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Bank Collections

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to stop payment after certification of a check—no matter who procures the certification.

Not affected by the Uniform Commercial Code is the general rule that a bank may cancel, rescind, or revoke its certification of a check, where such certification was induced by fraud;³⁷ made because of a mistake as to the drawer's account;³⁸ made by mistake after a drawer has stopped payment on the check;³⁹ even though negligent;⁴⁰ by immediately notifying the holder, provided, that the rights of third persons have not intervened, and the holder, relying on the certification, has not altered his position so as to render it inequitable to permit a revocation.

CONCLUSION

The NIL, which has been a part of Wyoming statutory law since 1905, would be superseded in the Uniform Commercial Code. Concerning certified checks, there are a few significant changes in the Code, but it makes no basic changes in the relationships of the parties. Establishing that there can be no stop-payment order after certification should greatly facilitate the negotiable value of such instruments, take a burden off commercial and banking interests, and generally aid commercial intercourse.

J. T. HAYS

BANK COLLECTIONS

Article IV of the Uniform Commercial Code, entitled Bank Deposits and Collections, is the third time that drafters have attempted to state a workable uniform law governing banks during the collection process.

In 1928 the American Bankers Association proposed a bank collection code which was subsequently enacted in law in 18 states, including Wyoming in 1931.¹ This code, although unwittingly referred to as the Uniform Bank Collection Code by many writers, has never received sanction by the drafters of our uniform laws. In 1933 a Uniform Bank Collection Code was proposed but never passed farther than the drafters' hands.

The variety of situations that arise in the process of collecting a check have caused the drafters of bank collection rules much consternation. The following examples are a few of the simpler situations.

The easiest case is one in which Jack borrows money from Jill. Jack

37. *Farmer's Savings Bank of West Plains v. American Trust Co. of Warrensburg*, 199 Mo.App. 491, 203 S.W. 674 (1918).

38. 29 A.L.R. 140.

39. *Baldinger & Kupferman Mfg. Co. v. Manufacturer's Citizens' Trust Co.*, 93 Misc. Rep. 94, 156 N.Y.Supp. 445 (1915).

40. *Security Savings & Trust Co. v. King*, 69 Ore. 228, 138 Pac. 465 (1914).

1. Wyo. Comp. Stat. §§ 35-1001 through 35-1016 (1945).

then repays the loan by writing a check payable to the order of Jill on the X National Bank in Hometown, Wyoming. We may assume that Jill has her checking account in this bank and deposits Jack's check in her account. This is what the banks call an "on us" item, and in this first example, we are concerned only with the internal operations of one bank.

We can bring onto the picture the operations of three banks by supposing that Jack banks in a small state bank. Jill keeps her account in a bank in the same city, but not a member of any clearing house association, but which clears through a member bank. Here we have the operations of three banks and a clearing house before Jill will be certain that her deposited check is converted into firm credit.

Now, let's take the situation in which Jack is a dude on vacation in Wyoming and does his banking in Chicago. Jill is a resident of Wyoming and deposits Jack's check in her bank at Hometown, Wyoming. Jack's check must travel from Hometown to Chicago, and we will suppose that Jill's bank send the check to its correspondent bank in Cheyenne and this bank then clears checks through the Stockgrower's Bank in Cheyenne, by whom it is sent to the Kansas City Branch of the Federal Reserve Bank in Omaha, Neb., from Omaha it is sent to the Federal Reserve Bank in Chicago and finally on to Jack's bank. Here we have added the risk of loss from Hometown to Cheyenne and from Cheyenne to Chicago, as well as a situation involving five banks.

The last two situations are examples of "transit items" or checks drawn on other banks than the one in which they are deposited. To handle these "transit" items, banks have what they call correspondent banks in which they keep a reserve fund to pay these checks. A bank in Laramie, for example, will have as its correspondent banks: (1) the other bank in Laramie to handle checks as in example two; (2) a bank in Cheyenne to clear checks written on other Wyoming banks; (3) three or four out-of-state banks to take care of handling items as in example three. These banks are usually federal reserve branch banks, as a federal reserve member bank must keep a certain percentage of its demand deposits in a federal reserve bank.

With this rather sketchy background, let's look at the Uniform Commercial Code and determine if its adoption would affect the bank collection process as it exists in Wyoming under the Bank Collection Code.

Perhaps one of the most litigated questions concerning the check collection process prior to the enactment of the Bank Collection Code was the question of whether the depository bank was an agent of the depositor or the purchaser of the item from the depositor and hence the owner. The common law rule was that the bank was the owner of the item, therefore, the depositor could recover from the bank in which the check was deposited for collection if one of its correspondent banks was negligent in

collecting the item.² This has been referred to as the New York rule. The Massachusetts rule, on the other hand, placed the risk of negligence on the depositor by making the depository bank the agent for collection of the depositor.³ This rule was adopted by the Bank Collection Code⁴ and has been carried forward in the Uniform Commercial Code.⁵

Section 4-201 of the Uniform Commercial Code says, in effect, that unless a contrary intention appears, the bank is an agent of the depositor regardless of the form of indorsement, or the lack of indorsement. This provision will apply where the item is handled by the banks for collection, even though the action of the parties indicates that the bank has purchased the item. According to the drafters' comments following this section, a contrary intent would have to be very explicit to overcome the agency presumption; i.e., it would have to be stated on the item that it was sold absolutely to the depository bank.

The Bank Collection Code, as adopted in Wyoming, provides that the sub-agent is authorized to follow the instructions of the sending bank. This would tend to indicate that the correspondent bank would have to, in all cases, follow the instructions sent to it by the depository bank, no matter how absurd they seem.⁶ A provision of this type has been included as section 4-203 of the Uniform Commercial Code. The code section provides, in general, that if the collecting bank follows instructions given it by the transferor, it is not liable to prior parties for following the instructions. As stated in the comment to this section, this rule was required in order to speed up the collection process as the collecting bank will not have to worry about the authenticity of the instructions and will not be put on notice of any revocation if notice is received from any one except the transferor.

Under the Uniform Commercial Code, a bank taking an item for collection must use ordinary care in: (a) presenting or sending the item for presentment; (b) sending notice of dishonor after learning that the item has not been paid; (c) settling for the item when the bank receives final settlement; (d) making necessary protest; and (e) notifying its transferor of any loss or delay in transit, within a reasonable time of discovery thereof.⁷ In the same section, a bank is held to have acted seasonably if it takes action before its midnight deadline or midnight of its next banking day following the banking day it receives the item.⁸ The Massachusetts Rule is then adopted which makes the bank responsible for its own negligence and not the negligence of its correspondents. This

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2. *City of Douglas v. Federal Reserve Bank of Dallas*, 271 U.S. 489, 2 Fed 2d. 818 (1924).
 3. *Federal Reserve Bank v. Malloy*, 264 U.S. 160, 291 Fed. 763 (1924).
 4. Wyo. Comp. Stat. § 35-1002 (1945).
 5. Uniform Commercial Code § 4-201 (1957) (Official Text).
 6. *Carter v. Piercy*, 156 Va. 640, 159 S.E. 154 (1931).
 7. Uniform Commercial Code § 4-202(1) (Official Text).
 8. *Ibid.*, § 4-104 (h).

does not relieve the bank from using ordinary care in selecting properly qualified intermediary banks and agents and giving them proper instructions.

The bank is also subject to the ordinary care rule under the Bank Collection Code.⁹ However, under the bank collection code, banking custom is used as a criterion for determining ordinary care. Although the Uniform Commercial Code tends to state a more strict rule, this need not worry the bankers as the U.C.C., in section 4-103, provides that Federal Reserve regulations and operating letters, as well as clearing house rules, when followed, constitute the exercise of ordinary care. This provision in itself will give the bank the necessary flexibility to handle many collection problems.

The Uniform Commercial Code differs greatly from the Bank Collection Code in providing the applicable standards for proper sending or forwarding of items. The U.C.C., in order to preserve flexibility, provides, in section 4-204, that a collecting bank must send items by reasonably prompt methods, taking into consideration its instructions, the nature of the item, the number of items on hand, cost, and the method generally used. The Bank Collection Code, on the other hand, provides that if the item is a transit item, it must be sent by mail to the other bank. If it is a check on a local bank, the B.C.C. permits its presentation over the counter or through a local clearing house.¹⁰

Bankers may wonder if they are adequately protected by section 4-204, forwarding by a reasonably prompt method. It must be remembered that all that is required of the collecting bank is that it make the collection by ordinary means, it is in no case required to use extraordinary methods.¹¹ Also, even at common law, the burden of proving the bank did not use a reasonably prompt method will fall on the person for whom the collection is being made.¹² There is no reason why these rules should be changed under the Uniform Commercial Code. Hence, it would appear that if a bank uses the general method of collection, it will not get in any trouble.

Before the Bank Collection Code, sending an item directly to a drawee bank was considered negligent, as the party who was to pay the check was not considered a suitable agent for its collection.¹³ Both the Commercial Code and the Bank Collection Code have taken care of this problem by providing for direct sending to a drawee bank.¹⁴

A new intervention has been introduced by the Uniform Commercial Code in order to step up the collection process. In section 4-205, a deposi-

9. Wyo. Comp. Stat. § 35-1005 and § 35-1006 (1945).

10. *Ibid.*, § 35-1006.

11. *Waggoner Bank and Trust Co. v. Garner Co.*, 113 Tex. 5, 213 S.W. 927 (1919).

12. *Bank of Keo v. Bank of Cabot*, 173 Ark. 1008, 294 S.W. 49 (1927); *Olds Motors Works v. First State Savings Bank of Morenic*, 258 Mich. 269, 241 N.W. 813 (1932).

13. *Pinkney v. Kanawha Valley Bank*, 68 W. Va. 254, 69 S.E. 1012 (1911).

14. Uniform Commercial Code § 4-204(2) a; Wyo. Comp. Stat. § 35-1006 (1945).

tory bank is permitted to supply missing indorsements necessary to title. Because of this section, it will no longer be necessary to return to a non-bank depositor any item he may have failed to indorse. Section 4-205 (2), which provides that an intermediary bank or payor bank will not be affected by a restrictive indorsement, would seem to eliminate the possibility of a result as happened in *Soma v. Handrulis*.¹⁵ This was a New York case in which an intermediary bank was held liable for conversion for collecting a check which carried a restrictive indorsement "for deposit." The result in this case seemed unfair, since the intermediary bank had no way of knowing that the check had been stolen. Under the Commercial Code only the depository bank may not ignore a restrictive indorsement. As pointed out in the comments to this section, the reason for a restrictive indorsement "for deposit" or "for collection" is to guard against further negotiation by a finder or thief and if the depository bank is responsible for this indorsement, then this purpose is fulfilled.

The Commercial Code has also done away with the necessity for a formal bank indorsement which states, in effect, that all prior indorsements are guaranteed, pay to any bank or banker, then the bank name is given. Now date and transit code number is all that is required. Section 4-206 says that checks may be transferred between banks with only enough indorsement to identify the bank.

In our example of the check collecting procedure, both Jack and Jill will be interested in knowing when credit will be available to Jane. Jane will be interested for the obvious reason of being able to withdraw the money for other uses. Jack will be interested in knowing when he has been relieved of the obligation to Jane. Section 4-213 (4) of the U.C.C. states when certain credits given by a bank to its customer become available for withdrawal as of right. According to the code, credit will be available as a matter of right in any case where the bank has received a provisional settlement for the item and the bank has had a reasonable time to learn that the settlement is final. In the drafters' comment to this section, it is pointed out that what is a reasonable time will depend on the circumstances of each case. Factors to be considered will be the distance the item has to travel and the number of banks the item must pass through enroute. A bank will usually learn that an item has become final or paid by not learning the opposite.¹⁶ If, as pointed out in sub-section (b) of 4-213 (4), the depository bank is also the payor bank, the item is available as credit at the opening of the second banking day following receipt of the item. This allows the bank enough time to process the item through the bookkeeping department. A deposit of money may be withdrawn at the opening of the bank's next banking day following receipt of the deposit.¹⁷ It should be remembered that these rules specify only the time that the

15. 277 N.Y. 223, 14 N.E.2d 46 (1938).

16. Uniform Commercial Code § 4-213.

17. *Ibid.*, § 4-213 (5).

customer has a right to withdraw the money. There is nothing in the Code that says a bank cannot let the customer withdraw the money sooner.

Time of final payment is important for a number of reasons: (1) it is the end of the collection process, the point when the drawer has satisfied his obligation; (2) it determines relative priorities between items and legal notices; (3) it is the point when provisional credit becomes final. Section 4-213 states that an item is finally paid by a payor bank when the bank has done any of the following things: (1) paid the item in cash; (2) settled for the item without reserving the right to revoke or without having the right to revoke by a statute or clearing house rule; (3) completed the process of posting to the indicated account; (4) made a provisional settlement for the item and failed to revoke such settlement. This section rejects the election idea of the Bank Collection Code. The Bank Collection Code gives the collecting bank an election to treat the item as dishonored in certain cases.¹⁸ In one case this right of election was given to the payee owner and gave the payee owner the right to treat the item as dishonored where the collecting bank did not make the election.¹⁹

Section 4-213 also rejects the rule that final payment occurs only when the check has been accepted, certified, or paid. Some courts have carried this rule to an extreme. In a Minnesota case in 1951, a check had been posted to the drawer's account and had been perforated with the word "paid." Still, the court held that this was not final payment and the bank had to recognize a later stop-payment order. The court said the acceptance and certification must be in writing and signed by the drawee.²⁰

Section 4-303 of the U.C.C. specifies the process the bank must complete in order to give the item priority over any legal notice or stop-payment order that might interfere with the check. Certain of the tests are the same as those of final payment under section 4-213 of the U.C.C. In addition, another test is provided for. 4-303 (d) provides for "sight posting" of the item by either a teller or bookkeeper. "Sight posting" is an action by the bank employee whereby the account is checked to make sure that there is enough money to cover the check but actual posting is postponed until later. In a 1903 case, action similar to "sight posting" was held to constitute payment.²¹ The comments of the drafters point out that this type of posting does not constitute a final decision to pay the item.²² This section, along with section 4-213, rejects all cases that hold that such credit cannot be revoked.²³

18. Wyo. Comp. Stat. § 35-1011.

19. *In re Liquidation of State Bank of Binghamton*, 156 Misc. 353, 281 N.Y. Supp. 706 (1935).

20. *Bohlig v. First National Bank in Wadena*, 233 Minn. 263, 48 N.W.2d 445 (1951).

21. *Nineteenth Ward Bank v. First National Bank of South Weymouth*, 184 Mass. 49, 67 N.E. 670 (1903).

22. Uniform Commercial Code § 4-303, Comments at page 413.

23. *Cohen v. First National Bank of Nogales*, 22 Ariz. 394, 198 Pac. 122 (1921).

Prior to the enactment of the Bank Collection Code, it was considered negligence on the part of the collection bank to receive from the payor anything except cash.²⁴ It was later realized that a bank could not effectively carry on its collection operations by demanding "legal tender" for each item collected. Therefore, bank custom, to receive a draft or check instead of cash, was recognized and held to protect the bank.²⁵ The Uniform Commercial Code, as well as the Bank Collection Code, have both provided for the use of such provisional remittances. If ordinary care is exercised, the Bank Collection Code provides for three types of remittances in lieu of actual cash: (1) a check or draft of the drawee on another bank, (2) the draft of another bank drawn on the payor, or (3) payment by such method as customary according to local clearing house regulations.²⁶ The Uniform Commercial Code, section 4-211, sub-section 1, states various types of remittance instruments that may be received by a collecting bank without danger of its being held responsible in case the instrument is not paid. Under the U.C.C. a bank may take: (1) a check of the remitting bank on any bank except the remitting bank; (2) a cashiers check of a remitting bank if the remitting bank clears through the same clearing house as the collecting bank; (3) a collecting bank may accept authority to charge the account of the remitting bank with the collecting bank; (4) if the check is drawn payable to a person other than a bank, the collecting bank may accept a cashiers check or other bank obligation. Like the Bank Collection Code, section 4-211, has transferred the risk of a collecting bank accepting another form of payment rather than cash on to the owner of the item. This has some compensating advantages to the owner: (1) mainly, it tends to speed up the collection process and (2) if the requirement of a money shipment for each collection was mandatory, the cost to the customer would probably make check collection prohibitive.²⁷

Deferred posting is now an accepted practice for banks in all 48 states. Deferred posting allows the bank to accept a check through the teller window on Monday, for example, and not post the check to the customer's account until the next day, Tuesday. Under this method, the bookkeeping department will always be a day behind. The U.C.C. provides that the bank must take action on a check by either returning the item or sending a notice of dishonor before midnight of the next banking day. The U.C.C. also provides that the bank may return an item directly to the depository bank.²⁸ This is a new practice growing up throughout the

24. Federal Reserve Bank of Richmond v. Mallay, 264 U.S. 160, 445 S.Ct. 296 (1924); National Bank of Commerce v. American Exchange Bank, 151 Mo. 320, 52 S.W. 265 (1899).

25. First National Bank of Memphis v. First National Bank of Clarendon, 63 Tex. Civ. 469, 134 S.W. 831 (1910); Jefferson County Saving Bank v. Commercial National Bank, 98 Tenn. 337, 39 S.W. 338 (1897).

26. Wyo. Comp. Stat. § 35-1009.

27. 8 Tulane L. Rev. 236, 238.

28. Uniform Commercial Code § 4-212 (2).

country as a means of speeding up the collection process and certainly shows the foresightedness of the drafters of the Uniform Commercial Code.

In concluding, it should be remembered that any law affecting bank collections must be flexible enough to take care of the many different types of factual situations that may arise. A bank collection code must reduce the credit risk involved in the collection process by requiring greater speed in making the collection. If greater speed and flexibility can be obtained without imposing a greater cost to the bank or an increased service charge to its customers, then the law should meet with favor in the banking profession. The Uniform Commercial Code provides for flexibility by section 4-103 which, as previously pointed out, permits, within wide limits, variation of provisions of Article IV by agreement. Greater speed is insured by permitting direct sending of items and allowing missing indorsements to be supplied, to state just a couple of examples. Cost is kept at a minimum, as the code permits certain types of provisional remittances instead of requiring a shipment of "legal tender."

As pointed out in the comment to section 4-101, Article IV adopts many of the rules of the American Bankers Association Code that are still in current operation. In both, the bank is merely an agent to make the collection. The Commercial Code adopts the principles and rules of the Deferred Posting Laws and other statutes, codifies some rules established by court decisions, and in addition states certain patterns and procedures that exist even though not heretofore covered by statute.

Certainly, if the other sections of the Commercial Code be adopted, so should Article IV, Bank Deposits and Collections. Article IV does have the advantage of giving the bankers definite rules to follow in the collection process. It is doubtful if Article IV will materially change the bank collection process in Wyoming. It is, however, a well drafted section and certainly no worse than the present Wyoming banking laws.

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