[Florida Law Review](https://scholarship.law.ufl.edu/flr)

Volume 37 | Issue 4 Article 5

September 1985

The Uniform New Payments Code: You Can Bank on It

Melanie S. Cherdack

Follow this and additional works at: https://scholarship.law.ufl.edu/flr

Part of the Law Commons

Recommended Citation

Melanie S. Cherdack, *The Uniform New Payments Code: You Can Bank on It*, 37 Fla. L. Rev. 863 (1985).
Available at: https://scholarship.law.ufl.edu/flr/vol37/iss4/5

This Note is brought to you for free and open access by UF Law Scholarship Repository. It has been accepted for inclusion in Florida Law Review by an authorized editor of UF Law Scholarship Repository. For more information, please contact kaleita@law.ufl.edu.

NOTE

THE UNIFORM NEW PAYMENTS CODE: YOU CAN BANK ON IT

I. INTRODUCTION 863
II. FINAL PAYMENT: *Price v. Neal* 865
A. *Forged Signature v. Forged Indorsement* 869
III. CURRENT REGULATION OF ELECTRONIC BANKING 871
A. *Emergence of EFT Systems* 871
B. *Electronic Payment Systems* 872
C. *Scope of EFTA* 874
IV. EFTA UNAUTHORIZED TRANSFER LIABILITY 875
A. *EFTA More Favorable to Consumers Than the UCC for Unauthorized Transactions* 875
B. *Insufficient Banking Regulations* 876
V. THE USE OF COMPUTERS IN CHECK COLLECTION LEADS TO REGULATORY PROBLEMS 877
A. *MICR Posting* 877
B. *Electronic Check Truncation Posting* 879
VI. THE NEED FOR UNIFORM TREATMENT OF FINANCIAL TRANSACTIONS 880
A. *Forgery Categorization Under the UCC and the EFTA* 881
VII. UNIFORM NEW PAYMENTS CODE 882
A. *Uniform Treatment Invites New Problems in Check Regulation* 886
B. *The Policy Choice is Finality or Fairness* 887
VIII. CONCLUSION 888

I. INTRODUCTION

X owns a company and uses a checking account to handle its financial transactions. He negligently leaves the company checkbook unattended and an opportunistic employee steals these checks, forges fictitious payee names, and cashes them. About two months later, while examining an old bank statement, X discovers these forgeries. Unfortunately, due to X's negligent actions, he is unable to recover any monies paid out by his financial institution and he himself must bear this loss.

Y also owns a company and handles her business finances through an Automated Clearing House (ACH) system. She negligently leaves her ACH authorization forms unguarded and a dishonest employee uses them to obtain money from the account. About two months later, Y discovers these unauthorized transactions in her company bank statement. At this point, if she

Published by UF Law Scholarship Repository, 1985

notifies the bank, she is only liable for a maximum of fifty dollars of the loss. This incongruity in liability illustrates a common problem found when legal guidelines governing various financial transactions differ depending on the form of the transaction.

A barrage of electronic based payment systems[1] now permeates the financial transactions area. The affect of the Uniform Commerical Code (UCC)[2] on such systems, however, has become less certain with the advent of the Electronic Funds Transfer Act (EFTA),[3] leaving some electronic payment systems apparently unpoliced.[4] In reaction, the Permanent Editorial Board (PEB)[5] of the UCC, in 1977, created the "3-4-8" Committee (the Committee)[6] to determine whether the inapplicability of the UCC to electronic funds transfer (EFT) transactions poses serious legal ramifications.[7] In 1978, the Committee received a report[8] recommending modification or replacement of UCC articles 3[9] and 4[10] in order to create similar legal guidelines for all non-cash payment systems.[11] By attaching identical legal consequences to all payment methods, statutory considerations would no longer affect user choice.[12]

After much debate,[13] the PEB authorized the Committee to draft an outline

---

1. An electronic payment system replaces a paper order or promise of payment or credit with an electronically-generated message.

2. U.C.C. (1978). The U.C.C. is written by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

3. 15 U.S.C. §§ 1693-1693r (1982). The EFTA has been implemented by Regulation E, 12 C.F.R. §§ 205.1-.14 (1985).

4. Historically, the financial community has opposed legislation, claiming the banks are best suited to set standards through private contract. Mittelsteadt, *The Stop Payment Right in an Electronic Payment Environment: An Analysis of the Transition Problems Involved When Integrating a Traditional Right Into New Value Transfer Systems*, 17 NEW ENG. L. REV. 355, 360 (1982).

5. The PEB was created by the sponsors of the Uniform Commercial Code to promote uniformity in the promulgation and construction of the Uniform Commercial Code and to propose and evaluate any revisions. Miller, *A Report on the New Payments Code*, 39 BUS. LAW. 1215, 1215 n.1 (1984).

6. The "3-4-8" Committee is a subcommittee of the PEB, set up to review U.C.C. articles 3, 4 and 8 in relation to their applicability to new developments in the transfer of funds. The committee is comprised of 11 members involved in the areas of law, academics and consumer advocacy. H. SCOTT, AN INTRODUCTION TO THE UNIFORM NEW PAYMENTS CODE, P.E.B. DRAFT NO. 3 (1983) (prepared for the National Conference of Commissioners on Uniform State Laws).

7. *Id.*

8. H. Scott, Report to the 3-4-8 Committee (Feb. 1978).

9. Article 3 of the U.C.C. entitled "Commercial Paper" governs the characteristics and requirements of commercial paper, while articulating the rights and obligations of the parties on negotiable instruments. U.C.C. art. 3.

10. Article 4 of the U.C.C. entitled "Bank Deposits and Collections" governs check collection and sets out requirements for banks and their customers. *Id.* art. 4.

11. Non-cash payment systems include all electronic and card based payment systems.

12. Haydock, *The 3-4-8 Committee — An Interim Report*, 2 COMP. L.J. 27, 28 (1980). The New Payments Code is "the first attempt to compare, cross-justify and [condense] such payment system rules" to the greatest extent possible. Scott, *Corporate Wire Transfers and the Uniform New Payments Code*, 83 COLUM L. REV. 1664, 1666 (1983).

13. In the spring of 1978, at an invitational meeting in Williamsburg, Virginia, bankers, lawyers, academics, consumer advocates and legislators discussed the necessity and possibility of drafting a new payments code. *See* H. SCOTT, *supra* note 6, at 2.

for a "Uniform New Payments Code" (NPC).[14] Following many discussion drafts, the PEB submitted Draft #2 of the NPC to the ABA Commissioners[15] in May 1982. The subsequent public distribution of Draft #2 encouraged open consideration and criticism.[16] In response to general comment, the PEB presented Draft #3 in July 1983. The ABA Commissioners, objecting primarily to the consumer disclosure provisions,[17] failed to approve this as an Official Draft.[18] Until approval and promulgation of the final NPC draft,[19] a closer examination into consequences arising from parallel treatment of paper and electronic based mechanisms is mandated.

The effectuation of an all-encompassing uniform payments regulation will require significant changes in contemporary check law.[20] The most dramatic deviations include a three-day limit after check issuance for stop payments,[21] the abrogation of holders in due course status for consumer checks,[22] and the abolition of the forged drawer's signature rule of *Price v. Neal*.[23] This note will explore both the legal and practical aspects of the NPC's proposed forged drawer rule. After a brief analysis of the time honored doctrine of *Price* and the subsequent emergence of EFTs, the author will examine the need for a uniform system of payments regulation. Next, this Note will study the policy arguments for and against the proposed NPC section in relation to traditional theories underlying modern check law. Finally, the author will recommend legislation digressing from established UCC principles in order to better accommodate both paper and electronic-based financial transactions.

II. FINAL PAYMENT: *Price v. Neal*

The final payment doctrine, set out in *Price*,[24] expounds a rule predating the UCC by two centuries. Under Lord Mansfield's famous opinion, the drawee

14. *Id.*

15. There must be at least two readings before the Commissioners can approve a draft of the Uniform New Payments Code. National Conference of Commissioners on Uniform State Laws Const. §§ 8.1, .2 & .3, *reprinted in* THE HANDBOOK OF NATIONAL CONFERENCE OF COMMISSIONERS 254-61 (1979).

16. The 3-4-8 Committee invites comments and ideas from banking and bar associations.

17. Telephone interview with Hal S. Scott, Professor of Law at Harvard University Law School, and Reporter to the 3-4-8 Committee of the PEB (Jan. 14, 1985). Part I of the NPC draft incorporates various disclosure requirements of the Truth in Lending Act (TILA) and Regulation E of the EFTA.

18. The American Law Institute Council and its members must also approve the final draft. A.L.I. Bylaws, pt. V, 58 A.L.I. Proc. 667, 672 (1981).

19. The NPC is likely to be promulgated after a new draft is constructed excluding the controversial consumer provisions. Prutzman, *CHIPS and the Proposed Uniform New Payments Code*, 10 RUTGERS COMP. & TECH. L.J. 1, 8 (1983).

20. Vergari, *A Critical Look at the New Uniform Payments Code*, 9 RUTGERS COMP. & TECH. L.J. 317, 319-20 (1983).

21. *See generally* Note, *Stop Payment in the New Uniform Payments Code*, 9 RUTGERS COMP. & TECH. L.J. 353 (1983) (discussion of the new three-day stop payment limit).

22. *See generally* Benfield, *The New Payments Code and the Abolition of Holder in Due Course Status as to Consumer Checks*, 40 WASH. & LEE L. REV. 11 (1983) (discussing the effect of the new holder in due course provision in relation to transferees of consumer checks).

23. 3 Burr. 1354, 97 Eng. Rep. 871 (1762).

24. *Id.* In reaching his celebrated decision that the drawee is bound to know the signature

is bound to know the signature of his drawer.[25] Therefore, money mistakenly paid out under a forged drawer's signature is not recoverable by the drawee.[26] This proposition is contrary to the well-settled contract principle that money paid under a mistake of fact is recoverable unless inequity would result.[27] Lord Mansfield postulated his equitable solution on the premise that the drawee owes a duty to the drawer to examine the check signature carefully.[28]

United States courts have followed the *Price* rule fairly consistently.[29] The earliest published decision appeared in the 1902 Pennsylvania case of *Levy v. Bank of United States*.[30] In *Levy*, a bank received a forged check from an innocent holder and debited the drawer's account, while crediting the holder's account.[31] Upon discovering the forgery, the bank charged the holder's account for the loss. The holder sued the bank and recovered the money under the rationale of *Price*.[32] The United States Supreme Court adopted the rule twenty-three years later.[33] Since then, courts have found the *Price* doctrine applicable to forged drawer cases under various circumstances.[34]

A frequently cited rationale for disallowing drawee banks from recovering money paid out on a forged check is the irrationality of expecting an indorsee or subsequent holder of a check to ascertain whether the drawer's signature is genuine.[35] In comparison, a drawee bank may recover money mistakenly paid out under a forged indorsement[36] because the assumption that the drawee knows

---

of his drawer, Lord Mansfield addressed the plaintiff-drawee's liability for the forged draft, stating:

> Here was no fraud: no wrong. It was incumbent upon the plaintiff, to be satisfied "that the bill drawn upon him was in the drawer's hand," before he accepted or paid it: but it was not incumbent upon the defendant, to inquire into it...if there was any fault or negligence in any one, it certainly was in the plaintiff, and not in the defendant.

Id. at 1357, 97 Eng. Rep. at 872.

25. *Id.*

26. For a comprehensive treatment of the history of check forgery law, see generally F. BRADY, THE LAW OF FORGED AND ALTERED CHECKS (1st ed. 1925).

27. RESTATEMENT (SECOND) OF RESTITUTION § 20 (1978). *See also* Germania Bank v. Boutell, 60 Minn. 189, 62 N.W. 327 (1895).

28. *See Price*, 3 Burr. at 1357, 97 Eng. Rep. at 872.

29. H. BAILEY, BRADY ON BANK CHECKS § 22.12 (5th ed. 1979).

30. 1 Binn. 27 (Pa. 1802).

31. *Id.*

32. *Id.*

33. Bank of the United States v. Bank of Georgia, 23 U.S. (10 Wheat.) 333 (1825).

34. *See, e.g.*, Dedham Nat'l Bank v. Everett Nat'l Bank, 177 Mass. 392, 59 N.E. 62 (1901) (holding drawee bank could not recover for paying out on a forged signature, even though the depository bank dealt with the forger); National Bank v. Marshburn, 229 N.C. 104, 47 S.E.2d 793 (1948) (application of *Price* rule where bank paid a check by charging the account of customer with same name as actual drawer). *But see* Hardy v. Chesapeake Bank, 51 Md. 562, 563 (1879) ("[I]f the bank pays money on a forged check, no matter under what circumstances of caution, or however honest the belief in its genuineness, if the depositor himself be free of blame, and has done nothing to mislead the bank, all the loss must be borne by the bank...."); American Express Co. v. State Nat'l Bank, 27 Okla. 824, 113 P. 711 (1911) (holding drawee bank may recover after paying out under a forged drawer's signature).

35. *See, e.g.*, Neal v. Coburn, 92 Me. 139, 42 A. 348 (1898).

36. *See, e.g.*, Krinsky v. Pilgrim Trust Co., 337 Mass. 401, 149 N.E.2d 665 (1958) (pre-UCC case holding a bank which pays on a forged indorsement is generally entitled to recover

whether indorsements are genuine is equally unrealistic. The drawee is only in a superior position to know the drawer's signature, not signatures of subsequent indorsees.[37] At the turn of the century, notes and drafts comprised the currency of commerce.[38] Therefore, the need to place an ascertainable end point on fraudulent business transactions became important.[39] Additionally, individual determinations on a case-by-case basis would have led to commercial uncertainty.[40] The need for a swift determination of liability in commercial paper transactions allowed the *Price* principle to flourish in the twentieth century.

After the inception of the negotiable instruments law (NIL),[41] judicial interpretations[42] indicated that a statutory provision codified[43] the *Price* doctrine. The NIL provided that an acceptor, when accepting an instrument, admits the drawer's signature is genuine.[44] Many courts held this rule applicable even without prepayment acceptance by the drawee.[45] Thus, although the final payment language was absent from the NIL, courts applied the rule through statutory construction.[46] Subsequently, the UCC expanded the original NIL and expressly codified the doctrine of *Price*.[47]

UCC section 3-418[48] states that, except for liability for breach of warranty on presentment, payment or acceptance of any instrument is final in favor of

---

money paid out); Hibernia Nat'l Bank v. National Bank of Commerce, 204 La. 777, 16 So. 2d 352 (1943) (a bank paying out under a forged indorsement may recover money from presentor or prior collecting bank).

37. *But see* J. WHITE & R. SUMMERS, THE UNIFORM COMMERCIAL CODE § 16-2 (2d ed. 1980). There is no adequate rationale to explain the difference between the liability of the drawee bank on checks bearing forged signatures and its liability on those bearing forged indorsements. *Id.*

38. *See generally* F. BRADY, *supra* note 26.

39. Comment, *Allocation of Losses from Check Forgeries Under the Law of Negotiable Instruments and the Uniform Commercial Code*, 62 YALE L.J. 417, 459-60 (1953). The commercial transactions during the late 19th century were entirely by means of drafts and checks. *See, e.g.*, Germania Bank v. Boutell, 60 Minn. 189, 62 N.W. 327 (1895).

40. *See* Neal v. Coburn, 92 Me. 139, 42 A. 348 (1898).

41. N.I.L. § 62 (1927).

42. *See, e.g., id.*

43. However, §§ 65 and 66 presented problems for those insisting the doctrine of *Price* was included, because these sections required indorsers to warrant the instrument as genuine.

44. *Id.* § 62.

45. *See, e.g.*, Fidelity & Cas. Co. v. Planenscheck, 200 Wis. 304, 227 N.W. 387 (1929).

46. *See* Banca Commerciale Italiana Trust Co. v. Clerkson, 274 N.Y. 69, 8 N.E.2d 281 (1937). *But cf.* South Boston Trust Co. v. Levin, 249 Mass. 45, 143 N.E. 816 (1924) (holding *Price* not included in the NIL, but that the doctrine is part of common law and could be applied regardless).

47. U.C.C. § 3-418, comment 1 (1978) (specifically stating the U.C.C. has adopted the rule of *Price*).

48. *Id.* § 3-418. The Finality of Payment or Acceptance rule reads:

> Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.

Id.

a holder in due course,[49] or a person who has in good faith changed his position in reliance on payment. However, these presentment warranties[50] do not include a warranty to the drawee that the drawer's signature is not a forgery.[51] The presentor merely warrants he accepts payment from a drawee without knowledge that the drawer's signature is unauthorized or forged.[52] Together, these code provisions effectively adopt the *Price* rationale with regard to forged checks paid by drawees.

The UCC goes beyond the basic final payment doctrine by applying the rule to other parties to the transaction as well as to drawees. The code implies other parties may be subject to this rule by extending only the limited knowledge of forgery warranty to any maker, drawer, indorser, or drawee-acceptor who makes payment.[53] Consequently, any one of these parties paying out under a forged signature cannot sue his presentor for breach of warranty unless he shows the presentor's knowledge of the forger. This "no knowledge" provision is narrowed further by the exception that if a holder in due course acquires a forged check after the drawee's acceptance, the holder may still invoke the final payment rule, even if he learned of the forgery prior to presentment.[54] For example, a holder of a previously accepted check, who later acquires knowledge of its forged signature, does not breach a presentment warranty and may force payment.[55] Conversely, if the holder learns of the forgery after he received the check and then presents it for payment or acceptance, the "no knowledge" presentment warranty is breached.[56] This result overrides application of the final payment rule to the drawee.

Since actual knowledge is difficult to prove, a drawee bank usually cannot collect from its presentor. Likewise, the drawee cannot collect funds from the drawer, because the bank must follow the UCC-imposed contractual duty of charging only items "properly payable"[57] to its customers. If a bank pays out on an item not "properly payable," it breaches its contract with its drawer and is precluded from recovery.[58] However, some UCC protection is afforded the bank because a customer who is negligent is prohibited from asserting a forgery claim.[59] Customer negligence includes failure to exercise "reasonable care and promptness" in examining bank statements and cancelled checks for

---

49. *Id.*

50. *Id.* §§ 3-417(1)(b), 4-207(1)(b).

51. *Id.* These U.C.C. provisions warrant that the presentor has no knowledge that the signature of the maker or drawer is unauthorized. *Id.*

52. *Id.*

53. *Id.* § 3-418, comment 1 specifically states payment or acceptance can be from any party in order to invoke the presentment warranty.

54. *Id.* § 3-417(1)(b)(iii).

55. *Id.* § 3-417, comment 4.

56. *Id.*

57. *Id.* § 4-401.

58. An order by the customer carries with it an implied promise by the customer to reimburse the bank and an implied authorization to charge the customer's account. *Id.* § 4-401, comment 1.

59. *Id.* § 4-406.

unauthorized signatures.[60] Additionally, estoppel prevents a customer from asserting any subsequent forgeries if he does not notify the bank within fourteen days after receiving the first forged check in his bank statement.[61] Despite customer negligence, the drawer may still be able to assert the final payment doctrine if he establishes lack of ordinary care by the payor bank.[62] However, if the customer's negligence substantially contributed to the creation of the unauthorized signature, he is precluded from asserting the *Price* UCC provision.[63]

Although various UCC sections deal with negligence, negligent conduct is not defined.[64] Thus, factual determinations must be made on a case-by-case basis to determine whether customer negligence will preclude utilization of the final payment doctrine. This analysis is not parallelled, however, when determining liability in forged indorsement cases.

A. *Forged Signature v. Forged Indorsement*

The UCC defines unauthorized signature or indorsement as a forgery, or as any indorsement made without actual, implied or apparent authority.[65] Thus, a check bearing a forged indorsement is not properly payable[66] because the person receiving payment has no title to the check and no right to any of the proceeds. Any such payment by the bank is a breach of contract to its customer to pay out only in accordance with the drawer's order.[67] In this respect, the payor bank faces essentially the same liability as it would when paying on a forged check. However, UCC treatment of forged indorsements differs markedly from its treatment of forged drawer's signatures because recovery by the bank from prior parties is possible under warranty principles.[68] By allowing the drawee bank to sue anyone in the chain of indorsers, the indorsement warranty virtually prohibits enforcement of the final payment rule on banks. Under this warranty,

---

60. *Id.* If the bank establishes that the customer failed to exercise reasonable care and promptness in examining his bank statement, he will be precluded from asserting the unauthorized signature in his case. *Id.*

61. *Id.* § 4-406(2)(b).

62. *Id.* § 4-406(3). *See, e.g.*, Jackson v. First Nat'l Bank, 55 Tenn. App. 545, 553, 403 S.W.2d 109, 113 (1966).

63. U.C.C. § 3-406 (1978) (comment 7 gives as an example a drawer who negligently leaves his signature stamp unsafeguarded).

64. *See id.* Not many cases are decided under *id.* § 3-406. Lechner, *The Drawer's Negligence: A Powerful But Underutilized Defense in Forged Check Cases*, 15 U.C.C. L.J. 291, 293 (1983). Although the defense is available, drawees often do not assert it. *See, e.g.*, First Bank & Trust Co. v. Insurance Serv. Ass'n, 154 Ga. App. 697, 269 S.E.2d 527 (1980).

65. U.C.C. § 1-201(43) (1978).

66. *Id.* § 4-401(1).

67. *See, e.g.*, Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 184 N.E.2d 358 (1962) (the drawer can require the drawee to recredit his account when it paid out under a forged indorsement); Philadelphia Title Ins. Co. v. Fidelity-Philadelphia Trust Co., 419 Pa. 78, 212 A.2d 222 (1965) (a forged indorsement by an imposter is not properly payable).

68. U.C.C. § 3-417, comment 8 (1978). An indorser warrants all signatures are genuine or authorized. *Id.* § 3-417(2)(b). Where there is an indorsement, the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly. *Id.* § 3-417, comment 8.

an indorser warrants to all subsequent holders his good title to the check.[69] This warranty that all indorsements on the check are genuine and authorized, is not limited to "no knowledge" of forgeries as it is in the forged signature scenario. When an indorser transfers paper bearing a forged indorsement, the warranty is breached regardless of knowledge.[70] If the drawee bank pays on such a draft, it may then sue any previous indorser for money paid out. Each indorser may then sue any previous indorser in the chain, until the party who dealt with the forger is sued.[71]

Courts have reacted vehemently to this unparallel treatment of forged checks and forged indorsements.[72] *Perini Corp. v. First National Bank*[73] illustrates the inefficacy of this dichotomy. In *Perini*, the checks in question bore both forged drawer's signatures and forged indorsements.[74] The court, in discussing the divergent rules addressing forgeries, reasoned the UCC set up a strict liability system resting on two flawed policy bases. First, the UCC incorporates a partially obsolete view of the relative opportunities of drawee banks and prior indorsers to detect different types of forgeries.[75] Second, the UCC's goal of facilitating commerce by bringing the swiftest conclusion to the check collection process is unmet.[76] The court then reiterated the policy behind placing UCC liability on the drawee for forged drawer signature cases, and on the party who ultimately dealt with the forger in forged indorsement scenarios. Originally, these were the parties in the best position to detect the forgery. When adopting the *Price* rule, however, the UCC drafters recognized this rationale as unrealistic today because drawees cannot individually scrutinize check signatures when handling millions of items each day.[77] Therefore, the historical purpose underlying the final payment doctrine does not apply in contemporary banking systems. The *Perini* court reasoned that this forged signature provision was adopted by the UCC drafters for speed and commercial certainty, "at some expense to exact checks and balances."[78]

Following its determination that the forged signature rule is primarily based on the merits of finality, the *Perini* court found no justification for the alternative

---

69. *Id.* § 3-417(1)(9).

70. *See id.*

71. *Id.* § 3-414.

72. *See, e.g.*, Perini Corp. v. First Nat'l Bank, 553 F.2d 398 (5th Cir. 1977).

73. *Id.*

74. This is commonly referred to as a "double forgery." Under the U.C.C., if the signator actually intended the named payee to have no interest in the instrument, an indorsement by any person in the name of a payee is effective against the forger. U.C.C. § 3-405 (1978) Thus, the presentor transfers good title to the drawee bank and the check is treated merely as a forged signature item. *See* Aetna Life & Cas. Co. v. Hampton State Bank, 497 S.W.2d 80 (Tex. Civ. App. 1973) (finality of payment rule invoked in a double forgery case).

75. 553 F.2d at 405.

76. *Id.*

77. *Id.* For a detailed study of the cost-benefit analysis underlying the banking industry's newer expedient check process, see Murray, Price v. Neal *in the Electronic Age: An Empirical Survey*, 87 BANKING L.J. 686 (1970).

78. 553 F.2d at 406.

treatment of forged indorsements.[79] The forged indorser provisions, placing ultimate liability on the party dealing with the forger, seem to comply with the historical rationale of delegating losses to those in a superior position to detect the forgery. Thus, the disparate treatment of forged drawer's signature and forged indorsements demonstrate inconsistency with the UCC drafters' policies of swiftness and finality. Additionally, as in *Perini*, when a check has a forged signature and a forged indorsement, the first party to take the check is in no better position than the drawee to discover the forgery.[80]

The focus of the *Perini* court on finality as the UCC drafters' main concern allowed it to hold the drawee bank liable for paying out on forged signatures, although forged indorsements also appeared on the checks. In refusing to enforce indorser warranty liability against intermediary banks, the court concluded that electronic check processing makes application of old notions set out in *Price* ludicrous.[81] Intermediary banks today are merely conduits of commercial paper, using sophisticated technology to move items expediently. Because inequity would result from requiring these banks to examine indorsements, the drawee bank must, consequently, swallow the entire loss in a forged drawer's signature-forged indorsement scenario.

Perini illustrates that increases in check volume and the electronic banking revolution make the original *Price* rationale obsolete. The purpose underlying the final payment concept today is economic efficiency, not liability.[82] This reality indicates a need for change in the traditional forged signature rule. Currently, entire new bodies of law regulating electronic banking outside of the UCC have sprung up.

III. Current Regulation of Electronic Banking

A. *Emergence of EFT Systems*

The paper-based check system is frequently criticized as time consuming, cost inefficient and inconvenient.[83] Consequently, many banks initiated numerous electronic devices to expedite consumer account accessibility. The term "electronic funds transfer" (EFT) encompasses a variety of payment systems in which value exchanges are initiated by electronic means.[84] A barrage of electronic-based payment systems came into existence in a relatively short time period, with no existing legal framework to police them. The UCC is inapplicable to such systems because it defines "item" as "any instrument for the

79. *Id.*

80. *Id.*

81. *Id.* at 420.

82. *Id.* at 406. In today's electronic banking world, to base drawee liability on the basis of hand to hand commercial conditions existing over 200 years ago would be a sham. *Id.* at 420.

83. Katskee & Wright, *An Overview of the Legal Issues Confronting the Establishment of Electronic Fund Transfer Systems*, 2 Comp. L.J. 7, 7 (1980).

84. *See* Naar & Stein, *EFTS: The Computer Revolution in Electronic Banking*, 5 Rutgers J. Computers & L. 429, 429 (1976). To increase efficiency and decrease personnel costs, EFTs have been utilized by banks for check processing. *See* Fox, *Another Step Toward the Cashless Society? The 1978 Federal Electronic Fund Transfer Act*, 18 Am. Bus. L.J. 209, 209 (1980-81).

payment of money."[85] Electronic transfers are not initiated by instruments, so they presumably fall outside the ambit of the UCC.[86] Congress enacted the Electronic Funds Transfer Act (EFTA or Act)[87] in response to this situation. Primarily, the EFTA provides a basic framework establishing the rights, liabilities and responsibilities of participants in EFT systems. Unlike the UCC, the EFTA mainly serves as a safeguard for consumer rights, because it is actually an amendment to the Consumer Credit Protection Act.[88]

B. *Electronic Payment Systems*

Although all are not fully covered by the EFTA, six methods of value transfer comprise what are commonly referred to as EFTs. The first system ever used by banks was the Automated Clearing House (ACH).[89] This system is an interbank function in which the originating bank electronically transfers payments to the ACH. The ACH then retransmits the message through another medium to the customer's bank. This mechanism also may handle pre-authorized debits and credits. An example of a debit transaction is an electric company sending a debit message to a customer for his electric bill.[90] A common credit transaction occurs when an employer pays employees through an ACH, rather than using traditional payroll checks.[91] In these situations, the ACH acts as a processor between debtor and creditor by transferring the appropriate funds into the payee's bank. By sorting and delivering payment codes, ACHs are fundamentally central clearing houses expediting financial activities.

Another frequently used EFT device is the automatic teller machine (ATM).[92] This unmanned teller allows a customer to insert a card to conduct various banking activities. These activities include deposits, withdrawals, transfers of funds between accounts, borrowing on approved lines of credit and making loan payments.[93] ATM transactions are two-party, involving both the bank and customer, and are initiated by plastic card coupled with a secret security code.[94]

---

85. U.C.C. § 4-104(1)(g) (1978). A wire transfer does not constitute an "item" under the U.C.C. Evra Corp. v. Swiss Bank Corp., 673 F.2d 951, 955 (7th Cir. 1982). *See also* Delbrueck & Co. v. Manufacturers Hanover Trust Co., 609 F.2d 1047, 1051 (2d Cir. 1979). *Cf.* Houston Contracting Co. v. Chase Manhattan Bank, 539 F. Supp. 247, 249 (S.D.N.Y. 1982) (asserting a wire transfer is not a "demand item" although it is an "item" under U.C.C. § 4-104(1)(g) (1978)).

86. Clarke, *An Item Is an Item Is an Item: Article 4 of the U.C.C. and the Electronic Age*, 25 BUS. LAW. 109, 109 (1969). Some state commercial codes have incorporated electronic transmissions into their definitions of "item." *See, e.g.*, FLA. STAT. § 674.104 (1983).

87. 15 U.S.C. §§ 1693-1693r (1982).

88. *See* S. REP. No. 915, 95th Cong., 2d Sess. 1-2, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 9403, 9403-04.

89. The ACH is a computerized mechanism implemented by member depository institutions to process payment orders. NAT'L SCIENCE FOUND., THE CONSEQUENCES OF ELECTRONIC FUND TRANSFER 239 (1975).

90. *See* Mittelsteadt, *supra* note 4, at 418-20.

91. *Id.*

92. *Id.* at 410-12.

93. ATMs are the most common and fastest expanding EFT system. Silas, *Theft by Plastic*, 70 A.B.A. J. 40 (1984).

94. This code is commonly referred to as a "PIN" number.

Additionally, there is a point of sale (POS)[95] EFT, which is a debit card, utilized for purchasing services or goods. Debit cards are substitutes for checks and work similarly to credit cards. They differ markedly from credit cards, however, because funds from the customer's account are immediately transferred to the merchant as payment.[96] This transfer eliminates "float," which ordinarily results from using checks and credit cards, and protects the merchant from accepting payment from an account with insufficient funds. Check verification is currently the most popular use for POS systems.[97] This process allows a bank to electronically guarantee check payment, give credit authorization, and insure a credit card or cash transaction.[98]

The fourth EFT process is the GIRO.[99] The GIRO is basically a consumer telephone-initiated payment method and an alternative to pre-authorized debits. When the financial institution receives debit authority, it will transfer funds to the payee's institution through an ACH.[100] This transfer is advantageous to payors, since they have more control over amounts paid out by their bank than if they had arranged pre-authorized payments. The payee benefits by being assured the payor has sufficient funds to cover the payment. The payor initiates the payment through a toll-free number, his access code and a vendor code. Thus, with these extra safeguards, GIRO averts thievery even more effectively than ATMs.

Wire transfers comprise a sophisticated EFT communications system connecting financial institutions. The most common of these are Fed Wire, Bank Wire II, Cash Wire, CHIPS, S.W.I.F.T. and telex.[101] Wire transfers between two banks originate in a number of ways.[102] The payor may telephone his bank and request that it wire funds to the payee's account, or he may use a terminal linked to his bank's computer.[103] Transfers sometimes may originate from written instructions.[104] Financial institutions also send wires to other banks, including the Federal Reserve, to settle interbank obligations. Advantages of this system are its speed and integrity.[105]

---

95. Katskee & Wright, *supra* note 83, at 9.

96. In the Mastercard credit situation, the account is not charged until the merchant deposits the form and the form is processed by the purchaser's bank.

97. Brandel & Olliff, *The Electronic Fund Transfer Act: A Primer*, 40 OHIO ST. L.J. 531, 533-34 (1979).

98. *See* Note, *Electronic Funds Transfer Systems: A Need for New Law?*, 12 NEW ENG. L. REV. 111, 111 (1976).

99. This European system is named after the greek word "gyros," meaning to resolve. Electronic GIRO is the processing of payment and remittance orders initiated by telephones, ATMs and other EFT systems. Vegari, *Electronic CIRO for the United States*, 2 COMP. L.J. 101, 102 n.5 (1980).

100. *Id.*

101. For a comprehensive look at CHIPS in relation to regulation, see Prutzman, *supra* note 19.

102. Scott, *supra* note 12, at 1669.

103. *Id.*

104. *Id.*

105. Mittelsteadt, *supra* note 4, at 427.

The final EFT system of significance is "check truncation."[106] In reality, this system is a hybrid EFT, since the original form of payment is a check. However, rather than physically routing the paper to the payor bank, the information on the check is captured in computer language and transmitted to the payor bank.[107] The transferred information contains all necessary data visible on the item.[108] The drawer of the check then receives a descriptive statement of his transaction, rather than a cancelled check in his bank statement. The principle benefit of this system is its significant cost savings, because paper is not being physically transferred back and forth.[109]

C. *Scope of EFTA*

The EFTA requires that the terms and conditions of EFTs involving a consumer account be disclosed in understandable language at the time the consumer contracts for such services.[110] The financial institution must send each customer a written document detailing every transfer made.[111] For pre-authorized transfers, the customer is required to notify the bank by a written request. Regardless of whether it completes the transfer, the bank must send a return notice reporting the status of the transaction to the consumer.[112] The customer may stop payment on a pre-authorized transfer by notifying the financial institution.[113]

Additionally, the EFTA sets forth procedures for error resolution.[114] When a customer reports an error, the bank must investigate, determine whether an error has actually occurred, and report its results to the customer within ten days.[115] The bank may take additional time if necessary, provided it re-credits the customer's account until the investigation is complete.[116] A customer's liability for any unauthorized EFT is the lesser of fifty dollars or the amount retained as a result of the unauthorized transfer prior to the time the customer reported the error to his institution.[117]

---

106. For a discussion on the relationship of corporate check truncation systems to electronic fund systems, see Leary & High, *The Place of EFT and Check Truncation in Corporate Payment Systems*, 5 DEL. J. CORP. L. 1 (1980).

107. At this point, the transaction transforms into an electronic one.

108. J. CLARK, H. BAILEY & R. YOUNG, BANK DEPOSITS AND COLLECTION 7-12 (1972).

109. Check truncation involves stopping the manual handling of checks and transmitting the MICR data. The effect is an overall cost savings. White, *A Legal Framework for Check Truncation*, 2 COMP. L.J. 115, 116 (1980).

110. 15 U.S.C. § 1693(c) (1982).

111. *Id.* § 1693(d).

112. *Id.* § 1693(e).

113. *Id.*

114. *Id.* § 1693(f).

115. *Id.*

116. *Id.*

117. *Id.* § 1693(g).

IV. EFTA Unauthorized Transfer Liability

A. *EFTA More Favorable to Consumers Than the UCC for Unauthorized Transactions*

Although the EFTA superficially appears to be mere consumer advocacy, it does contain a fraudulent transactions section which is somewhat analogous to the forged drawer's signature rule in check payment systems.[118] Under the Act, liability does not attach to consumers until the means of account access, in card or code form, becomes validated by the consumer's acceptance.[119] The financial institution must provide a means to identify each consumer issued an access device. This means may include verification methods such as signatures, photographs, fingerprints or electronic confirmation.[120] The bank must also provide a written summary of the consumer's liability for unauthorized EFTs, and apprise its customers of the benefits of promptly reporting loss or theft of an access device.[121] Apparently, if an interceptor causes a loss before consumer verification of the access device, the consumer bears no liability, even if he fails to report the unauthorized transactions found in his bank statement.[122] This actuality sharply contrasts with the UCC section placing liability upon any customer who fails to report any forged checks enclosed in his bank statement.[123] The UCC labels this conduct negligent, and the final payment rule cannot be invoked against the bank.[124]

The EFTA also regulates losses caused by unauthorized transfers. If a consumer reports a missing card within two business days after discovering the loss, he is only liable for the lesser of fifty dollars or the total loss at the time the bank is notified.[125] If, however, the consumer fails to report the lost access device within two business days and such prompt notice would have minimized the loss, his potential liability is limited by a $500 cap.[126] Failure to report within sixty days of the transmittal of the periodic statement containing the unauthorized transfers exposes the consumer to unlimited liability. This unlimited exposure is only with respect to additional losses from unauthorized transfers that occur subsequent to the sixty-day period, and only to such extent that notice would have prevented the loss.[127]

118. *See* Greguras, *Electronic Funds Transfers and the Financial-Institution/Consumer Relationship*, 10 U.C.C. L.J. 172, 193 (1978). *See also* Greguras & Wright, *How the New EFT Act Affects the Financial Institution/Consumer Relationship*, 11 U.C.C. L.J. 207, 210 (1979).

119. 12 C.F.R. § 205.6(a)(1).(1985).

120. For a lengthy analysis of verification of identity in EFTs, see Greguras & Sykes, *Authentication in EFT: The Legal Standard and the Operational Reality*, 2 Comp. L.J. 67 (1980).

121. 12 C.F.R. § 205.6(a)(3) (1985).

122. Greguras & Wright, *The Preemption Dilemma Under the New EFT Act*, 12 U.C.C. L.J. 3, 15 (1979).

123. *See supra* notes 60-64 and accompanying text.

124. U.C.C. § 4-406 (1978). *But cf. id.* § 4-406(1)-(2) (bank customers who fail to report unauthorized checks are precluded from asserting later forgeries by the same wrongdoer).

125. 12 C.F.R. § 205.6(b) (1985).

126. *Id.* § 205.6(b)(1).

127. *Id.* § 205.6(b)(2). The burden of proof that losses would not have occurred unless the consumer failed to report a lost or stolen card is on the financial institution. *Id.*

These provisions of the Act are much less stringent than the UCC rules. Under the UCC, if the consumer contributed, through his negligence, to the unauthorized signature, the bank may assert this as a defense to the final payment rule.[128] Furthermore, under the UCC, failure to examine bank statements exposes the customer to unlimited liability, regardless of whether notice would have prevented a loss.

B. *Insufficient Banking Regulations*

In theory, the UCC and EFTA encompass all fraudulent transactions arising from electronic and paper systems. Practically, however, some payment forms remain outside the ambit of these codes. The EFTA explicitly lists exemptions within its regulations.[129] Among these exemptions are check guarantees and authorization services, wire transfers not designed for consumers, non-preauthorized automatic transfers, telephone initiated transfers not under a pre-ar-

---

128. U.C.C. §§ 4-406, 3-406 (1978).

129. 12 C.F.R. § 205.3 (1985). The EFTA exemption section reads:

This Act and this regulation do not apply to the following:

(a) *Check guarantee or authorization services.* Any service that guarantees payment or authorizes acceptance of a check, draft, or similar paper instrument and that does not directly result in a debit or credit, to a consumer's account.

(b) *Wire transfers.* Any wire transfer of funds for a consumer through the Federal Reserve Communications System or other similar network that is used primarily for transfers between financial institutions or between businesses.

(c) *Certain securities or commodities transfers.* Any transfer the primary purpose of which is the purchase or sale of securities or commodities regulated by the Securities and Exchange Commission or the Commodity Futures Trading Commission.

(d) *Certain automatic transfers* Any transfer under an agreement between a consumer and a financial institution which provides that the institution will initiate individual transfers without a specific request from the consumer:

(1) Between a consumer's accounts within the financial institution, such as a transfer from a checking account to a savings account;

(2) Into a consumer's account by the financial institution, such as the crediting of interest to a savings account.

(3) From a consumer's account to an account of the financial institution, such as a loan payment; or

(4) From a consumer's account to an account of another consumer, within the financial institution, who is a member of the transferor's family.

(e) *Certain telephone-initiated transfers.* Any transfer of funds that (1) is initiated by a telephone conversation between a consumer and an officer or employee of a financial institution and (2) is not under a telephone bill-payment or other prearranged plan or agreement in which periodic or recurring transfers are contemplated.

(f) *Trust accounts.* Any trust account held by a financial institution under a *bona fide* trust agreement.

(g) *Preauthorized transfers to small financial institutions.*

(1) Any preauthorized transfer to or from an account if the assets of the account-holding financial institution are $25 million or less on December 31.

(2) If the account-holding financial institution's assets subsequently exceed $25 million, the institution's exemption for this class of transfers shall terminate one year from the end of the calendar year in which the assets exceed $25 million.

Id.

ranged plan, and pre-authorized transfers to small financial institutions.[130] By definition, the EFT refers to electronically initiated transfers excluding paper instruments deposited at an electronic terminal.[131] Therefore, the part EFT-part paper check truncation process emerges unregulated.[132]

This hybrid illustrates how the lines between traditional banking transactions and electronic transfers blur as banks increasingly rely upon electronic data processing and data capture.[133] Although each EFTA excluded payment system poses error resolution problems, check truncation raises the most serious ramifications in relation to unauthorized transfers.[134] A check may bear a forged signature, yet the UCC provisions are inapplicable because the truncated collection process involves electronic impulses.[135] Because check truncation involves both paper and electronics, it explicitly illustrates the inadequacy of present legal alternatives and the need for a uniform payments regulation.

V. The Use of Computers in Check Collection Leads to Regulatory Problems

A. *MICR Posting*

In our electronic age, a computer pays checks using electronically encoded messages.[136] This process bifurcates the check collection system into two elements: a message element and an account element.[137] First, the payor bank receives the paper and sorts the checks mechanically through high speed ma-

---

130. *Id.*

131. *Id.* § 205.2(g) defines "Electronic Fund Transfer" as:

[A]ny transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, that is initiated through an electronic terminal, telephone, or computer or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account. The term includes, but is not limited to, point-of-sale transfers, automated teller machine transfers, direct deposits or withdrawals of funds, and transfers initiated by telephone....The term does not include payments made by check, draft, or similar paper instrument at an electronic terminal.

" 'Electronic terminal' means an electronic device, other than a telephone operated by a consumer, through which a consumer may initiate an electronic fund transfer. The term includes, but is not limited to, point-of-sale terminals, automated teller machines, and cash dispensing machines."

Id. § 205.2(h).

132. Brandel & Olliff, *supra* note 97, at 546.

133. Brandel & Geary, *Electronic Fund Transfers*, 36 Bus. Law 1219, 1223 (1981). *See generally* Clarke, *supra* note 86.

134. *See* Note, *The Emergence of the Electronic Fund Transfer System: Consumer Protection, Federal Antitrust, and Branch Banking Laws*, 10 Ohio N.U.L. Rev. 323, 325-26 (1983).

135. Once the paper transaction turns into an electronically transmitted message, the U.C.C. no longer applies. This bifurcation removes the item from within the definition in U.C.C. § 4-104.

136. *See generally* Murray, *supra* note 77. *See also* Perini Corp. v. First Nat'l Bank, 553 F.2d 398, 420 (5th Cir. 1977).

137. Leary & High, *supra* note 106, at 6. U.C.C. §§ 4-109 & -204(3) were added to the text in 1962 to cover the usage of electronic check processing and bookkeeping. *Id. See id.* § 4-109, comment, example 3 stating the item may be sorted and processed and provisionally recorded on tape by an electronic computer.

chines.[138] These devices electronically identify a series of encoded integers on the bottom of the check.[139] These numbers identify the bank on which the check is drawn, the customer's account number to be debited, and the amount of the check previously encoded by the depositor bank.[140] This process is called Magnetic Ink Character Recognition (MICR). After the sorting machines have prepared a computer tape recording the debit and new customer balance, the checks are sent out for physical inspection.[141] Under this posting system, although electronic operations process the checks, the payor bank still has the opportunity to examine visually drawer's signatures.

Although this posting process appears expedient, accurate and unobstructive to forgery detection, many banks absorb unreported numbers of losses while using computerized MICR machines.[142] Banks are reluctant to disclose this information; however, surveys show that most banks find it more profitable to forego "hand massaging" smaller checks for forgeries.[143] A majority of financial institutions opt for insurance coverage to protect them against claims for forged instruments which are wrongfully paid.[144] Consequently, banks view insurance settlements as part of operational expenses and lump their total forgery losses under one category.[145] Thus, many banks have no accounting of the incidence of forged drawers' signatures as distinguished from forged indorsements. Additionally, while absorbing all forgery losses associated with hi-tech check processing, some banks have no cost-accounting information comparing electronic and manual posting expenses.[146]

The typical forgery claim stems from "smaller" checks, because most banks set a monetary amount above which they manually inspect checks.[147] Factors demonstrating why most forgeries are for small sums include: (a) the bulk of personal checks are for small amounts; (b) the customer accounts of people whose checks are stolen are not large enough to pay out large checks; (c) most check cashing services limit check amounts; and (d) large checks invoke greater suspicion.[148] Therefore, scrutiny of large checks curtails just a fraction of actual

---

138. These machines do the sorting at a rate of about 100,000 an hour.

139. These numbers are printed in magnetic ink and the machine decodes the integers through a magnetic reaction to this ink.

140. The customer account numbers are preprinted on the check bottom MICR line.

141. The checks are inspected for alteration, forgery and for stop orders in accordance to each financial institution's posting process. Leary & Tarlow, *Reflections on Articles 3 and 4 for a Review Committee*, 48 TEMP. L.Q. 919, 928 (1975).

142. Farnsworth & Leary, *UCC Brief No. 10: Forgery and Alteration of Checks*, 14 PRAC. LAW. 75, 76 (1968). *Compare* F. BRADY, THE LAW OF BANK CHECKS 478 (3d ed. 1962).

143. Murray, *supra* note 77, at 700-01.

144. *Id.* at 713-15. This survey found most banks have forgery loss insurance with at least a $1,000 deductible clause, so more losses are absorbed by the banks themselves. *Id.*

145. *Id.* at 695-96. Because of this, many banks do not know their actual final payment type losses. *Id.*

146. *Id.* at 696.

147. These amounts are closely guarded trade secrets.

148. Murray, *supra* note 77, at 711-12.

forged checks; and, although the average forgery is for a small sum, the aggregate total can be staggering.[149]

B. *Electronic Check Truncation Posting*

Although the payor bank is afforded an opportunity to physically examine each instrument, many forgeries remain undetected when checks are posted through MICR. This signature verification problem is exacerbated by the banking community's increasing use of electronic check truncation.[150] Unlike the MICR method, the payor bank never receives the actual instrument for visual inspection. Likewise, because the bank sends each customer a detailed report of each check transaction, the customer holds no items documenting any alleged forgery. Physical transportation of the item ends with the depository bank. This bank has no mechanism to verify the drawer's signature because the drawer is not its customer.[151] Thus, forgery detection is virtually impossible. Consequently, the *Price* rationale that drawee banks are in a superior position to discover forgeries becomes a nullity when checks are electronically posted. In this scenario, neither the drawee bank nor the depository bank occupies an advantageous position for forgery discovery.

Check truncation poses difficulties as to which law governs liability.[152] Clearly, the EFTA does not apply because this transaction is paper initiated.[153] The UCC also appears inapplicable because drawee receipt of electronic data from the depository bank may not qualify as a properly payable order constituting an "item."[154] Consequently, check truncation constitutes a banking transaction left unregulated by current law.

A recent Florida case raised the problem of applying the UCC when checks are not sent back for the customer's inspection. In *Florida Federal Savings & Loan Association v. Martin*,[155] the financial institution never returned the accompanying checks to its customers in their bank statements. Accordingly, the court held the drawee bank could not assert the defense of customer negligence in failing to discover unauthorized signatures.[156] Under *Martin*, in order to trigger the UCC preclusion of the final payment rule, the bank must either: (1) send its

---

149. Some banks do not examine checks for less than $1,000, categorizing them as checks for "small" sums. *See, e.g.*, Winkie, Inc. v. Heritage Bank, 99 Wis. 2d 616, 299 N.W.2d 829 (1981) (holding the defendant bank not negligent in failing to check indorsements and signatures on instruments drawn for less than $1,000).

150. The American Bankers Association says recent postal rate increases, which will add an estimated $80 million to annual commercial bank costs, will prompt more banks to destroy checks rather than send them. Wall St. J., Feb. 1, 1985, at 1, col. 5.

151. The drawee bank may be able to set up mechanisms of verification wherein other banks could discover these forgeries.

152. Note, *supra* note 134, at 325-26.

153. *See supra* notes 131-35 and accompanying text.

154. *See supra* notes 79-80 & 125 and accompanying text. *See also* Clarke, *supra* note 86, at 109.

155. 400 So. 2d 151 (Fla. 2d D.C.A. 1981).

156. *Id.* at 154.

customer the items paid along with a statement, (2) hold the items pursuant to customer instructions, or (3) make the statement and items reasonably available to the customer.[157] Although *Martin* did not involve electronic check processing, its rationale is applicable because check truncation also denies check return to customers. *Martin* demonstrates how inconsistencies in the check collection processes can lead to disparate results in court. The disproportionate treatment due to different payment mechanisms should be eliminated so that consumer choice remains unaffected by liability considerations.

VI. The Need for Uniform Treatment of Financial Transactions

The UCC drafters believed in uniformity for two reasons. First, achievement of a uniform state law, through an all-encompassing payment system, would facilitate commerce.[158] Second, uniform treatment of functionally similar transactions would insure certainty and security to users.[159] The objective of the UCC was to effectuate similar treatment to similar transactions.[160] Since enactment of the EFTA, however, uniform treatment has eroded into separate treatment, dependent upon the form of the transaction. Because of the EFTA's design for consumer protection, its loss allocation policies are framed to favor consumers. Under the UCC, intermediary banks may be liable under the indorsement warranties for transferring an instrument bearing a forged indorsement. Unlike the UCC's concern for fairness in loss attribution, the EFTA excludes intermediary institutions from liability resulting from unauthorized transfers; rather, it implements rigid rules designed to protect consumers from litigation.[161] Under a totally uniform code, the optimum provision would allow courts to make fair risk and duty allocations to all parties involved in the transaction.[162] Presently, when a financial transaction is not regulated by any

157. *Id.* The bank could not rely on the UCC defense of customer negligence because it did not include the items paid on its statements of account sent to the customer. It made no showing that it had held the items pursuant to a request by the customer, nor did it afford the customer a reasonable manner in which to discover the forgeries. *Id.* This practice of omitting checks from bank statements is on the increase. *See supra* note 150.

158. U.C.C. § 1-102(2)(c) (1978) reads: "Underlying purposes and policies of this act are to make uniform the law among various jurisdictions." For a discussion of the previously inconsistent state laws under NIL principles, see Malcom, *The Uniform Commercial Code*, 39 Or. L. Rev. 318, 319 (1960).

159. Note, *Electronic Funds Transfer Act — A Departure from Articles Three and Four of the Uniform Commercial Code*, 1980 Wis. L. Rev. 1008, 1048.

160. U.C.C. § 4-207(2) (1978).

161. *See supra* notes 125-28 and accompanying text.

162. Some courts chose not to implement strict UCC standards for a negligence defense and opted for a more comparative analysis. *See, e.g.*, Trust Co. v. Port Terminal & Warehousing Co., 153 Ga. App. 735, 741, 266 S.E.2d 254, 259 (1980) (where the parties are both negligent, the reasonableness of the bank's conduct should be assessed in light of the drawer's actions); Gordon v. State St. Bank & Trust Co., 46 Mass. App. Ct. 86, 89 (1971) (where both parties are negligent, the one whose conduct caused the loss is liable); Gresham State Bank v. O & K Constr. Co., 231 Or. 106, 370 P.2d 726 (1962) (holding the payor liable for paying out under a forged in-

body of legislation, the courts must fill in these gray areas by analogy.[163]

A. *Forgery Categorization Under the UCC and the EFTA*

Two scenarios exemplify the outcome determinativeness of applying either the UCC or EFTA. One situation is an unauthorized electronic funds transfer to a fictitious corporate employee.[164] Because no law currently covers corporate EFT use,[165] courts draw analogies from the EFTA and UCC. The UCC would allocate the entire loss to the employer if he negligently left his checkbook exposed,[166] allowing an employee to collect money by forging fictitious payees' names. The EFTA, however, would only allocate fifty dollars of the loss to the employer who negligently makes available the ACH authorization forms through which the crime was committed.[167] Under a uniform payments code, the employer's choice of payment form would not affect his liability.

A second scenario of disparate results occurs when check deposits are made through ATMs.[168] The law remains unsettled as to loss allocation resulting from a stolen check taken from an ATM after a consumer deposit.[169] If the check was bearer paper, the UCC may place the loss on the consumer for contributing to the forgery by not using a restrictive indorsement.[170] Under the EFTA, the consumers' loss is limited to fifty dollars.[171] This outcome, too, depends upon the technology of the payment system.

Similar banking functions should be treated alike. In order to advance complementary regulation for payment methods performing functionally equivalent transactions, an all-encompassing uniform payments code is mandatory. This need lead to the drafting of the Uniform New Payments Code (NPC).[172]

---

dorsement despite the drawer's negligence because the payor's act of commercial unreasonableness greatly outweighed the drawer's negligence).

163. *See, e.g.*, Bradford Trust Co. v. Texas Am. Bank, No. H-81-2144 (S.D. Tex. Oct. 3, 1983). In expressing concern over unregulated areas in electronic transfers the court reasoned:

> The cases provide no real guidance as to how the loss should be allocated among the parties. . . . We have found no statute which governs the allocation question. . . . It is unfortunate that neither Congress nor any of the legislative bodies of the individual States has yet taken action regarding this problem. . . . [T]he district courts find themselves adrift in a sea of unsettled questions. . . .

Id. Due to EFTA exclusions of particular wire transfers from coverage, courts have analogized to the finality of payment rule to support the irrevocability of an unauthorized transfer. *See* EVRA Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982); *see also* Delbrueck & Co. v. Manufacturers Hanover Trust Co., 609 F.2d 1047, 1051 (2d Cir. 1979).

164. Note, *supra* note 159, at 1050-51.

165. *See supra* note 129.

166. U.C.C. § 3-405(1)(b) (1978). Section 3-406 also may be used here if a court held the employer liable for negligence only.

167. 15 U.S.C. § 1693(g) (1982). If the employer failed to report the loss within the requisite time period, his liability may be greater, but it would still be subject to a $500 cap. *Id.*

168. Note, *supra* note 159, at 1051.

169. *See supra* note 131.

170. U.C.C. § 3-406 (1978). *See supra* notes 63-64.

171. 15 U.S.C. § 1693(g) (1982).

172. UNIFORM NEW PAYMENTS CODE (P.E.B. Draft No. 3 1983) [hereinafter cited as NPC].

VII. UNIFORM NEW PAYMENTS CODE

The Uniform New Payments Code attaches identical legal consequences to similar transactions where technology and the nature of the transactions permit.[173] The NPC covers commercial paper, card and electronically initiated fund transfers homogeneously.[174] The philosophy that legal consequences should not affect consumer choice among payment systems underlies this code. To accomplish this task, the drafters of the NPC altered traditional laws to allow for uniform payment treatment. A major innovation in existing UCC law addresses the unauthorized signatures and the *Price* rule.[175]

NPC section 204(1)[176] titled "Transmission Liability" treats liability for unauthorized orders in terms of tort liability rather than the traditional UCC contract warranty theories.[177] Tort principles are more adaptable to allocating risks among multiple parties.[178] Tort concepts avoid problems of backward warranties, which frequently occur under a UCC analysis.[179] Additionally, this NPC section is stated in terms of absolute liability,[180] thus curtailing any causational problems. In effect, such wording abrogates the firmly established *Price* doctrine, which holds no warranty of the genuineness of a drawer's signature is made by a presentor to the drawee bank.[181] This also disbands UCC warranties of transfer and the final payment rule.[182] The NPC drafters disapproved of the UCC fiction creating holder status for presentors of forged checks so that payment by the drawee bank becomes final.[183]

In attacking the traditional bases of the UCC provision, the NPC drafters construct a number of arguments. First, the assumption that the drawee is in

---

173. H. SCOTT, *supra* note 6, at 1.

174. *Id. See supra* note 12.

175. Titled "transmission liability" the provision states:

Each customer, transmitting account institution or transferor of an unauthorized draw order is liable to all parties to whom the draw order is subsequently transmitted and who pay, accept or give value in exchange for the order in good faith, if it has transmitted an unauthorized order or the duplicate of an order for which it has already received final payment under section 420(1). NPC, *supra* note 172, § 204. For a discussion of electronic fund payments and the NPC, see Brandel & Geary, *Electronic Fund Transfers and the New Payments Code*, 38 BUS. LAW. 1355, 1365-66 (1983). *See also* NPC, *supra* note 172, § 204. *Id.* Section 54(1) defines an authorized order as an order "initiated by the drawer or with the drawer's consent or authorization or is authorized to be paid by the drawer....[It becomes unauthorized if] materially altered,...transmitted without any necessary authorization, including, in the case of a written draw order, all valid endorsements."

176. *See supra* notes 57-58 and accompanying text.

177. NPC, *supra* note 172, § 204, comment 1.

178. *See supra* notes 67-71 and accompanying text.

179. NPC, *supra* note 172, § 204, comment 1. Absolute liability avoids problems of comparing negligence. *See supra* notes 162-63.

180. NPC, *supra* note 172, § 204(1) comment 2. *See supra* notes 24-34 and accompanying text

181. *See supra* notes 48-56 and accompanying text.

182. NPC, *supra* note 172, § 204(1) comment 2. *See* U.C.C. § 3-404 (1978). The drafters also found other U.C.C. rules obsolete. *See generally* Vergari, *supra* note 20, at 318.

183. NPC, *supra* note 176, § 204(1) comment 2.

a superior position to detect forgeries seems dubious today.[184] This assertion takes into account modern technological innovations in the check collection area. A high volume of checks are electronically processed, while physical inspection or "hand massaging" is becoming less frequent.[185] Because absorbing liability for forgeries is more cost efficient than setting up avoidance mechanisms, only large checks receive visual scrutiny.[186] Consequently, financial institutions swallow losses occurring from most small check forgeries.[187]

The NPC drafters convincingly argue that the choice of many banks to insure themselves, rather than physically screen each signature, suggests the industry itself believes forgeries cannot readily be discovered.[188] The *Price* era, where individual examination of checks prevailed, has passed with the advent of the electronic banking age.[189] If mass check posting necessitates that the burden of signature verification be placed on financial institutions, certainly the finality argument is more palatable than the drawee's superiority of position argument.

The NPC drafters considered the finality of transactions rationale, but dismissed it as unpersuasive.[190] The UCC comments support the final payment rule, reasoning that resolving all forged drawer's signature cases by making the

---

184. *See supra* notes 136-49 and accompanying text. In using the MICR process to encode check amounts on the MICR line, misencoding has created problems. The original amount of the check controls and the misencoding is disregarded. *See, e.g.*, First Nat'l Bank & Trust Co. v. Georgia R.R. Bank & Trust Co., 238 Ga. 693, 235 S.E.2d 1 (1977) (underencoding); Gabalac v. Firestone Bank, 46 Ohio App. 2d 124, 346 N.E.2d 326 (1975). *Cf.* Exchange Bank v. Florida Nat'l Bank, 292 So. 2d 361 (Fla. 1974) (misencoding of routing symbol). Clearinghouses may provide specific rules for this. *See* Rules and Regulations of the Los Angeles Clearing House §§ 4.04-.10.

185. Some drawee defendants have unsuccessfully attempted to assert the defense of impracticability of check inspection. *See, e.g.*, Jackson v. First Nat'l Bank, 55 Tenn. App. 545, 553, 403 S.W.2d 109, 113 (1966).

> It is argued on behalf of the Bank that such examination of the signature card, which admittedly was not made in the instant case, is not practical under modern banking methods. Such may be true as a practical matter, but, if so, the Bank, because of that fact, cannot escape the consequences and must,...be held guilty of negligence.

Id. at 113.

186. *See supra* notes 147-49 and accompanying text.

187. NPC, *supra* note 172, § 204 comment 2. *See supra* note 144 and accompanying text.

188. Many corporate accounting executives have instituted electronic payment systems for economic reasons. The U.S. Treasury Department saves 15.6 cents per check while paying social security benefits through direct electronic deposits, rather than by check. NAT'L AUTOMATED CLEARING HOUSE ASS'N, SURE PAY UPDATE 5 (Aug. 1979).

189. NPC, *supra* note 172, § 204 comment 2.

190. U.C.C. § 3-418, comment 1 (1978). The U.C.C. recognizes the superior position argument is a fiction, while setting out the rationale for this provision.

> The traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker's signature and is expected to know and compare it; a less fictional rationalization is that it is highly desirable to end the transaction on the instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered.

Id.

drawee bank liable avoids the reopening of transactions.[191] However, although transactional certainty through finality occurs through implementation of this UCC provision, transactions may be reopened under the forged indorsement warranties. The drafters of the NPC point out that this disparity illustrates the irrationality of the finality argument.[192]

This disparate treatment of forged drawers' signatures and forged indorsements under the UCC has never been fully resolved. If the *Price* rule is founded on the theory that any drawee failing to discover a forged drawer's signature is negligent, an exception should be allowed when the signature is so artfully forged that due care would not reveal the forgery.[193] Alternatively, if the final payment rule is premised on the undesirability of reopening commercial transactions, the same rule should apply to forged indorsement cases.[194] The NPC's similar treatment of forged indorsements and drawers' signatures is not objectionable in light of the UCC's weak justification for dissimilar rules.

The NPC drafters also assert that if the *Price* rule were abolished, the payees would have more incentive to insure the authenticity of the drawer's signature.[195] Under the UCC, a merchant cashing a check need not be concerned whether the presentor is actually the account owner, because the final payment rule imposes losses on the drawee bank.[196] Personal check cashing outside banking parameters is usually manual and more personal.[197]

Since manual checking affords an easy opportunity for signature verification, the English courts limited *Price* by allowing the payor bank to sue a payee for restitution under mistake of fact if the payor could establish the payee's negligence in check acceptance.[198] The NPC transmission liability provision operates similarly to this common law principle, because the ultimate loss falls upon the party dealing with the forger. Under the NPC, not only would the depository bank be liable to the drawee bank on a forged check, but the presentor would be liable to the depository bank.[199] This result is a great departure from the EFTA procedure for unauthorized transactions, which insulated all intermediary banks from liability.[200] Under the NPC, if the presentor of a forged check was

---

191. NPC, *supra* note 172, § 204 comment 2. *See supra* notes 65-80 and accompanying text. U.C.C. § 3-417(2) (1978) extends the warranties of any indorser beyond the immediate transferee in all cases. Where there is an indorsement, the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly. *Id.* § 3-417 comment 8.

192. *See* J. WHITE & R. SUMMERS, *supra* note 37, at 610.

193. *Id.*

194. NPC, *supra* note 172, comment 2. Even if the payor were not taking directly from the drawer, verification systems may be set up. *See supra* note 120.

195. U.C.C. § 3-418 (1978).

196. NPC, *supra* note 172, comment 2. In a less computerized atmosphere, better opportunities exist for verification of each check cashed. *Id.*

197. *See* National Westminister Bank Ltd. v. Barclays Bank Int'l Ltd., [1975] 1 Q.B. 654.

198. NPC, *supra* note 172, § 204, comment 2. This is because every transferor can be liable under this provision. *See supra* note 175 and accompanying text.

199. 15 U.S.C. § 1693(g) (1982).

200. This can be paralleled with the effect of the U.C.C. forged indorsement outcome. *See supra* notes 62-82 and accompanying text.

not the payee, loss would ultimately lie on the payee who took from the forger.[201] This solution maximizes fairness to all parties, while sacrificing finality by reopening the transaction. This parallels the effect of the UCC warranties for forged indorsements. The NPC mandates that whether a party takes a forged check, or a check bearing a forged indorsement, he will be liable for the loss if he took directly from the forger.[202] His face to face dealings with the forger outweigh placing losses on the drawee bank, which is flooded with electronically processed paper.

The most persuasive argument against applying the *Price* rule occurs in relation to check truncation. The purpose for the rule becomes obsolete where the drawer's signature is never available for drawee inspection.[203] Without an opportunity to discover forgeries, holding the drawee bank liable under *Price* principles is inequitable. However, under the NPC, a customer has the same duty to discover and report unauthorized transfers as imposed by the UCC.[204] The customer must exercise reasonable care and promptness in examining bank statements reflecting debits and credits. This requirement of statement examination for unauthorized transfers applies in all cases of check truncation, regardless of whether checks are returned to the customer.[205] Therefore, although the customer, like the drawee bank, may not physically examine each check, he remains liable for scrutinizing debits on his statement.

The NPC allows fourteen days for reporting unauthorized orders when checks are returned, and sixty days if no paper is sent with the statement.[206] These time periods originate from the UCC and EFTA, respectively.[207] The NPC imposes this liability for forgeries on the consumer in the check truncation process even though the consumer may not possess the written order for visual signature verification. The NPC drafters believed the customer is in a better position than the drawee bank to detect forgeries because the customer maintains records of his personal financial transactions. This rule provides greater incentives for the consumer to safeguard his checkbook and to keep accurate balance

---

201. *See supra* note 200.

202. NPC, *supra* note 172, § 204, comment 2. *See supra* notes 150-57 and accompanying text.

203. NPC, *supra* note 172, § 203(1).

> Notwithstanding any other provision of this Code, a customer must exercise reasonable care and promptness to examine any statement furnished or made available by its payor account institution reflecting debits or credits to its account and to discover any orders not authorized by it or materially altered and must notify the payor account institution promptly after discovery thereof....

Id.

204. *Id.* § 203, comment 1. This duty is imposed regardless of whether orders are actually returned to the customer from the account institution. *Id.*

205. *Id.* § 203(2). Noncompliance with these time requirements precludes customer recovery for an unauthorized transfer. *Id.*

206. U.C.C. § 4-406(2)(b) (1978); 12 C.F.R. § 205.6(b)(2) (1985). *See supra* notes 60 & 127 and accompanying text.

207. Under this NPC section, all subsequent parties to which a draw order is transmitted, including a payor account institution paying in good faith, can recover from prior parties if a draw order is unauthorized, or is a duplicate. NPC, *supra* note 172, § 204, comment 3. *See supra* note 200.

recordings. After a customer's report, forgery liability will ultimately run to the person who took from the forger.[208] Subsequently, due to his prompt detection, the customer will recover the money wrongfully paid out.

The NPC rejects the possibility of allowing a party to avoid liability by showing, for instance, the drawee bank's negligence in paying out under an obvious forgery on a million dollar check.[209] The drafters, instead, opted to place tort liability on each transmitting financial institution. Imposing absolute liability on prior transferring banks is less complicated than comparing the negligence of these prior transferors to that of the drawee bank.[210] This approach assumes that no party in the check collection chain may rely on payment made by the drawee bank.[211] In effect, all subsequent parties to whom a check is transferred, including the drawee bank acting in good faith, can recover from prior parties if the transfer is unauthorized.[212] This rule covers forged drawers' signatures, forged indorsements and material alterations uniformly.[213]

A. *Uniform Treatment Invites New Problems in Check Regulation*

Although the NPC's approach appears practical for the above mentioned uniformity and fairness purposes, the changes to traditional law may cause new delays and add additional costs to the error resolution process. For example, the abrogation of the *Price* doctrine shifts final responsibility for forged checks away from the drawee bank. The payee, indorsers, and collecting and presenting banks are now subject to liability from which they were previously insulated.[214] With the final payment doctrine gone, this liability shift may cause additional litigation among parties, resulting in greater expenditures of time and money.[215] Furthermore, the NPC treats liability in tort terms, rather than the more easily proved contract theories. This more complex burden of proof may also lead to expenditures of time and money not occasioned by a UCC or EFTA type resolution.[216]

Another problem with risk shifting is the virtual impossibility for some intermediary parties to verify the validity of the drawer's signature.[217] With the NPC's unlimited liability, exposure of non-financial institution payees and indorsers could reach astronomical proportions.[218] Insurance against insolvency

---

208. *Id.* § 204, comment 2.

209. *See supra* note 162.

210. This proposition is in direct opposition to the aims of the finality of payment rule set out in U.C.C. § 3-418, comment (1). *See supra* note 190.

211. *See supra* note 210.

212. NPC, *supra* note 172, § 204, comment 3.

213. The finality of payment doctrine effectively safeguards the parties from forged signature liability. *See* U.C.C. § 3-418 (1978).

214. Vergari, *supra* note 20, at 327.

215. *Id.*

216. *But see generally* Greguras & Sykes, *supra* note 114.

217. *See* Vergari, *supra* note 20, at 327.

218. *Id.*

exposure could greatly increase the costs of check collection to consumers.[219] Additionally, allegations of forgeries need documentation. Because truncated checks stop at the depository bank stage, the process of the consumer gathering tangible proof of the forgery is delayed.[220] Until the claiming consumer locates and takes possession of proof supporting a forgery, his available account funds may be cut off by the drawee bank. For these reasons, some argue the drawee banks should bear the risks and costs associated with unauthorized signatures; after all, drawee banks can set up mechanisms for inexpensive, expedient check scrutiny.[221]

B. *The Policy Choice is Finality or Fairness*

Looking at each factor involved in drafting an unauthorized transfer provision, the decision seems to rest upon a choice between finality of transactions or fairness to the parties. The main policy of the UCC is not finality.[222] This point is evident upon examination of the forged indorsement rule. The totality of circumstances surrounding the *Price* decision, which allowed banks to easily discover forged drawers' signatures, are all but extinct today. In choosing a uniform forgery rule, the NPC drafters took these realities into account.[223]

Many claims against the effectiveness of the proposed NPC rule can be refuted. Because consumers already bear the burden of insurance coverage for drawee banks against forged check losses,[224] the claims of higher costs to consumers under the NPC rule are unfounded. All banks insure against forged checks; thus, shifting forgery liability to other banks in the check collection chain should not cause significant rate increases to consumers. As to litigation expense and burden of proof arguments, studies show that most forged check claims are absorbed by banks settling out of court. Settlements result because most forged checks are for small sums and settlement is more cost efficient to the drawee bank's insurance company.[225]

Lastly, the finality argument must be addressed. In creating a uniform law, gross inequity would result from choosing the finality of payment concept of the UCC. Applying this concept would be patently unfair because, in a forged

---

219. Microfilm copies of checks may be admissible in court as evidence of a forgery if the original check was destroyed. The UNIFORM PHOTOGRAPHIC COPIES OF BUSINESS AND PUBLIC RECORDS AS EVIDENCE ACT and similar acts have been adopted by most of the states. These acts provide for business records to be preserved on microfilm. The original checks can be destroyed and the microfilm admitted as evidence. *See, e.g.*, CAL. CIV. EVID. CODE §§ 1550-1551 (West 1966); DEL. CODE ANN. tit. 10, § 4309 (1953); MASS. GEN. LAWS ANN. ch. 233, § 79E (West 1968); N.J. REV. STAT. § 2A 82-38 (1964); PA. STAT. ANN. tit. 28, § 141 (Purdon 1958).

220. *See* Vergari, *supra* note 20, at 327.

221. *But see* U.C.C. § 3-418, comment 1 (1978) (payment is final in favor of a holder in due course).

222. *See generally* NPC, *supra* note 172, § 204, comments 1-3.

223. *See generally* Murray, *supra* note 77.

224. *Id.*

225. The drawee bank would have an opportunity for forgery detection, however, if it were possible to set up electronic mechanisms for detection of indorsement forgeries.

indorsement situation, the drawee bank would have no opportunity for forgery detection. Therefore, uniformity mandates that forgery losses for both drawers' signatures and indorsements be imposed on the party dealing with the forger.

VIII. Conclusion

The NPC presents the optimal fair alternative. Clearly, when tort principles underlie loss allocation, negligence must be shown for a party to incur liability. Such a standard is more equitable than, for reasons of finality, using the UCC contract theory and claiming that the drawee bank breached a duty to its customer. The latter rule represents more of a fiction created for commercial certainty than a breach of contract. In effect, the NPC drafters eradicated outdated policies and legal fictions and produced an unauthorized transmission provision that is ultimately equitable in every payment system.

Melanie S. Cherdack