rules.¹⁵ But

Mo. App. 1925); *Citizens' State Bank v. Ferson*, 208 S.W. 136 (K.C. Mo. App. 1919); *Mudd v. Farmers' and Merchants' Bank*, 175 Mo. App. 398, 162 S.W. 314 (K.C. Ct. App. 1914); *Midland Nat'l Bank v. Roll*, 60 Mo. App. 585 (K.C. Ct. App. 1895).

12. *First Nat'l Bank v. Federal Reserve Bank*, 6 F.2d 339 (8th Cir. 1925); *Bank of Aurora v. Fruit Growers' Union*, 52 S.W.2d 574 (Spr. Mo. App. 1932); *Commerce Trust & Sav. Bank v. Schuler*, 27 S.W.2d 492 (St. L. Mo. App. 1930); *Midwest Nat'l Bank & Trust Co. v. Parker Corn Co.*, 211 Mo. App. 413, 245 S.W. 217 (K.C. Ct. App. 1922); *Brigance v. Bank of Cooter*, 200 S.W. 668 (Spr. Mo. App. 1918). *Contra*, *Nomland v. First Nat'l Bank*, 64 F.2d 399 (8th Cir. 1933).

13. *Foristel v. Security Nat'l Bank Sav. & Trust Co.*, 320 Mo. 436, 7 S.W.2d 997 (1928); *Jefferson Bank v. Merchants' Refrigerating Co.*, 236 Mo. 407, 139 S.W. 545 (1911); *Ayres v. Farmers and Merchants Bank*, 79 Mo. 421 (1883); *Mississippi Cottonseed Prod. Co. v. First Nat'l Bank*, 142 S.W.2d 1106 (St. L. Mo. App. 1940); *Bank of Buchanan County v. Gordon*, 250 S.W. 648 (K.C. Mo. App. 1923); *Charles Renfrow Comm. Co. v. W. B. Northrup Co.*, 222 S.W. 487 (Spr. Mo. App. 1920); *Hendley v. Globe Refinery Co.*, 106 Mo. App. 20, 79 S.W. 1163 (K.C. Ct. App. 1904).

14. § 402.030, RSMo 1959. "We cannot agree that the adoption of the Bank Collection Code has not changed the rule of law previously existing in this state as to the passing of title to the bank of deposited checks when credit is at once given to the depositor with the right to check against such credit. This statute establishes the relationship of agency in such case and makes the credit so given a revocable one, except as to such part of the credit as has actually been withdrawn. Title to the check and its proceeds does not at once pass to the bank in the absence of an agreement to the contrary. It is conceded here that there is no agreement to the contrary, that is, no agreement of sale of the check to the bank other than what is termed an implied agreement from the facts. Such implied agreement, it is argued, arises from the fact that the check was indorsed in blank, deposited in the bank, and credit for the same given at once, with the unrestricted right to check against such credit. To hold that there is such an implied agreement of sale from these facts is in the teeth of the statute. . . ." *Farmers Exch. Bank v. Farm & Home Sav. & Loan Ass'n*, *supra* note 10 at 723, reversing 52 S.W.2d 608 (Spr. Mo. App. 1932); *Hartford Acc. & Indem. Co. v. Federal Deposit Ins. Corp.*, 204 F.2d 933 (8th Cir. 1953); *Robertson v. Central Manufacturers' Mutual Ins. Co.*, 239 Mo. App. 1169, 207 S.W.2d 59 (Spr. Ct. App. 1947).

15. Official comment 2 to V.A.M.S. § 400.4-201. *First Trust & Sav. Bank v. Fidelity-Philadelphia Trust Co.*, 214 F.2d 320 (8th Cir. 1954), *cert. denied*, 348 U.S. 856 (1954). This does not prevent a bank from becoming the owner of an item if the fact can be clearly established, *e.g.*, where a check is given to a bank

the rule is shorn of importance for most questions arising out of bank collections by the provision that "when an item is handled by banks for the purposes of presentment, payment and collection, the relevant provisions of this Article apply even though action of parties clearly establish that a particular bank has purchased the item and is the owner of it."¹⁶ With the development of mass handling the terms of an agreed agency have become more conjectural¹⁷ and have a decreasing connection with anything the owner is apt to have had in mind when he deposited his check. Courts have been more inclined to supply the facile answer that he intended his check to be handled according to standard bank collection practice, whatever that might be. Under Article 4 the rights and obligations of collection banks will arise primarily from their participation in the collection process without need to seek support in the express or implied agreements between the bank and the depositor. Article 4 completes the transition of the bank collection process from a matter of contract to a matter of statutory obligations which the parties are, by and large, free to vary by agreement if they choose.

B. *The Bank's Duty of Ordinary Care*

The basic obligation which a bank undertaking collection assumes is to exercise ordinary care in its own actions and in the selection of competent intermediate collecting banks when the circumstances indicate. It does not assume responsibility for the action of the intermediate collection banks which it selects.¹⁸ Failure of any bank to fulfill the duty of ordinary

in payment of a debt owed to the bank. The 1952 Official Draft omitted all reference to agency from UCC § 4-201. In the 1958 and 1962 drafts, no reference to agency occurs outside of UCC § 4-201 (1962).

16. § 400.4-201, RSMo 1963 Supp.

17. Note the conceptual difficulties in § 402.050, RSMo 1959, which, after agency is generally established in § 402.030, RSMo 1959, provides that where there is a blank indorsement or a bearer item subsequent parties may rely on the presumption of the bank's ownership. See Comment 6 to UCC § 4-201 (1962).

18. § 400.4-202, RSMo 1963 Supp. At common law there has been a split of authority between the "Massachusetts rule" which held that the depositary bank was only liable for the careful selection of correspondent banks and the "New York rule" which made the depositary bank responsible for the negligence of subsequent collection banks. *City of Douglas v. Federal Reserve Bank*, 271 U.S. 489 (1926); *Federal Reserve Bank v. Malloy*, 264 U.S. 160 (1924); *First Nat'l Bank v. Federal Reserve Bank*, *supra* note 12.

Missouri decisions followed the Massachusetts rule: *Daly v. Butchers' & Drovers' Bank*, 56 Mo. 94 (1874); *Hoffman v. Mechanics-American Nat'l Bank*, 211 Mo. App. 643, 249 S.W. 168 (St. L. Ct. App. 1923); *Landa v. Traders' Bank*, 118 Mo. App. 356, 94 S.W. 770 (K.C. Ct. App. 1906) (this rule could be varied by contract and a bank which received compensation for making the collection was liable for the default of its correspondent despite a contrary agreement in the passbook). This rule was incorporated in the Bank Collection Code, § 402.060, RSMo 1959.

care will render it liable to the owner for damages. But carelessness will not bring down upon the bank the additional sanction of destroying its right to charge the item back to the depositor or to the prior collecting bank and to reverse any provisional credit which it has allowed.¹⁹

The determination of what constitutes ordinary care in discharging a bank collection obligation involves consideration of three elements: the actions taken, the manner in which they are performed and the time required to do them. Negligence may be found when a bank performs in a slovenly manner, when the course of action it chooses is unreasonable or when it is unduly slow in performing acts which otherwise would be unobjectionable.

The requirement that a bank use ordinary care in performing what it undertakes is not a technical requirement. The bank's employees must use a degree of skill and attention which may normally be expected of one performing these tasks. More is required than the conscientious bungler who might meet the subjective test of good faith but would scarcely meet any objective standard of ordinary care.²⁰ "Ordinary care" is expressly required of a collecting bank in: (a) presenting an item or sending it for presentment, (b) sending notice of dishonor or non-payment or returning an item other than a documentary draft after learning that it has not been paid or accepted, (c) settling for an item when it has received a final settlement, (d) making any necessary protest, and (e) giving notice of loss or delay within a reasonable time after it learns the facts.²¹

By contrast, cases concerning preferences on insolvency often treat the insolvent payor bank to which an item was forwarded for collection as the agent of the presenting bank. *Federal Reserve Bank v. Millspaugh*, *supra* note 10.

19. § 400.4-212(4)(b), RSMo 1963 Supp. The measure of damages is stated in § 400.4-103(5), RSMo 1963 Supp., to be "the amount of the item reduced by an amount which could not have been realized by the use of ordinary care, and where there is bad faith . . . other damages, if any, suffered by the party as a proximate consequence." Compare *Midwest Nat'l Bank & Trust Co. v. Parker Corn Co.*, *supra* note 12 (depositor must show that the draft was collectable and that the bank was negligent in not collecting it and that the actual loss resulted from this negligence); *Selz v. Collins*, 55 Mo. App. 55 (St. L. Ct. App. 1893) (in order to recover the face value on an instrument, the plaintiff must show that the entire loss was caused by bank's negligence).

20. See *Ivory v. Bank of the State of Missouri*, 36 Mo. 475 (1865) (unfamiliarity with the collection of a particular type of instrument would not relieve a bank from the duty to exercise proper diligence).

21. § 400.4-202, RSMo 1963 Supp. This listing is probably not intended to be exhaustive of the cases in which a collecting bank owes a duty of ordinary care. Note that a bank also owes a duty of good faith in all actions undertaken; § 400.1-203, RSMo 1963 Supp. See *Gerhardt v. Boatman's Sav. Inst.*, 38 Mo. 60 (1866) (when banking usage directed that a dishonored item be turned over to a notary for protest, a bank would normally have fulfilled its duty by so acting); *Silverforb v. Bank of Nashua*, 233 Mo. App. 1239, 128 S.W.2d 1070 (K.C. Ct. App. 1939) (a bank must give prompt notice of nonpayment).

These responsibilities have been conceived in terms of duties which the collecting bank owes to the owner of the instrument or to prior collecting banks. However, with the development and increasing use of electronic processing equipment the duties owed by the collecting bank to subsequent banks are apt to become equally significant.

High speed check processing equipment, both for sorting checks and for posting them to the drawers' accounts in the payor bank, operates by means of characters having a passing resemblance to arabic numerals which are inscribed on the check in magnetic ink. These characters allow the equipment to "read" the amount of the check and the routing symbol identifying the payor bank. Routing symbols are preprinted on the check forms when they are prepared by the payor bank's stationer but the amount of each check must be inscribed after the check has been deposited for collection. Ideally this is done by the first bank in the collection chain which possesses high speed equipment.

Possibilities for mistakes exist either in the preprinted encoding of the bank's routing symbol or in encoding the amount. In the former case, a subsequent bank to which the check has been forwarded is likely to discover the error when its machine is unable to find any bank fitting the magnetic description of the destination to which the check is to be sent. If the subsequent collecting bank follows a practice of returning misrouted items to the bank from which they were received in the same cash letter with checks being sent for collection, the entire shipment is apt to be fed back into the processing equipment of the first bank with the result that the misdirection will be repeated. With unflagging application of established routine on the part of the second bank the journeys back and forth can be repeated until the check disintegrates or becomes so dilapidated from repeated handling and the stamping of indorsements that it will no longer pass through the electronic equipment. The possibilities of loss are apparent. The question to be resolved is what duties does a bank owe to the depositary bank or other prior collecting banks to return misrouted items in a manner which is calculated to appraise the prior bank of the error.²²

Again, difficulties may arise through mistakes in electronic encoding of the amount of the check. An error in this procedure is likely to ride

22. A bank to which an item has been erroneously sent would appear to be within the definition of a collection bank, *i.e.*, "any bank handling the item for collection except the payor bank." § 400.4-105(d), RSMo 1963 Supp.

Loss through misrouting may be incurred by the depositary bank if, because of the length of time which has passed with no adverse report on a check, it assumes that the misrouted check has been paid and allows the depositor to withdraw his funds.

through undetected until the drawer of the check complains if his account has been overcharged (if his account is undercharged it is less likely that the error will come to light). Errors in encoding of the amount will often result in no more serious consequences than embarrassment and loss of time required to straighten out the records, since in most instances an overpayment will come to rest with the bank that made the mistake; a difference between an underpayment and the actual amount of the check could be recovered by the payor bank from a solvent drawer. However, a compensating error in the encoding of a deposit slip may have caused the overpayment to reach the depositor's account where it may have been withdrawn, or the drawer whose account has been undercharged may no longer be solvent. In such a case, does the encoding bank also owe a duty to the payor bank, or to the drawer, to exercise ordinary care in encoding the amount?²³ These problems not only indicate the areas where development through inter-bank agreements may be expected, but point up the fact that the problems of mechanized bank collections involve dimensions for which continued elaboration of the principles of agency would scarcely be productive.

The time within which a bank exercising ordinary care must take action is stated as follows: "A collecting bank taking proper action before its midnight deadline following receipt of an item, notice or payment acts seasonably; taking proper action within a reasonably longer time may be seasonable but the bank has the burden of so establishing."²⁴ Thus, a time limit

23. What is ordinary care in these circumstances may prove a difficult question. Ordinary care may appear differently depending upon whether the mis-coded check is viewed individually or as one item in a great volume of work handled by an operator. Considered individually, encoding a wrong figure can scarcely be reconciled with ordinary care, but considered in context, it must be recognized that a small percentage of mistakes will be made. Otherwise, the duty to exercise ordinary care would be transformed into a requirement that the bank guarantee the results except in cases of mechanical failures.

Ordinary care may require that a bank take such steps as employing trained personnel, "penny balancing" of checks received and dispatched in order to catch uncompensated errors and separate encoding of checks deposited and deposit slips in order to minimize the chance that the same error will be repeated.

Section 400.4-204, RSMo 1963 Supp., dealing with forwarding and presenting items provides: "A collecting bank must send items by reasonably prompt methods taking into consideration . . . the number of such items on hand, and the cost of collection involved. . . ." Similar qualifications are probably implied in the duty to exercise ordinary care. Cf. 8 ZOLLMANN, *op. cit. supra* note 4, at 301: "The fact that a bank does a large business cannot relieve it from the duty of giving due attention to every piece of paper it undertakes to collect."

24. § 400.4-202(2), RSMo 1963 Supp. The circumstances which would justify a bank in taking a longer time to act are indicated in § 400.4-108(2), RSMo 1963 Supp.: "Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this chapter or by instructions is excused if caused by interruption

is established allowing flexibility in the event of unforeseen circumstances. The term "midnight deadline" is a technical term defined as midnight of the next banking day following receipt of an item or notice that gives rise to the need for taking action.²⁵ In view of the definition of a "banking day" as a day on which a bank is open to the public for carrying on "substantially all" of its banking functions,²⁶ and the authorization for a bank to establish a "cut-off" hour of two p.m. or later:²⁷ If an item is received on a Friday afternoon after the cut-off hour, the item will be considered as not received until Monday morning and the midnight deadline will not occur until Tuesday midnight.²⁸

Much of the litigation involving collection banks has considered whether a particular course of action followed by the bank was consistent with ordinary care. Appellate judges, giving the matter unhurried consideration have sometimes arrived at conclusions different from those developed in the day-to-day conduct of bank operations. Probably the most noted of these disagreements was the decision that the bank was negligent if it sent items to the payor bank.²⁹ It was held unreasonable to believe that a payor bank could serve three masters, acting as the collecting agent of the forwarding bank, the paying agent of the drawer, and yet protecting possible claims of its own against the drawer's account. This rule was reversed in the Bank Collection Code³⁰ and permission to send checks directly

of communication facilities, suspension of payments by another bank, war, emergency conditions or other circumstances beyond the control of the bank provided it exercises such diligence as the circumstances require."

Under the Bank Collection Code no similar provision existed for delay beyond the specified time, § 402.070, RSMo 1959. However, that section did not exclude the possibility as it did not purport to be an exhaustive statement of what constitutes ordinary care.

Failures to act seasonably may render a collecting bank liable for damages but does not make it accountable for the amount of the check as occurs under § 400.4-302, RSMo 1963 Supp., when a payor bank delays.

25. § 400.104(1)(h), RSMo 1963 Supp.

26. § 400.104(1)(c), RSMo 1963 Supp.

27. § 400.107(1), RSMo 1963 Supp. The Bank Collection Code, § 402.040(2), RSMo 1959, allows items received after the close of regular business hours to be treated as though received at the opening of business on the next business day.

28. Further delay may be permitted in the case of a collecting bank (but not a payor bank) which decides to allow an additional banking day in a good faith effort to obtain payment of a specific item. § 400.108(1), RSMo 1963 Supp.

29. *Maronde v. Vellenweider*, 220 Mo. App. 67, 279 S.W. 774 (Spr. Ct. App. 1926); *American Exch. Nat'l Bank v. Metropolitan Nat'l Bank*, 71 Mo. App. 451 (K.C. Ct. App. 1897).

30. § 402.070, RSMo 1959. Use of the mails was specifically authorized only when forwarding to banks in a different town or city. Section 400.4-204, RSMo 1963 Supp., will authorize use of motor carriers or air express between cities and the use of the mails for moving checks within the city provided this is reasonable under the circumstances.

to the payor bank continues under section 400.4-204. Permission is also now given to send an item directly to a payor other than a bank where authorized by the bank's transferor. Any item other than a documentary draft may be sent to a non-bank payor when authorized by Federal Reserve regulations or operating letters, clearinghouse rules or the like.³¹

Addressing itself generally to the question of what procedures are consistent with the exercise of ordinary care, section 400.4-103(3), (4) provides:

Action or non-action approved by this Article or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care, and in the absence of special instructions, action or non-action consistent with clearing house rules and the like or a general banking usage not disapproved by this Article, prima facie constitutes the exercise of ordinary care.

. . . The specification or approval of certain procedures by this Article does not constitute disapproval of other procedures which may be reasonable under the circumstances.³²

C. *The Collecting Bank's Security Interest*

While banks usually have been at pains to maintain the position of an agent receiving the checks of its depositor for collection, it is a common practice to allow the depositor credit, normally revocable, for the item which he deposits. Often the depositor is allowed to draw against this credit. When subsequent events reveal that the bank will not receive final settlement for the check, and, in addition, the disappearance or insolvency of the depositor makes "charge-back" to his account impossible, the bank is forced to seek reimbursement from the maker or from prior indorsers of the instrument. They, in turn, maintain that the bank, as agent for collection rather than owner, has no standing to enforce the engagements which they have given to the missing principal. In dealing with this argument courts have strained to find circumstances which might be construed as a transfer of ownership. The Bank Collection Code provided that, to the extent any

31. Query whether Federal Reserve operating letters or clearinghouse rules could authorize the direct sending of documentary drafts to non-bank payors. § 400.4-103, RSMo 1963 Supp., on variation through agreements seems broad enough to suggest that they can.

32. § 400.4-103, RSMo 1963 Supp. See § 402.070(1), RSMo 1959; *Massey-Harris Harvester Co. v. Federal Reserve Bank*, 340 Mo. 1133, 104 S.W.2d 385 (1937); cf. *Farm & Home Sav. & Loan Ass'n. v. Stubbs*, 231 Mo. App. 87, 112, 98 S.W.2d 320, 337 (K.C. Ct. App. 1936). ("The rules of a clearing house, as such, do not govern the rights of a drawer or a payee of a check who are not members of a clearing house.")

revocable credit had been withdrawn, the bank would have the rights of an owner against prior and subsequent parties.³³

The provisions of Article 4 reach similar conclusions within an altered theoretical framework. Though credit may have been given for an item which has been drawn against, the bank continues to be classified as an agent of the depositor.³⁴ However, a bank is given a security interest in any item, accompanying documents or proceeds to the extent that it has made an advance against that item or given credit which has actually been withdrawn or is available for withdrawal as of right.³⁵ Giving credit or an advance in the manner which will create a security interest constitutes giving value so that if the bank can meet the other requirements it can achieve the status of a holder in due course.³⁶ A security interest may arise not only in favor of a depository bank which has given credit to its customer, but also in favor of a collecting bank which has given credit to a prior collecting bank or possesses a valid right of set-off.³⁷ This may prove a matter of more than passing interest because schedules for the availability of credits often allow a bank to draw against its account with its correspondent

33. § 402.030, RSMo 1959.

34. § 400.4-201, RSMo 1963 Supp.

35. § 400.4-208, RSMo 1963 Supp. When credit is given against a group of items received together and subject to one agreement, *e.g.*, in the same deposit or cash letter, the security interest attaches to all items and documents or their proceeds. In matching credits withdrawn or allowed as a matter of right against items so as to determine which items are covered by a bank's security interest, the rule is that the first credits given are the first withdrawn.

The bank's security interest is subject to the provisions of Article 9 on Secured Transactions except that:

- a. no security agreement is needed,
- b. no filing is required, and
- c. the bank's security interest has priority over conflicting security interests in the item, accompanying documents or proceeds.

If two collecting banks have a security interest in the same item, *e.g.*, where the depository bank has allowed the depositor to withdraw and the next collecting bank has allowed the depository bank to draw against its correspondent balance or reserve account, priority between the security interest appears to be determined by § 400.9-312(5)(b), RSMo 1963 Supp. The claim of the depository bank or its receiver would be superior.

36. § 400.3-302, RSMo 1963 Supp. A bank can be a holder in due course even though it may have taken the check without indorsement, § 400.4-206, RSMo 1963 Supp.; *cf.* § 400.3-201(3), RSMo 1963 Supp.

37. What set-offs may be valid is left for each state to determine. However, "an intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of set-off would not produce a valid set-off." Comment 5 to UCC § 4-201.

Granting subsequent collecting banks a security interest for advances to prior collecting banks is an innovation. *Vickrey v. State Sav. Ass'n*, 21 Fed. 773 (C.C.E.D. Mo. 1884) (funds could only be applied against the account of a forwarding bank if the forwarding bank's agency was not known by the subsequent bank).

or with a Federal Reserve Bank before a final settlement has been received. The security interest of each bank in the collection chain is satisfied and discharged upon receipt of a final settlement.

D. Indorsements and Warranties

Rules for determining the responsibilities of collecting banks look to the indorsements of the holders and prior collecting banks as a prime source of enlightenment. Viewed strictly as a matter of negotiable instruments law, it is doubtful whether the indorsement of a holder seeking payment through an agent is necessary.³⁸ Yet in the matter of bank collections, the indorsements of the holders and prior banks not only identify the parties involved, but are important for establishing the agency status of collecting banks, conveying instructions as to how the item and the proceeds are to be handled and determining the rights of the payor bank against the collecting banks in the event the check proves to be defective in some regard.³⁹

This superstructure of deductions about bank relations rests on the basic assumption that a person receiving a check examines the indorsements to see what he is getting and will tailor his actions accordingly. Between individuals, for instance, in the case of the small grocery store or the filling station which cashes checks for its customers, this probably accords with the facts. The assumption is less valid in bank collection operations where a great volume of checks is handled. Normally an intermediate collecting bank does not examine indorsements on the checks it receives, and its own indorsements—unvarying in content—are machine stamped on the item as an adjunct to sorting. To make a collecting bank's duties depend upon an inscription which it cannot take time to read, or to make the right of a payor bank to recover from prior parties depend on whether a machine failed to stamp, may be likened to a requirement that incantations be properly made.⁴⁰

The treatment of indorsements in Article 4 is designed to limit their importance to circumstances where it is reasonable to expect that they will receive individual attention. As rights and duties arising out of con-

38. *Glen Falls Indem. Co. v. Palmetto Bank*, 23 F. Supp. 844 (D.C.S.C. 1938), *aff'd*, 104 F.2d 671 (4th Cir. 1939).

39. The Bank Collection Code, § 402.050, RSMo 1959, placed importance on indorsements. The guaranty of prior indorsements was an automatic concomitant of a restrictive indorsement but not of a blank indorsement; a blank indorsement allowed subsequent parties to assume that the bank was the owner of an item.

40. For checks collected through the Federal Reserve System the presence of a guaranty of prior indorsements is less important because a bank makes the same warranties by the act of sending a check to the Federal Reserve Bank for collection. 12 C.F.R. § 210.5 (1963).

tract have been replaced by those derived from the status of participation in the bank collection process, it is appropriate that the inscriptions which have been relied on in determining the substance of the agency agreement should decline in importance.

Probably the majority of checks which are deposited with banks for collection bear only the signature of the payee-depositor. Not infrequently, however, a depositor indorses a check restrictively or fails to indorse it at all. The restrictive indorser intends that his funds will be handled in the manner he has specified and heretofore his restrictive indorsement has been taken as conveying notice of his intentions to all subsequent parties who may come into possession of the instrument.⁴¹ Under Article 4 this rule will be changed so that a restrictive indorsement is notice only to the bank in which the check is deposited.⁴² The draftsmen recognized that the depositor or owner of a check has a legitimate interest in having the funds handled according to his instructions, but felt that a reasonable balance between safeguarding this interest and leaving collection activities unfettered by special restrictions should be struck by imposing responsibility on the depositary bank to see that the instructions are observed.

Checks may be deposited with no indorsement either through oversight or because the payee has arranged to have his check sent directly by his employer to the bank. Regardless of the necessity of the owner's indorsement of a check being collected, it is uncommon practice for a payor bank to return an unindorsed check.⁴³ Contacting the payee to secure his signature may be an irritating and time consuming solution. In order to facilitate payment in such cases, banking practice has developed the use of a legend to be added by the depositary bank stating that the amount of the check has been credited to the account of the payee. If the payee has received the amount of the check, he would be in no position to claim damages on the grounds that the payor bank has converted his check and payor banks have been prepared to rely upon the assurance of depositary banks that this has in fact occurred. This practice is recognized and approved in section 400.4-205(1) which allows the depositary bank to supply the missing indorsement of the depositor in the absence of a statement in the instrument specifically requiring the indorsement of the payee.⁴⁴

41. Indorsements "for deposit" or "for collection" will still be effective in preventing a depositary bank from paying cash for a check. §§ 400.3-205—3-206, RSMo 1963 Supp.

42. § 400.4-205(2), RSMo 1963 Supp.

43. PATON, *DIGEST OF LEGAL OPINIONS* 2131 (1942).

44. The legend "credited to the account of within named payee" is equivalent to an indorsement. The authorization in § 400.4-205(1), RSMo 1963 Supp., goes

Between banks in the chain of collection, any agreed method of transfer which identifies the transferor will be sufficient.⁴⁵ Perhaps this will contribute to the solution of the problem of the numerous and often illegible over-stampings that appear on the back of almost any collected check. However, simplification of indorsement plates to the extent of including only the transferor bank's transit number does not seem probable for the immediate future because of the continued importance of phrases such as "Pay any bank."⁴⁶ After an item has been indorsed with words such as "Pay any bank," only a bank can acquire the rights of a holder in the item until it has either been returned to the customer initiating collection or has been specially indorsed by a bank to someone other than a bank.⁴⁷

The indorsements of collecting banks have played an important role in apportioning liability for losses resulting from forgeries or unauthorized indorsements.⁴⁸ The assumption that a payor bank could look to the presenting bank or remote prior parties in the event the indorsements were not proper was upset by judicial decisions that the warranty of validity which a general indorser gives to subsequent holders in due course did not extend to the payor and that banks handling checks for collection under a restrictive indorsement acted merely as agents, assuming no responsibility for forged indorsements. After the collecting bank had paid over the funds to its principal or to another agent bank, no possibility of recovering as a payment made under a mistake of fact remained.⁴⁹ To remedy this situation, clearinghouse rules were adopted requiring checks presented by members to bear the legend "Prior indorsements guaranteed." With the enactment of Article 4 the assurances of validity of the instrument become attributes of forwarding an instrument for collection.⁵⁰

further than the previous practice in that the indorsement supplied by the depository bank is not merely a guaranty given to the payor bank, but is sufficient to transfer title to the instrument. Whether the amount has actually been credited to the payee's account is not open to question and the responsibility for misguided reliance on the honesty of the depository bank rests with its depositor rather than with subsequent banks.

45. § 400.4-206, RSMo 1963 Supp. Presumably agreed identification outside the check would be sufficient.

46. Indorsing is not necessarily linked to the sorting process. If electronic encoding becomes widespread the more elaborate indorsement containing "Pay any bank" could be a concomitant to amount encoding and a simpler indorsement identifying the transferor could be used in sorting.

47. § 400.4-201(2), RSMo 1963 Supp.

48. § 401.066, RSMo 1959.

49. Cf. *Northwestern Nat'l Bank v. Bank of Commerce*, 107 Mo. 402, 17 S.W. 982 (1891).

50. Warranties can no longer be avoided by a qualified indorsement. See Trumbull, *Bank Deposits and Collections in Illinois Under the Proposed Uniform Commercial Code*, 55 Nw. U.L. Rev. 253 (1960). § 400.3-417(3), RSMo 1963 Supp., is inapplicable in the bank collection situation.

Two sets of warranties are provided in section 400.4-207: those which the customer and each collecting bank make to the payor, and those which the customer and each collecting bank give to every subsequent collecting bank. The warranties given to the payor are similar to those arising under the guarantee of prior indorsements and under a bank's general duty to exercise good faith in its actions. The payor bank or other payor is assured that the prior parties had good title or are authorized to receive payment on behalf of one who has good title (which covers the matter of forged or unauthorized indorsement); that the instrument has not been materially altered;⁵¹ and that the party giving the warranty has no knowledge that the signature of the maker is unauthorized.⁵² By phrasing this last warranty in terms of good faith rather than an absolute assurance, Article 4 adopts the rule of *Price v. Neal*⁵³ to the effect that a drawee is held to know his customer's (the drawer's) signature at his peril.⁵⁴

The warranties given by the depositors and each collecting bank to subsequent collecting banks correspond to those given to the payor except that the assurance of the validity of the drawer's signature is absolute and several other matters are included, the most important of which is an undertaking to take up any item which may be dishonored.⁵⁵

The matter of enforcing the warranties may be greatly simplified, since each party making a warranty may be held on his undertaking without joining intervening parties and he remains liable on his warranties even after remittance of the proceeds has been made.⁵⁶ However, the liability

51. This warranty is limited so as to render the practice of acceptance or certification of an instrument "as drawn" ineffectual. In the case of an instrument which has been accepted, a holder in due course and acting in good faith, warrants against alterations only if he held the instrument prior to acceptance. § 400.4-207(1)(c), RSMo 1963 Supp. Similar provisions apply to transfers and presentments outside the bank collection channels. § 400.3-417(1)(c), RSMo 1963 Supp. A party who transfers an item after learning of an alteration or of a forged signature would not be acting in good faith and, therefore, would be liable to the payor.

52. This warranty is also limited in that it is not given by a holder in due course acting in good faith to the maker or drawer of an instrument, or to the acceptor, when the holder in due course took the instrument after acceptance. § 400.4-207(1)(b), RSMo 1963 Supp. Similar provisions apply to transfers and presentment outside the bank collection channels. § 400.3-417(1)(b), RSMo 1963 Supp.

53. 3 Burr 1354, 97 Eng. Rep. 871 (1762).

54. *National Bank v. First Nat'l Bank*, 141 Mo. App. 719, 125 S.W. 513 (Spr. Ct. App. 1910).

55. Other warranties are (1) that no defense of any party is good against the party making the warranty, and (2) that he has no knowledge of any insolvency proceedings instituted against the maker or acceptor or the drawer of an unaccepted item. § 400.4-207(d),(e), RSMo 1963 Supp.

56. "Further, the warranties and engagements run with the item with the result that a collecting bank may sue a remote prior collecting bank or a remote customer and thus avoid multiplicity of suits." Comment 2 to UCC § 4-207 (1962).

of any party on a warranty cannot exceed the amount of consideration he received plus finance charges and expenses.⁵⁷ Unreasonable delay in making claim on a warranty after the breach is discovered results in discharge of the person liable to the extent that he has suffered loss through the delay.

E. *Payment*

The point of time in the collection process that an instrument is paid has often proved critical. When payment is made, the drawer's liability on the instrument is satisfied. In exchange, the drawee bank becomes accountable to the owner of the instrument. In the event of the payor bank's insolvency, whether the events constituting payment have occurred prior to the suspension of payments determines which party, the drawer or the payee, must bear the loss even though no remittance of the proceeds has been made. Not only is payment the pivotal event for determining the loss between the buyer in a commercial transaction (drawer) and the seller (payee), it is the point against which directives not to pay the check and competing claims on the account must rush. An attachment, a stop payment order or the exercise of a right of set-off by the bank itself comes too late if the check has been paid.⁵⁸

At first glance the identification of the acts amounting to payment would seem a simple matter.⁵⁹ The situation comes to mind of the individual holder presenting a bill of exchange to the drawee's clerk (preferably, a clerk perched on a high stool and wearing a green eye shade), who can make an examination of the instrument and his books on the spot and count out the money if he determines to pay. But this situation has little resemblance to the circumstances of presentment and payment in modern banking operations. Examination of the check to make sure that it is in proper form, that there are sufficient funds in the account, that the order to pay has not been countermanded, that there is no competing claim on the funds which must be respected; making entries to the account; and stamping the check "paid" may take the check through several operational

57. § 400.4-207(3), RSMo 1963 Supp. Cf. § 400.3-217, RSMo 1963 Supp., where liability is not limited and which is broad enough to apply in these cases. But in case of conflict the provisions of Article 4 control. § 400.4-102(1), RSMo 1963 Supp.

58. Payment does not end all rights of the drawee to recover on the check, as the warranties made by prior parties are designed to be effective after payment. Payment does, however, end any question as to whether the bank will pay the particular check or apply the credit in the depositor's account to some competing purpose.

59. Different actions which have been held to constitute payment are discussed in Malcolm, *Article 4—A Battle with Complexity*, 1952 Wis. L. Rev. 265.

areas. When a bank uses a processing center, checks may even be carried to other premises.⁶⁰ To pick one action out of this multistep operation, as has been the tendency with marking the check "paid"⁶¹ and say that precisely at this point payment occurs would inhibit development of new procedures which might reasonably combine the designated pivotal action with other steps. Article 4 has wisely broken down the monolithic concept of the act of making payment into "the process of posting."⁶²

Payment of a check in the broader sense of substituting accountability to the payee for that of the payor bank to the drawer involves elements of both action and time. In determining what actions constitute payment the question arises whether payment can occur through inactivity.

The growing volume of checks to be processed coupled with the shortages of bank personnel which occurred during World War II brought assembly line techniques to the banking industries. Under arrangements to provide bulk handling, checks coming in from various sources, by mail or through the clearing house, were accumulated so that they could be processed at one time, often on the day following receipt,⁶³ in keeping with established work routines. In order to allay fears that resulting delays might make a payor bank accountable for a check before it had reached its decision

60. When the operations of determining to pay checks and posting to the drawers' accounts are conducted away from the bank's premises, presentment directly to the processing center can be authorized. § 400.4-204(3), RSMo 1963 Supp.

61. *Maget v. Bartlett Bros. Land & Loan Co.*, 226 Mo. App. 416, 41 S.W.2d 849 (K.C. Ct. App. 1931); *cf. Rock Island Plow Co. v. Perry*, 224 Mo. App. 639, 20 S.W.2d 956 (Spr. Ct. App. 1929) (a check was not paid by marking it "paid" if no remittance was sent); *German-American Bank v. Third Nat'l Bank*, 10 Fed. Cas. 253 (No. 5359) (C.C.D.Mo. 1878) (sending a remittance draft was only a provisional payment; payment occurred when the remittance was paid).

62. § 400.4-109, RSMo 1963 Supp. The process of posting means the usual procedure followed in (1) reaching the determination to pay and (2) recording payment. Inclusion of this definition in the 1962 Official Draft of the Uniform Commercial Code puts at rest an interesting question concerning the meaning of "process of posting." Checks are often posted by machine to the drawers' accounts even though an overdraft may be involved. After the routine posting has been completed, the matter will be considered by a bank official to determine whether the overdraft should be accepted. If "process of posting" were read to refer to the mechanical acts, the check would be paid before it was referred to the official. Griffiths, *Bank Deposits and Collections Before and After the Uniform Commercial Code*, 23 OHIO ST. L. J. 236 (1962). On the contrary, it was suggested that the process of posting involves decisional as well as mechanical aspects. Huggins & Phemister, *The Illinois Uniform Commercial Code: Article 4—Bank Deposits and Collections*, 50 ILL. B. J. 838 (1962).

63. For a discussion of deferred posting see Brome, *Bank Deposits and Collections*, 16 LAW & CONTEMP. PROB. 308 (1951); Leary, *Deferred Posting and Delayed Returns—The Current Check Collection Problem*, 62 HARV. L. REV. 905 (1949).

to pay or dishonor, "deferred posting" was authorized by statute in many states⁶⁴ and by the Federal Reserve regulations.⁶⁵

Authority for deferred posting is continued under section 400.4-301. Except in the case of an item presented over the counter for immediate payment (in which case the bank must act expeditiously—work patterns or no), a bank may take until its midnight deadline (midnight of the next banking day) to decide whether to pay or dishonor the check. In the case of "on-us" items deposited with a bank for credit on its books this right follows as a matter of course; but where checks are received from collecting banks the payor must make an authorized provisional settlement before midnight on the day of receipt to be entitled to return dishonored checks during the next banking day.⁶⁶ This does not mean that a bank has a period up until its midnight deadline during which it may "unpay" any checks it decides it would prefer not to have paid. Once a decision for payment has been made and carried through, the deferred posting period is irrelevant.

Within this limitation, payment occurs (other than where an item presented over the counter is paid in cash) (a) when the payor bank has given a settlement which it has no right to revoke; (b) when its right to revoke has expired, as might be the case under a clearinghouse agreement providing for finality of settlements within a shorter time than the midnight deadline; or (c) when it has completed the process of posting the item to the drawer's account.⁶⁷ Generally, the same standards determine when a stop payment order, notice of a competing claim, or the exercise of a right of set-off comes too late to halt payment—but with the additional requirement that the set-off must be exercised, or the notice must arrive, in sufficient time to allow the bank a reasonable opportunity to act before the process of posting is completed and also before the bank "has evidenced by examination of the indicated account and by action its decision to pay the item."⁶⁸ The draftsmen make it clear that evidencing a "decision to pay" is not intended to refer to preliminary and provisional actions but to a determination which leaves only the technicalities to be completed.⁶⁹ The reason for establishing this penumbra of payment is not entirely clear. While the item remains unpaid as far as discharging the drawer and rendering the

64. See, e.g., § 402.050, RSMo 1959.

65. 12 C.F.R. § 210.5(d) (1963).

66. A settlement other than one approved by § 400.4-207(1), RSMo 1963 Supp., or otherwise agreed to by the presenting bank would not be an "authorized" settlement and would not give the payor bank the privilege of deferred posting.

67. § 400.4-213, RSMo 1963 Supp.

68. § 400.4-303(1)(d), RSMo 1963 Supp.

69. Comment 3 to UCC § 4-303 (1962).

drawee bank accountable, it is insulated from all claims and vicissitudes except the possibility of the drawee bank's insolvency. Perhaps this may be justified as providing a more easily applied rule for apportioning loss between the drawer and the owner of the check when, in the context of an insolvent bank, the evidence of the decisional processes may be hard to find.

Section 400.4-303(2) contains an important provision allowing a bank to accept, pay or certify checks on the account of a particular drawer in any order which it finds convenient. The former rule, that a bank must act upon checks in the order in which they are received,⁷⁰ becomes unworkable when checks arriving from different sources are accumulated for handling according to work schedules and are processed by electronic equipment.

F. *Settlement and Remittance*

Depending upon the type of instrument which is being handled, payor banks may account to presenting banks, and collecting banks to prior banks or to the depositor in one of two methods. Under the simpler method (known as "non-cash" collection) no settlement is made until after the instrument is paid. Each bank receives the item from the prior party with the understanding that it will make settlement with its transferor as soon as it has received the proceeds from the party to whom it has in turn transferred the instrument. The instrument moves forward through the collection chain from the depositary to the payor and the proceeds move backward in exactly reverse order. Under the "cash" collection procedure, used in the collection of checks (thus accounting for the greater part of the volume passing through the bank collection system), the journey of items and proceeds is reduced to a one-way trip except in the case of a dishonored item. Working on the assumption that over ninety-nine and one-half per cent of all checks are paid on the first presentation, each bank, when it receives an item from a prior bank, makes a provisional settlement with that bank with the understanding that if the instrument is not paid the provisional settlement will be reversed. If all goes well and the check is paid, the provisional settlements become final without further notice or action by anyone. Silence means a successful collection. There are no firm time limits for converting provisional settlements into final ones,⁷¹ though, as a matter of operating practice, the Federal Reserve Banks and other intermediate col-

70. *Louisville & N. R.R. v. Federal Reserve Bank*, 157 Tenn. 497, 10 S.W.2d 683 (1928).

71. When a settlement becomes final is important in determining when the depositor is entitled to draw against his deposit as of right, § 400.4-213(4), RSMo 1963 Supp. The question may become involved in whether a subsequent check drawn by the depositor has been wrongfully dishonored.

lection banks establish availability schedules for funds based partly on the normal length of time needed for presentment. In the case of an instrument which has been misrouted by electronic processing equipment, the settlement may remain provisional for an extended length of time.

In making settlements, banks may use either a remittance (either cash or an instrument) or accounting entries giving the transferor credit on the payor's books or on the books of the subsequent collecting bank, or conversely, charging the transferee's account on the books of the transferor. The difficulty arises if the bank making the remittance becomes insolvent and the remittance is dishonored. In such an instance, is the bank accepting a remittance instrument entitled to turn to the depositor or to prior collection banks and express its regret at being unable to complete the collection, or is it to be considered liable for the amount of the remittance? Should the risk of non-collection of a remittance instrument, as well as the original check, rest with the depositor or should it fall on the collecting bank? Where the collecting bank accepts a credit to its account with the insolvent bank, it is clear that the collecting bank has received payment; the funds have come to rest where the collecting bank chooses to keep them.⁷² But a remittance draft, even if drawn on a bank which is a correspondent of the collecting bank, or an authorization to charge the payor's account with the collecting bank requires its own acceptance of the authority to charge or the acquiescence of the drawee of the remittance draft before the funds come to rest where the collecting bank wants them.

The rule developed in the cases was that a bank's agency authorized it to accept nothing but cash in exchange for an instrument; and if it accepted any other type of remittance, it was as liable to prior parties as if it had insisted on and obtained cash.⁷³ Thus, all risk that a remittance instrument might not be paid was placed on the collecting bank. The impracticality and expense of transporting innumerable small bags of money around the country had the result of transforming collecting banks into guarantors of remittance instruments. This situation was changed by the Bank Collection Code which provided that the collecting bank might receive "the check or draft of the drawee or payor bank upon another bank or the check or draft of any other bank upon any bank other than the drawee or payor of the item or such method of settlement as may be cus-

72. *Maget v. Bartlett Bros. Land & Loan Co.*, *supra* note 61.

73. *Federal Reserve Bank v. Malloy*, 264 U.S. 160 (1924); *German-American Bank v. Third Nat'l Bank*, *supra* note 61; *Midland Nat'l Bank v. Brightwell*, 148 Mo. 358, 49 S.W. 994 (1899); *National Bank of Commerce v. American Exch. Bank*, 151 Mo. 320, 52 S.W. 265 (1899); *Landa v. Traders' Bank*, 118 Mo. App. 356, 94 S.W. 770 (K.C. Ct. App. 1906).

tomary in a local clearinghouse or between clearing banks or otherwise" without becoming responsible as a debtor.⁷⁴ This permission continues under section 400.4-211 which gives the collecting bank authority to accept the check of the remitting bank or another bank on any bank except the remitting bank or an authority from the remitting bank to charge its account or another bank's account with the collecting bank. Cashiers checks or certified checks or other bank obligations are acceptable when the payor is a person other than a bank; a bank's own obligation is acceptable when the remitting bank and the collecting bank clear through the same clearing house or group. This last provision is not included to allow a bank to substitute one primary obligation for another, but because this may be the most expeditious means of obtaining the funds, where both banks exchange checks through the same clearinghouse. If a bank goes beyond the types of instruments approved in the statute (or, presumably, by modifying agreements) and authorizes remittance in a different manner, it is liable to the same extent as if it had received cash if the remittance instrument proves uncollectable.⁷⁵

While a collecting bank is protected in following the commercial necessity of accepting a recognized type of remittance draft, it is placed under the duty of acting promptly to secure its payment. This is an area where detailed provisions are new. If a bank allows the midnight deadline to pass without deciding whether to honor an authorization to charge the remitting bank's account, or without forwarding a remittance instrument for collection, the settlement becomes final and the collecting bank is answerable to its transferor. However, if the collecting bank acts within the time period permitted to collect the remittance instrument (and this applies to an unapproved type of remittance not authorized by the collecting bank, on the theory that the depositor's interest would be better served by trying to collect the irregular remittance instrument), it does not become liable for the amount of the remittance until it receives a final settlement for the remittance instrument. The process could become extended: if, for instance, the remittance draft is on a third bank which is also not a correspondent of the collecting bank, it may be paid by another remittance draft on yet a fourth bank. This situation can be prolonged almost at will, but the point when the collecting bank's liability for having received a final settlement for

74. §§ 402.090—.100, RSMo 1959.

75. § 400.4-211(3)(b), RSMo 1963 Supp. A collecting bank authorizing an unapproved remittance is accountable for the amount involved from the time the remittance is received.

the original item arises is not reached until the credit has come to rest in a place acceptable to the collecting bank.⁷⁶

In a collection of a particular item both credits and the remittance drafts may be employed, as where all banks prior to the presenting bank have given provisional credit for items but, because the presenting bank and the payor bank are not correspondents, the payor bank returns a remittance draft on its city correspondent. The payment of the remittance draft results in final settlement being received by the presenting bank which in turn has the instantaneous chain reaction effect of causing all the provisional credits given by prior collecting banks to become final.

G. *Return of Dishonored Checks*

For the one-half of one per cent of checks which are not paid on presentation, current banking practices dictate that they shall retrace their path bank by bank until they are returned to the bank of deposit and charged back to the depositor. As an alternative, and admittedly novel, means of handling dishonored items, section 400.4-212(2) provides that the payor bank or an intermediary collecting bank may return an unpaid item directly to the depository bank. If the returning bank has settled for the unpaid item, it may recover the amount by sending a draft on the depository bank, which, if it has received a provisional settlement, must reimburse the returning bank. All provisional credits which have been given throughout the chain of collection are allowed to become final.

The practice of direct returns was advocated as a method of shortening the time needed to get notice to the depository bank that an item will not be paid. The advantages to be realized over present procedures may not be striking because of the current practice of sending a telegraphic notice of nonpayment when the amount of the dishonored instrument is \$1,000 or more.⁷⁷ Direct returns do not promise a substantial reduction in the number of steps of the collection system, since collecting a draft for reimbursement from the depository bank would require the intervention of a number of banks substantially equal to that required to return the unpaid check. Other problems with regard to direct returns remain unresolved, including the rights of a payor bank to look to the intermediate collecting banks if the expected remittance from the depository bank does not materialize.⁷⁸

76. § 400.4-211, RSMo 1963 Supp.

77. See the uniform instructions of the Federal Reserve Banks, Operating Letter No. 9 of the Federal Reserve Bank of St. Louis, September 1, 1964, p. 9.

78. The problems are discussed in CLARKE, BAILEY & YOUNG, *BANK DEPOSITS AND COLLECTIONS* 102 (3rd ed. 1963).

Notwithstanding the difficulties, the concept of direct returns offers a key to electronic handling of dishonored checks should the volume of return items become great enough to make automation imperative.

Encoding the identification of each collecting bank in a manner which could be machine "read" selectively so as to allow return through the collection chains is beyond the competence of present equipment. However, the bank which encodes the initial amount (frequently not the depository bank and there is no present authorization for direct returns to an intermediate bank) could encode its own transit number in a separate field which could be "read" in directing the return. Probably the advantages of automating the return desk will be outweighed by the unresolved difficulties until there is a far reaching reassessment of the role of intermediate collecting banks, and direct returns will remain an instance where the ingenuities of innovators is over-balanced by the weight of established procedures.

II. THE PAYOR BANK AND ITS CUSTOMER

The focus of Article 4, Part 4, shifts to the rights and the obligations which arise between a bank and its customer from the bank's action in paying or not paying checks drawn on the depositor's account.⁷⁹ An exhaustive treatment of the relationship involved in a checking account is beyond the scope of Part 4. It is concerned with the circumstances under which a bank may properly charge its customer's account for the amount of checks it has paid, the responsibilities which rest upon the depositor to help his bank discover errors and the liabilities which are incurred by the bank through improper payment or refusal to pay.

A. *The Bank's Authority to Pay*

A bank which pays a check expects to charge the drawer-depositor's account for the amount which it has disbursed or for which it has become liable. Although in some instances, extraneous factors, such as the depositor's own negligence,⁸⁰ the passage of time,⁸¹ or his inability to show that he has suffered any loss⁸² may preclude the depositor from objecting to the charge, the question of whether a bank is entitled to charge the depositor's account usually turns upon whether it has acted within the authority its depositor has given it. This involves a consideration of the scope of the

79. It has been argued that the provisions of Part 4 are not properly included in the Uniform Commercial Code. Maldom, *Article 4—A Battle with Complexity*, *supra* note 59.

80. § 400.3-406, RSMo 1963 Supp.

81. § 400.4-404, RSMo 1963 Supp.

82. § 400.4-403, RSMo 1963 Supp.

authority—was the particular check which the bank paid one which comes within the general or specific instructions, expressed or implied, given by the depositor as to the type of instrument which the bank is to pay?—and a question of time—was the authority given by the depositor still operative at the time the bank made payment?

The basic rule that a bank is entitled to reimbursement for payment made in accordance with the depositor's instructions is stated obliquely in section 400.4-401 which provides that a bank may charge the customer's account for any item which is otherwise properly payable even though an overdraft is created.⁸³

1. Incomplete and Altered Checks

Difficulties arise when a bank has paid a check which, although not a forgery, does not conform strictly to the instructions issued by the depositor. This situation may occur when the check left the drawer's possession signed but otherwise incomplete and was subsequently completed in an unauthorized manner, or where the check has been materially altered. In most instances, the difference between these two situations is likely to be no more than whether the amount line of a check was left completely blank or whether enough space was left in the amount as written to permit it to be raised. In either case, whether the bank or its customer must bear the loss turns upon whether the customer acted with reasonable care and whether the payor bank acted in good faith and in accordance with reasonable commercial practice. Signing blank checks can scarcely be squared with reasonable care. Consequently, an item which has left the drawer's possession uncompleted can be charged to the drawer's account according to its terms as subsequently completed unless the bank has notice that the completion was improper.⁸⁴

83. The Official Comment is more explicit: "It is fundamental that upon proper payment of a draft the drawee may charge the account of the drawer." Comment 1 to UCC § 4-401 (1962). *Stone & Webster Eng'r Corp. v. First Nat'l Bank*, 345 Mass. 1, 184 N.E.2d 358 (1962). Under Missouri cases, an overdraft made the customer the debtor of the bank. *Vandagriff v. Masonic Home of Missouri*, 242 Mo. 138, 145 S.W. 448 (1912); *Bank of Darlington v. Atwood*, 225 Mo. App. 974, 47 S.W.2d 1097 (K.C. Ct. App. 1930). Cf. *S. S. Allen Grocery Co. v. Bank of Buchanan County*, 192 Mo. App. 476, 182 S.W. 777 (K.C. Ct. App. 1916) (when an overdraft is involved, a bank purchases rather than pays a check).

84. The rule under the Uniform Negotiable Instruments Law, § 401.015, RSMo 1959, that an uncompleted and undelivered instrument is not a valid contract in the hands of any holder, is reversed in the Uniform Commercial Code: §§ 400.3-115, 3-407, RSMo 1963 Supp. Missouri cases reached results similar to those indicated under the Uniform Commercial Code. *World Tire Corp. v. Mutual Bank & Trust Co.*, 174 S.W.2d 230 (St. L. Mo. App. 1943) (the provision that an uncompleted, undelivered instrument is not a valid contract has no application

When a check turns out to have been materially altered, a bank which has paid it in good faith may charge the drawer's account in accordance with the original tenor of the item.⁸⁵ The bank's position is amplified when this rule is read together with section 400.3-406, declaring that a drawer whose negligence has substantially contributed⁸⁶ to the alteration is precluded from asserting it against a drawee who pays in good faith and in accordance with reasonable commercial practice. In view of the growing reliance upon electronic equipment in posting checks, it is probable that an alteration which escapes the depository bank and the bank encoding the amount of the check will be paid under circumstances meeting the latter conditions.

2. Stale Checks and Stop Payment Orders

The authority of a bank to make payment may be affected either by the passage of time during which a particular item has been outstanding or by the occurrence of specific events which terminate the bank's authority either as to particular items or generally as to all outstanding items of the drawer.

Under the case law, a check bearing a date many months before presentment placed a bank in a dilemma of deciding whether it should make payment and run the risk that a court might decide the check was stale and that consequently the bank was under a duty to inquire as to its right to pay,⁸⁷ or to refuse payment and risk the drawer's complaint with which another court might agree, that the check was wrongfully dishonored. Missouri statutes settled the matter by providing that a bank incurred no liability in refusing to pay a check presented more than one year after its

between the drawer and his bank); *S. S. Allen Grocery Co. v. Bank of Buchanan County*, *supra* note 83 (drawer estopped by negligence from denying validity of instrument).

The question of what action a bank may take if it receives notice of an unauthorized completion after it has become accountable for the check but before it has charged the drawer's account is resolved by § 400.4-303, RSMo 1963 Supp., which provides that any notice received by a bank after it becomes accountable for an item comes too late to affect the bank's right to charge the customer's account.

85. On similar rights of a holder in due course, see § 400.3-407(3), RSMo 1963 Supp.; *cf.* § 401.124, RSMo 1959.

86. When negligence substantially contributes to a forgery, the drawer may also be barred from asserting that defect. In the case of an alteration, apparently a drawee bank could elect to waive its claim for negligence against the drawer and sue prior parties on their warranties under § 400.4-207, RSMo 1963 Supp.; *cf.* § 400.4-407(5), RSMo 1963 Supp.

87. PATON, *DIGEST OF LEGAL OPINIONS* 1107 (1942). *Goldberg v. Manufacturers Trust Co.*, 199 Misc. 167, 102 N.Y.S.2d 144 (Mun. Ct. N.Y. 1951) (a stale check places a duty on the bank to inquire before payment).

date unless expressly instructed to make payment.⁸⁸ The period within which a check becomes "stale" will now be reduced to six months.⁸⁹ More importantly, a drawee bank is now given explicit authority to pay "stale" checks provided it acts in good faith. Since magnetic ink encoding does not show the date of checks, many banks may look to this permission as relieving them of making visual inspection of the date of all checks and it is likely that an increasing number of stale checks will be routinely paid. A drawer who does not want a long outstanding check paid would be well advised to give his bank explicit instructions.

Termination of the authority to pay a specific item also occurs through the countermand of the instructions from the drawer. Stop payment orders, which Lord Ellenborough somewhat expansively described as converting the check into a "piece of waste paper" as far as the payor bank was concerned,⁹⁰ have generally been a source of vexation to banks. The trouble involved in observing them is likely to be out of proportion to any charge the bank can make. Nevertheless, the draftsmen of the Code have concluded that the right to stop payment on an outstanding check "is a service which depositors expect and are entitled to receive notwithstanding its difficulty, inconvenience and expense."⁹¹ The privilege of stopping payment is, however, limited to the drawer of the item.⁹²

Stop payment orders may be either oral or written; an oral order binds the bank for fourteen days, and a written order, for six months.⁹³ All extensions must be in writing and are binding for six months. Although the length of time of the effectiveness of oral stop payment has been re-

88. §§ 362.370, 363.610, RSMo 1959.

89. § 400.4-404, RSMo 1963 Supp.

90. *Wienhold v. Spitta*, 3 Comp. 376, 170 Eng. Rep. 1416 (1813). For a discussion of stop payment orders, see Morrison & Sneed, *Bank Collections: The Stop Payment Transaction—A Comparative Study*, 32 TEXAS L. REV. 259 (1954); Comment, 20 U. CHI. L. REV. 667 (1953).

91. Comment 2 to UCC § 4-403 (1962).

92. Several Missouri cases involve circumstances where payment was refused by a bank because the payee or a subsequent holder had requested the drawee to stop payment. *Farmers' Exch. Bank v. Farm & Home Savings & Loan Ass'n*, 332 Mo. 1041, 61 S.W.2d 717 (1933); *Bank of Aurora v. Fruit Growers' Union*, 52 S.W.2d 574 (Spr. Mo. App. 1932). These could be explained by reasoning that the owner had revoked the agency of the collecting banks. *But see* § 400.4-203, RSMo 1963 Supp., making a bank answerable only to the instructions of its immediate transferor. The payee who wishes to prevent payment may have a remedy under § 400.3-603(1), RSMo 1963 Supp.

The Uniform Commercial Code broadens the right to give stop payment orders to include not only the drawers of checks, but also the makers of any other instrument payable at a bank.

93. § 400.4-403, RSMo 1963 Supp.

duced,⁹⁴ in practical operations and litigation, the oral stop payment order may be expected to continue to be the customary practice. The situation where a stop payment order will be given is often one where the buyer-drawer, either with or without good reason, has become disenchanted with his bargain and would prefer to have the money in his hands while he and the seller squabble or litigate. Very likely the payee will not be unaware of his feelings, and there is apt to be a race between the drawer and the payee to see who can make it to the payor bank first.⁹⁵ While a stop payment order must be given "at such time and in such manner as to afford the bank a reasonable opportunity to act," no provision is made for solving the operating problems of what information must be contained in a stop payment order, how the drawee bank can assure itself that its customer is on the other end of the phone or how a drawee bank can establish, in a dispute with its depositor, that an oral stop payment order was never received.⁹⁶ The customer has the burden of establishing the amount of his loss when a stop payment order has not been honored.⁹⁷

3. Death or Incompetency

A bank's authority to pay the checks of a depositor is, according to the general rules of agency, terminated when the depositor dies or becomes incompetent.⁹⁸ Section 400.4-405 restates and refines this rule, making it plain that bank officers need not read the obituary columns or draw the line between eccentricity and lunacy at their peril. The bank's authority to pay checks is not revoked until it has actual knowledge of death or of an adjudication of incompetence. An adjudication of incompetence does not

94. §§ 362.365, 363.600, RSMo 1959. While the statutes are not explicit, an initial stop payment order can probably be either oral or in writing. See, Committee On Legislative Research General Assembly of the State of Missouri, *Proposed Uniform Commercial Code: Its Effect Upon Cognate Missouri Statutes*, 192 (1954).

95. "The order must be received in such time and in such manner as to afford the bank a reasonable opportunity to act. . . ." § 400.4-403(1), RSMo 1963 Supp.; cf. *Albers v. Commercial Bank*, 85 Mo. 173 (1884) (bank has burden of proving that stop payment order was not timely).

96. The problem may be aggravated because a bank cannot rely upon exculpatory agreements which it may have in its contract with its depositor and which might be considered as relieving the bank of its duty to use ordinary care. A bank may still be able to include exculpatory clauses in cases where the stop payment order is missed because the amount of the check was erroneously encoded and thus was able to escape detection in electronic processing.

97. Some consolation for banks is found in *Dinger v. Market Street Trust Co.*, 69 Dauph. 236, 7 Pa.D. & C.2d 674 (C.P. 1956) (the customer alleging a stop payment must show when it was given and to whom).

98. *Fisher v. Bagnell*, 194 Mo. App. 581, 186 S.W. 1097 (St. L. Ct. App. 1916); *Lewis v. International Bank*, 13 Mo. App. 202 (St. L. Ct. App. 1883).

have the effect of providing constructive notice. In this respect, the present Missouri rule is continued.⁹⁹

Section 400.4-405 introduces a new rule for Missouri. Following the satisfactory experience of a number of state statutes, provision is made that a bank may, even after it is aware of the death of its customer, continue to pay his checks¹⁰⁰ for ten days following the date of his death. "The justification is that such checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank."¹⁰¹ This authority is permissive and imposes no obligation upon the drawee bank to pay any check. While this provision is not intended to prevent an executor or administrator from recovering payments from the party who has received them or stop any interested party from questioning the validity of a transfer in contemplation of death, a bank would render better service in suspicious circumstances, or where unusual amounts are involved, by refusing payment on the check and leaving the holder to file a claim in probate. Furthermore, a bank's authority to pay after the death of the depositor can be terminated by any person claiming an interest in the estate. The bank is not called upon to determine whether or not his claim is justified.

B. Responsibilities of the Customer

The ability of a bank customer to compel his bank to recredit his account depends upon his compliance with two time limits for discovering and reporting irregularities.¹⁰² First, after his paid checks are made available to

99. *Caldwell v. First Nat'l Bank*, 283 S.W.2d 921 (St. L. Mo. App. 1955). RESTATEMENT (SECOND), AGENCY § 120 (1958).

100. See PATON, *op. cit. supra* note 87 at 1085. Leary, *Article 4: Bank Deposits and Collections Under the Uniform Commercial Code*, 15 U. PITT. L. REV. 565 (1959).

The authority to continue payment after knowledge of the drawer's death is limited to checks.

101. Comment 3 to UCC § 4-405 (1962).

102. § 400.4-406, RSMo 1963 Supp., differs from the present statute, § 401.201, RSMo 1959, in that:

(a) unauthorized indorsements as well as unauthorized signatures are covered. *But see*, *Royal Indem. Co. v. Poplar Bluff Trust Co.*, 223 Mo. App. 908, 20 S.W.2d 971 (Spr. Ct. App. 1929); *contra* *American Sash & Door Co. v. Commerce Trust Co.*, 332 Mo. 98, 56 S.W.2d 1034 (1934) (no duty to examine indorsements);

(b) all items paid by a bank, not merely checks are included;

(c) holding paid items and giving notice becomes an acceptable procedure only if it is requested by the customer or is reasonable under the particular circumstances, *e.g.*, when the whereabouts of the customer are unknown;

(d) the period in which the customer can object is less than the stated maximum when it can be shown that the customer failed to act with reasonable care and promptness. *But see*, *Ward v. First Nat'l Bank*, 224 Mo. App. 472, 27 S.W.2d

him (through returning them, or holding them in accordance with his instructions, or in some other reasonable manner), he must exercise reasonable care and promptness to discover and report his unauthorized signature and any alterations.¹⁰³ Second, regardless of the care or negligence with which he acts, he is precluded from making a claim after the passage of certain stated periods.¹⁰⁴

With regard to a particular item in dispute, if the payor bank can establish that the customer has not acted with reasonable promptness and care and that as a consequence it has suffered a loss, the customer is precluded from asserting that his signature was unauthorized or that there was an alteration. The problem which confronts a bank in this situation is to establish that the customer's failure to report is causally related to the loss it has suffered. When a bank pays on an unauthorized signature, the loss results from its initial delusion in making the improper payment, rather than from the customer's failure to find the irregularity promptly, except in the unlikely circumstance that the delay has deprived the bank of recourse against a solvent culprit. In cases where an alteration is involved, the same considerations apply except that the payor bank often has the added possibility of avoiding loss through enforcement of its guarantee against material alterations upon prior collecting banks.

In addition, if the same wrongdoer has put through other items bearing unauthorized signatures or alterations which have been paid by the bank between the time when the first improper one has been available to the customer for a reasonable period (fourteen days is conclusively presumed to be a reasonable period and a lesser time may be) and the time when the bank receives notice of the irregularity, the customer cannot complain about those payments. The reasoning behind this provision is that alerting the bank to the existence of improper practices is an excellent protection against their repeated success.¹⁰⁵ There is no requirement that

1066 (Spr. Ct. App. 1930) (the statute does not relieve a customer of the need to act diligently); *Kenneth Inv. Co. v. National Bank of the Republic*, 103 Mo. App. 613, 77 S.W. 1002 (St. L. Ct. App. 1903) (depositor must examine vouchers within a reasonable time, but is not estopped if bank was also negligent); *McKeen v. Boatman's Bank*, 74 Mo. App. 281 (St. L. Ct. App. 1898); *Wind v. Fifth Nat'l Bank*, 39 Mo. App. 72 (St. L. Ct. App. 1899) (forged indorsements).

103. § 400.4-406(1), RSMo 1963 Supp.

104. § 400.4-406(4), RSMo 1963 Supp.

105. "One of the most serious consequences of failure of a customer to comply with the requirements of subsection (1) is the opportunity presented to the wrongdoer to repeat his misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine his statement and notify the bank of any unauthorized signature or alteration so that the bank will be alerted to stop paying further items." Comment 3 to UCC § 4-406 (1962).

the bank be misled through reliance on the first signature when it decides to pay the later items. In either of these cases the customer may reply by showing that the bank failed to exercise ordinary care in paying the item.

However, without regard to the negligence or impeccable care of either the payor bank or its customers, claims arising out of payment of an item bearing an unauthorized signature of the customer or an alteration are barred if not asserted within one year after the paid items are made available; in addition, claims based on an unauthorized indorsement are barred if not asserted within three years. The reason given for the unqualified termination date as to indorsements, even though the customer may have no way of learning of the forgery until the payee complains, is that "the balance in favor of a mechanical termination of the liability of the bank outweighs what few residuary risks the customer may still have."¹⁰⁶

The final provision of section 400.4-406 is tailored to put an end to the practice whereby a payor bank, motivated by business judgment and the desire to maintain good customer relations, decides to waive the defense of its customer's tardiness and sue prior collecting banks for breach of their warranties of valid indorsements.¹⁰⁷ It is provided that a payor bank which waives or fails upon request to assert a valid defense against its own customer cannot assert a claim based on the unauthorized signature or alteration against any prior party.¹⁰⁸

With the development of check handling by electronic equipment, the important question is apt to become whether the customer is under any duty to examine his checks or his bank statement to discover errors made somewhere along the collection path in encoding the amount of his check

106. Comment 5 to UCC § 4-406 (1962). The bank's liability to persons other than its customer is not "mechanically" terminated according to this time schedule. Payment of a check bearing a forged indorsement constitutes conversion of the property of the true owner. § 400.3-419(1)(c), RSMo 1963 Supp.; *Good Roads Mach. Co. v. Broadway Bank*, 267 S.W. 40 (K.C. Mo. App. 1924). An aggrieved payee can be expected to raise his claim against the payor bank at least as readily as he will against the drawer who may have no liability for his loss.

107. *National Sur. Corp. v. Federal Reserve Bank*, 188 Misc. 207, 70 N.Y.S.2d 636 (Manhattan Munic. Ct. 1946), *aff'd* without opinion, 188 Misc. 213, 70 N.Y.S.2d 642 (Sup. Ct. 1946). See Clarke, *Bank Deposits and Collections*, 16 ARK. L. REV. 45 (1961).

108. § 400.4-406(5), RSMo 1963 Supp. Query whether this provision may not involve some difficulty where a customer has delayed unreasonably in reporting material alterations. "Loss" as used in the requirement of § 400.4-406(2)(a), RSMo 1963 Supp., that a bank must establish that it has suffered, must mean a loss which cannot be recovered from other sources. In this circumstance the customer's claim can be resisted only if the bank has sustained a loss; the bank has sustained a loss only if the warranties are unenforceable; the warranties are unenforceable only if the customer's claim can be defeated.

and which have resulted in an overcharge to his account. It is doubtful that erroneous amount encoding in magnetic ink characters could be considered an alteration of the check which would bring it within section 400.4-406. The problem appears to be one for which a solution must be developed through bank-customer agreements.

C. *The Measure of the Payor Bank's Liability*

1. Wrongful Dishonor

A bank is under a duty to pay the checks of a depositor upon presentation if the account of the depositor is sufficient. A breach of this duty will render the bank liable for ensuing damages.¹⁰⁹ At common law a merchant or trader was presumed to have suffered damage to his reputation when his check had been wrongfully dishonored. Consequently, he could recover from the drawee without proving actual damages.¹¹⁰ This rule has been altered by statute in Missouri so that, except where malice is involved, the depositor's recovery is limited to the amount of actual damages he has alleged and can prove;¹¹¹ this changed rule is continued by section 400.4-402.¹¹² Whether arrest or prosecution of the depositor can be considered damages caused by the dishonor of a check has been a vexatious question. In Missouri such an occurrence was held too remote because it involved the independent judgment of the holder who could reasonably have been expected to investigate before taking drastic action.¹¹³ This position will now be reversed by a provision that "whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case."¹¹⁴

2. Subrogation for Improper Payments

In the reverse situation where a bank has paid a check contrary to its authorization, circumstances may combine to reduce the bank's liability.

109. *Farmers' Bank v. Moberly*, 229 Mo. App. 595, 78 S.W.2d 906 (K.C. Ct. App. 1935); *Johnson v. Farmers' Bank*, 223 Mo. App. 513, 11 S.W.2d 1090 (K.C. Ct. App. 1928); *Claxton v. Cantley*, 297 S.W. 975 (Spr. Mo. App. 1927).

110. *Third Nat'l Bank v. Ober*, 178 Fed. 678 (8th Cir. 1910).

111. § 401.200, RSMo 1959. Note that § 401.208, RSMo 1959, prevents recovery of damages on an inland bill if payment with interest and protest charges is made within 20 days. This provision will be repealed and no equivalent provision is contained in Article 4.

112. Wrongful dishonor creates liability only to the depositor and does not give a cause of action to the payee. See *Richardson v. Empire Trust Co.*, 230 Mo. App. 580, 94 S.W.2d 966 (K.C. Ct. App. 1936).

113. *Waggoner v. Bank of Bernie*, 220 Mo. App. 165, 281 S.W. 130 (Spr. Ct. App. 1926).

114. § 400.4-402, RSMo 1963 Supp.

To prevent either the customer-drawer or the holder of the check from being unjustly enriched, the bank is given certain rights of subrogation.¹¹⁵ Against the customer, the drawer is subrogated to the rights of any holder in due course or any rights which the payee or other holder may have had on the transaction which gave rise to the disputed instrument. Conversely, if the customer had a valid claim on the underlying transaction against the payee or other holder, the bank which has made an erroneous payment is subrogated to that claim. This ability to climb into the shoes of the party who is "in the right" provides substantial protection but it may not be the answer to all of the bank's worries. When it is impossible to join all the parties in one action, the bank may still find itself with the problem of deciding which shoes it wants and then convincing a court of the correctness of its decision.¹¹⁶ Possibility of double recovery is removed by the provision that the rights of subrogation exist only so far as necessary to prevent loss to the bank.

III. VARIATION BY AGREEMENT

Probably no other provision of Article 4 has drawn as much criticism as section 400.4-103 which permits the statutory rules for bank collections and deposits to be varied by agreements between banks and their customers or among banks.¹¹⁷ This authority is viewed by its critics as little better than a *carte blanche* in unreliable bankers' hands¹¹⁸ and even advocates of the enactment of the Uniform Commercial Code have expressed doubts as to the advisability of this provision.¹¹⁹

Clearly the past development of bank collection procedures has occurred through contracts and the growth of customs for handling and transmitting items among banks. A customer who avails himself of the service of his bank for collecting his checks has been presumed to agree to performance in keeping with the usual practices. Matters such as the time limits within which a bank must take action on an item which it receives for collection or for payment, the guarantees which a prior bank gives to the payor bank or to a subsequent collecting bank, the methods which may be used in transmitting instruments from one place to another, and the types of remittances which a bank may accept in payment of items

115. § 400.4-407, RSMo 1963 Supp.

116. Leary, *supra* note 100.

117. Cf. § 400.1-102(2), RSMo 1963 Supp., which deals generally with the power to vary the provision of the Uniform Commercial Code by agreement.

118. Beutel, *The Proposed Uniform (?) Commercial Code Should Not Be Adopted*, 61 YALE L. J. 334 (1952).

119. Gilmore, *Uniform Commercial Code: A Reply to Professor Beutel*, 61 YALE L.J. 365 (1952).

all were settled through agreements between the banks and their customers contained in deposit slips, passbooks or similar documents, clearinghouse rules and regulations of the Federal Reserve System.

The opponents of continuing and giving statutory recognition to such consensual arrangements argue that the revision and codification of the law dealing with bank collections afford an excellent opportunity to provide equitable rules for the settlement of future disputes. The bank customer who deposits his checks for collection is in no position to hammer out any agreements as to how his checks are to be handled even if he happens to be a lawyer with a passable understanding of how the collection system operates. The advocates of inflexible rules feared that the banking system might use its power to rewrite collection practices in a manner which would shift the possibilities of loss, even from bank negligence, onto the bank's customers.

The difficulty with this argument is that it requires a greater degree of omniscience that can be reasonably expected from legislative draftsmen. With the probabilities of even further substantial increases in the great volume of checks which are passing back and forth continuously, and with the initiation of radical changes in the mechanics of check procession, exact rules, perhaps appropriate for the present, may become the hobbles of new procedures.

The term "agreement" as used in section 400.4-103 contemplates a much wider range than the consensual arrangement between the bank and its customers. Federal Reserve regulations and operating letters, clearinghouse rules and similar arrangements are binding upon the depositor even though he has not given his express consent and may be unaware of their existence. Any agreement which may be entered into to vary the effect of the provisions of Article 4 is subject to the limitation that it cannot excuse a bank's liability for failure to act with good faith and exercise ordinary care or limit the damages which may be recovered for such failure. However, the agreement may establish the standard by which a bank's performance of its obligations is to be measured if such standard is not manifestly unreasonable.¹²⁰

Probably neither the efficacy or the dangers of the power to vary the rights and duties of the parties through agreement are as great as the advocates or opponents supposed. Any agreement would fall substantially short of being universal. Even the most inclusive—Federal Reserve regulations—would apply only to checks which are handled through the Federal Re-

120. § 400.4-103(1), RSMo 1963 Supp.

serve System. As a result, substantial variation by agreement could mean that the rules which apply to a particular check could vary with the happenstance of what collection route was employed and that the expected benefits of uniformity would be jeopardized. Agreements may hold the solution to meeting local problems or experimenting with minor innovations, but substantial alterations will probably have to depend upon statutory amendments. The trend in this regard is evidenced by the changes which have already been made to resolve some of the areas of suspected difficulty in Article 4.¹²¹

While the need for flexibility is evident in the high-volume, rapidly developing check collection operation, to what extent do similar considerations apply to the relations between the payor bank and its customer? Certainly automation holds as much promise for simplifying the posting of checks within a payor bank as it does for expediting collections between banks. As automation has progressed, banks rely more and more heavily on the machines and have tended to reduce manual examinations of checks.¹²² The risks which are inherent in such procedure are balanced against the economies a bank may hope to effect. In order to reach a sound business decision, it is important to know precisely what risks a bank is accepting if it decides to forego rigorous manual inspections. The danger that a forgery will be paid is an obvious risk, but other situations are less clear cut. In order to charge the customer's account with a stale check it has paid, a bank must have acted in good faith; the amount it can charge for an altered check depends upon whether the bank has acted in good faith and in accordance with reasonable commercial standards; and the bank's ability to complain if it suffers loss because its customer does not exercise reasonable care in the discovery and reporting of forgeries is lost if it can be shown that the bank itself did not use ordinary care in paying the forged item. The meaning of "good faith" is expressly stated.¹²³ "Reasonable commercial practice" and "ordinary care" remain subject to interpretation. It seems likely that in this area agreements between banks

121. §§ 400.4-109, 4-204(3), RSMo 1963 Supp. These 1962 amendments were intended to forestall possible difficulties in the meaning of "process of posting" and as to the validity of off-premises presentments. As to the latter point, see Clarke, *Electronic Brains for Banks*, 17 BUS. LAW. 532 (1962); Funk, *Presentment Under the Uniform Commercial Code—A Reply to Mr. Clarke*, 17 BUS. LAW. 548 (1962).

122. The extent to which reliance is placed upon electronic processing is shown by the difficulties created by certified checks which the machine may still charge to the drawer's account. See Windsor, *The Certified Check*, 81 BANKING L. J. 480 (1964).

123. § 400.1-201(19), RSMo 1963 Supp.: "good faith, means honesty in fact."

and their customers legitimately may be expected in order to make the payor bank's duties and risk more precise.

However, when the matter shifts from filling in the blank areas in bank-customer relationships, to changing the effect of the provisions of Part 4, freedom of agreement may have been less thoroughly considered. The apparent motivation for the inclusion of the rules of Part 4 was that these are services which a customer should be able to expect and which consequently should be removed from the area of agreement and fixed by statute. To say, then, that the time allowed the customer for discovering and reporting irregularities may be shortened at will, that a bank may be permitted to charge the customer's account for altered checks according to their tenor as altered, or that a customer may be precluded from giving any stop payment orders at all, seems to involve an inconsistent approach. Despite this, however, the dangers from agreements in this area should not be overestimated. Any agreements to vary the provisions of Part 4 will usually be contained in various documents which the customer is given or which he signs.¹²⁴ In addition to the restraints which competition may impose on the terms which a bank may submit for the customer's consent, such agreements, although now recognized by statute, are not insulated from judicial scrutiny. Standards which have been applied in the past, such as lack of effective consent, lack of consideration or violation of public policy, will continue to be available to curtail unconscionable agreements.¹²⁵

IV. CONCLUSION

Out of the many hours of study which separate the present date from July 1, 1965, Article 4 can expect to claim only a modest number. Compared to the changed rules and new concepts which are found in some articles of the Uniform Commercial Code, the provisions of Article 4 have

124. The extent to which Federal Reserve regulations or clearinghouse rules can govern this area is doubtful. "There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term, 'clearing house rules' should be understood in the light of functions the clearing houses have exercised in the past." Comment 3 to UCC § 4-103 (1962).

125. Agreements exculpating a bank from liability for failure to observe stop payment orders have been considered lacking in consideration: *Calamita v. Trademens Nat'l Bank*, 135 Conn. 326, 64 A.2d 46 (1949); *Reinhardt v. Passaic-Clifton Nat'l Bank & Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd*, 9 N.J. 607, 89 A.2d 242 (1952); or against public policy, *Thomas v. First Nat'l Bank*, 376 Pa. 181, 101 A.2d 910 (1954).

Whether a bank customer gives consent to terms printed on deposit slip or in a checking account pass book, may be a question of fact. *Los Angeles Inv. Co. v. Home Sav. Bank*, 180 Cal. 601, 182 Pac. 293 (1919); *Ryan v. Columbia Nat'l Bank*, 142 S.C. 231, 140 S.E. 593 (1927). On consent by bank customers to terms which are not signed, see *Annots. 5 A.L.R. 1203 (1920)*, *60 A.L.R.2d 708 (1958)*.

the appearance of old acquaintances. Except for some alterations in the relations between a payor bank and its customer, they are basically restatements of practices which have evolved. Not only does Article 4 parallel the Bank Collection Code in many respects, but solutions developed through agreement or banking usage to close the gaps in the previous statute will continue by virtue of the wide latitude allowed for such nonstatutory arrangements.

It is true that Article 4 will provide a more complete and consistent statement of the law of bank collections and deposits than has previously existed. Many of the problems which have heretofore called for learned discourse and analysis can now be answered by a simple reference to the statute. But one is tempted to wonder whether, in an area of the law which has given rise to a scant handful of litigated cases in the last twenty-five years, these unresolved problems are not largely the "million-to-one" cases. Barring a return to the era of failing banks the particular provisions of Article 4 will probably be involved in no greater amount of litigation in the next twenty-five years. Future concern will be over resolving the problems arising out of automated check handling. The most significant contribution of Article 4 is likely to be that it provides a timely and sound basis on which these developments can build.