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The Uniform Commercial Code in Minnesota: Article 4 — Bank Deposits and Collections

This article is one of several being published to acquaint Minnesota practitioners with the newly enacted Uniform Commercial Code. The authors examine the Bank Deposits and Collections Article of the UCC.

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INTRODUCTION

The huge and ever-growing number of checks passing through commercial banking channels made the need for uniform rules governing bank deposits and collections increasingly apparent. Article 4 of the Uniform Commercial Code¹ is designed to provide a comprehensive statutory scheme governing this process. Of course, prior to the enactment of the Code, the bank collection process functioned with some regulations. In addition to the common law, bank collections were regulated by the American Bankers Association Bank Collection Code² (enacted in eighteen states), the American Bankers Association Deferred Posting Statute,³ Federal Reserve regulations⁴ and operating letters, clearing house

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1. ALI & NATIONAL CONFERENCE ON UNIFORM LAWS, UNIFORM COMMERCIAL CODE, 1962 OFFICIAL TEXT WITH COMMENTS (1963) [hereinafter cited as CODE; the official comments will be cited CODE §—, comment]. The Code has been enacted in Minnesota. MINN. STAT. ANN. §§ 336.1-101 through 336.10-105 (Temp. pamph. 1965). The Minnesota version of article 4 omits the optional provisions of § 4-106 (dealing with branch banks) and includes the optional provisions of sections 4-202 and 4-212 (dealing with the direct return of unpaid items). The balance of the article is without variation from the 1962 official text.

2. Reprinted in 2 PATON, DIGEST, *Collections* § 27, at 1373-78 (1942).

3. MINN. STAT. § 48.515 (1961). Reprinted in PATON, *op. cit. supra* note 2, § 27, at 3-4 (Supp. 1965).

4. Federal Reserve Regulation G, 12 C.F.R. §§ 207.1-4 (1963 Supp. 1965)

rules, deposit and collection agreements,⁵ and general banking usage. Many states also enacted partial or complete collection codes.⁶

The draftsmen of article 4, working in an area where current procedures were in most instances functioning smoothly, made very few changes from present law and practice. Nonstatutory forms of regulation such as clearing house rules receive official recognition.⁷ In addition, recognizing the likelihood of increased technological innovation in the collection process, article 4 permits substantial variation by agreement from its provisions.⁸

Since checks make up the great bulk of the items handled by banks, the principal focus of the sections of this article dealing with collection will be on the provisions relating to checks. The reader should be aware, however, that article 4 also deals with other types of commercial paper entering the bank collection process, and that in some cases the rules are different for the handling of nondemand items, nonnegotiable items, and items not drawn on banks.⁹

PART ONE

SCOPE OF ARTICLE 4

Part one contains general provisions and definitions applicable to the rest of the article. The key definition is that of "item" — "any instrument for the payment of money even though it is not negotiable but does not include money."¹⁰ It is the handling of items by banks that constitutes the subject matter of this article.

Negotiable instruments (usually checks), which make up the (collection of noncash items), Federal Reserve Regulation J, 12 C.F.R. §§ 210.1-.6 (1963 Supp. 1965) (check clearing and collection).

5. The American Bankers Association Standard Collection Agreement is reprinted in PATON, *op. cit. supra* note 2, § 26, at 1 (Supp. 1954).

6. *E.g.*, MINN. STAT. § 335.75 (1961) (addition to the Negotiable Instruments Law); see PATON, *op. cit. supra* note 2, § 27, at 1379-81 (list of collection statutes in other states).

7. See CODE § 4-103(3).

8. See CODE § 4-103. See also notes 19-21 *infra* and accompanying text.

9. Compare CODE § 4-210, with CODE § 4-301. In addition, because bank failure is presently a rare event, this article does not deal with § 4-214 which sets forth the rules governing insolvency and preference. As the draftsmen recognized, this section is not applicable to national banks. See Jennings v. United States Fid. & Guar. Co., 294 U.S. 216 (1935); CODE § 4-214, comment (3).

10. CODE § 4-104(1)(g).

vast bulk of items handled by most banks, are also covered by article 3 of the Code. However, since the transfer of commercial paper between banks involves substantially different problems from the negotiation of such paper among private parties, section 4-102 provides that in the event of conflict between the provisions of article 3 and article 4, the provisions of article 4 are to govern. Items which are also securities are governed by article 8 in the event of a conflict with article 4.¹¹

CONFLICT OF LAWS

Under section 4-102(2) liability of a bank for action or non-action with respect to an item is governed by the law of the jurisdiction where the bank is located. This provision should serve to settle most choice of law problems, and with virtually nationwide adoption of the Code, banks may safely rely on this provision even though they may become subject to suits in foreign jurisdictions.

DEFINITIONS

Section 4-104 is the principal definition section; of course, the definitions of article 1 are also applicable. Many of the terms used in the definitions are themselves defined elsewhere in the Code.

Certain of the definitions have particular importance in determining the time period during which a bank must take specified action. "Banking day" is a vital phrase which means "that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions."¹²

It must be read in conjunction with "midnight deadline" which "with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice, or from which the time for taking action commences to run, whichever is later."¹³ Section 4-107 also deals with the time element:

(1) For the purpose of allowing time to process items, prove balances and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of two P.M. or later as a cut-off hour for the handling of money and items and the making of entries on its books.

(2) Any item or deposit of money received on any day after a cut-

11. CODE §§ 4-102(1); 8-102(1)(b).

12. CODE § 4-104(1)(c).

13. CODE § 4-104(1)(h).

off hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day.

These sections provide the basis for later sections of the article which define the time periods during which a bank must forward items for collection,¹⁴ give notice of dishonor,¹⁵ and take other action promptly.¹⁶ It should be noted that "banking day" means only that part of the day when a bank is open for "substantially all" its banking functions. Thus, items received by a bank when only partial services are available, such as evening teller hours, may be treated as having been received on the next day the bank is fully open for business.

"Settle," another important term for purposes of the collection process, is defined as "to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A settlement may be either provisional or final."¹⁷

Any bank will handle several hundred items in a day, in various capacities. Here, again, the Code supplies definitions:

In this Article unless the context otherwise requires:

- (a) "Depository bank" means the first bank to which an item is transferred for collection even though it is also the payor bank;
- (b) "Payor bank" means a bank by which an item is payable as drawn or accepted;
- (c) "Intermediary bank" means any bank to which an item is transferred in course of collection except the depository or payor bank;
- (d) "Collecting bank" means any bank handling the item for collection except the payor bank;
- (e) "Presenting bank" means any bank presenting an item except a payor bank;
- (f) "Remitting bank" means any payor or intermediary bank remitting for an item.¹⁸

VARIATION BY AGREEMENT

Although variation by agreement is permitted for the entire Code generally,¹⁹ the draftsmen thought that flexibility in the bank collection process was particularly necessary.²⁰ Section 4-103(1) permits the effect of the provisions of article 4 to be

14. CODE § 4-202(2).

15. CODE § 4-212(1).

16. See CODE § 4-211(2) (handling of remittance checks); CODE § 4-212 (charge-back of provisional settlements).

17. CODE § 4-104(1)(j).

18. CODE § 4-105.

19. CODE §§ 1-102(3), (4) ("except as otherwise provided").

20. See CLARKE, BAILEY & YOUNG, *BANK DEPOSITS & COLLECTIONS* 28-31 (3d ed. 1963).

varied by agreement, with two exceptions. An agreement may neither disclaim a bank's responsibility to act in good faith and use ordinary care, nor may it limit the measure of damages for failure to act in good faith and with ordinary care. The need for this additional flexibility is easily explained. Except in those states having bank collection codes, the entire law of bank collection evolved without substantial statutory guidance through banking usage and agreements with customers. Thus, the old scheme already had a considerable degree of flexibility. In addition, the Code was promulgated at a time when electronic data processing was becoming increasingly common, with the prospect of greater changes in the collection process in the future. As a result the draftsmen felt that it was necessary to leave provisions open to variation in order to permit reasonable changes to be made in the light of increased volume and greater automation.

The freedom to vary by agreement is by no means a *carte blanche* which permits an individual bank to impose onerous terms upon customers or other parties involved in the handling of an item. For example, an agreement between a bank and its customer would not be binding upon a drawer of a check presented for deposit by the customer or upon any parties farther on in the collection chain. Similarly, an agreement which did not expressly disclaim a bank's liability for lack of good faith or failure to exercise due care, might still be held to have done so in effect.²¹

Under section 4-103(2), however, Federal Reserve regulations and operating letters, as well as clearing house rules have the effect of agreements and are binding on all parties interested in an item whether they have assented to them or not. Similarly, conduct in conformance with such regulations and operating letters, or with the provisions of the article is declared by section 4-103(3) to constitute the exercise of ordinary care; conduct in conformance with clearing house rules or general banking usage not disapproved by the article is declared to constitute the *prima facie* exercise of ordinary care.

The net result will probably be that any substantial variation

21. Cf. *Thomas v. First Nat'l Bank*, 376 Pa. 181, 101 A.2d 910 (1954). *Thomas* held that a clause in a stop payment order which purported to relieve a bank from liability for failure to honor the order through "inadvertence, accident or oversight" was ineffective. While the case was decided under pre-Code law, in dictum, the court said the same result would be reached under § 4-103. *Id.* at 188, 101 A.2d at 913. This section permits the parties to agree on standards by which the responsibility for the exercise of good faith and due care are to be measured. But such standards are still subject to the test of reasonableness.

in collection practices from the provisions of the Code will come about only through action by bodies with a collective responsibility such as the Federal Reserve Board or groups of banks associated in a clearing house.

PROCESS OF POSTING

One final preliminary matter deserves further comment. Section 4-109 defines the "process of posting" as the usual procedure followed by a payor bank in (1) determining to pay an item and (2) recording the payment. This provision becomes important in determining when a payor bank becomes accountable for an item it receives²² or in determining the priority of an item as against a stop order or other action affecting the account upon which the item is drawn.²³

PART TWO

AGENCY STATUS OF COLLECTING BANKS

Part two deals generally with the collection process up to the time an item reaches a payor bank. The basic theory of the collection provisions is that a collecting bank acts as an agent or subagent for the owner in handling an item, "unless a contrary intent clearly appears," up to the time a settlement given for the item becomes final.²⁴ This is probably not inconsistent with prior Minnesota law²⁵ and standard collection agreements. The Code makes it clear, however, that the agency status of a collecting bank is not affected by the form of indorsement on the item or by giving credit subject to immediate withdrawal after the deposit of the item.²⁶ Even in cases in which a bank has become the owner of an item, the relevant provisions of article 4 still apply to the collection process.²⁷

As a consequence of the agency status of collecting banks, an owner continues to bear the risk of loss, prior to final settlement, caused by insolvency, neglect, misconduct, mistake, or default of

22. CODE § 4-213(1)(c).

23. CODE § 4-303(1)(d).

24. CODE § 4-201(1).

25. See A STUDY OF THE EFFECT OF THE UNIFORM COMMERCIAL CODE ON MINNESOTA LAW 474 (1964) [hereinafter cited MINN. STUDY]. Compare MINN. STAT. § 335.75 (1961).

26. CODE § 4-201(1).

27. *Ibid.*

another bank in the collection chain, although collecting banks continue to be responsible for losses caused by their failure to exercise good faith and ordinary care.²⁸

STANDARD FOR ORDINARY CARE

The obligations of a collecting bank to which the requirement of due care expressly attaches are spelled out in section 4-202(1): "(a) presenting an item or sending it for presentment . . . ; (b) sending notice of dishonor or non-payment . . . ; (c) settling for an item . . . ; (d) making or providing for any necessary protest;²⁹ and (e) notifying its transferor of any loss or delay in transit" This would involve, of course, proper selection of correspondent banks, reasonable routing of an item,³⁰ and, most commonly, taking action within a reasonable time. On this latter point, section 4-202(2) establishes some guidance for collecting banks by providing that a bank taking proper action before its midnight deadline following receipt of an item, notice, or payment acts "seasonably." A reasonably longer time may also be seasonable, but the bank has the burden of establishing this fact. In effect, this means a bank with a 2 P.M. cut-off hour that receives an item for collection after that time on Monday has at least until midnight on Wednesday to forward the item for collection without risking possible liability for delay. Substantially similar provisions have been in effect for *payor* banks under the deferred posting statute,³¹ but the liability of collecting banks has been governed only by the "reasonable" time limits of the Negotiable Instruments Law.³²

Section 4-204 spells out in greater detail the permissible collection methods available to collecting banks. As under prior statutory law,³³ a collecting bank may send an item directly to a payor bank, a practice disapproved by some of the older cases.³⁴ In addition, this section permits a collecting bank to send items directly to nonbank payors, but only if authorized by its transferor or (except for documentary drafts) if authorized by Federal

28. See Code §§ 4-202, 4-103.

29. Under § 3-501(3) protest is unnecessary except on items drawn or payable outside the United States and its territories.

30. See Code § 4-204 (forwarding items for collection).

31. MINN. STAT. § 48.515 (1961).

32. MINN. STAT. §§ 335.271, 335.74, 335.78 (1961); UNIFORM NEGOTIABLE INSTRUMENTS LAW §§ 71, 186, 193.

33. MINN. STAT. 335.75 (1961).

34. *E.g.*, *Minneapolis Sash & Door Co. v. Metropolitan Bank*, 76 Minn. 186, 78 N.W. 980 (1899).

Reserve regulation, operating letter, or clearing house rule. This is so because such direct forwarding is not yet standard banking practice and involves the risk of placing the item in the hands of the party primarily liable thereon prior to payment.

INDORSEMENT AND TRANSFER

Under section 4-205 a depository bank may supply any indorsement of a customer necessary to title³⁵ unless the item contains the words "payee's indorsement required" or the like.³⁶ A stamp such as "credited to the account of the within named" should be sufficient.

Sections 4-206 and 4-207 deal with the transfer and the effect of the transfer of items between banks. Section 4-206 provides that "any agreed method which identifies the transferor bank is sufficient for an item's further transfer to another bank." This permits the use of a simple identifying mark, such as a bank's American Bankers Association identifying number, to effect a transfer and eliminates the often illegible superimposition of bank stamps on the back of a check.³⁷

WARRANTIES

"Transfer" itself is not defined in the Code,³⁸ but it appears to be less than a negotiation.³⁹ In the bank collection process, however, the distinction is unimportant because the Code spells out a separate set of warranties applicable to collecting banks upon transfer of an item. Section 4-207(1) deals with the warranties made by a customer or collecting bank to any payor (bank or

35. If a bank takes a bearer instrument from its depositor, his indorsement is not necessary to title. As a consequence, a bank taking such an instrument could not supply its depositor's indorsement under section 4-205 and thereby make him liable *on the instrument*. See CODE § 3-401. However, under § 4-207(2), the engagement to take up a dishonored instrument attaches to a customer as well as a collecting bank notwithstanding the absence of indorsement.

36. This provision will not apply to checks drawn on the Treasurer of the United States. 31 C.F.R. § 360.3 (1965).

37. Most banks will want to continue using the collection legend "pay any bank" on their indorsement stamps. Such words serve to "lock" the item into the bank collection process, at least until specially indorsed by a bank to a person not a bank. CODE § 4-201(2)(b).

38. *But see* section 3-201 on the rights of a transferee of a negotiable instrument.

39. See MINN. STUDY 486.

nonbank) that pays or accepts the item. The presenting party warrants that he has good title to the item or is authorized to collect on behalf of one who has good title. In effect, this warranty serves as the guarantee of prior indorsements. In addition, the payor is given the warranty that the presenting party *has no knowledge* that the signature of the drawer or maker is unauthorized.⁴⁰ These warranties parallel the warranties of section 3-417(1) to any person paying or accepting a negotiable instrument and reflect the rule of *Price v. Neal*,⁴¹ which put the risk of a forged drawer's signature on the paying or accepting drawee (who should know his drawer's signature) as against a holder in due course who has no knowledge of the forgery. The presenting party also warrants that the item has not been materially altered.⁴²

Subsection (2) of 4-207 sets forth the warranties made by each customer or collecting bank receiving a settlement or other consideration to all subsequent collecting banks taking an item. In these cases the transferor warrants:

- (a) He has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and
- (b) all signatures are genuine or authorized;⁴³ and
- (c) the item has not been materially altered; and
- (d) no defense of a party is good against him;
- (e) he has no knowledge of any insolvency proceedings instituted . . . [against a] maker or acceptor or the drawer of an unaccepted item.

In addition, each such customer or collecting bank "engages that upon dishonor and any necessary notice or protest he will take up the item." Once again these warranties parallel the warranties made by any transferor for value of a negotiable instrument to a transferee.⁴⁴

40. There are exceptions to this warranty in cases in which the presenting party is a holder in due course and the payor has particular reason to be familiar with the signature involved; *i.e.*, when presentment is made to a maker, drawer, or acceptor.

41. 3 Burr. 1354, 97 Eng. Rep. 871 (K.B. 1762).

42. Again there are exceptions to this warranty when a holder in due course presents an item to a drawer or maker. In addition, there is no such warranty when an item is presented to an acceptor with respect to an alteration made prior to the acceptance if the holder in due course took the item after acceptance, even though the acceptance provided "payable as originally drawn." CODE § 4-207(1)(c)(iii).

43. Compare this with the warranty to a payor. See note 40 *supra* and accompanying text.

44. See CODE § 3-417(2).

These warranties arise regardless of the absence of indorsement or words of guaranty or warranty.⁴⁵ The net effect will be the possibility of eliminating collection legends such as "prior indorsements guaranteed" on bank stamps. Until the Code is adopted in all the states, however, most banks will want to keep these legends to avoid possible misunderstanding with regard to items passing into non-Code states.

SECURITY INTEREST

The Code provides protection for collecting banks which advance credit by giving the bank a security interest in the item and any accompanying documents or the proceeds of either.⁴⁶ This security interest attaches (a) to the extent to which credit given for an item has been withdrawn or applied, (b) to the extent credit is available for withdrawal as of right, whether or not it is drawn upon or subject to chargeback, or (c) if the bank has made an advance on or against the item.⁴⁷ Such a security interest is subject to the provisions of article 9, except that a security agreement is unnecessary and no filing is required for perfection.⁴⁸ The security interest is self-liquidating upon the collecting bank's receipt of final settlement.⁴⁹ This security interest is meant to be an additional form of protection for the collecting bank and does not supersede or derogate from a bank's general common law lien or right of setoff against indebtedness owing in deposit accounts.⁵⁰

HOLDER IN DUE COURSE

To the extent that a bank has a security interest in an item, it is considered to have given value therefor and becomes a holder in due course if it has otherwise complied with the requirements of section 3-302. That is, it must take the instrument as a holder⁵¹

45. CODE § 4-207(3).

46. CODE § 5-208.

47. If credit is given for several items received at the same time, the security interest attaches to all of them. CODE § 4-208(2). For purposes of the entire section, credits first given are first withdrawn. *Ibid.*

48. Such a security interest also has priority over conflicting perfected security interests in the item, accompanying documents or proceeds. CODE § 4-208(3)(c).

49. CODE § 4-208, comment 3.

50. *Ibid.*

51. To become a holder one must take by negotiation. See Code §§

in good faith and without notice of any defense against or claim to it on the part of any person or that the instrument is overdue or has been dishonored. This will apply, of course, only in the case of items that are negotiable. This does not represent a change in Minnesota law inasmuch as it was clear under the Uniform Negotiable Instruments Law that a holder with a lien on an instrument arising either by contract or operation of law was a holder for value to the extent of his lien.⁵²

The result of making collecting banks holders in due course will be to give them additional protection in the event of non-payment of an item. For example, if a depository bank receives a check for deposit and permits its customer to draw on the credit given, upon dishonor the bank will have a right to go back against prior parties even though they may have a defense good against the bank's customer.

PAYMENT AND SETTLEMENTS

Sections 4-211 to 4-213, among the most complex and technical provisions in the entire Code, deal with the problems of payments and settlements between banks in the collection chain. In order to make these provisions meaningful, it will be necessary to supply some details on the mechanics of the collection process.

When a bank receives a check from its depositor drawn on another bank, it will start the collection process by forwarding the check to the payor bank. In return, the depository bank will expect to receive some form of settlement from its transferee. In the collection of most cash items (such as checks), the settlement will be made through a clearing house or by debits and credits in an account between the banks. This settlement, by agreement or clearing house rule, usually will be provisional.⁵³ When the item reaches the payor bank and is finally paid, all the provisional settlements "firm up" and become final.⁵⁴ There is no

1-201(20), 3-202. In cases where an instrument has entered the collection process as order paper, an indorsement will be necessary to further negotiation. The question then arises whether a simplified bank stamp (such as an identifying number) would be an indorsement. The answer is probably yes in view of the broad definition of "signature" in § 3-401 and "signed" in § 1-201(39). See MINN. STUDY 486.

52. MINN. STAT. 335.133 (1961); UNIFORM NEGOTIABLE INSTRUMENTS LAW § 27.

53. Other forms of settlement are approved by § 4-211 which also states rules for determining when settlement in this manner becomes final.

54. CODE § 4-213(2).

requirement in the Code that such credits between collecting banks be solvent credits. As a consequence, a depository bank would become accountable to a customer on a check deposited for collection after the depository bank has had a reasonable time to learn that final settlement was made,⁵⁵ even though thereafter one of the banks in the collection chain became insolvent and the depository bank was unable to realize on the credit given to it. As the *Study of the Effect of the Uniform Commercial Code on Minnesota Law* indicates,⁵⁶ this is a change from prior Minnesota law which required the settlement to be in solvent credits before a depository bank became liable to its customer.⁵⁷

The crucial act in "firming up" provisional credits is the final payment by the payor bank. According to section 4-213(1):

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

- (a) paid the item in cash; or
- (b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or
- (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.

Payment in cash will occur most frequently when a payor bank receives an item over the counter from a party desiring cash. In this situation, of course, there will be no provisional settlement involved. Otherwise, the most common form of final payment in the collection process will be the completion of posting by the payor bank.

In the event of dishonor or some other form of nonpayment of an item, the entire process is reversed. Under section 4-301, on demand items a payor bank has until its midnight deadline to revoke a provisional settlement and return the item or send written notice of nonpayment,⁵⁸ provided the payor bank has not finally paid the item as defined in section 4-213(1). Section 4-212(1) gives substantially the same rights to a collecting bank,

55. CODE § 4-213(4)(a).

56. MINN. STUDY 509-10.

57. MINN. STAT. 335.75 (1961). See also *Bay State Milling Co. v. Hartford Acc. & Indem. Co.*, 193 Minn. 517, 259 N.W. 4 (1935).

58. Different rules apply if the payor bank is also the depository bank. See CODE § 4-301(2).

if it acts by its midnight deadline, provided that the settlement received by such a bank has not become final.

As an alternative to the complete reversal of the collection process in the case of dishonor, section 4-212(2) permits a payor or intermediary bank to return an unpaid item directly to the depository bank, accompanied by a draft drawn on the depository bank for collection and reimbursement. If the depository bank has received provisional credit for the item, it must reimburse the bank drawing the draft; consequently, all provisional credits given in the collection chain then become and remain final. This procedure is a rapid means of getting a check back to the bank which must ultimately pursue the parties to the instrument. It represents an innovation in banking practice, however, and was made an optional provision by the draftsmen.⁵⁹ This procedure is included in the Minnesota version of the Code.

PART THREE

DEFERRED POSTING

Part three deals with the role of the payor bank in the collection process. Section 4-301 is the deferred posting section. It makes only minor changes in Minnesota's pre-Code law.⁶⁰ Under subsection (1), a payor bank receiving a demand item (other than a documentary draft) has until its midnight deadline to revoke any provisional settlement given and return the item or give notice of nonpayment or dishonor. This rule only applies, however, if the payor bank has settled for the item before midnight of the day of receipt and has not finally paid the item. In a case where a bank is both depository and payor (*i.e.*, when it receives an "on us" item), subsection (2) gives the bank the same right to revoke credit given for the item⁶¹ and there is no requirement

59. The principal problem raised by direct return, but one not answered by the Code, involves the right of the payor bank to notify its presenting bank of dishonor of the item in order to preserve its right of charge-back in the event the draft sent to the depository bank is not honored. Section 4-301(1)(b) permits a payor bank to send a written notice of dishonor if the item is held for protest "or is otherwise unavailable for return." Whether an item is otherwise unavailable for return to a presenting bank because it has been sent directly to the depository bank is unclear. See the discussion in CLARKE, BAILEY & YOUNG, *op. cit. supra* note 20, at 88, 102-04.

60. See MINN. STAT. § 48.515 (1961); MINN. STUDY 517.

61. The MINNESOTA STUDY implies that credit given a depositor for an "on us" item may be revoked even though the item has been finally paid, in contrast to the provisions of § 4-301(1) relating to items received from pre-

that any settlement be made on the day of receipt.⁶²

In the event a payor bank fails to act within the time limits of section 4-301, section 4-302 provides that such a bank is accountable for the amount of an item whether the item is properly payable or not. Thus, the bank would be accountable, for example, even if there are insufficient funds available to pay the item. There is no comparable provision in the present deferred posting statute but analogous Minnesota cases decided prior to the enactment of the statute indicate that the same result would have been reached on the theory that the bank had become a constructive acceptor of the item.⁶³

STOP ORDERS AND OTHER ACTION AFFECTING AN ACCOUNT

The dilemma faced by a payor bank in determining priorities when it receives a stop order or garnishment on one of its accounts at the same time that it is holding items drawn on the account should be eliminated in most cases by the provisions of section 4-303. Under the terms of this section a stop order, as well as any knowledge, notice, legal process, or setoff cannot terminate, suspend, or modify the bank's right or duty to pay or charge a customer's account for an item if the bank has already taken certain specified actions with respect to the item. Generally, these include any actions which would constitute a certification or acceptance of the item, or a final payment under section 4-213(1). In addition, the bank may become accountable for the amount of an item if it fails to return the item or to send notice within the time limits specified by section 4-302 prior to the time it should have acted on the stop order. In such a case the stop order cannot affect that item.

In any case, the cutoff point is not the exact time at which the stop order, etc., is received; the bank has a reasonable time to act thereon. If any of the specified actions with respect to the item take place prior to the expiration of such reasonable time, the stop order is still defeated. If, for example, a bank in the

senting banks. MINN. STUDY 520. However, this is not entirely clear. Section 4-301(2) states that the right of charge-back is given to a depository-payor bank "if it acts within the time limit and in the manner specified in the preceding subsection." Thus, the draftsmen of this article may have meant to forbid charge-backs on "on us" items after final payment, just as in the case of other items. See FUNK, BANK DEPOSITS & COLLECTIONS 143 (2d ed. 1964), which disagrees with the MINNESOTA STUDY.

62. CODE § 4-301, comment.

63. MINN. STUDY 522-23.

exercise of reasonable care requires two hours from the time of receipt to get a stop order to that point in the bookkeeping department where it will serve as a proper warning, any completion in posting during this interval will serve to defeat the stop order even though the posting was done after the stop order was received.

ORDER OF HANDLING ITEMS

Under section 4-303(2), a payor bank may accept, pay, or certify items or charge them to the indicated account in any convenient order.

PART FOUR

THE RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

Part 4 consists of seven sections dealing with the relationship between the payor bank and its checking account customer. It makes significant changes in existing Minnesota law.

The deposit contract, which is entered into when the customer opens his account, establishes the relationship between the bank and the customer. This relationship is also subject to statutory regulation which varies considerably from state to state. Part 4 codifies some deposit contract provisions and incorporates some of the more desirable state statutory provisions.

WHEN A BANK MAY CHARGE A CUSTOMER'S ACCOUNT

Section 4-401(1) permits the bank to charge an overdraft to its customer's account and is merely a codification of existing Minnesota law.⁶⁴ In effect, the bank has loaned money to the customer who, by the act of drawing the check against nonexistent funds, has promised to repay the loan. It is not clear under present Minnesota law as to whether the bank can charge an overdraft against all members of a joint account. However, it has been suggested that the Code, because of its broad definitions of "Customer" and "Account" in section 4-104, authorizes the bank to charge an overdraft to all members of an overdrawn joint account.⁶⁵

64. See *Mendota State Bank v. Riley*, 203 Minn. 409, 281 N.W. 767 (1938).

65. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE, 385-386. *But see* *National Bank v. Derhammer*, 27 Lehigh 519, 16 Pa. D. & C.2d 286 (C.P. 1958), where the court stated that it was not the intention of article 4 to impose this liability upon a codepositor.

Section 4-401(2) changes present Minnesota law to some extent.⁶⁶ A bank which pays an altered item in good faith may charge the customer's account according to the original tenor of the item. Further, the bank may charge the customer's account according to the tenor of a completed item, even though it knew the item was incomplete when delivered unless it had notice that the completion was improper. Under Minnesota Statutes sections 335.08 and 335.48 (1961), if the bank had paid a holder in due course who had the rights set forth by those statutes, as against the drawer, the bank was subrogated to those rights. If, however, the bank in good faith had paid the wrongdoer or one who was not a holder in due course, the bank had no rights against the drawer under the subrogation theory. This can be illustrated with the following example. If a customer left a signed blank check in his desk drawer and if his employee took the check, filled it in and cashed it at the drawee bank, the bank could not have charged the check against the drawer's account under section 335.08. Under subsection 4-401(2)(b) of the Code, however, the bank can charge the account if the bank had no notice of the improper completion. This result is entirely reasonable and is in accordance with the policy of the Code to place the burden of loss on the one who is in the best position to prevent it.⁶⁷

BANK'S LIABILITY TO CUSTOMER FOR WRONGFUL DISHONOR

As noted above, the relationship between the payor bank and its customer is a contractual one whereby the bank agrees to pay checks drawn against the account if certain conditions are met. These include a proper signature on the check, proper endorsement, and an adequate balance in the account to cover the amount of the check. If the bank fails to pay the check when the requisite conditions exist, it may be liable to the customer for wrongful dishonor. Section 4-402 sets forth a reasonable set of rules covering a bank's liability for wrongful dishonor. Actual damages must be proved by the customer, including damages to traders or merchants, which eliminates the "slander per se" rule established in *Svendson v. State Bank*,⁶⁸ and followed in a number of subsequent Minnesota cases.⁶⁹ Since section 4-402 does not

66. Compare CODE § 4-401(2), with MINN. STAT. §§ 335.08, .48 (1961).

67. See CODE §§ 3-115, comment, 3-407, comment.

68. 64 Minn. 40, 65 N.W. 1086 (1896).

69. See, e.g., *Marudas v. Odegard*, 215 Minn. 357, 10 N.W.2d 233 (1948); *Swanson v. First Nat'l Bank*, 185 Minn. 89, 239 N.W. 900 (1931).

state any rule of damages for wrongful and willful dishonor, it is possible that the customer can recover substantial damages without proving actual loss in the event of a willful dishonor.

CUSTOMER'S RIGHT TO STOP PAYMENT

Although the customer's right to stop payment was not covered by the Uniform Negotiable Instruments Law, Minnesota (and a number of other states) adopted a specific statute covering stop payment orders. Minnesota Statutes section 48.518 (1961), authorized stop payment orders for a period of six months and required the bank to give at least thirty days written notice of expiration of the six month period. It was not clear under section 48.518(3) whether the right to stop payment was limited to the drawer or whether the payee or a holder also could have stopped payment on a demand item. Code section 4-403, however, limits the right to stop payment to "a customer."

Section 4-403 also validates a *written* stop payment order for an initial period of six months and imposes the obligation on the customer to renew the stop payment in writing. The prior requirement⁷⁰ that the bank had to give at least thirty days written notice of the expiration of the six month period has been eliminated.⁷¹

Section 4-403(2) contains a new provision expressly validating oral stop payment orders for a period of fourteen days. This oral order automatically expires at the end of the fourteen day period unless it is confirmed in writing within the period. Although Minnesota Statutes section 48.518 (1961), was silent on the question, the deposit contract used by most Minnesota banks provides that the bank has no obligation to comply with stop payment orders unless they are in writing and delivered to the bank during regular banking hours. Such an exculpatory provision was probably valid under prior law. Under section 4-103 of the Code, however, banks may not be able to shorten or eliminate the fourteen day period.

It has also been customary for banks to insert a provision in the deposit contract excusing the payment of a check over a stop payment order through inadvertance or oversight. While there are no reported Minnesota decisions on this point, the Minnesota Supreme Court has recognized the right of a party to

70. See MINN. STAT. § 48.518(3) (1961).

71. CODE § 4-403(2).

contract against his negligence.⁷² The decisions in other states are in hopeless conflict.⁷³ Under section 4-103, however, it appears that such exculpatory clauses may not be effective to limit bank liability for paying over a stop payment order. The subrogation rights conferred by section 4-407, however, do offset some of the disadvantages to banks imposed by section 4-103. In addition, under section 4-403(3) the customer has the burden of establishing the amount of loss resulting from a payment made over his stop order. This will also help to mitigate the effect of the strict rule imposed by section 4-103.

Section 4-403(1) helps to clarify former Minnesota law by providing that a stop payment order "must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it" The section, however, does not state how much information must be furnished to the bank, nor does it provide any defense against a false claim that a customer gave the bank an oral stop payment order over the telephone.⁷⁴

BANK NOT OBLIGATED TO PAY CHECK MORE THAN SIX MONTHS OLD

Minnesota, unlike a majority of the states, never adopted a "stale check" statute. Furthermore, there does not appear to have been any uniformity among Minnesota banks as to when a check was "stale." This, of course, placed Minnesota banks in a hopeless dilemma. If a check several months old was presented, and if the bank was unable to contact its customer, the bank could be sued for wrongful dishonor if it refused to pay; or, if it paid the check,

72. *Weirick v. Hamm Realty Co.*, 179 Minn. 25, 228 N.W. 175 (1929); *James Quirk Milling Co. v. Minneapolis & S.L. Ry.*, 98 Minn. 22, 107 N.W. 742 (1906). In *Semingson v. Stock Yards Nat'l Bank*, 162 Minn. 424, 203 N.W. 412 (1925), it was held that a bank may effectively limit its liability for the negligence of its correspondents. With respect to the validity of exculpatory provisions in stop payment orders, see 34 MINN. L. REV. 330 (1950); 33 MINN. L. REV. 179 (1949); 14 MINN. L. REV. 172 (1930).

73. It appears that the recent trend of the courts has been to invalidate such exculpatory clauses on the ground of lack of consideration, or on the ground that such clauses are against public policy. See CLARKE, BAILEY & YOUNG, *BANK DEPOSITS AND COLLECTIONS* 154-55 (3d ed. 1963), for a brief discussion of the more recent decisions in this area.

74. Some solace for the banks can be derived from *Dinger v. Market Street Trust Co.*, 69 Dauph. 236, 7 Pa. D. & C.2d 674 (C.P. 1956). The court held that the customer had not met his burden of proof since he failed to establish when he gave the oral stop payment order and the name of the bank employee to whom he gave the order.

it might have been sued on the ground that the check was "stale." Section 4-404 establishes the clear rule that checks more than six months old do not have to be honored. Section 4-404, however, is not applicable to certified checks which, under Minnesota law, the drawee bank is obligated to pay if presented within six years.

DEATH OR INCOMPETENCE OF CUSTOMER

Section 4-405(1) merely sets forth the generally accepted rule that the drawee bank is not liable for payment of a check before it has notice of the death or incompetence of the drawer. Section 4-405(2), which is new in Minnesota, permits the drawee to collect, pay, or certify its customer items for a period of ten days after the death, even though the bank has knowledge of the death, "unless ordered to stop payment by a person claiming an interest in the account." This is a sensible rule because the checks of a decedent are normally given in immediate payment of an obligation; there is almost never any reason why they should not be paid; and filing a claim in probate is a useless formality, burdensome to the holder, the executor, the court, and the bank.⁷⁵ Inasmuch as the bank merely has a permissive right to pay checks, it should comply with any stop payment request from any person claiming an interest in the decedent's account without attempting to ascertain whether or not the claim is bona fide.

THE CUSTOMER'S DUTY TO DISCOVER AND REPORT UNAUTHORIZED SIGNATURES OR ALTERATIONS

It is the practice of Minnesota banks to furnish periodic bank statements to their customers together with the canceled checks covered by the bank statements. It is generally held that the depositor has a duty to examine, with ordinary care, the bank statement within a reasonable time and to report forgeries or irregularities which he discovers or should have discovered.⁷⁶ The reason for this rule, of course, is that forgery or the alteration can be most readily discovered by the depositor.⁷⁷ Section 4-406(1) codifies this duty of the depositor. It should be noted, however,

75. CODE § 4-405, comment.

76. See *Scanlon-Gipson Lumber Co. v. Germania Bank*, 90 Minn. 478, 97 N.W. 380 (1903); 2 PATON, DIGEST OF LEGAL OPINIONS 1872 (1940).

77. *Wm. M. Barrett, Inc. v. First Nat'l Bank*, 191 La. 945, 186 So. 741 (1939).

that the customer does not have a duty to examine indorsements in order to ascertain the genuineness of the payee's signature.⁷⁸ Section 4-406(2)(a) requires the bank to establish that the customer's failure to carry out the duties imposed in section 4-406(1) prejudiced the bank.

Section 4-406(2)(b) is new in Minnesota. If a wrongdoer forges or alters other items which the bank pays after the depositor has had a reasonable period of time to discover the first forgery or alteration, the depositor is thereby precluded from asserting a claim against the bank.

Under prior law, a claim on a forged or raised check was required to be presented within six months after receipt of the bank statement.⁷⁹ Section 4-406(4) makes another change in Minnesota law by lengthening the limitation period to one year without regard to due care or negligence on the part of the bank or its customer. This subsection also includes a completely new provision which creates a three-year limitation period on claims based on unauthorized indorsements.

Section 4-406(5) is also new. If the drawee bank waives a valid defense against a claim of its customer, it may not assert the claim against any collecting bank or prior party by virtue of an unauthorized signature or alteration.

PAYOR BANK'S RIGHT TO SUBROGATION ON IMPROPER PAYMENT

In the discussion of section 4-403, it was pointed out that exculpatory clauses in the bank's form of deposit contract may not be effective to limit the bank's liability with respect to payments made over a stop payment order. To some extent at least, section 4-407 mitigates the effect of this rule. It is apparent under section 4-407(a) that if the bank has paid a check contrary to a stop payment order, the bank is subrogated to the rights of any holder in due course who received payment from the bank.

If the bank has made payment contrary to a stop payment order and the payee or holder who received the payment is not a holder in due course, under section 4-407(b) the bank can bring an action against the drawer to recover on the underlying transaction. The bank, of course, would be subject to any defenses the drawer might have. If the drawer has a valid defense, the bank can resort to section 4-407(c) and bring an action against the

78. This in accordance with prior law. See 2 PATON, *op. cit. supra* note 76, at 1877.

79. MINN. STAT. § 48.29 (1961).

holder who received the payment. Theoretically, at least, the bank will be made whole if it gets jurisdiction over both the drawer and the holder in a single action. This right of subrogation against the payee apparently is a new concept not heretofore recognized by any court.⁸⁰

PART 5

This part of article 4 deals with the collection of "documentary drafts" which are defined by section 4-104(f) as "any negotiable or non-negotiable draft with accompanying documents, securities or other papers to be delivered against honor of the draft."

A typical transaction involving the collection of a documentary draft is one in which a seller on the west coast agrees to ship goods to a buyer in Minnesota on condition that the Minnesota buyer accept a draft before he obtains possession of the goods. The seller then delivers the goods to a carrier, obtains a bill of lading from the carrier and attaches it to a draft which he then discounts or delivers to a bank for collection. In either case the bank must present the draft or send it for presentment. The collecting bank customarily will notify the buyer in writing that it holds the item and that presentment is being made.⁸¹ If the bank learns that the draft has not been paid or accepted in due course, it must reasonably notify its customer, in this case the seller, of such fact.⁸²

Occasionally a documentary draft will require the collecting bank to present it "on arrival," "when goods arrive," or the like. Under former Minnesota law the proper procedure for the collecting bank to follow upon receiving an "on arrival" draft was not clear. Section 4-502 eliminates any doubt, however, by stating that "the collecting bank need not present until in its judgment a reasonable time for arrival of the goods had expired." It does not constitute dishonor if the buyer of the goods refuses to pay or accept the draft because the goods have not arrived. The collecting bank must notify its transferor of such refusal; but it need not present the draft again until it is instructed to do so or learns of the arrival of the goods.⁸³ Additional duties of the presenting bank are spelled out in section 4-503.⁸⁴

80. See CLARKE, BAILEY & YOUNG, *op. cit. supra* note 73, at 160.

81. This method of presentment is permissible under CODE § 4-210.

82. CODE § 4-501.

83. CODE § 4-502.

84. This section should also be considered in conjunction with article 5 and with CODE § 2-514 which covers when documents are deliverable on acceptance

If the presenting bank notifies its transferor of the dishonor and has requested the transferor for instructions but has not received them within a reasonable time, it is then authorized to deal with the goods in any reasonable manner.⁸⁵ The presenting bank is also given a lien upon the goods or their proceeds for expenses incurred by it in taking steps to handle the goods in such an event. It may foreclose its lien in the same manner as an unpaid seller's lien.⁸⁶

CONCLUSION

The bulk of article 4 will not work any significant changes in the Minnesota law on bank collections and deposits. The article is, without question, much more comprehensive in scope than any previous legislation in this area. It undoubtedly will clarify some of the more troublesome areas of bank collections and deposits. The chief value of article 4, however, would seem to be the recognition by the draftsmen that the handling of bank collections and deposits has become a high volume process that demands extreme speed on the part of the banks involved. It is hoped, therefore, that judicial interpretations of article 4 will be consistent with the policy considerations underlying this comprehensive and flexible statute.

and when on payment. If the draft is drawn under a letter of credit, article 5 controls.

85. CODE § 4-504(1).

86. CODE § 4-504(2).