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BANK COLLECTION UNDER THE UNIFORM COMMERCIAL CODE

I. AN INTRODUCTION TO THE PROBLEM

When is a check finally paid? At what particular moment does the payee lose his rights against the drawer and receive his rights against a bank? Are these rights against his own bank, the drawer's bank or both of them? These and many similar questions are clearly not academic. The fact that a high percentage of checks are paid¹ does not detract from

71. See note 22 and accompanying text *supra*.

1. "The Federal Reserve Bank of Boston reported in 1947 that during the year 1946 dishonored items represented 40/100ths of 1% of all items handled by the Federal Reserve Bank of Boston and in dollar amount involved 27/100ths of 1%." Malcolm, *Article 4—A Battle With Complexity*, 1952 WIS. L. REV. 265, 269 n. 31 (1952).

the desire to ascertain whether a *disputed* check has or has not been finally paid. The intricate system of bank collections demands a clear definition of final payment, not as one all-encompassing concept, but in each situation where difficulty might arise.

With a history of chaos and attendant unreliability in defining final payment for all purposes as a background, article 4 of the Uniform Commercial Code attempts to clarify the concept of final payment by setting out specific provisions which define "final payment"² and "final settlement"³ in the different bank collection situations that are particularly troublesome. The Bank Collection Code as enacted in Indiana⁴ deals with this problem to some extent, but falls short of the detailed coverage of the Code.

There are certain general areas where the problem of final payment is of special significance. Concentration on the three situations with which the Code deals most explicitly, however, would seem to be the best method of investigation of final payment. The first situation arises under section 4-213(1) of the Code where the payor bank becomes "accountable" for the amount of the item. At this point the drawer is released on his obligation and the payee may go against the payor bank for the proceeds of the item. Next, the payee's rights against his own depository bank will be considered. The Code sets out this point of time in section 4-213(3) and it is in this regard that the concept of "final settlement" becomes most relevant. The final area of significance arises in determining when a notice, stop-order, legal process, or set-off, received by the payor bank, is too late to be effective and it is dealt with in section 4-303.

For explanation purposes, the bank collection process is usually broken down into three areas, depending upon how the payor bank receives the item, *i.e.*, "on us" items, clearing house items, and transitory items.

"On Us" Items. In an "on us" item the payor bank is the bank both of the drawer and the payee. The check is drawn on the payee's bank. If the payee receives cash for this item, the common law is fairly consistent in calling this final payment.⁵ The alternative situation is where the payee deposits the check to his account. The general rule at common law

2. See UNIFORM COMMERCIAL CODE § 4-213(1).

3. See UNIFORM COMMERCIAL CODE §§ 4-211(2), -211(3), -213(3).

4. See IND. ANN. STAT. §§ 18-2503, -2507 (Burns 1950). See also IND. ANN. STAT. § 18-2518 (Burns 1950), which is relevant but was not enacted as part of the Bank Collection Code.

5. See *Bellvue Bank v. Security Nat'l Bank*, 168 Iowa 707, 712, 150 N.W. 1076, 1077 (1915); *Fidelity & Cas. Co. v. Planenscheck*, 200 Wis. 304, 227 N.W. 387 (1929).

was that the giving of credit in the payee's bank book or on his duplicate deposit slip constituted final payment.⁶ The Model Deferred Posting Statute, however, enacted in Indiana⁷ and almost all other jurisdictions in some form,⁸ has changed this rule. It gives the payor bank until midnight of the day subsequent to deposit to revoke the credit given. A similar position has been adopted by the Code in sections 4-301 and 4-302.

Some banks have attempted to avoid this final payment issue by inserting a clause in the deposit slip to the effect that "all items are credited subject to final payment in cash or solvent credit." The provisional credit thus given is subject to revocation if the bank deems it necessary within a reasonable time. The courts, however, have been somewhat reluctant to enforce such provisions if there is some reasonable way to circumvent their effect.

Clearing House Items. When the depository and the payor banks are in the same city they will normally transact their business at the same clearing house. In such a situation a representative of each bank will take checks drawn on the other banks to the clearing house where they will exchange credits on the total amount of the items so drawn. Under the Model Deferred Posting Statute the credit is only provisional and will become "firmed up" if it is not returned at the return item clearing on the following day.¹⁰ When the bank's representative returns from the clearing house with the items drawn on his bank, the bank decides whether or not it will honor the items and, if dishonor is necessary it will set the item aside to be returned the next day at the return item clearing.¹¹

Prior to the adoption of the Deferred Posting Statute the time allowed for returns to the clearing house was normally determined by individual clearing house regulations and, in general, a much shorter interval was permitted.¹² A difficult question arises as to whether the credit

6. See *Briviesca v. Coronado*, 19 Cal. 2d 244, 120 P.2d 649 (1941); *White Brokerage Co. v. Cooperman*, 207 Minn. 239, 290 N.W. 790 (1940); *Scotts Bluff County v. First Nat'l Bank*, 115 Neb. 273, 212 N.W. 617 (1927) (held that credit given in depositor's passbook was equivalent to payment in cash); *Oddie v. National City Bank*, 45 N.Y. 735 (1871).

7. IND. ANN. STAT. § 18-2518 (Burns 1950).

8. 1 PATON, DIGEST OF LEGAL OPINIONS 13 (Supp. 1951), states that all jurisdictions, except Kentucky have adopted some form of the Model Deferred Posting Statute.

9. See *Hay & Stephens v. First Nat'l Bank*, 244 Ill. App. 286 (1927) (court would not allow notation to include checks drawn on the depository); *Olenger v. Sanders*, 92 Ind. App. 358, 174 N.E. 513 (1931) (although this was not an "on us" item the deposit slip condition was not allowed to change the relationship between the depositor and depository bank); *Andrew v. Security Trust & Sav. Bank*, 214 Iowa 1199, 243 N.W. 542 (1932); *White Brokerage Co. v. Cooperman*, 207 Minn. 239, 290 N.W. 790 (1940).

10. IND. ANN. STAT. § 18-2518 (Burns 1950).

11. *Andrews, The City Clearing House*, 27 IND. L.J. 155, 164 (1952).

12. See *German Nat'l Bank v. Farmers Deposit Nat'l Bank*, 118 Pa. 294, 12 Atl. 303 (1888) (stop payment was given effect though provisional credit was entered in a

becomes final by some activity at the payor bank prior to the return item clearing, or by the expiration of the time allowed by clearing house rules. Cases covering this particular point are almost non-existent,¹³ and discussion by the authorities is in conflict.¹⁴ If it is the payor's activity which constitutes final payment of these clearing house items, it will be similar to the activity which is considered relevant in a transitory item situation (discussed below).

Transitory Items. When the payor and depository banks are outside of the area of the same clearing house, the method of payment is somewhat more complex than the "on us" or clearing house items. If the depository bank chooses to mail the check directly to the payor bank,¹⁵ the depository bank will give provisional credit to the payee's account and the credit will become firmed up by certain action undertaken at the payor bank.

The depository bank may choose to send the item to an intermediary collecting bank, probably one with whom it has an account, *i.e.*, a correspondent bank. The check is then forwarded to other intermediaries until it comes finally to rest at the payor bank.¹⁶ Throughout the journey to the payor bank, each intermediary collecting bank will give a provisional credit for the item to its immediate presenting bank. When the payor bank undertakes the vital activity which constitutes final payment, all of these provisional credits become firmed up. If the payor bank dishonors the item a reversal of all the provisional credits will be entered.

clearing house arrangement); Andrews, *The Operation of the City Clearing House*, 51 YALE L.J. 582, 598 (1942).

13. See *Sneider v. Bank of Italy*, 184 Cal. 595, 194 Pac. 1021 (1920); *Akron Scrap Iron Co. v. Guardian Sav. & Trust Co.*, 120 Ohio St. 120, 165 N.E. 715 (1929) (stamping an item "paid" did not constitute final payment); *German Nat'l Bank v. Farmers Deposit Nat'l Bank*, *supra* note 12 (placing a check on a spindle would not constitute final payment).

14. See Andrews, *supra* note 11, at 156. Mr. Andrews, after a thorough analysis, concludes that it is probably the expiration of the time period which makes the payment final. See also Wallace, *Comments on the Proposed Uniform Check Collection Code*, 16 VA. L. REV. 792, 805 (1930), where it is maintained that certain cases have held payment to take place when the drawer's account was charged, despite the fact that the time period has not expired.

15. This method of sending was not approved at common law. UNIFORM COMMERCIAL CODE § 4-204(2) (a), now explicitly allows the direct mailing from collecting to payor bank.

16. During this process of collection there will usually be one or more Federal Reserve Banks involved. The procedure in this case is somewhat different, but a detailed analysis would not be particularly helpful for our immediate purposes. The Federal Reserve System has set up the procedure whereby they act similar to a clearing house for these particular items in a given area. They will give provisional credit to the account of the depository bank and send the item to the payor bank, and, if the payor honors the item, will charge the payor's account for the amount thereof. See Board of Governors Fed. Res. System, *Check Clearing & Collection*, Reg. J §§ 3-5 (1959).

When the payor bank decides to honor the item, the firming up of the previous credits is an automatic process. This is the usual situation and involves a debit and credit relationship between all the banks along the line. If, however, the payor does not have an account with its immediate presenting bank it will probably settle with the immediate presenting bank by issuing a remittance draft drawn on another bank with whom the payor has an account. Regardless of which method of settlement is employed, there is some activity undertaken by the payor bank which constitutes final payment.

The precise activity of the payor bank which will constitute final payment of transitory items, however, has been handled inconsistently by the courts for years. For example, a Massachusetts court has held that merely stamping the item "paid" prior to charging the account of the drawer was enough to constitute final payment by the payor bank so that the payee was entitled to the proceeds of the item.¹⁷ Such a result, however, is contrary to the weight of authority.¹⁸ If the payor bank retains the item for an unreasonable time the court may hold that they have "accepted" the item and, under the majority common law rule, cannot dishonor the item thereafter.¹⁹ Some courts will consider the drawing of the draft for remittance as final payment,²⁰ while others hold that even mailing the remittance is not final, since the payor bank can recover the draft from the mail if they so desire.²¹ An Indiana court felt that mailing a letter to the immediate presenting bank saying the item was paid did not amount to payment, but only evidenced the payor's intention to pay.²² It is thus seen that, in transitory as well as "on us" and clearing house items, little reliability can be placed upon the common law.

Since courts have inconsistently dealt with the problem of payment

17. *Nineteenth Ward Bank v. First Nat'l Bank*, 184 Mass. 49, 67 N.E. 670 (1903) (although this case involved a promissory note, the court was explicit in saying that the situation would be the same if it was a check).

18. See *First Nat'l Bank v. Wisconsin Nat'l Bank*, 210 Wis. 533, 246 N.W. 593 (1933) (where charging drawer's account made subsequent stop order ineffective; *accord*, *Union State Bank v. Hibernia Bank & Trust Co.*, 224 Mo. App. 375, 18 S.W.2d 93 (1929)).

19. *Wisner v. First Nat'l Bank*, 220 Pa. 21, 68 Atl. 955 (1908) (The court held that prolonged or unreasonable detention by the payor could imply acceptance. Failure to return to the immediate collecting bank within 24 hours after delivery is sufficiently unreasonable to hold the payor as honoring the item).

20. *Nineteenth Ward Bank v. First Nat'l Bank*, 184 Mass. 49, 67 N.E. 670 (1903).

21. *Bohlig v. First Nat'l Bank*, 233 Minn. 523, 48 N.W.2d 445 (1951).

22. *Guardian Nat'l Bank v. Huntington State Bank*, 206 Ind. 185, 187 N.E. 388 (1933), held that the drawee bank is not bound until it has done something equal to paying or accepting the item. "An intention to pay is not payment." Here the payor sent a letter to the immediate presenting bank saying that the checks were paid. The letter was withdrawn from the mail when the payor learned that they had been protested by a Federal Reserve Bank.

as one general concept, applicable to any troublesome situation, it is obvious that the Code clarification was in order. Because of the complexities of the collection process, however, the final payment sections of the Code are somewhat confusing and difficult to understand. Once understood, though, they present a uniform approach to the problem and either change or codify, in a generally desirable manner, present common and statutory law. Due to the difficulty in understanding the cross references and intricate detail of these sections, particular emphasis will be placed upon simple explanation and illustration. Since payment under the Code is not an all-encompassing concept, the subdivisions will cover the different purposes for which payment is defined. Particular emphasis will be placed on sections 4-211, 4-212, 4-213 and 4-303, and how they interrelate in setting a point of time when payment is final.

II. WHEN DO RIGHTS OF THE PAYEE ACCRUE AGAINST THE PAYOR BANK

A. SECTION 4-213(1) OF THE UNIFORM COMMERCIAL CODE

Section 4-213(1) of the Code provides that a payor bank will be deemed to have finally paid an item when it has:

- (a) paid the item in cash; or
- (b) settled for the item without reserving a right to revoke the settlement, and without having such right under statute, clearing house rule or agreement; or
- (c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or
- (d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon a final payment under subparagraphs (b), (c), or (d) the payor bank shall be accountable for the amount of the item.²³

The payee receives the rights under this section to sue the payor bank for the amount of the item. Subsection (1)(a) would normally apply to an "on us" item and will, therefore, be considered in the section dealing with the payee's rights against the depository bank. Subsection (1)(b) would come up very infrequently, if ever, since the right to revoke a provisional credit is now standard procedure under statute,²⁴

23. UNIFORM COMMERCIAL CODE § 4-213.

24. See IND. ANN. STAT. § 18-2503 (Burns 1950).

clearing house rules,²⁵ Federal Reserve Regulations²⁶ and agreements between correspondent banks. Therefore the relevant subsections, in holding the payor accountable to the payee for the amount of the item, are subsections (1)(c) and (d).

Section 4-213(1)(c) recognizes the general common law rule that posting the account of the drawer is final payment.²⁷ This provision attempts to further clarify by adding that the process of posting must be "completed," so that although the process may extend over a period of time, the final notation necessary to charge the drawer is the critical time.

The Uniform Commercial Code Editorial Board has recommended, and Indiana has adopted, a further clarification of this subsection by setting out a detailed definition of "process of posting," found in section 4-109:

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 "paid" or other stamp;
- (d) entering a charge or entry to a customer's account;

25. A typical clearing house agreement was set out in *Akron Scrap Iron Co. v. Guardian Sav. & Trust Co.*, 120 Ohio St. 120, 165 N.E. 715 (1929). The relevant provisions are as follows:

All checks, notes, bills of exchange or other items, received through morning clearings, returned unpaid for any reason by city banks shall be returned through the afternoon return item exchanges on the day of clearance at 2:20 P.M., except on Saturday, when unpaid items received through the morning clearings shall be returned through the morning return item exchanges at 8:30 A.M. on the next succeeding business day. By mutual agreement, in the case of emergency or necessity, where it has been found impossible to return items through the 2:20 P.M. Return Item Session, arrangements to return these items shall be made between the interested banks by telephone. But in every instance the return must be made to the receiving bank and the transaction completed by 3:30 P.M. on the day of clearance.

To hold that debits and credits at the clearing house constitute final, irrevocable payment . . . would result in gross injustice and would evidence a complete failure to comprehend the purposes and methods of the clearing routine. Fortunately the courts take no such absurd position; instead, they hold with practical unanimity, that the debits and credits at the clearing house are merely provisional and do not constitute final payment.

Andrews, supra note 11, at 156. See generally, *Andrews, supra* note 12.

26. See Board of Governors Fed. Res. System, Check Clearing & Collection, Reg. J. §§ 3-5 (1959).

27. *Union State Bank v. Hibernia Bank & Trust Co.*, 224 Mo. App. 375, 18 S.W.2d 93 (1929); see *First Nat'l Bank v. Wisconsin Nat'l Bank*, 210 Wis. 533, 246 N.W. 593 (1933).

(e) correcting or reversing an entry or erroneous action with respect to the item.²⁸

Subsections (a), (b) and (c) set out points of time which are somewhat earlier than what has normally been considered the "process of posting," whereas subsection (d) is the action which has normally been held to constitute the vital determining factor. Without the detailed definition of section 4-109, subsection (d) would stand as the relevant activity of the payor for accountability under section 4-213(1)(c), however, subsection (e) of 4-109 broadens the definition of the "process of posting" to make it almost meaningless. A payor bank, it appears, is now able to reverse an entry which was previously considered final. In other words, the payor bank can perform one of the vital steps in (a), (b), (c) or (d) and it would not be accountable since, by the plain meaning of subsection (e), it can correct or reverse an entry as it sees fit.

Why such extreme latitude is permitted after the Code has gone to great lengths to set out a precise point of time for payor accountability is difficult to comprehend. Perhaps, in the desire to be consistent, this subsection should be read narrowly to apply *only* to erroneous entries. If it can be limited to mechanical errors of the entry, then the preciseness of section 4-213(1) will not be lost. If it is not narrowed to this point, however, the payor bank would be able to charge the account of the drawer and later reverse this charge, contending that the initial entry was erroneous, since it did not realize that the drawer had insufficient funds.

It is thus seen that the plain meaning of section 4-109 would destroy the effect of section 4-213(1)(c) and negate the effect of the Code for consistency in each section where final payment is a consideration.²⁹ Perhaps, if litigation should arise under any of the final payment sections, the narrow construction would appeal to the court, but until such a time a result of such litigation is unpredictable. If limitation and clarification is not possible, the only alternative would seem to be repeal of subsection (e).

Section 4-213(1)(d),³⁰ the other relevant provision of payor accountability, states, in effect, that final settlement is final payment. This subsection covers the situation where the time to revoke a provisional settlement has expired; the "settlement" between the payor and the im-

28. UNIFORM COMMERCIAL CODE § 4-109.

29. See UNIFORM COMMERCIAL CODE §§ 4-301, -303.

30. As mentioned previously, UNIFORM COMMERCIAL CODE § 4-213(1)(b) will arise infrequently, but what is covered in UNIFORM COMMERCIAL CODE § 4-213(1)(d) will also apply to subsection (b) if the right to revoke is not reserved at all.

mediate presenting bank being critical. In such a case the provisional settlement becomes firmed up and the payor bank is treated as having paid the item. In defining "settlement" as "payment in cash, clearing house settlement, in a charge or credit, or by remittance or otherwise as instructed"³¹ and in providing that a "settlement may be either provisional or final"³² the Code drafters have been of little help in enabling a determination of payor accountability under subsection (1)(d). Although the definition of settlement, standing alone, would seem to be of no help in payor bank accountability in the Code sections which treat settlement for the purposes of collecting bank accountability, the drafters of the Code, by the indirect method of adequately treating collecting bank settlement, have alleviated the payor bank accountability problem.³³ The essence of this solution is that the debits and credits, usually made provisional by each presenting bank along the chain forward to the payor bank, are settlements *for* the item. Likewise, the settlement between the immediate presenting bank and the payor bank is settlement *for* the item. It is when the time for this settlement expires that there has been a payment *of* the item.³⁴ Payment takes place only by a transaction of the payor, while various settlements take place between all the banks in the chain. When the provisional settlement becomes final between the payor and its immediate presenting bank, final payment has taken place under section 4-213(1)(d).

If the section 4-109 posting provision potential is as extreme as has been previously indicated the effect of section 4-213(1)(c) on payor accountability is minimized and the most significant provision becomes section 4-213(1)(d). If the determining factor as to the "settlement" of subsection (d) is "clearing house rules or agreement" it appears as if the intermediary banks may make any arrangements they care to as to when the provisional settlement becomes final. Therefore the limitation as to these inter-bank agreements will have to come from a statute which firms up such settlements automatically. One such limitation has been provided in section 4-213(1)(c), but its effect has been shown to be drastically hampered by the broad definition in section 4-109. The only other way firming up could take place by statute would be under sections 4-301 and 4-302, the deferred posting sections of the Code. Under the terms of section 4-302 failure to revoke a provisional settlement will make

31. UNIFORM COMMERCIAL CODE § 4-104(j).

32. *Ibid.*

33. For a detailed discussion of collecting bank accountability and how settlement relates thereto, see note 41 and accompanying text, *infra*.

34. See 2 STATE OF NEW YORK LAW REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE, 1379 (1955).

that settlement final at the payor's midnight deadline.³⁵ As in section 4-213(1) the payor bank is said to be "accountable for the amount of the item." Thus the inter-bank arrangements will not be given effect if they forestall the final settlement beyond midnight of the day following the payor's receipt of the item.³⁶

B. THE EFFECT OF SECTION 4-213(1) ON PRIOR LAW

Section 7 of the Bank Collection Code was enacted in Indiana and provided that: "When an item is received by mail by a solvent drawee

35. UNIFORM COMMERCIAL CODE § 4-104(1)(h) provides: "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later."

36. UNIFORM COMMERCIAL CODE § 4-214 provides that:

(1) Any item in or coming into the possession of a payor or collecting bank which suspends payment and which item is not finally paid shall be returned by the receiver, trustee or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(2) If a payor bank finally pays an item and suspends payment without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(3) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement becoming final if such finality occurs automatically upon the lapse of certain time or the happening of certain events (subsection (3) of section 4-211, subsection (1)(d), (2) and (3) of section 4-213).

(4) If a collecting bank receives from subsequent parties settlement for an item which settlement is or becomes final and suspends payments without making a settlement for the item with its customer which is or becomes final, the owner of the item has a preferred claim against such collecting bank.

Although bank failures are no longer a prominent source of litigation, it seems that brief attention should be given to § 4-214, since it enters into the concept of final payment. Subsection (1) is clear in providing that if the payor suspends payment before the item is finally paid (as determined by UNIFORM COMMERCIAL CODE § 4-213), the payee with the returned item must take recourse against the drawer for the amount of the item. Likewise, subsection (2) appears to be self explanatory. If final payment (as determined by UNIFORM COMMERCIAL CODE § 4-213) occurs at the payor bank before the suspension of payments, the payee has a preferred claim against the payor bank for the amount of the item and insolvency will not defeat it. Subsection (3) states, in effect, that if the series of activities which will firm up a provisional settlement have already been set in motion, the suspension of payments will not interfere with the automatic process. The insolvency of the collecting bank is dealt with in subsection (4). For each collecting bank along the chain of banks this provision raises no problems. If a particular collecting bank has received a final settlement and thereafter suspends payment, the payee has a preferred claim against it for the proceeds of the item. If, however, it is the depository which suspends payments, different considerations may arise. It might be argued that the customer's relationship with his bank is not fortuitous and is such that he should assume the role of a general, as opposed to a preferred creditor. While his casual relation with the payor and the other collecting banks is a sound reason for a preference, no such involuntary relationship exists when his own bank fails. UNIFORM COMMERCIAL CODE § 4-105(d), however, is clear in defining the term "collecting bank" so that the payee under a literal reading of the provision will get a preference even as against his own depository bank.

or payor bank, it shall be deemed paid when the amount is finally charged to the account of the maker or drawer."³⁷ This section, applying only to items received by mail, did not encompass the "on us" situation nor did it cover clearing house settlements. The one method of final payment provided in section 7 of the Bank Collection Code, however, was not exclusive in the mail collection situation. A recent Indiana case³⁸ clearly showed that revocable credit given by the payor bank for a mail item can become final by letting the statutory time lapse without revocation. The decision was based on section 1 of the Model Deferred Posting Statute³⁹ on the grounds that the payor had been inactive for four days and the statute made a revocable credit irrevocable if the bank did not dishonor by midnight of the day following receipt of the item.⁴⁰

Section 4-213(1) in defining when the payor bank shall be "accountable" for the item does not appear to change the common law any more than the Bank Collection Code has already changed it. It is, however, a more detailed clarification and becomes very effective in setting down the exact moment when the payor bank can be said to have finally paid the item. This final payment by the payor has the effect of reversing the direction of the collection, *i.e.*, prior to this time the check was being collected, whereas after this time the proceeds of the check are being remitted. It is after the reversal of direction that the depositor may be certain that his rights on the instrument have been substituted for a debt of the payor bank, and if necessary, sue the payor for the amount of the item.

III. WHEN DO RIGHTS OF THE PAYEE ACCRUE AGAINST THE DEPOSITORY BANK?

A. THE ACCOUNTABILITY OF A DEPOSITORY BANK UNDER THE UNIFORM COMMERCIAL CODE

The determination of when a payee may sue the payor bank becomes unimportant to a typical depositor in many instances since the usual situation will find the payor bank in a different locality many miles from the payee. It thus becomes much more desirable for an unpaid payee to look to his depository bank for payment, since in all probability it will be in the same locality as the payee and he can save the hardship and expense of traveling to the payor's city for reimbursement.

37. IND. ANN. STAT. § 18-2507 (Burns 1950).

38. *First Nat'l Bank v. Universal C.I.T. Credit Corp.*, 132 Ind. App. 353, 170 N.E. 2d 238 (1960).

39. IND. ANN. STAT. § 18-2518 (Burns 1950).

40. A similar outcome would occur under the UNIFORM COMMERCIAL CODE §§ 4-301, -302.

In an "on us" item the payee's right to sue the depository is equivalent to his right to sue the payor, since the payor and depository are one and the same. If, in an "on us" situation, the payor credits the account of its depositor, such a credit is subject to the charge back provision of section 4-213(3) which provides that the payor-depositor may charge back or obtain a refund from its customer, governed by the rules of section 4-301. While section 4-301 does not prevent a charge back or refund where the credit granted is only provisional, section 4-301(1) provides that recovery of payment must take place prior to final payment as found in section 4-213(1). Since in an "on us" item section 4-213(1)(a) recognizes that payment in cash by the payor bank constitutes final payment, a payee, desiring to circumvent the charge back or refund rights of section 4-213(3) and yet deposit the amount in his account, could receive final payment in cash on the check and move to another window in the bank to deposit the cash amount to his account. It would seem section 4-301, in conjunction with section 4-213(1)(a) would put such a change in the form of the transaction outside of the section 4-213(3) charge back and refund right, when in substance there was no change in effect of the transaction; *i.e.*, a deposit of an "on us" item to the account of the payee.

The Code covers the payee's rights against the depository in other than "on us" items in section 4-213(3):

If a collecting bank receives a settlement for an item which is or becomes final (subsection (3) of Section 4-211, subsection (2) of Section 4-213) the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.⁴¹

Thus, when the depository bank receives final, irrevocable credit for the amount of the item, the payee has a right against his bank for the proceeds. Where it was previously an agent for collection, it has now become a debtor to its depositor.

The cross reference to section 4-211(3),⁴² is applicable in a situa-

41. UNIFORM COMMERCIAL CODE § 4-213(3).

42. UNIFORM COMMERCIAL CODE § 4-211(3) provides that:

A settlement for an item by means of a remittance instrument or authorization to charge is or becomes a final settlement as to both the person making and the person receiving the settlement,

(a) if the remittance instrument or authorization to charge is of the kind approved by subsection (1) or has not been authorized by the person receiving the settlement and in either case the person receiving the settlement acts reasonably before its midnight deadline in presenting, forwarding for collection or paying the instrument or authorization,—at the time the remittance instrument or authorization is finally paid by the payor by which it is payable;

tion involving a transitory item, which is settled for by a remittance draft of the payor. Section 4-211(3)(a) provides that the settlement becomes final when the payor of the remittance draft finally pays the remittance, as determined by 4-213(1). Subsection (a) applies only when the remittance is approved under 4-211(1).⁴³ Therefore, if the payor bank elects to discharge its accountability by a remittance draft and all parties act within the statutory time limits, their accountability is discharged when the remittance draft is finally paid. If settlement is made by a non-bank check or by a check drawn upon the payor bank, *i.e.*, not approved by section 4-211(1)(a), and it is so authorized by the party receiving the settlement, it becomes final under section 4-211(3)(b) when the presenting bank receives it. Finally, under section 4-211(3)(c), if the settlement is not covered by either subsection (a) or (b) and the party receiving the settlement does not return or forward by its midnight deadline, the settlement is final at the midnight deadline.⁴⁴ Thus, under

(b) if the person receiving the settlement has authorized remittance by a non-bank check or obligation or by a cashier's check or similar primary obligation of or a check upon the payor or other remitting bank which is not of a kind approved by subsection (1)(b),—at the time of the receipt of such remittance check or obligation; or

(c) if in a case not covered by paragraphs (a) or (b) the person receiving the settlement fails to seasonably present, forward for collection, pay or return a remittance instrument or authorization to it to charge before its midnight deadline,—at such midnight deadline.

43. UNIFORM COMMERCIAL CODE § 4-211(1) provides that:

- (1) A collecting bank may take in settlement of an item
 - (a) a check of the remitting bank or of another bank on any bank except the remitting bank; or
 - (b) a cashier's check or similar primary obligation on a remitting bank which is a member of or clears through a member of the same clearing house or group as the collecting bank; or
 - (c) appropriate authority to charge an account of the remitting bank or of another bank with the collecting bank; or
 - (d) if the item is drawn upon or payable by a person other than a bank, a cashier's check, certified check or other bank check or obligation.

The purpose of UNIFORM COMMERCIAL CODE § 4-211 was to clarify the common law rule and reiterate the rule of the Bank Collection Code. At common law the collecting bank became liable if it accepted anything but cash from the prior collecting bank. If the collecting bank accepted a worthless draft it became personally liable. *Federal Reserve Bank v. Malloy*, 264 U.S. 160 (1924).

BANK COLLECTION CODE §§ 9-10 reversed this common law position and authorized the collecting bank to accept the draft of the payor bank upon any other bank, the draft of any other bank drawn upon any bank other than the payor or "such method of settlement as may be customary in a local clearing house or between clearing banks or otherwise."

Thus, UNIFORM COMMERCIAL CODE § 4-211(1)(a) is simply a reiteration of the Bank Collection Code provisions. UNIFORM COMMERCIAL CODE §§ 4-211(1)(b) and (c) would probably be approved under the Bank Collection Code by virtue of the "catch-all" provision, *i.e.*, such method of settlement as may be customary. Comment 4 points out that UNIFORM COMMERCIAL CODE § 4-211(1)(d) simply recognizes the practice of the collecting bank accepting these type remittances as proper from non-bank payors.

44. See note 35 *supra*.

the section 4-211(3)(a), (b) and (c) remittance draft or authorization to charge provisions the payee can assert his claim against his depository bank, when that bank has received final settlement for the item.

The more frequent arrangement for collection on non "on us" items, however, is revealed by the other cross reference of section 4-213(3) and covers the cases where the payor has settled through a clearing house or by debits and credits.

In the usual case where the immediate presenting bank has provisionally charged the account of the payor bank, final settlement is determined by section 4-213(2) of the Code which provides that:

If provisional settlement for an item between presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in the accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.⁴⁵

The final payment section of the Code, 4-213(1), once more becomes relevant in this situation to pinpoint the liability of the depository bank. The payee now receives his rights against the depository at the same time that his rights accrue against the payor. Thus, when the arrangement is one of debits and credits along the collection process, the activity of the payor bank, which, under section 4-213(1), is considered final payment will firm up all the other debits and credits, making the depository bank accountable to its customer for the amount of the item. Likewise, in a clearing house arrangement, final payment by the payor will constitute final settlement under section 4-213(2) and the depository bank will become a debtor to the payee.

Under section 4-212(1) the depository or intermediary collecting bank receives the right to debit the account of a customer whose account it had previously credited.⁴⁶ The provisional credit given or an amount

45. UNIFORM COMMERCIAL CODE § 4-213(2).

46. UNIFORM COMMERCIAL CODE § 4-212(1) provides that:

If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund from its customer whether or not it is able to return the item if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final (subsection (3) of section 4-211 and subsections (2) and (3) of section 4-213).

paid to its customer may be charged back or become subject to refund regardless of whether or not the bank is able to observe the midnight deadline;⁴⁷ the right accruing if the provisional settlement which the collecting bank has received never becomes final.

The 1955 draft of the Code did not include the last sentence of 4-212(1): "These rights to revoke, charge back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final (subsection (3) of section 4-211 and subsections (2) and (3) of section 4-213)."⁴⁸ The addition of this sentence clarifies certain objections which were made to this section by the New York Law Revision Commission.⁴⁹ The commission maintained that subsection (1) assumed the answer as to whether or not the credit given was provisional or final. The inclusion of the cross reference now clearly indicates that when the settlement becomes final the charge back and refund rights under section 4-212(1) are lost. So the commission's observation that "a bank which has become liable for an item as if it had actually received the proceeds in money, ([section] 4-211(2) now [section] 4-211(3)), has no remaining right of charge-back or refund,"⁵⁰ is completely correct, but is spelled out in the direct language of section 4-212. The point of time when the depository has received final settlement sets the point of time when its right to charge back or obtain a refund under section 4-212 is lost; section 4-211(3) setting the time for remittance drafts and section 4-213(2) setting the time for debits and credits and clearing house items.

Although the payee has acquired a cause of action for the proceeds from his depository, it does not mean that his right to withdraw the deposit is established; the right of withdrawal being covered in section 4-213(4) and (5) of the Code. Subsection (4)(a) deals with the situation where the bank has received provisional settlement for the item and has credited its customer's account. The customer's right of withdrawal accrues when this settlement becomes final and the bank has a reasonable time to so learn.⁵¹ How the depository is able to determine this reasonable time is not explained, but the comment suggests that it will vary with different distances between banks and different types of settlement, no clear-cut rule being available for determination of the right of with-

47. See note 35 *supra*.

48. UNIFORM COMMERCIAL CODE § 4-212(1).

49. See 2 STATE OF NEW YORK LAW REVISION COMMISSION, *op. cit. supra* note 34, at 1363.

50. *Ibid.*

51. The right is determined by UNIFORM COMMERCIAL CODE, §§ 4-211(3), -213(2).

drawal.⁵² Perhaps, however, this will not be important in practical application. If the depositary refuses to allow withdrawal and later learns that the settlement has become firmed up, it will then permit withdrawal and litigation will seldom arise. If, on the other hand, it permits withdrawal prematurely section 4-212(1) gives it the right to obtain a refund if its settlement never becomes final. Subsection (4)(b) of section 4-213 deals with the situation where the depositary credits the payee's account in an "on us" item; the payee's right of withdrawal accruing two days after the deposit. Section 4-213(5), applicable to cash deposits, states that this type deposit is "final when made," but becomes available for withdrawal "at the opening of the bank's next business day following the receipt of the item."⁵³ It is, therefore, apparent in each right to withdraw situation, that a cause of action may accrue against the depositary bank before the payee may withdraw as a matter of right.

B. THE EFFECT OF CODE ON DEPOSITARY ACCOUNTABILITY UNDER PRIOR LAW

Liability of the depositary bank was not a separate consideration at common law or under the Bank Collection Code. Section 3 of the Bank Collection Code, however, does cover "on us" items and clearly makes the credit entered on the depositor's account only provisional,⁵⁴ thereby changing the rule at common law⁵⁵ and allowing the depositary-payor bank an extra day to charge back the credit which they have given for the deposit. Under section 2 of the Bank Collection Code the depositary bank is made an agent for collection and any credit entered is considered revocable. The time set for making this credit final is when the "proceeds are received in actual money or an unconditional credit given on the books of another bank"⁵⁶ and, therefore, it appears that the depositary becomes a debtor rather than an agent; the payee having a right to sue his own bank of deposit.

These sections of the Bank Collection Code are greatly clarified by the Uniform Commercial Code, especially in the case of transitory and clearing house items and the use of the undefined phrase "unconditional

52. UNIFORM COMMERCIAL CODE § 4-213, comment 10.

53. UNIFORM COMMERCIAL CODE § 4-213(5).

54. IND. ANN. STAT. § 18-2503 (Burns 1950) provides that:

A credit given by a bank for an item drawn on or payable at such bank shall be provisional subject to revocation at or before the end of the day on which the item is deposited in the event the item is found not payable for any reason. Whenever a credit is given for an item deposited after banking hours such right of revocation may be exercised during the following business day.

55. See note 6 and accompanying text *supra*.

56. IND. ANN. STAT. § 18-2502 (Burns 1950).

credit" of the Bank Collection Code⁵⁷ has been replaced by the detailed concept of "final settlement."⁵⁸

The Bank Collection Code and previous common law defined final payment for one general purpose, *i.e.*, final payment for one purpose was final payment for all purposes. The Code, however, has in its definitions distinguished the purposes for which the final payment is being considered. Section 4-213(1) sets out the point in time when the payor bank becomes "accountable" for the item, and section 4-213(3) sets out the point in time when the collecting bank becomes "accountable" for the item. There is, however, a point in time earlier than either of the above which the Code drafters felt necessary to set out. Therefore, section 4-303 was provided to determine the priority of a notice, stop-order, legal process or set-off with respect to the item presented to the payor bank for collection.

IV. WHEN DOES A NOTICE, STOP-ORDER, LEGAL PROCESS OR SET-OFF COME TOO LATE TO BE EFFECTIVE?

The question of whether or not a notice, stop-order, legal process or set-off comes too late for the payor bank to reverse its activity in paying the item involves somewhat different problems than those involved in "final payment" for the purposes of payor bank accountability of section 4-213(1). The payor bank needs to know if it should recognize the drawer's stop-order, notice of an assignment to creditors, etc., or whether the item has been processed too far for such recognition. The activity of the payor bank which will constitute the finality of section 4-303(1) is somewhat broader than what was required in section 4-213(1): subsections (1)(b), (1)(c) and the first parts of (1)(d) and (1)(e) of 4-303 being the same criteria used to measure "final payment" in section 4-213(1); the broadening provisions of section 4-303 being subsections (1)(a) and the last parts of (1)(d) and (1)(e).

Subsection 1(a) makes any of the "four legals" come too late in the case where the payor bank has "accepted or certified the item."⁵⁹ After a bank accepts or certifies a check it is considered to have set aside sufficient funds of the drawer to cover the amount of the check and the drawer is discharged from liability.⁶⁰ It appears quite reasonable, therefore, to hold any of the legals ineffective after such certification or acceptance. Subsection (1)(b) dealing with payment by the payor in cash

57. *Ibid.*

58. See UNIFORM COMMERCIAL CODE §§ 4-211(2), -211(3), -213(3).

59. UNIFORM COMMERCIAL CODE § 4-303(1)(a).

60. See UNIFORM COMMERCIAL CODE § 3-411(1).

presents no problem, since, quite reasonably, this has always been considered final with respect to the "four legals."⁶¹ Likewise, subsection (1)(c), involving final settlement, presents no problem, since the same concepts are involved that were covered in the final payment concepts of section 4-213(1)(b) and (d). Subsection (1)(d), however, has broadened the requirement of completing the process of posting by adding the provision, "or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item."⁶² The comments to section 4-303 are careful to spell out that under no circumstances is provisional settlement to be considered such a decision.⁶³ The generality of this addition, however, may well lead to the vagueness which the Code is trying to eliminate in the present collection process.

The import of the above provision upon existing law might well be illustrated using a hypothetical situation taken from a 1951 Minnesota case.⁶⁴ The payor bank had received certain items from a Federal Reserve intermediary; they then stamped the items "paid" and posted them to the drawer's account. Thereafter, a draft was prepared for mailing to the Federal Reserve Bank. The drawer then phoned the payor bank and requested stop payment on one of the items involved (it appears that such conversation may have been prior to the actual mailing, but the court said that it did not matter). The payor bank said that it was too late and the stop payment was not given effect, but the court held that the payor bank was wrong in refusing to recognize the stop order since, even if the item had already been mailed, they could have withdrawn it from the mails.

Under section 4-303(1)(d) of the Code it seems that this outcome would be otherwise, since the payor had charged the drawer's account and, therefore, final payment had occurred for the purpose of making a stop order ineffective. Once again, though, we are confronted with the broad definition of the process of posting of section 4-109. Since section 4-109(e) permits a reversal of an entry, the payor bank might be able to honor the stop order with immunity. If, however, the more consistent, narrower interpretation of section 4-109 is followed,⁶⁵ the payor could not call this entry erroneous and so the charging of the drawer's account would stand; the stop order being considered too late. Suppose,

61. *But see* National Loan & Exch. Bank v. Lachovitz, 131 S.C. 430, 128 S.E. 10 (1925), (The payee was paid in cash and then the bank learned of the stop-order. The bank was permitted to recover from the payee).

62. UNIFORM COMMERCIAL CODE § 4-303(1)(d).

63. UNIFORM COMMERCIAL CODE § 4-303, comment 3.

64. *Bohlig v. First Nat'l Bank*, 233 Minn. 523, 48 N.W.2d 445 (1951).

65. For a complete discussion see note 28 and accompanying text *supra*.

however, the payor had simply stamped the item "paid" and had not yet posted it to the drawer's account; would this have enough finality to hold the stop order ineffective as coming too late?⁶⁶ If the payor had done so after it examined the drawer's account, the strict wording of the "omnibus" phrase of section 4-303(1)(d) would hold the stop order ineffective and likewise, section 4-109(c) would call this activity "completing the process of posting."⁶⁷

These and other border line situations, must be left to judicial interpretation since there are so many different activities which might evidence a payor's decision to pay the item that the Code does not even attempt to spell out a strict rule. The crucial factor, however, is that for the "omnibus phrase" to have any effect, the payor bank must have first examined the drawer's account and thereafter taken the steps indicating the intention to pay. When, after this examination, the intention of the payor to pay appears to be unequivocal, the stop order should not be given effect.

Subsection (1)(e) of section 4-303 recognizes the finality of payment when the payor bank does not dishonor the item within the statutory time. The provisional settlement which has automatically become final by the payor's inactivity is dealt with in section 4-213(1)(d) concerning failure to revoke provisional settlement and section 4-302 concerning deferred posting. The provision here simply states that any of the "four legals" comes too late if the provisional settlement has become firmed up in such a manner.

Section 4-303(2) gives the payor bank discretion in deciding which of the items it receives will be paid first. This complete discretion would seem to be subject to the general rule that the bank act "reasonably" in regard to the items,⁶⁸ and would, of course, be subject to limitation for fraud in the order of payment.⁶⁹ The Code granting of discretion in the order of payment of items represents the first statutory provision on the point and is a departure from common law which required items received at different times to be paid in the order of presentment.⁷⁰

66. *Hunt v. Security State Bank*, 91 Ore. 362, 179 Pac. 248 (1919) (held that stamping "paid" was not enough action by the payor to hold a stop-order request ineffective); *but cf. Nineteenth Ward Bank v. First Nat'l Bank*, 184 Mass. 49, 67 N.E. 670 (1903) (when stamping the item "paid" by the payor was held to be final payment, entitling the payee to the proceeds of the item).

67. UNIFORM COMMERCIAL CODE § 4-303, comment 3, uses the example of "sight posting" where the bookkeeper, after examining the drawer's account, makes the decision to pay but the actual entry is temporarily postponed.

68. See CLARKE, BAILEY & YOUNG, *BANK DEPOSITS AND COLLECTIONS* 89-90 (1959).

69. *Ibid.*

70. *Ibid.*

V. CONCLUSION

The interrelation of "final payment" and "final settlement" plays the all important role in the Code's handling of bank collections. The concept of "final payment" has a direct bearing on payor accountability,⁷¹ and on the effectivness of the "four legals."⁷² While depositary accountability⁷³ is dealt with in terms of "final settlement," "final payment" is instrumental in determining when "final settlement" occurs. "Final payment" will effect a "final settlement" by either firming up the provisional credits⁷⁴ or by determining when a remittance draft is paid.⁷⁵ Finally, "final payment" and "final settlement" might also be determined by the automatic process provided for in the deferred posting sections.⁷⁶

The intricate detail provided in the Code makes the final payment sections complex and somewhat hard to understand. Up to this point our analysis has been on an explanatory basis and perhaps a clearer understanding of these difficult sections might be obtained through applying these sections to a hypothetical fact situation.

Payee deposits a check drawn on a Boston bank (payor) in his bank in Indianapolis (depositary). The check is deposited for collection and the depositary gives provisional credit to the payee's account. The depositary then sends a cash letter covering the payee's check and other similar items to its correspondent bank in Cleveland. The correspondent bank provisionally credits depositary's account and sends the payee's check along with others to the Federal Reserve Bank of Albany, New York. The Federal Reserve Bank gives the familiar provisional credit to the correspondent bank and forwards the payee's check, along with others, to the payor bank of Boston.

Dishonor. If the payor bank does not finally pay the check as determined by section 4-213(1), then section 4-212(1) gives the Federal Reserve Bank the right to revoke the provisional credit which it had given the correspondent bank.⁷⁷ The Federal Reserve Bank must then send the item to the correspondent bank or notify it of the facts within a reasonable time as provided in section 4-212(1) and each bank along the chain would have the same right as the Federal Reserve Bank with respect to the provisional credits previously given. If the payee had with-

71. See UNIFORM COMMERCIAL CODE § 4-213(1).

72. See UNIFORM COMMERCIAL CODE § 4-303.

73. See UNIFORM COMMERCIAL CODE § 4-213(3).

74. See UNIFORM COMMERCIAL CODE § 4-213(2).

75. See UNIFORM COMMERCIAL CODE § 4-211(3)(a).

76. See UNIFORM COMMERCIAL CODE §§ 4-301, -302.

77. This right of the Federal Reserve Bank is terminated if the settlement has become final under UNIFORM COMMERCIAL CODE §§ 4-211(3), -213(2), -213(3).

drawn some of the deposit, section 4-212(1) gives the depositary the right to obtain a refund or to charge back this amount to his account, but under section 4-213(4) (a) the depositary may refuse the payee the right to withdraw his deposit until sufficient time has elapsed for it to learn whether the settlement is final.

Payment. If the payor bank does finally pay the check (as determined by section 4-213(1)), all of the provisional credits between the parties in the chain firm up and become final under 4-213(2). If the settlement is accomplished by the payor sending a remittance draft to the Federal Reserve Bank (an approved means under 4-211(1)), section 4-211(3)(a), (b) and (c) set out the clear rules as to when such a settlement becomes final. Finally, if the payor does not act within the time limits of section 4-301 and 4-302 then the payment is automatic and all the provisional settlements again are firmed up.

The above hypothetical case is a usual bank collection situation and it is clearly seen that the Code well defines the exact position of the item and a given bank's relation to the item, at any point in the collection process.

The greatest problem in attempting to point out how the various provisions of the Code will affect Indiana law is that there is very little Indiana precedent on which to rely, since the significant provisions of the Bank Collection Code have seldom been interpreted by Indiana courts. The most significant change in the prior Indiana law when the Code becomes effective in July of 1964, therefore, will essentially be one of clarification. This, however, is not to say that such clarification in the area of bank collections is unimportant or undesirable. Despite the lack of cases in this area, the payor bank especially, and all other parties to the bank collection process in some degree, desire and have a right to know when an item has been paid. They desire to know when the proceeds of the item are en route to the payee, when the drawer is discharged on the obligation and when the payee's rights exist against a given bank for the proceeds. Each bank in the chain desires to know how long it has to honor or dishonor the item or remittance draft and what it might remit or charge in payment of the item. These and many other questions will be answered more easily and clearly in a jurisdiction with the Code, than they have been in a jurisdiction which operated under a mixture of the Bank Collection Code and common law and which has had few judicial guideposts to establish the validity of its speculations.