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Commercial Paper - Uniform Commercial Code - Liability of Payor Banks for Checks Retained beyond the Midnight Deadline - American National Bank of Powel v. Foodbasket

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CASE NOTES

COMMERCIAL PAPER—Uniform Commercial Code—Liability of Payor Banks For Checks Retained Beyond the Midnight Deadline. American National Bank of Powell v. Foodbasket, 497 P.2d 546 (Wyo. 1972).

Plaintiff Foodbasket had authorized Pat McPherson, their bookkeeper and office girl, to endorse checks and make deposits in their account in the First National Bank of Powell. Pat McPherson prepared deposits which included two checks payable to Foodbasket and drawn by Pat McPherson on defendant American National Bank. She endorsed both checks on behalf of Foodbasket. At no time did she have sufficient funds in her account to cover the checks. The checks were written to her employer a few days after she gave notice she was leaving her job, and the apparent purpose of the checks was to cover up some sort of fraud. On the same day she deposited the second check, she telephoned the vice-president of American National advising him she had written the checks which would be coming to the bank and requesting a loan to cover them. The vice-president responded that American National could not make the loan. The two checks were delivered by First National Bank to American National Bank on September 8, and American National returned the checks on September 11. The amounts of the checks were charged back by First National to Foodbasket. Foodbasket brought suit alleging that American National was liable by virtue of Wyoming Statutes, Section 34-4-302 because the checks were held beyond the midnight deadline. Defendant American National contended that Foodbasket had no reason to expect or right to require the checks to be accepted or paid. Summary judgment was issued in district court for Foodbasket in the amount of $8,400. The Supreme Court held that absent a valid defense American National would have been accountable for its failure to meet the midnight deadline. But American National had a valid defense since notice of dishonor was given to Pat McPherson as agent of Foodbasket and that notice was imputed to Foodbasket, excusing American National from liability for late dishonor.[1]

1. American Nat'l Bank of Powell v. Foodbasket, 497 P.2d 546 (Wyo. 1972).

Because Foodbasket based its cause of action solely on Wyoming statutes, Section 34-4-302, the court's consideration was limited to liability under that statute. Other considerations which would normally be relevant to determining the liability of payor banks were omitted.[2] The *Foodbasket* case, therefore, affords an excellent opportunity to consider the liability of payor banks under 34-4-302 as interpreted in Wyoming.

34-4-302 is one of the provisions of the Uniform Commercial Code[3] having been numbered in the original Code as 4-302. It provides as follows:

> In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of section 34-4-207), a settlement affected or the like, if any item is presented on and received by a payor bank, the bank is accountable of the amount of (a) a demand item other than a documentary draft whether properly payable or not if the bank, in any case where it is not also a depository bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or (b) any other properly payable item unless within the time allowed for acceptance of payment of that item the bank either accepts or pays the item or returns it and accompanying documents.[4]

The official comments annotated in the Code provide little explanation of 4-302, merely stating that "4-302 states the rights of the customer if the payor bank fails to take the action required within the time limits prescribed."[5] A "payor bank" is defined as "a bank by which an item is payable as drawn or accepted."[6] The midnight deadline is midnight on the next banking day on which a bank receives the item.[7] Beyond the terse official comment and the definitions in other

2. For a general discussion of liability of payor banks under the Uniform Commercial Code see Leary, *Check Handling Under Article Four of the Uniform Commercial Code*, 49 MARQ. L. REV. 330 (1965); Bunn, *Bank Collections Under the Uniform Commercial Code*, 1964 WISC. L. REV. 278 (1964).
3. WYO. STAT. § 43-1-101 to 10-105 (Supp. 1971).
4. WYO. STAT. § 34-4-302 (Supp. 1971).
5. UNIFORM COMMERCIAL CODE § 4-302, Comment 1.
6. WYO. STAT. § 34-4-105 (Supp. 1971).
7. WYO. STAT. § 34-4-104(h) (Supp. 1971).

sections, the meaning of 4-302 is open to judicial interpretation.

Although 4-302 was interpreted for the first time by the Wyoming Supreme Court in *Foodbasket,* it had already been interpreted in other jurisdictions. The first case to interpret the provision and the case which most courts appear to follow is *Rock Island Auction Incorporated v. Empire Parking Company.*[8] *Rock Island* concerned a bank that held an insufficient funds check beyond the midnight deadline in the belief that the maker would soon deposit funds sufficient to cover the check.

The defendant bank in *Rock Island* argued that 4-302 meant that it must only "account" for the check and that the amount for which it was liable was controlled by 4-103(5).[9] The court, however, held that "accountable" in 4-302 is the amount of the demand item which was held beyond the midnight deadline.

The defendant bank's other argument in *Rock Island* was that 4-302, by placing a more stringent liability upon payor banks, was a denial of due process and, hence, unconstitutional. The court found 4-302 constitutional, reasoning that since the role of payor banks was crucial to the collection process, the distinction made between payor and depository banks was not arbitrary or irrational.

Other cases since *Rock Island* have consistently followed it, at times adding detail to its basic holding. In *National City Bank of Rome v. Motor Contract Company of Rome*[10] the Georgia Court of Appeals held that customary practice had no bearing on the application of 4-302 because the legislature, in adopting the use of the midnight deadline, had established its own mandatory standard. In *Exchange Bank and Trust Company v. Pure Ice and Cold Storage Company*[11] the Su-

8. 32 Ill. 2d 269, 204 N.E.2d 721 (1965).
9. UNIFORM COMMERCIAL CODE § 4-103(5) provides: "The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by the amount which could not have been realized by the use of ordinary care, and where there is bad faith it includes other damages, if any, suffered by the party as a proximate consequence."
10. 112 Ga. App. 268, 166 S.E.2d 742 (1969).
11. 415 S.W.2d 897 (Tex. 1967).

preme Court of Texas ruled that although 4-302 gave rise to a cause of action, a plaintiff could not recover when he had waited over two years before electing to hold the drawee liable. *Farmers' Cooperative Livestock Market Inc. v. Second National Bank of London*[12] determined that a check is a "demand item" within the meaning of 4-302.

In several of the cases the defendant argued that where the account in the drawee bank contained insufficient funds, the plaintiff was left in no worse position due to the delayed return of the check since even if the check had been returned promptly, it would not have been paid. The courts consistently held that whether the maker had sufficient funds in the drawee bank or whether the check was otherwise properly payable were not relevant factors when liability was based upon 4-302(a).[13]

The effect of all of these decisions is to create a uniform interpretation that 4-302 requires payor banks who retain checks beyond the midnight deadline to pay the checks. Payment is required in the "absence of a valid defense" under the Code.

In *Foodbasket* the Wyoming Supreme Court acknowledged that American National would be liable under the standard interpretation of 4-302[14] but found that the bank had presented a valid defense. From the language used by the court, it would seem the uniform interpretation developed by other courts had been adopted in Wyoming. However, a close examination of the "valid defense" accepted by the court indicates that the result in *Foodbasket* is in conflict with the majority view of 4-302.

The defense recognized by the court is that when Pat McPherson telephoned the vice-president of American National and was informed American National would not grant

12. 427 S.W.2d 247 (Ky. App. 1968).
13. Bank of America Nat'l Trust & Savings Ass'n v. Security Pacific Nat'l Bank, 23 Cal. App. 3rd 638, 100 Cal. Rptr. 438 (1972). *See also* cases cited *supra* notes 8 and 12.
14. "Thus while we agree that, under various authorities heretofore cited (footnote 2), absent a valid defense American National would have been accountable for its failure to meet the midnight deadline . . . ." *Supra* note 1, at 548.

her a loan to cover the checks, she received notice of dishonor. Such notice of dishonor was imputed from Pat McPherson to Foodbasket because of the sole actor doctrine. Since Foodbasket had no reason to expect the check would be honored, American National is excused from further notice by section 34-3-511.[15]

The major premises of this defense need to be evaluated. The first conclusion of the court is that when the vice-president of American National told Pat McPherson she would not receive the loan, that notice of dishonor was given. There is little detail offered in the case report to indicate the exact words spoken. All that is known is that a loan to cover the checks was requested and refused. The UCC provides that notice of dishonor may be given in any reasonable manner, whether spoken or written, as long as the person receiving notice is aware of the identity of the item being dishonored and that the item is being dishonored.[16] Since Pat McPherson called about the checks, there can be little doubt that she knew what items were under discussion. It is doubtful, however, that refusing the loan was sufficient to constitute notice of dishonor. At a minimum, it was an unusual bank procedure.

The court's conclusion that notice to the agent, Pat McPherson, was imputed to the principal, Foodbasket, is also open to dispute. Foodbasket apparently contended that where an agent is acting adversely to his principal in his own interest, an exception must be made to the usual rule that notice to an agent acting within the scope of his authority is notice to the principal. The court agreed that the exception existed but countered that in this case there is an exception to the exception. The exception to the exception which the court invoked is that where the agent is the sole representative of a principal in a transaction, knowledge is imputed to the principal. The court supported its statement of the sole actor

15. WYO. STAT. § 34-3-511 (Supp. 1971). Subsection (2)(b), relied upon by the court, provides that notice is excused when the party has no reason to expect the instrument will be paid.

16. WYO. STAT. § 34-3-508(3) (Supp. 1971).

rule with references to *Am. Jur.*[17] and *Great American Indemnity Company v. First National Bank of Holdenville.*[18]

Although the existence of the sole actor exception to the exception is not to be disputed, it is doubtful that the rule was properly applicable in this situation. A careful examination of the cases cited by *Am. Jur.* in support of the rule leads to the conclusion that the rule applies primarily to agents of corporations having close identification with the corporation.[19] Typically the cases cited involved an agent who was a stockholder or officers of a corporation in addition to being an agent.[20] The sole actor doctrine is an equitable doctrine to be applied only in situations where the third party believes it is dealing with the principal.[21]

The kind of close identification between agent and principal which is the basis of the sole actor doctrine is lacking in this situation. Pat McPherson was not a corporate officer or a stockholder or otherwise intimately identified with the principal. It is unlikely American National felt it was dealing with the principal. The sole actor exception was, therefore, misapplied.

Further doubt concerning the propriety of imputing notice to Foodbasket in this situation arises from the likelihood that American National knew Pat McPherson would not convey the notice to her employer. It would seem unreasonable to expect that an employee who has written insufficient fund checks to her employer for $8,400 would inform her employer the bank had dishonored the checks. Under the circumstances, American National probably realized that some sort of fraud was being perpetrated and could hardly expect the notice to be conveyed.

The *Am. Jur.* reference relied upon by the court to support its use of the sole actor doctrine states that when the

17. 3 AM. JUR. 2d *Agency* § 284 (1962).
18. 100 F.2d 763, 765 (10th Cir. 1938).
19. *See* 3 AM. JUR. 2d *Agency* § 284 nn. 6-8 (1962).
20. *See, e.g.*, Curtis, Collins and Holbrook Co. v. United States, 262 U.S. 215 (1923) (agent was vice president and active manager of corporation); Atlantic Cotton Mills v. Indian Orchard Mills, 147 Mass. 268, 17 N.E. 496 (1888) (agent was also treasurer of corporation).
21. Pearll v. Selective Ins. Co., 8 Ariz. App. 152, 444 P.2d 443 (1968).

third party does not "intend or expect that the agent would communicate" the truth to the principal or where it is known to the third party that the agent "is acting adversely to the principal", knowledge should not be imputed.[22] Reference to the *Restatement of Agency* leads to a similar conclusion. The *Restatement* rule is that notice is imputed to the principal even though the agent is acting adversely, except when the third party is aware of the agent's adverse interest.[23]

The foregoing discussion indicates that notice should not have been imputed to Foodbasket. Since Foodbasket was without notice of dishonor, imputed or actual, American National was not excused by 3-511.[24] The subsection of 3-511 relied upon by the court excuses notice only when the other party has no reason to expect or right to require that the instrument be accepted or paid.[25] The defense which the court recognized was, therefore, improper.

At this point a word should be said about justice. Since Pat McPherson was a part-time bookkeeper earning $54 a week, it is unlikely either party would recover the $8400 from her. The party losing this suit ends up suffering an unrecoverable loss. Where the court is in effect imposing a loss on one of two parties, it would seem appropriate to weigh the equities between them. Of the two, Foodbasket seems the proper party to bear the loss. American National was inefficient but it was Foodbasket who created the circumstance under which their agent could perpetrate a fraud. Furthermore, as the court notes, Foodbasket had already been cheated before the checks were written. The checks were merely an attempt to hide the fraud.

Even though the equities favor American National, such considerations should not alter the rules of liability established by 4-302. However laudable the idea of doing justice in the individual case may be, endeavoring to deliver ad hoc justice in each case will operate to undermine the purpose of 4-302 and bring confusion to banking transactions. The

22. 3 AM. JUR. 2d *Agency* § 286 (1962).
23. RESTATEMENT (SECOND) OF AGENCY § 271 (1957).
24. WYO. STAT. § 34-3-511 (Supp. 1971).
25. *Id.* at (2)(b).

purpose of the provisions contained in Article 4 of the UCC, and 4-302 in particular, is to create a system which ensures prompt payment to a chain of individuals and institutions involved in a fluid commercial transaction.[26] The typical situation involves a series of banks each extending credit to each other.[27] If payor banks delay too long the rights of others may be compromised. Often the depositor may be a seller whose rights will be impaired if he must wait too long to discover if the check has been paid.[28] It is sometimes a practice of depository banks to permit their depositors to withdraw credit after a fixed time calculated to be sufficient for the check to have reached the payor bank and notice of dishonor to have been received.[29]

The dangers inherent in this chain of interdependent banks and individuals is made more serious by the volume of such transactions. It has been estimated that the number of checks processed by American banks is 17 billion annually and is increasing at a rate of seven per cent a year.[30] Given the nature of the transactions and the tremendous volume of transactions, banks must act quickly for their mutual protection and support the imposition of some sort of penalty upon banks that fail to act promptly.[31]

To the extent that exceptions are made in individual cases in order to do equity, the system which enforces prompt payment is weakened. Obviously the incentive for prompt payment is reduced when individual banks feel that liability might not be imposed for delay. Creating defenses not recognized by the Code or misapplying defenses provided by the Code frustrates the purpose of 4-302.

The decision in *Foodbasket* appears to have been the result of equitable considerations. It seems that the court has applied agency law as a device to prevent Foodbasket from

26. Leary, MARQ. L. REV., *supra* note 2.
27. Leary, *Deferred and Delayed Returns—The Current Check Collection Problem*, 62 HARV. L. REV. 905 (1949).
28. *Id.*
29. *Id.*
30. Rohner, *Posting of Checks: Final Payment and the Four Legals*, 23 BUS. LAW. 1075 (1968).
31. Bunn, *supra* note 2; Leary, *supra* note 27.

recovering under the Code. In the process of finding against Foodbasket, the court has misapplied agency law and confused the meaning of the Code.

The same result might have been reached without interfering with the uniform views of the liability of payor banks under 4-302. The court in its reasoning stressed the idea that if Pat McPherson was authorized to receive and endorse the checks on behalf of Foodbasket, she also must have been authorized to receive notice of dishonor. Reversing the court's logic, it could be argued that she did not have authority to accept payment for her own defalcations on behalf of Foodbasket. If she was acting outside her scope of authority when she received the checks, then she could not have received them for Foodbasket. Foodbasket, never having owned the checks, could hardly expect to receive notice of dishonor.

Although this approach would not interfere with usual ideas of what constitutes notice of dishonor, and is more in harmony with other applications of 4-302, it is not the best result. It does less violence to the language of the Code than the approach adopted by the court, but it still operates to defeat the policy of prompt payment and definiteness.

The best approach to this type of case in the long run appears to be to apply the Code as written and avoid considerations of fairness in the individual case. Under such an approach, it is possible that some undeserving parties might receive something in the nature of a windfall. However, the overall effect of applying the Code in such a direct manner would be to better protect the rights of all in the long run. The necessity for a standardized procedure of prompt payment greatly outweighs whatever benefit is derived from denying an undeserving party a windfall.

CONCLUSION

In *Foodbasket* the Wyoming court ostensibly accepted the majority views of 4-302 as requiring payment by payor banks when checks are retained beyond the midnight deadline. However, the actual decision rendered conflicts with

a proper application of 4-302 as interpreted by these cases. The result of claiming adherence to the majority views while deviating in actual practice is that the meaning of 4-302 has been muddied. Whether the court will continue to find defenses to 4-302 when deemed convenient to do so is not known.

If further erosions on the responsibility of payor banks are tolerated under the guise of valid defenses, banks will inevitably suffer from the resulting uncertainty. On the other hand, if the court's ostensible acceptance of majority views of 4-302 is an indication that they will be applied in the future, then the Wyoming view of 4-302 could be aligned with other jurisdictions as soon as other cases arise under 4-302. In the interim, doubt will remain. After *Foodbasket* the general rule is that 4-302 imposes liability for payment upon payor banks that retain checks beyond the midnight deadline, but it is uncertain under what circumstances the court will be willing to apply the rule.

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