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Article 4: Bank Deposits and Collections

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For an indorser to be liable on a check, presentment must first be made on the drawee bank within a reasonable time. Then, if the bank refuses to pay, notice of dishonor must be given to the indorser before midnight of the third business day after the indorsee receives notice of dishonor from the drawee bank, under Section 3-508. As the court correctly noted, in the case of uncertified checks drawn and payable in the United States there is a presumption that, if presentment or the initiation of bank collection is made within seven days after indorsement, it is made within a reasonable time. In the present case there is no evidence that timely presentment was not made on the drawee bank. What the plaintiffs failed to prove was that timely notice of dishonor was given to the indorsee, or that tardy notice was excusable. Thus, under Section 3-502(1)(a), the indorser Robinson was discharged. However, as the court goes on to point out, even if timely notice of dishonor were given, the plaintiffs could not prevail since they were neither holders nor owners of lost, destroyed or stolen checks.

H.S.

ARTICLE 4: BANK DEPOSITS AND COLLECTIONS

SECTION 4-104. Definitions and Index of Definitions

MALPHRUS v. HOME SAV. BANK

254 N.Y.S.2d 980 (Albany County Ct. 1965)

Annotated under Section 4-403, infra.

SECTION 4-109. Process of Posting

GIBBS v. GERBERICH

1 Ohio App. 2d 93, 203 N.E.2d 851 (1964)

Annotated under Section 4-303, infra.

SECTION 4-208. Security Interest of Collecting Bank in Items, Accompanying Documents and Proceeds

CITIZENS BANK v. NATIONAL BANK OF COMMERCE

334 F.2d 257 (10th Cir. 1964)

Annotated under Section 4-209, infra.

SECTION 4-209. When Bank Gives Value for Purposes of Holder in Due Course

CITIZENS BANK v. NATIONAL BANK OF COMMERCE

334 F.2d 257 (10th Cir. 1964)

The plaintiff, an Arkansas bank, held a past due note executed by one of its customers. The customer attempted to satisfy the note with a large check payable to him, drawn on an Oklahoma bank. Before cashing the check and discharging the note the plaintiff bank telephoned the Oklahoma bank and asked one of its officers whether the drawer of the check had sufficient funds

in his account to cover the check. The Oklahoma bank said that he did but indicated that he might not if the check were presented through conventional channels. On this information the plaintiff bank accepted the check in discharge of the customer's note, and on the same day one of its officers drove 150 miles to the Oklahoma bank to present it. When he arrived, he was asked to indorse the check on behalf of his bank, which he did. The Oklahoma bank then accepted the check and gave the plaintiff bank a cashier's check in return. Later that day, the Oklahoma bank discovered that the check presented to it was a forgery and immediately notified the plaintiff bank. Later, when the Oklahoma bank refused to honor its cashier's check, the plaintiff bank sued on the instrument. The lower court gave judgment to the defendant. On appeal, reversed.

The court first determined that Oklahoma law applied. Under the law of that state an indorser who was a holder in due course did not warrant to the drawee bank the genuineness of the drawer's signature. Thus, if the plaintiff were a holder in due course, the defendant bank could not legitimately resist collection of its cashier's check. Under Oklahoma conflict of laws rules, the question of whether the plaintiff bank was a holder in due course depended on Arkansas law. There, the Uniform Commercial Code was in effect, and under it [Section 3-302], the plaintiff was found to be a holder in due course. First, despite the fact that the customer was a bad credit risk against whom the plaintiff had been forced in other matters to take legal action, the bank did not have "notice" of the check's infirmity. Section 1-201(25). Second, by acting honestly throughout, the plaintiff bank had acted "in good faith." Section 1-201(19). And third, the plaintiff had given "value" for the forged check. On this last point, the defendant disagreed, arguing that the Arkansas bank, presumptively a collecting agent, had only provisionally settled with its customer under Section 4-201 and had not, therefore, given value. Furthermore, after acknowledging that the plaintiff bank could take in settlement of the forged check a cashier's check under Section 4-211(1)(b), the defendant argued that if the cashier's check were dishonored, the plaintiff bank had a right of chargeback under Section 4-212 and, having this right of chargeback against its customer, it could not enforce payment of the cashier's check.

The court rejected these arguments, holding that under Article 4 the Arkansas bank could be a holder in due course while acting as collection agent for its customer. Whether it had given value or not depended on whether it had a security interest in the check, under Section 4-209. And under Section 4-208(b), the bank had a security interest in the check to the extent of the credit it had provisionally extended to its customer. In discharging the customer's debt, the plaintiff had given credit. In an analogous situation where collecting banks are not involved, if a negotiated instrument is taken in satisfaction of an antecedent debt, the taker gives value under Section 3-303.

The plaintiff was thus a holder in due course under Arkansas law, and entitled to recover under Oklahoma law.

COMMENT

Under the prevailing Oklahoma law, so long as the Arkansas bank was a holder in due course, it made no warranty to the drawee bank that the drawer's signature was authorized. This is the common law rule of *Price v. Neal.* If the Code were controlling in Oklahoma, however, the Arkansas bank would not have been required to establish that it was a holder in due course. Whether it was or was not, it would make no warranty to the drawee bank that the customer's signature was authorized. Section 4-207(1)(b). It is important to note, however, that under any circumstances it *would* warrant that it had no *knowledge* that the drawer's signature was unauthorized.

S.L.P.

SECTION 4-303. When Item Subject to Notice, Stop-Order, Legal Process or Setoff; Order in Which Items May be Charged or Certified

GIBBS v. GERBERICH

1 Ohio App. 2d 93, 203 N.E.2d 851 (1964)

Gerberich, a realtor, placed the proceeds he received from the sale of Hewitt's property into his own escrow account. He then drew Hewitt a check on that account, which was received for payment by the drawee bank on July 19, 1962. On the day the check was received, but after it had been mechanically charged against Gerberich's account by a posting machine, a restraining order was served on the bank, prohibiting it from paying money out of the escrow account. The money was thereupon recredited to the account. The issue, as the court saw it, was whether the check had been paid before the bank had notice of the restraining order. This depended on whether the "process of posting" had been completed. If the process of posting was completed before the restraining order arrived, the item was finally paid to Hewitt under Section 4-213 (Section 1304.19, Ohio Rev. Code). But if the process of posting was not completed when the order arrived, then, under Section 4-303 (1034.23), the bank's duty to pay the check to Hewitt was terminated. Section 4-109 defined process of posting but that section was not incorporated into the Ohio Code. The court therefore looked to non-Code law where it found that the process of posting involved two basic steps: (1) a decision by the bank to pay, and (2) a recording of that payment. Whether these steps had been taken was largely a matter of the bank's chosen procedures. In the present case the bank had recorded the payment but there was no evidence indicating a final decision to pay. The debiting of Gerberich's account was not conclusive. According to the testimony given at trial, the bank did not consider the machine posting as evidencing its final decision to pay since overdrawn checks would still have to be recredited and properly posted checks cancelled. Moreover, the day's posting was not found to be in balance prior to the receipt of the restraining order, and the check had not been voided or cancelled. Accordingly, the court held that the process of posting was not completed when the

restraining order arrived, and that the funds in question should be turned over to Gerberich's receiver.

COMMENT

1. Section 4-303 states five conditions the happening of any one of which prevents a restraining order or other legal process from being effective as to an individual item. One of these conditions, as the court correctly stated, is the completion of the posting process. The other four occur when the bank (a) accepts or certifies the item; (b) pays the item in cash; (c) settles for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; and (d) becomes accountable for the amount of the item under subsection (1)(d) of Section 4-213 and Section 4-302 dealing with the payor bank's responsibility for late return of items.

2. Section 4-109, added to the Official Code in 1962, defines "process of posting" in a flexible way.

> The "process of posting" means the usual procedure followed by a payor bank in determining to pay an item and in recording the payment including one or more of the following or other steps *as determined by the bank:*
>
> (a) verification of any signature;
> (b) ascertaining that sufficient funds are available;
> (c) affixing a "paid" or other stamp;
> (d) entering a charge or entry to a customer's account;
> (e) correcting or reversing an entry or erroneous action with respect to the item. [Emphasis added.]

Of overriding importance, as the italicized words show, is the bank's own view of whether it has completed the process of posting. Though the court could not rely on the guidelines set out in Section 4-109 since the legislature had not yet incorporated it into the Ohio Revised Code, it came up with substantially the same set of controlling factors, including the bank's own view of when the process of posting was completed, whether the check had been cancelled, whether a charge had been made to the customer's account, etc.

R.W.D.

SECTION 4-403. Customer's Right to Stop Payment; Burden of Proof of Loss

MALPHRUS v. HOME SAV. BANK

254 N.Y.S.2d 980 (Albany County Ct. 1965)

A depositor in the defendant savings bank requested the bank to issue a teller's check payable to the order of the plaintiff and to deduct the amount of the check from her account. The depositor then delivered the check to the plaintiff in part payment for an automobile. When the check was presented at the bank upon which the defendant-bank had drawn it, it was dishonored

on the ground that the defendant had stopped payment. The plaintiff brought an action to recover the amount of the check and moved for summary judgment. In granting the motion, the court acknowledged that under Section 4-403(1) a customer may stop payment and that under Section 4-104(1)(e) a "customer" includes "a bank carrying an account with another bank." However, in this case the defendant could not stop payment because it "had no stake in the transaction whatsoever." The purpose in permitting payment to be stopped is to protect either an actual party to an underlying transaction (the depositor) or the bank on which the check is drawn. The defendant fell within neither class. Moreover, Section 3-802(1)(a) supported the holding. Under that section, the depositor's underlying obligation to the plaintiff was pro tanto discharged when the plaintiff took in satisfaction of that obligation a check drawn by a bank which did not contain a right of recourse against the underlying obligor. Consequently, if the defendant-bank were not liable, the plaintiff would have no enforceable rights under the Code. Such a result could not be tolerated since the Code was enacted to protect persons engaged in business transactions involving instruments for the payment of money.

COMMENT

The opinion does not state the reason why the bank stopped payment; however, it is reasonable to assume that it did so on instruction from its depositor, the car buyer. In this respect it should be noted that under Section 3-306(d) the bank could not, as a general rule, have successfully interposed a defense or claim belonging to its depositor. The only defenses belonging to its depositor which it could have interposed are (1) that the check was stolen, or (2) that payment or satisfaction would be inconsistent with a restrictive indorsement.

R.G.K

ARTICLE 7: DOCUMENTS OF TITLE

SECTION 7-203. Liability for Non-Receipt or Misdescription

NATIONAL DAIRY PRODS. CORP. v. LAWRENCE AM. FIELD WAREHOUSING CORP.

255 N.Y.S.2d 788 (App. Div. 1965)

The defendant (hereinafter Field) was a field warehouseman for Allied Crude Oil Refining Company. The plaintiffs are holders of non-negotiable warehouse receipts issued to them or their predecessors in interest by the defendant in conjunction with the deposit of large quantities of soybean oil. Four of the plaintiffs are holders of diverse security interests in the oil; the remaining two are direct shippers of the oil. Subsequent to the issuance of the receipts the defendant transferred its assets, including the oil, to a second bailee. The receipts were dishonored after this transfer when it was discovered that the oil had mysteriously disappeared. No explanation has been offered by either party of the loss of the oil.