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## Commercial Law--Article 4 of the Uniform Commercial Code-- Completion of the Process of Posting Constitutes Final Payment-- H. Schultz & Sons, Inc. v. Bank of Suffolk County

George E. Murray III

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## RECENT CASES

# COMMERCIAL LAW—ARTICLE 4 OF THE UNIFORM COMMERCIAL CODE—COMPLETION OF THE PROCESS OF POSTING CONSTITUTES FINAL PAYMENT

*H. Schultz & Sons, Inc., v. Bank of Suffolk County*<sup>1</sup>

On November 26, 1973, Unishops, Inc. drew a check for \$40,000 on the defendant Bank of Suffolk County payable to the plaintiff. The plaintiff deposited the check for collection with its own bank. The check was forwarded to the Federal Reserve Bank of New York, and then presented to the defendant bank on November 29. That day the defendant bank photographed, "proved," and debited the check to Unishops' account. Normally no additional processing would have taken place.<sup>2</sup> The next day the defendant bank learned of Unishops' bankruptcy and promptly gave telephone notice of dishonor of the check to the Federal Reserve Bank.<sup>3</sup> The defendant never honored the check.

The plaintiff brought a diversity action in federal district court to obtain the \$40,000 face value of the check and sought summary judgment on the ground that final payment had occurred so that the defendant bank was accountable for the check under U.C.C. section 4-213.<sup>4</sup> This contention depended on whether the "process of posting" which would

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1. 22 U.C.C. Rep. Serv. 1013 (E.D.N.Y. 1977). The court entered summary judgment on October 19, 1977. Subsequently, upon defendant's motion for reargument, the court vacated its original order on December 30, 1977. The court determined that even under the law as set forth in its opinion additional facts need be adduced.

2. It was stipulated upon oral argument that the defendant bank had fully performed its normal procedures regarding the handling of checks. *Id.* at 1014.

3. The defendant bank thus had actual knowledge of Unishops' bankruptcy. This is sufficient as notice under the provisions of U.C.C. § 1-201(25), -201(27).

The effect of notice of a customer's bankruptcy is to draw off his funds and so prevent normal payment of checks drawn on his account. Under § 70(a) of the Bankruptcy Act, 11 U.S.C. § 110(a)(5)(1970), the trustee takes title to the unencumbered assets of the bankrupt. The trustee may hold the payor bank liable for the amount of any checks paid after notice of bankruptcy. Consequently, if a check drawn on the bankrupt's account has not yet been finally paid, the payor bank would dishonor the check.

4. N.Y. [U.C.C.] § 4-213(1)(c) (McKinney 1964). The New York statute is identical to U.C.C. § 4-213(1)(c). Hereinafter, citations will be made only to the 1972 Official Text of the Uniform Commercial Code. See note 19 *infra*.

constitute final payment under that section had been completed as defined by U.C.C. section 4-109.<sup>5</sup> Although it had proven the check and debited Unishops' account, the defendant bank argued that under subparagraph (e) of section 4-109 it retained discretion to reverse the entry, and that it could do so properly anytime before midnight of the 30th—the deadline for return of the check.<sup>6</sup> The bank claimed that the process of posting would be deemed completed only at the expiration of this midnight deadline. The court disagreed and granted the plaintiff's motion for summary judgment, stating that reversal of an entry after the completion of normal processing would be permissible only in the case where an actual error has occurred. No error occurred in this case; completion of the defendant bank's standard posting procedures constituted final payment, at which point the defendant became accountable for the amount of the check.

The *Schultz* decision is most notable for its rejection of the analysis of *West Side Bank v. Marine National Exchange Bank*.<sup>7</sup> *West Side* stands for a construction of U.C.C. sections 4-213(1)(c) and 4-109 under which the process of posting is completed and final payment occurs only at the expiration of the midnight deadline for the return of checks. The court in *Schultz* determined that posting would be completed normally at an earlier point. This is a much sounder approach to the concept of final payment than that of *West Side*; it substantially furthers the intent and policies of Article 4 of the Uniform Commercial Code.<sup>8</sup>

The determination of when final payment occurs is a matter of great significance in the banking industry.<sup>9</sup> Final payment does not denote

5. See note 22 *infra*.

6. 22 U.C.C. Rep. Serv. at 1015. The court pointed out that under the deferred posting practice employed by the defendant and authorized by U.C.C. § 4-301, the latest possible time for the defendant to have returned the check unpaid was the "midnight deadline." As defined by U.C.C. § 4-104(1)(h), the "midnight deadline" is "midnight on [the payor's] next banking day following the banking day on which it receives the relevant item. . . ." As the check had been received on the 29th, midnight of the 30th was the deadline for return. After that point, the check would have been deemed finally paid under U.C.C. § 4-213(1)(d).

7. 37 Wis. 2d 661, 155 N.W.2d 587 (1968). Heretofore, *West Side* has been the leading though controversial case on § 4-109(e). See note 25 *infra*. *Schultz* is the first case to arise closely in point with *West Side*.

8. However, there have been several decisions construing the "process of posting" under U.C.C. § 4-213(1)(c) in a manner inferentially inconsistent with *West Side*. *Brown v. South Shore Nat'l Bank*, 1 Ill. App. 3d 136, 273 N.E.2d 671 (1971); *Security Trust Co. v. First Nat'l Bank*, 79 Misc. 2d 523, 358 N.Y.S.2d 943 (Sup. Ct. 1974); *Community Bank v. United States Nat'l Bank*, 276 Or. 471, 555 P.2d 435 (1976).

9. According to U.C.C. § 1-102, the Code "shall be liberally construed and applied to promote its underlying purposes and policies." See also the official comment to this section.

10. See J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 16-4 (1972); Rohner, *Posting of Checks: Final Payment and the Four Legals*, 23 BUS. LAW. 1075,

the time of transfer of funds or irrevocable credits from the payor bank to the presenting bank; that moment is called settlement.<sup>10</sup> Rather, final payment is used to mark an arbitrary point in the check payment process which establishes a multitude of rights and liabilities. At such time the payor bank becomes accountable to the presenting party for the amount of the check.<sup>11</sup> In turn, any credits given intermediary banks in provisional settlement are firmed up, and the deposit credit given by the depository bank to the payee of the check becomes firm. The check no longer can be returned because of insufficient funds, forgery, or legal process affecting the drawer's account (such as a stop payment order or notice of the drawer's bankruptcy).<sup>12</sup> Additionally, final payment relieves the drawer of liability on the check to the payee and discharges any indorsers.<sup>13</sup> As a result of the broad effects of final payment, all parties to a check have an interest in determination of the point at which it occurs.

Despite the importance of the concept, prior to the Uniform Commercial Code there existed no clear guide for the determination of final payment. With respect to items not presented directly, *i.e.*, presented through intermediary banks like, in *Schultz*, the Federal Reserve Bank, the majority rule was that final payment occurred when a payor bank posted an item to the drawer's account.<sup>14</sup> However, decisions varied

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1077 (1968); Leary, *Check Handling Under Article Four of the Uniform Commercial Code*, 49 MARQ. L. REV. 331 (1965).

The court in *Schultz* quoted a passage highlighting the importance of final payment from Note, *Bank Procedures and the U.C.C.—When Is a Check Finally Paid?*, 9 B.C. IND. & COMM. L. REV. 957 (1968). 22 U.C.C. Rep. Serv. 1013, 1016-17 (1977).

10. U.C.C. § 4-104(1)(j) defines "settlement." The time of final settlement determines when depository and collecting banks have a right to obtain the actual proceeds of a check. See U.C.C. § 4-213(2)-(4).

11. U.C.C. § 4-213(1) & comment 7.

12. U.C.C. § 4-213, comment 1.

13. It has been suggested that the discharge of the drawer and indorser follows from U.C.C. § 3-603(1). Note, *Final Payment and the Process of Posting Under the Uniform Commercial Code*, 68 COLUM. L. REV. 349, 350 n.10 (1968). This position does not appear tenable, for the provisions of U.C.C. § 3-603 clearly state: "The liability of any party is discharged to the extent of *his* payment or satisfaction to the holder. . . ." (emphasis added). In the normal situation, the payor makes the payment, not the indorser or drawer.

In the same article two better views are offered. The first is that the "accountability" of the payor established by payment under U.C.C. § 4-213(1) implicitly relieves other parties of liability on the note. Alternatively, since no code section specifically deals with this question, one could look to the common law rule. U.C.C. § 1-103 provides that "unless displaced by the particular provisions [of the Code] . . . the principles of law and equity . . . shall supplement its provisions." At common law, final payment of a note discharged the maker and subsequent indorsers. J. BRADY, *THE LAW OF BANK CHECKS* § 189, at 313 (2d ed. 1926).

14. *First Nat'l Bank v. Wisconsin Nat'l Bank*, 210 Wis. 533, 246 N.W. 593 (1933). *Accord*, *Hay & Stevens v. First Nat'l Bank*, 244 Ill. App. 286 (1927);

widely from one jurisdiction to another;<sup>15</sup> little reliability could be placed on any particular procedures. Early attempts at legislative clarification aided little in providing consistency or an acceptable definition. Section 137 of the Negotiable Instruments Law gave a payor a fixed period of twenty-four hours in which to return an item.<sup>16</sup> If the payor failed to do so, the item was deemed finally paid and the payor became accountable. An already confusing situation deteriorated under the burden of a tremendous increase in the volume of checks subsequent to World War II. The banking industry found an acute need for more time for processing checks and for consistency in the rules regulating final payment,<sup>17</sup> and therefore sought legislation providing a uniform system of deferred posting.<sup>18</sup>

The drafters of Article 4 of the Uniform Commercial Code responded to the need. Section 4-213(1)<sup>19</sup> provides a uniform guide as to how final

Union State Bank v. Hibernia State Bank & Trust Co., 224 Mo. App. 375, 18 S.W.2d 93 (K.C. Ct. App. 1929).

15. Nineteenth Ward Bank v. First Nat'l Bank, 184 Mass. 49, 67 N.E. 70 (1903) (stamping an item "paid" before charging it to the drawer's account held to be final payment); Bohlig v. First Nat'l Bank, 233 Minn. 523, 48 N.W.2d 445 (1951) (mailing a remittance draft held not sufficient to constitute final payment because payor could recover the draft from the mail); Dewey v. Margolis & Brooks, 195 N.C. 307, 142 S.E. 22 (1928) (no final payment until the remittance draft was received); Wisner v. First Nat'l Bank, 220 Pa. 21, 61 A. 955 (1908) (prolonged or unreasonable detention of an item—here twenty-four hours—held to constitute final payment). See Malcolm, *Article 4—A Battle with Complexity*, 1952 WIS. L. REV. 265, 287-95 (1952).

16. This fixed time standard had the advantage of easy application, but the time allotted was brief. The AMERICAN BANKERS ASSOCIATION COLLECTION CODE §§ 3, 7, reprinted in 2 PATON'S DIGEST 1372, 1373, 1378 (1942), provided that items presented through the mail were paid either when the amount was debited to the account of the drawer or at the expiration of the business day of receipt. The A.B.A. Collection Code provided little uniformity, however, for it was adopted in only 18 states.

17. See U.C.C. § 4-101, comment. As of 1966, it was estimated that commercial banks in the United States handled over 70 million items daily. Clark, *Check-Out Time for Checks*, 83 BANKING L.J. 847, 848 (1966).

18. Deferred posting gives banks an additional period of time to process incoming checks—until the deadline for return, usually midnight of the next banking day after their receipt. See Leary, *Deferred Posting and Delayed Returns—The Current Check Problem*, 62 HARV. L. REV. 905 (1949).

19. U.S.C. § 4-213 provides:

(1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:

...

(c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or  
(d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon final payment under subparagraphs . . . (c) or (d) the payor bank shall be accountable for the amount of the item.

payment may be made, while adequately safeguarding the competing interests of both payor banks and holders of checks. Subparagraph (c) achieves the objective of sufficiently protecting the interest of the payor bank by basing the determination of final payment upon the actions of that bank in its processing of a check.<sup>20</sup> Subparagraph (d), when read in conjunction with U.C.C. section 4-301, provides assurance to the interest of the holder by setting a time limit, the midnight deadline, for the payor's completion of its posting process. Unfortunately, ambiguities persisted, especially due to the lack of any definition of what acts "completed the process of posting" under section 4-213(1)(c).<sup>21</sup> Many banks employed procedures in which the first step in the process was to charge a check to the customer's account, and subsequently verified the check. Bankers feared that this charging might be considered completion of posting so that an item would be finally paid before it had been examined and verified.

To eliminate this concern, U.C.C. section 4-109 was offered as a clarification of the process of posting.<sup>22</sup> This section makes the usual

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20. The "process of posting" was used as the determinant of final payment instead of mere posting because under modern machine operations posting has become a process. U.C.C. § 4-213, comment 5.

21. Groups of bankers in California and New York, two large commercial states, were particularly concerned with the ambiguities in the language. New York opted for legislative clarification of the "process of posting." The result was a statute defining the term. The Permanent Editorial Board of the Uniform Commercial Code subsequently adopted this New York definition, in what is now U.C.C. § 4-109.

California resolved the ambiguity by deleting subparagraph (1)(c) from § 4-213. The stated reason was that California banks first post and thereafter examine checks; verification did not appear to be included in the "process of posting." The California legislature therefore preferred to relate final payment to failure to revoke within the time allotted by the midnight deadline. MARCH AND WARREN REPORT, SIXTH PROGRESS REPORT TO THE LEGISLATURE BY SENATE FACT FINDING COMMITTEE ON JUDICIARY (1959-1961) PART 1, THE UNIFORM COMMERCIAL CODE, 476, cited in CAL. COMM. CODE § 4-213(1), comment 8 (West 1964). Only Nevada has followed the California approach. See 1964-65 NEV. STAT. ch. 353, § 4-213(1), at 848.

22. Added to the Code in 1962, U.C.C. § 4-109 provides:

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

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

The section was added to clarify the provisions of § 4-213(1)(c), not to change them. U.C.C. § 4-213, comment 5 indicates that the posting process includes both determining to pay an item and actually recording that determination; §

procedure of each bank the test. It lists common but not necessary steps which involve the two basic elements of posting: determination to pay an item and recordation of that determination. The first four subparagraphs describe steps traditionally associated with completion of posting. However, subparagraph (e) has caused confusion, referring to "correcting or reversing an entry or erroneous action" as a possible final step in the posting process. In *West Side Bank v. Marine National Exchange Bank*<sup>23</sup> the Wisconsin Supreme Court construed this subparagraph to authorize a bank to reverse an entry to its customer's account for any reason whatsoever. The court held that a payor bank could do so until expiration of the deadline for return of the entered item.<sup>24</sup> Consequently, *West Side* took the controversial<sup>25</sup> position that because a bank may reverse entries as part of the posting process, the process remains uncompleted and no final payment occurs until any opportunity for reversal has passed.<sup>26</sup> The payor bank's completion of its own normal posting process is irrelevant under the *West Side* analysis.

The dispute in *Schultz* involved facts only slightly different from those in *West Side*. In *West Side* the payor bank mechanically posted the check, examined it, and determined to pay it. Before the time limit for return of dishonored items had expired, the bank received and honored a stop payment order from its customer.<sup>27</sup> In *Schultz*, after completion of its normal subjective and objective steps in the process of posting, the payor bank received word of the drawer's bankruptcy and thereafter refused to pay the check.<sup>28</sup> Receipt of a stop order and notice of bankruptcy are two of the "four legals,"<sup>29</sup> so termed because of their identical legal

4-109 expressly so provides. In fact, in *Community Bank v. United States Nat'l Bank*, 276 Or. 471, 555 P.2d 435 (1976), the court used § 4-109 for guidance in determining when posting was completed, even though the Oregon statutes did not then include the section. The court reasoned that such use was permissible because the section was only a clarification of existing law.

23. 37 Wis. 2d 661, 155 N.W.2d 587 (1968).

24. In *West Side* the deadline for return of an item was modified by clearinghouse agreement to extend past the normal midnight deadline. *Id.* at 672, 155 N.W.2d at 593. Such agreements are recognized as proper in U.C.C. § 4-103, comment 3.

25. For the most part, the commentary on the *West Side* case has been critical. See, e.g., J. WHITE & R. SUMMERS, *supra* note 9, at § 16-4; Malcolm, *Reflections on West Side Bank: A Draftsman's View*, 18 CATH. U.L. REV. 23 (1968); Rohner, *supra* note 9; Note, *supra* note 9; Note, *supra* note 13.

However, some commentary has been supportive of the *West Side* stance. See Leary & Tarlow, *Reflections on Articles 3 and 4 for a Review Committee*, 48 TEMPLE L.Q. 919, 927-33 (1975); Note, *Banks—Final Payment—Uniform Commercial Code Section 4-109 or Clearinghouse Rule?*, 1968 WIS. L. REV. 946 (1968).

26. 37 Wis. 2d at 672, 155 N.W.2d at 593.

27. *Id.* at 665, 155 N.W.2d at 589.

28. 22 U.C.C. Rep. Serv. at 1014.

29. These four events which may intervene to prevent payment from the drawer's account are: (1) knowledge of notice of a customer's death, incompe-

effect on the bank collection process: to draw off a customer's funds and thus prevent normal payment of checks *drawn* on his account *but not yet finally paid*. Therefore, despite the slight factual difference, the question faced in *Schultz* was essentially the same as that dealt with in *West Side*: whether the "legal" arrived *after* the check had been finally paid by completion of posting or *before* final payment, because payment did not become final until the expiration of the return deadline.

The federal district court in *Schultz* rejected the *West Side* analysis.<sup>30</sup> It held that because the defendant bank had completed its normal posting procedures before receipt of notice of its customer's bankruptcy, final payment had occurred before the arrival of the "legal," and therefore the bank was accountable to the plaintiff. The basis of this holding was the court's interpretation of subparagraph (e) of U.C.C. section 4-109. The court said reversal of an entry as the final step in posting was proper only when an actual error had occurred in processing the check. In arriving at this view, the court first looked to the language of subparagraph (e) and the ambiguous phrase "correcting or reversing an entry or erroneous action." Parallel grammatical construction—having the first verb operate on the first direct object and the second verb operate on the second direct object—results in two readings in which the presence of an error is the determinative factor. Combinations of each of the verbs with each of the direct objects would render four readings, only one of which omits any reference to mistake. The court noted that "five out of [the] six possible readings of subsection (e) focus upon errors,"<sup>31</sup> either mechanical or judgmental. The conclusion was that the defendant bank should not be permitted to invoke section 4-109(e) because no error had occurred. The court held the bank accountable for its final payment, buttressing its position by pointing to the legislative intent and policy of the Code as evidenced by the official comments.<sup>32</sup>

The *Schultz* construction of U.C.C. section 4-109 and the concomitant effect of fixing final payment at the completion of the process of posting under section 4-213(1)(c) appear to promote both the intent behind these sections and the policies underlying Article 4 as a whole. Subparagraph (e) of section 4-109 can be best understood as a concession to modern processing demands and high-speed techniques.<sup>33</sup> Fairfax

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tency or bankruptcy; (2) the customer's stop order; (3) legal process (for example, garnishment); (4) set-off by the payor bank. J. WHITE & R. SUMMERS, *supra* note 9, § 17-7.

30. The court referred to the Wisconsin Supreme Court interpretation as "aberrational." 22 U.C.C. Rep. Serv. at 1018.

31. *Id.*

32. *Id.* at 1017.

33. The tremendous volume of checks passing through the contemporary banking system has necessitated the implementation of computerized techniques. See note 17 *supra*. Errors arise, but because of the volume of checks they are not detected immediately.



Leary, formerly a reporter for the Code, recognized this when he stated that "human error, and sometimes even machine error can creep in."<sup>34</sup> Prompt handling of checks and settlement of accounts would be impossible if banks were forced to take extraordinary and expensive precautions against the errors which inevitably arise. The listed steps in the process of posting include "the correction of errors and reversal of entries"<sup>35</sup> to provide some protection to payor banks in case of error. Nowhere do the Code or its official comments indicate that subparagraph (e) was intended to give banks discretion to fix the time of final payment by reversal of a nonerroneous entry.

By applying section 4-109(e) as intended, the *Schultz* approach makes possible the operation of all of the subparagraphs of sections 4-109 and 4-213. The same is not true under the *West Side* analysis. *West Side* renders performance of the acts enumerated in subparagraphs (a) through (d) of section 4-109 meaningless to determination of posting; posting can be completed only at the expiration of the deadline for return of an item.<sup>36</sup> *West Side* also reads subparagraph (1)(c) of section 4-213 out of the Code because final payment would occur only at the deadline governed by section 4-213(1)(d), not upon completion of any posting process.<sup>37</sup> *Schultz*, however, permits final payment to occur before the deadline through the process of posting; it makes the steps enumerated in the first four subsections of section 4-109 the normal determinants of the completion of posting.<sup>38</sup> The Code clearly contemplates such a result. Presumably section 4-213(1)(c) has *some* independent meaning. The comment to section 4-109 presents three situations as illustrations in

34. Leary, *supra* note 9, at 360. *Accord*, Malcolm, *supra* note 25, at 32.

35. *See* note 22 *supra*.

36. The court in *Schultz* pointed out this effect of the *West Side* analysis. 22 U.C.C. Rep. Serv. at 1018.

37. The *West Side* opinion expressly recognized that its interpretation "would almost completely negate the possibility of using completion of the 'process of posting' as the benchmark for determining final payment." 37 Wis. 2d at 669, 155 N.W.2d at 591. Nevertheless, the Wisconsin Supreme Court adopted that interpretation on the ground that "the meaning of the statute [was] plain and unambiguous." *Id.* at 670, 155 N.W.2d at 592.

The fact that the *West Side* interpretation renders subparagraph (1)(c) of § 4-213 meaningless has been the focal point of the criticism levelled against the opinion. *See generally* articles cited note 25 *supra*. Note, however, that the holding in the *West Side* case—that no final payment occurs until expiration of the deadline for return of a check—would be proper in California and Nevada, where the legislatures have excised subparagraph (1)(c) from their versions of U.C.C. § 4-213. *See* note 21 *supra*.

38. The completion of a particular bank's normal processing will almost always constitute final payment. Only when error has occurred in the processing will there be a postponement of final payment past this point. *See* text accompanying notes 30 & 31 *supra*.

which the process of posting is completed prior to the deadline for return of a check.<sup>39</sup>

The decision in *Schultz* is more than a guide to comporting with the intent behind section 4-109; it furthers several of the broader policies and considerations of Article 4. Most significantly, the decision promotes the prompt handling and quick retirement of checks. The importance of this to the draftsmen of the Code is evidenced by the provisions of section 4-213 relating to final payment. The preamble of the section states that a check is finally paid when the first of the events in the subparagraphs which follow occurs. This language clearly manifests a desire to minimize the period of time before final payment occurs.<sup>40</sup> Another general policy of the Code is to limit the liability of collecting banks.<sup>41</sup> *Schultz* advances this policy by making it possible and even likely to have final payment at a point earlier than the midnight deadline. The earlier the time of final payment, the smaller the likelihood that notice of a stop order will arrive to extend a collecting bank's liability.

Although it will not affect the soundness of the *Schultz* approach in this factual situation, there is a latent problem in the court's opinion which could greatly confuse this area of banking law. That problem arises from the court's brief reference to the applicability of U.C.C. section 4-303(1)(d). Although it based its decision squarely upon sections 4-109 and 4-213, the court cited section 4-303(1)(d) for the proposition that if the bank had completed posting, the notice of its customer's bankruptcy came too late to affect its accountability to the plaintiff.<sup>42</sup> This section provides that legal process such as notice of bankruptcy or a stop order comes too late to terminate the payor bank's right or duty to pay an item after the bank has completed the process of posting or evidenced its decision to pay the item.<sup>43</sup> Several commentators, notably

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39. U.C.C. § 4-109, comment.

40. The comments to the Code reinforce this notion that the section was drafted to make the earliest of four events constitute final payment. *See, e.g.*, U.C.C. § 4-213, comment 7. In fact, the only reason for permitting postponement of final payment until the midnight deadline is to give a payor bank a chance to examine the item. Once that examination has been concluded and the item has been fully processed, there is no reason to allow further time.

41. *See* U.C.C. § 4-201.

42. 22 U.C.C. Rep. Serv. at 1015.

43. U.C.C. § 4-303(1) provides:

(1) Any knowledge, notice or stop-order received by, legal process served upon or setoff exercised by a payor bank, whether or not effective under other rules of law to terminate, suspend or modify the bank's right or duty to pay an item or to charge its customer's account for the item, comes too late to so terminate, suspend or modify such right or duty if the knowledge, notice, stop-order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the bank has done any of the following:

Walter Malcolm,<sup>44</sup> a principal draftsman of Article 4, and Professors White and Summers,<sup>45</sup> urge the use of this section instead of section 4-213(1) in the *West Side* and *Schultz* situation. The rationale for this suggestion appears to be that section 4-303(1)(d) deals specifically with the effect of the "four legals" on a bank's duty to pay an item. However, analysis indicates that this section does not apply under the *Schultz* facts.

Two reasons strongly militate against deciding the issue of the liability of the payor bank to the payee or holder in a case such as *Schultz* under section 4-303(1)(d). First, the real question in such a lawsuit concerns the accountability of the payor to the payee or holder. U.C.C. section 4-213(1) expressly provides that the payor shall be accountable upon final payment. The ultimate determination of a plaintiff payee's (or holder's) right to the amount of the check hinges on the ability to show final payment has been made, for example, by completion of the process of posting.<sup>46</sup> In contrast, U.C.C. section 4-303(1) does not govern accountability of the payor to the payee or holder on the check. This section only establishes rules governing whether customer-derived legal claims can affect the payor.<sup>47</sup> A bank's "duty" to pay is owed only to the drawer, not to the payee or holder. The legislative background of section 4-303(1) reinforces this notion. The New York Law Revision Commission plainly resolved that the section "has no effect in itself to give the holder of an 'item' a right to payment."<sup>48</sup>

Secondly, application of section 4-303(1)(d) to give a payee or holder a right to payment could confuse the law due to patent differences between the acts required to trigger this section and the acts necessary

....  
(d) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item; . . .

44. Malcolm, *supra* note 25, at 26-31.

45. J. WHITE & R. SUMMERS, *supra* note 9, § 17-7.

46. See text accompanying note 30 *supra*.

47. The official comments to this section illustrate that it does not regulate accountability of payor to a payee or holder. "[H]olders have no direct right against the payor bank in any event, unless of course, the bank has accepted [§ 3-410], certified [§ 3-411], or finally paid [§ 4-213] a particular item. . . ." U.C.C. § 4-303, comment 6. Furthermore, when notice or a stop-order comes too late, *e.g.*, after a payor has complied with § 4-303(1)(d), "the item has priority and a charge to the customer's account *may* be made and is effective." U.C.C. § 4-303, comment 2 (emphasis added). There appears to be no indication whatsoever that this section *requires* the payor to pay the item at a holder's insistence.

48. The resolution is quoted in Malcolm, *supra* note 25, at 29. See NEW YORK LAW REVIEW COMM'N, REPORT AND APPENDICES RELATING TO THE UNIFORM COMMERCIAL CODE FOR 1956, at 429 (adoption of this resolution). These Commission reports are a type of "legislative history" to this section of the Code. New York was a key state in determining ultimate acceptance of the Code, and its suggestions carried great weight with the draftsmen.