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Recommended Citation
Henry D. Collins, Bank-Customer Relations under the Uniform Commercial Code, 64 W. Va. L. Rev. (1962). Available at: https://researchrepository.wvu.edu/wvlr/vol64/iss5/3
Bank-Customer Relations Under the Uniform Commercial Code*

HENRY D. COLLINS**

Prior to the enactment of the American Bankers' Association sponsored Bank Collection Code¹ in 1931, except for the relevant provisions of the Negotiable Instrument Law, West Virginia had only a few commonly-enacted statutes dealing with the depositor-bank relationship and the bank collection process. The miscellany of statutes cover such matters as specifying the extent of bank liability for payment of forged or raised checks and for wrongful nonpayment of checks,² permitting a collecting bank to send items direct to the payor bank,³ specifying the recognition to be given to deposits in trust and authorizing joint tenancy accounts,⁴ permitting payment of deposits to minors,⁵ specifying procedure and time limits for stop-payment orders or countermand of check or draft,⁶ authorizing the dishonor of a stale check or draft,⁷ and specifying circumstances justifying refusal to pay where there are adverse claims to bank credits.⁸

The pre-Bank Collection Code era decisional law of West Virginia on the depositor-bank relationship and the bank collec-

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*This is one of a series of studies of the Uniform Commercial Code and existing West Virginia law. Unlike other articles in this series, the present article will not reproduce all the Code provisions in full and will not make a section by section comparison of the Code and existing West Virginia law with respect to all sections of the Code. Such a detailed treatment would not be possible nor fruitful in view of the relatively few cases on the subject in West Virginia and the absence of any unique statutory provisions. Rather attention will be directed to those provisions of the Code of most interest to the larger segment of the bar representing the bank customer. All references to the Uniform Commercial Code are to the official edition of 1958. It will be cited throughout in the footnotes as U.C.C. References to Comments are to the official Comments accompanying the Code provisions.

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¹ W. VA. CODE, ch. 31, art. 4A (Michie 1961).
² W. VA. CODE, ch. 31, art. 8, § 21 (Michie 1961).
³ W. VA. CODE, ch. 31, art. 8, § 22 (Michie 1961). Prior case law held it was negligence for a collecting bank to send checks direct to a drawee bank irrespective of local custom and regardless of the fact the drawee bank was the only bank in the area. Pinkney v. Kanawha Valley Bank, 68 W. Va. 254, 89 S.E. 1012 (1910).
⁴ W. VA. CODE, ch. 31, art. 8, § 23 (Michie 1961).
⁵ W. VA. CODE, ch. 31, art. 8, § 24 (Michie 1961).
⁶ W. VA. CODE, ch. 31, art. 8 § 26 (Michie 1961).
⁷ W. VA. CODE, ch. 31, art. 8, § 27 (Michie 1961).
⁸ W. VA. CODE, ch. 31, art. 8, § 28 (Michie 1961).

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tion process is sparse, but, for the period, unusually appreciative of the need for protecting the banks in collection work to facilitate rapid transmission of commercial paper. But, nevertheless, some of the rules were narrowly and technically interpreted. For example, the next-day, or two-day rule for forwarding paper for presentment to out-of-town banks was construed to require forwarding of the item at least by the last mail train at the close of business on the second day even though a mailing on an early train on the third day would allow the item to reach the payor bank before opening for business on the third day. It was recognized that the crediting of the customer's account for the amount of an item deposited for collection was provisional until the money called for by the item was actually collected or until the payor bank debited the account of the drawer and credited the collecting bank. Accordingly, on the one hand, the depositor-customer could exercise a right of rescission he might have if the collecting bank failed before collection was made, and, on the other hand, the collecting bank had a right of charge back against the customer-depositor's account if the paper were dishonored or the payor bank failed before collection. Direct sending of an item to the payor bank was negligence on the part of the collecting bank, irrespective of local custom or the fact that the payor bank was the only bank in the area, the usual but cumbersome common law rule which persisted in West Virginia until 1925. The more liberal rule was adopted which permitted a collecting bank to accept in settlement the remitting bank's own primary obligation, such as its cashier's check. With respect to rights of third parties, the form of the

See Carroll v. Exchange Bank, 30 W. Va. 518, 4 S.E. 440 (1887), favoring the collecting bank over the true owner of item where collecting bank had credited the transmitting bank with proceeds of item, endorsed in blank to transmitting bank by true owner, and where transmitting bank and collecting bank had mutual and extensive dealings between them for several years in negotiable paper which on its face always appeared to be the property of the respective banks. See also Cattaruzza v. First Nat'l Bank, 106 W. Va. 458, 146 S.E. 393 (1928), which adopted the more liberal view permitting the collecting bank to accept the cashier's check of the payor bank in settlement for an item.

Pinkney v. Kanawha Valley Bank, supra note 3.


Pinkney v. Kanawha Valley Bank, supra note 3.

See Allman v. Sayre, supra note 11.

Pinkney v. Kanawha Valley Bank, supra note 3; Cattaruzza v. First Nat'l Bank, supra note 9.

Pinkney v. Kanawha Valley Bank, supra note 3.

See W. Va. Code, ch. 8, § 22 (Michie 1961), authorizing direct sending where the drawee or payor bank is situate in another town.

indorsement used by the depositor was determinative of the ownership of the deposited item, with a blank indorsement conferring title upon the depositary bank while an indorsement "For collection" created an agency relationship. 18

Given such a paucity of case law and statutes, why did the customer-bank relationship and bank collection process work out so well in West Virginia, as in other states, prior to 1931? The answer, of course, lies in the highly successful functioning of the Federal Reserve System. Acting as a clearing house for its member banks and accepting for exchange or collection the checks and drafts of nonmember banks as well and operating under the Federal Reserve Board of Governor's Regulation G (dealing with collection of noncash items) and Regulation J (dealing with check clearing and collection), each Federal Reserve bank issued "operating letters" prescribing the terms and conditions under which it would handle items. These "operating letters", being uniform to a large extent, soon became a standard manual of operations for bank collections throughout the country in interstate, intercity and intertown operations, supplemented by generally uniform rules of the various voluntary clearing house associations functioning within single cities and metropolitan areas. 19 In addition it was the practice of banks before the Bank Collection Code to state in legends upon signature cards, deposit slips, bank statements, collection letters and other form agreements, the terms upon which items would be accepted for collection, a practice not always sustained by case law. 20

The adoption of the Bank Collection Code in West Virginia, 21 and seventeen other states, provided a rather extensive set of bank collection rules based upon the actual manner in which bank collections were performed, 22 thus filling the many gaps in our statutory and case law on the subject. That the Bank Collection Code has worked well in West Virginia over the past thirty years is evidenced by the fact there appears but one case 23 in the Michie

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19 See Malcolm, Article 4—A Battle With Complexity, 1952 Wis L. Rev. 265.
20 Id. at 266.
22 See Malcolm, op. cit, supra note 19, at 266.
23 See Metropolitan Life Ins. Co. v. Lamb, 117 W. Va. 306, 185 S.E. 197 (1936), holding W. Va. Code, ch. 31, art. 4A, §13 (trust fund theory where agent collecting bank failed after receiving proceeds of item) applicable only to commercial paper in the ordinary course of banking business, thus not applicable where bank was acting as special agent of mortgagors in making installment loan collections from mortgagors.
annotations to the relevant Article 4A of Chapter 31. Only one amendment has been made to the Bank Collection Code, that being to permit deferred posting in 1949.24

When it was decided to draft one statute covering the entire field of commercial law, if negotiable instruments were to be included, it became necessary to include the subject of bank deposits and bank collections too, for the conversion of negotiable instruments into bank credit, as is most common, is usually accomplished by transferring the instrument to a bank for collection.25 Building upon the American Bankers Association Bank Collection Code, the draft of a proposed Uniform Bank Collections Act which had not been adopted by any state legislature, the numerous clearing house constitutions, rules and regulations as well as Regulations G and J of the Board of Governors of the Federal Reserve System and the largely uniform "operating letters" of the Federal Reserve banks, the draftsman developed article 4 of the Uniform Commercial Code,26 probably the most controversial article of the entire Code.27 One of the draftsmen of article 4 explained the general approach adopted in the following terms:28

"... The movement of perhaps 25,000,000 items through bank channels every business day was a volume operations of tremendous proportions. Such operation was primarily mechanical and the rules governing it similarly should be largely mechanical. Rules laid down would probably be of more value if they gave quick, clear-cut answers to the customers and banks interested in the collection of items than if they stated broad general principles from which courts or lawyers could reason their way to a result. An examination of the actual existing rules as they have developed in the last fifty

24 See W. VA. CODE, ch. 31, art. 4A, § 3 (Michie 1961), revised by Acts of 1949, ch. 21. "Deferred posting" is the process whereby a drawee or payor bank sorts and proves items received on the day of receipt, but does not post the items to the customers account or return "not good" items until the next day. See Malcolm, op. cit. supra note 19, at 269. The practice was made necessary by the practical impossibility of having sufficient personnel, at the increased wage rates of World War II era, to process the greatly increased number of items completely on the day of receipt. See Leary, Article 4: Bank Deposits And Collections Under The Uniform Commercial Code, 15 U. Prrt. L. REV. 565, 567 (1954).
26 See Leary, op. cit. supra note 24, at 567.
27 See Beutel, The Proposed Uniform [?] Code Should Not Be Adopted, 61 YALE L.J. 334, 357-60 (1952), attacking Article 4 for one-sided draftsmanship to protect the banks at the expense of the customer-depositor.
28 Malcolm, op. cit. supra note 19, at 270.
years in Federal Reserve operating letters, in clearing house rules and in state statutes . . ., indicates a marked trend toward such mechanical rules. The Code should follow this trend."

The following three common factors were kept in mind by the draftsmen: (1) Federal Reserve statistics indicated 99% percent of all collection items are promptly paid when presented, such good items being 99% percent of the dollar volume involved, with one-half of the bad checks being paid when presented the second time, making the area of risk one-eighth of one percent of dollar volume; and (2) the costs of collection should be kept at a minimum to encourage banks to continue to maintain low service charges; and (3) concern over a possible one-eighth of one percent loss situation should not require the imposition of safeguards, priorities and statutory rules upon all items, if the effect of such legal rules will be to increase the cost of handling for the 99% percent of the good items, with this third factor, rather than any sell-out to the banks, being the cause for the elimination of several provisions of earlier drafts that at first blush appeared fair and reasonable.29

Based on the foregoing approach and common factors, the following interest-weighing principles of bank collection law were adopted and observed in the drafting: (1) the rules of law must not require procedures that, in the interest of increasing the percentage of good items above 99% percent, will impose greater costs upon all items, resulting in increased costs of doing business and increased service charges; (2) the rules must be flexible enough to permit the myriad of possible cases to be efficiently and promptly handled and to permit the collection system to develop and take advantage of new methods and new procedures not presently envisaged, consequently there should be as few rules prescribing detailed mechanics as possible; and (3) the credit risk in taking a check should be reduced to the minimum by requiring speed in the collection process to permit a fast conversion of the check into a final credit on the books of the depository bank.30

Article 4 is divided into five main parts. Part I, General Provisions and Definitions, consists of rules of construction and a number of definitions, with definitions from other articles incorpo-

29 See Leary, op. cit. supra note 24, at 579-80.
30 See Leary, op. cit. supra note 24, at 570.
rated by reference. Part 2, Collections of Items: Depositary and Collecting Banks, sets forth rules relating to the handling of items by collecting and payor banks and the means of settling items. Part 3, Collection of Items: Payor Banks, relates to duties and liabilities of payor banks. Part 4, Relationship Between Payor Bank and its Customer, deals with rights and duties of the payor bank with respect to the handling of checks and other items drawn by its deposit customer. And Part 5, Collection of Documentary Drafts, concerns the rights and duties of banks handling, for collection and payment, drafts with documents (such as bills of lading and warehouse receipts) attached.

Because the article's definition of the more common terms will be used in discussing changes in West Virginia law which will be effected if the Commercial Code be adopted, those definitions are set forth verbatim.

Section 4-104(1) provides:

(a) "Account" means any account with a bank and includes a checking, time, interest or savings account;

(b) "Afternoon" means the period of a day between noon and midnight;

(c) "Banking day" means that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions;

(d) "Clearing house" means any association of banks or other payors regularly clearing items;

(e) "Customer" means any person having an account with a bank or for whom a bank has agreed to collect items and includes a bank carrying an account with another bank;

(f) "Documentary draft" means any negotiable or nonnegotiable draft with accompanying documents, securities or other papers to be delivered against honor of the draft;

(g) "Item" means any instrument for the payment of money even though it is not negotiable but does not include money;

(h) "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;

(i) "Properly payable" includes the availability of funds for payment at the time of decision to pay or dishonor;

(j) "Settle" means to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A settlement may be either provisional or final;

(k) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over or that it ceases or refuses to make payments in the ordinary course of business."

Section 4-105 states:

"In this Article unless the context otherwise requires:

(a) "Depositary bank" means the first bank to which an item is transferred for collection even thought it is also the payor bank;

(b) "Payor bank" means a bank by which an item is payable as drawn or accepted;

(c) "Intermediary bank" means any bank to which an item is transferred in course of collection except the depositary or payor bank;

(d) "Collecting bank" means any bank handling the item for collection except the payor bank;

(e) "Presenting bank" means any bank presenting an item except a payor bank;

(f) "Remitting bank" means any payor or intermediary bank remitting for an item."

Some Changes Effected by Article 4

There are many technical rules set forth in article 4 relating to the complex of rights and duties between banks and in the collection process which will not be discussed herein as they are of interest only to those lawyers counseling banks in such matters. For such lawyers, there is available much excellent source material
for a detailed and extensive examination of the inter-bank provisions of the article. The Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Association has published an excellent monograph\(^3\) in paper back form on article 4, written by some of the draftsmen in the easy-to-read style featured in the Joint Committee's publications, which gives a detailed, integrated explanation of the more important provisions of the article. In addition there are several law review pieces\(^2\) on article 4, giving valuable insights into the complex factual problems faced by the draftsmen and the approaches adopted for their solution as well as providing a detailed discussion of how the article changes the decisional and statutory law of particular states. Care must be exercised in relying on the earlier dated law review articles, however, for they fail to reflect the important changes made in the Official Text of the Commercial Code between 1951 and 1958. Finally, the comments to the 1958 Official Text are quite complete and extensive in scope, setting forth prior uniform statutory provisions as well as presenting a detailed discussion of the purposes of each section. For bank attorneys interested in a section by section comparison of article 4 with the A.B.A. Bank Collection Code and the other customary relevant statutes, a series of articles\(^3\) in The Oregon Law Review has performed this task. If article 4 should be adopted, bank attorneys will find that all statutory materials now existing on the subject of bank deposits and collections are covered therein except for the present statutes dealing with deposits in trust and

\(^{31}\) See Clark, Bailey & Young, Bank Deposits and Collections Under the Uniform Commercial Code (Joint Committee On Continuing Legal Education of the A.L.I. and A.B.A. 1959) [hereinafter cited Clark, Bailey & Young].


\(^{33}\) See Wilson, op. cit. supra note 32 and Love, op. cit. supra note 32.
joint bank accounts,34 payments of deposits to minors,35 and adverse claims to bank credits.36 Another drafting technique helpful to the bank attorney is the decision to place in article 4 much material formerly found only in the Negotiable Instruments Law which now appears in revised form as article 3. Furthermore, the negotiable instrument provisions of article 4 govern, for purposes of applying article 4, in the event of a conflict with Article 3.37

The discussion of article 4 which follows is directed to the practicing attorney, not primarily concerned with counseling banks, who has day-to-day problems in the area of article 4 dealing with aspects of the depositor-bank relationship. Some of the problems most commonly encountered with respect to that relationship involve such matters as variation of applicable law by private agreement, such as by legends on deposit slips in the banking field; indorsements and warranties; time limitations upon withdrawal of deposits; rules of priority for stop orders, attachments, etc., and the order in which items are to be charged against a bank account; when the bank may charge the customer's account; bank liability for wrongful dishonor; stop payment orders; stale checks; death or incompetence of the customer; customer's duty to discover and report forgeries and alterations; and collection of documentary drafts.

In the discussion which follows, reference to a section of the Uniform Commercial Code will be indicated by using the same numbering system as is used in the Official 1958 Edition, that is, a four digit number with a dash separating the first and second digits and with the first digit indicating the article and the second digit indicating the particular part subdivision of the article. For example, "secton 4-101" indicates subdivision 1 of Part 1 of Article 4. The phrase "ABA Code" will be used to refer to the Bank Collection Code contained in West Virginia Code, chapter 31, article 4A (Michie 1961). Other West Virginia statutory material will be referred to by using the word "Code" followed by the Arabic numerals, separated by dashes, for the particular chapter, article and section, e.g., Code 31-8-22 to refer to West Virginia Code, chapter 31, article 8, section 22.

34 W. VA. CODE, ch. 31, art. 8, § 23 (Michie 1961).
35 W. VA. CODE, ch. 31, art. 8, § 24 (Michie 1961).
36 W. VA. CODE, ch. 31, art. 8, § 28 (Michie 1961).
37 See U.C.C. § 4-102(1).
I Variations by Agreement

One of the major problems facing the draftsmen of article 4 concerned the extent to which freedom of contract should be preserved in the customer-bank relationship. For a long time prior to the ABA Code, banks had been stating in legends on deposit slips and other forms used in dealing with customers the terms upon which an item would be received for deposit or collection, a practice not uniformly sustained by case law.\(^{36}\) ABA Code, section 2, recognizes the right to vary by agreement the rules specified in section 2 relating to collecting banks being agents and sub-agents for depositors and to withdrawal of revocable credits. Heeding complaints that earlier drafts specifying in detail the rules variable by agreement would place the banks in a strait jacket and desiring to adopt flexibility as a standard to deal with the complexity of the subject and realizing that practices would certainly change,\(^{37}\) the draftsmen settled on the following provisions of UCC section 4-103:

Section 4-103. Variation by Agreement; Measure of Damages; Certain Action Constituting Ordinary Care.

"(1) The effect of the provisions of this Article may be varied by agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

(2) Federal Reserve regulations and operating letters, clearing house rules, and the like, have the effect of agreements under subsection (1), whether or not specifically assented to by all parties interested in items handled.

(3) Action or non-action approved by this Article or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care and, in the absence of special instructions, action or non-action consistent with clearing house rules and the like or with a general banking usage

\(^{36}\) See Malcolm, op. cit. supra note 19, at 266.
\(^{37}\) See Malcolm, op. cit. supra note 19, at 274-79; Vergari, op. cit. supra note 19, at 539-40; CLARK, BAILEY & YOUNG 27-29.
not disapproved by this Article, prima facie constitutes the exercise of ordinary care.

(4) The specification or approval of certain procedures by this Article does not constitute disapproval of other procedures which may be reasonable under the circumstances.

(5) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an 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."

Note that all that may not be changed by agreement is the measure of damages and the bank’s responsibility for its own lack of good faith and failure to exercise ordinary care. "Good faith" is defined in subsection 1-201(19) as "honesty in fact in the conduct or transaction concerned," a definition taken from the uniform acts on sales, warehouse receipts, bills of lading, and stock transfers, according to Comment 19 to that section. Subsection 4-103(2) penalizes the presence of "bad faith" by extending the measure of damages beyond the amount of the item involved to include other damages suffered as a proximate consequence of the failure to exercise ordinary care. Comment 4 to section 4-103 points out that the term "ordinary care" is not defined, that no attempt is made in article 4 to define in toto what constitutes ordinary care or lack of it, and that the term is used in its normal tort meaning and not in any special sense relating to bank collections. It should be noted, however, that subsection 4-103(3) specifies that conduct approved by article 4, Federal Reserve regulations, or Federal Reserve bank operating letters is per se ordinary care, while conduct consistent with clearing house rules and the like or with general banking usage not disapproved by article 4 is prima facie ordinary care in the absence of special instructions.

The Comment 2 points out that the term "general banking usage" means a general usage common to banks in the area concerned, such as throughout a state, a substantial portion of a state, or a metropolitan area, and requires a usage broader than a mere prac-

40 See Leary, op. cit. supra note 24, at 588, justifying the distinction made between the effect of Federal Reserve regulations and operating letters, on one hand, and clearing house rules, on the other, on the ground the former had a quasi-governmental status.
tice between two or three banks. An early West Virginia case 41 refused to permit a local banking custom of the Charleston area to vary the then generally accepted common law rule prohibiting direct sending of an item to the payor bank, a practice now permitted by Code 31-8-22 as well as by ABA Code, section 6. Also to be noted is that the agreement may set private standards by which the bank's responsibility for its own lack of good faith or failure to exercise ordinary care provided those standards are not manifestly unreasonable.

The private agreement to vary the provisions of article 4 as permitted by subsection 4-103(1) will be binding only upon the parties assenting thereto, whereas the variations by Federal Reserve regulations and operating letters, clearing house rules, and the like, as permitted by subsection 4-103(2), will be binding upon all parties interested in the item regardless of lack of assent. Comment 2 states the distinction made with regard to assent was made necessary by the fact that it would be impossible to obtain direct agreement from all the parties interested in all items inasmuch as banks now handled at least 25,000,000 items per day.

One author 42 does not believe the banks and their customers will avail themselves of the privileges of subsection 4-103(1) to any great extent since the rules of article 4 are so reasonably fair and workable that banks and depositors will be delighted to have them. It has been suggested the privilege be used by banks to require the customer to give more specific information about a check involved in a stop-order than is now required by section 4-403, covering stop-orders. 43 It has been stated 44 that the following kinds of agreements would be permissible, within reasonable limits, under subsection 4-103(1):

(a) An agreement between a group of banks permitting the adoption of an earlier cut-off hour than the 2:00 P.M. hour specified in section 4-107;

(b) An agreement extending times of collection, payment or return of items, if within reasonable limits, as well as agreements setting earlier time limits for action on items;

41 See Pinkney v. Kanawha Valley Bank, supra note 3.
42 See Malcolm, op. cit. supra note 19, at 278.
43 See Leary, op. cit. supra note 24, at 529.
44 See CLARK, BAILEY & YOUNG 43-44.
(c) An agreement relating to the mode of sending items or the channels through which items are sent, e.g., use of armored car service, air freight or air express, or direct sending of an item by a depositary bank to a Federal Reserve bank of another district in which the payor bank is situate;

(d) An agreement relating to protest of dishonored items and the giving of notice of dishonor, by wire or other means;

(e) An agreement between a bank and its depositor relating to the time within which an item may be charged back or the earliest period within which a depositor may draw on the provisional credit given him upon deposit of an item for collection;

(f) An agreement shortening the various periods set forth in section 4-406 within which a customer may question his bank statement.

It is believed the following types of agreements would not be permissible under subsection 4-103(1):

(a) An agreement between a bank and a customer excusing the bank from liability for wrongful dishonor of a properly payable item drawn by the customer or limiting damages for such wrongful dishonor;

(b) An agreement between a bank and a customer on a stop-payment order excusing the bank from liability for inadvertently paying the item against which the stop-order has been placed.

2 Indorsements and Warranties

Under ABA Code, section 2, where an item is deposited or received for collection, the bank of deposit is deemed the agent of the depositor for collection and each subsequent collecting bank is likewise deemed a sub-agent of the depositor for collection, with any credit given by the agent or sub-agent being revocable until the proceeds are received in actual money or an unconditional credit is given for the item on the books of another bank which is requested or accepted by the agent bank. Nevertheless, ABA Code section 4 provides that where the deposited item is payable to bearer or endorsed in blank or specially by the depositor, the

45 Id. at 44-45.
subsequent holders (sub-agents) have a right to rely on the presumption that the bank of deposit is the owner of the item, but the bank of deposit can negative the presumption of ownership, where the deposited item is endorsed specially or in blank, by converting the depositor's endorsement into a restrictive one, such as by writing over his signature the words “for deposit” or “for collection”. In addition ABA Code section 4 permits the bank of deposit to negative the presumption of ownership in the case of items payable to bearer by endorsing them “received for deposit” or “received for collection”. In the view of the draftsmen of article 4, it was unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements where the large volume of checks handled made it impossible for all banks to examine all indorsements and where in fact such an examination was never made, except perhaps by depositary banks. Accordingly, the general approach in article 4 is to provide rules or answers for problems known to exist in the bank collection process without regard to questions of status and ownership but the general principles of status and ownership should be kept available to cover residual areas not covered by the specific rules.

The article 4 solution, subsection 4-201(1), reads:

(1) Unless a contrary intent clearly appears and prior to the time that a settlement given by a collecting bank for an item is or becomes final (subsection (3) of Section 4-211 and Sections 4-212 and 4-213) the bank is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank such as those resulting from outstanding advances on the item and valid rights of setoff. When an item is handled by banks for purposes of presentment, payment and collection, the relevant provisions of this Article apply even though action of parties clearly establishes that a particular bank has purchased the item and is the owner of it.

46 Comment 6 to U.C.C. § 4-201.
47 Comment 1 to U.C.C. § 4-201.
It is clear that as between the customer and his depository bank, the customer remains the owner of the item (until final settlement is made), for purposes of attachment by his creditors, his own insolvency or the insolvency of the depository bank, risk of loss, and computation of the dollar limitations of Federal Deposit Insurance. Although subsection 4-201(1) makes it plain that the form of indorsement used by the customer will no longer be determinative of status, a clearly expressed contrary intent is permitted to negative the presumption of agency. Comment 2 suggests that an example of a clear contrary intent would arise where collateral papers established, or the item bore a legend stating, that the item was sold absolutely to the depository bank. Although the form of the customer's indorsement to the depository bank will not be determinative of status, a restrictive indorsement, such as "for deposit" or "for collection", will still protect the customer against further negotiation of the item to a holder in due course by a finder or a thief.

In the interests of speeding up collections by eliminating any necessity to return to a non-bank depositor any items he may have failed to indorse, subsection 4-205(1) permits a depository bank to supply any customer's indorsement "necessary to title" unless the item contained the words "payee's indorsement required" or similar language; and, in the event the payee's indorsement is not specifically required, a depository bank's statement on the item that it was deposited by a customer or credited to his account would be effective as the customer's indorsement. The ABA Code contains no like provision, but the procedure is in accord with accepted bank practice which has been sustained by case law.

With respect to warranties, the ABA Code, section 4 provides that the indorsement "pay any bank or banker" constitutes a guaranty by the indorser to all subsequent holders and to the drawee or payor of the genuineness of and authority to make prior indorsements and also to save the drawee or payor harmless in the event any prior indorsement is defective or irregular, unless such liabil-

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48 See U.C.C. § 214(1) entitling the customer to return of the item if the collecting bank suspends payment and the item is not finally paid. The rules of preference of article 4 generally follow those of the ABA Code except that the trust theory is abandoned. See Comment 2 to U.C.C. § 214.
49 See Comment 4 to U.C.C. § 201.
50 See Comment 2 to U.C.C. § 4-205.
ity is disclaimed by appropriate words coupled with the indorsement. For all other matters respecting warranties in the customer-depositor relationship and the bank collection process in ABA Code states, resort must be had to the Negotiable Instrument Law, section 65 and 66. The warranties in article 4 are contained in section 4-207 and, except for certain changes peculiar to the bank collection process and the fact they apply only to customers and collecting banks, they are identical in substance with the warranties provided in article 3, Commercial Paper, sections 3-414 and 3-417. The section provides as follows:

Section 4-207. Warranties of Customer and Collecting Bank on Transfer or Presentment of Items; Time for Claims.

"(1) Each customer or collecting bank who obtains payment or acceptance of an item and each prior customer and collecting bank warrants to the payor bank or other payor who in good faith pays or accepts the item that:

(a) he has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title; and

(b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by any customer or collecting bank that is a holder in due course and acts in good faith

(i) to a maker with respect to the maker's own signature; or

(ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or

(iii) to an acceptor of an item if the holder in due course took the item after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized; and

(c) the item has not been materially altered, except that this warranty is not given by any customer or collecting bank that is a holder in due course and acts in good faith

53 See Comment 1 to U.C.C. § 4-207.
(i) to the maker of a note; or
(ii) to the drawer of a draft whether or not the drawer is also the drawee; or
(iii) to the acceptor of an item with respect to an alteration made prior to the acceptance if the holder in due course took the item after the acceptance, even though the acceptance provided “payable as original-ly drawn” or equivalent terms; or
(iv) to the acceptor of an item with respect to an alteration made after the acceptance.

(2) Each customer and collecting bank who transfers an item and receives a settlement or other consideration for it warrants to his transferee and to any subsequent collecting bank who takes the item in good faith that

(a) he has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and
(b) all signatures are genuine or authorized; and
(c) the item has not been materially altered; and
(d) no defense of any party is good against him; and
(e) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted item.

In addition each customer and collecting bank so transferring an item and receiving a settlement or other consideration engages that upon dishonor and any necessary notice of dishonor and protest he will take up the item.

(3) The warranties and the engagement to honor set forth in the two preceding subsections arise notwithstanding the absence of indorsement or words of guaranty or warranty in the transfer or presentment and a collecting bank remains liable for their breach despite remittance to its transferor. Damages for breach of such warranties or engagement to honor shall not exceed the consideration received by the customer or collecting bank responsible plus finance charges and expenses related to the item, if any.
(4) Unless a claim for breach of warranty under this section is made within a reasonable time after the person claiming learns of the breach, the person liable is discharged to the extent of any loss caused by the delay in making claim."

Subsection (1) of section 4-207 sets forth warranties that run only to the payor while subsection (2) details the warranties that run to the transferee and subsequent collecting banks who are not the payor. Having decided to allow certain warranties to run to the payor, in order to permit the payor to recover on a warranty theory rather than on a "mistake of fact" theory or on a specific guaranty of prior indorsements,\textsuperscript{44} it was necessary for the draftsmen to segregate the warranties to the payor in a separate subsection in order to retain the rule of \textit{Price v. Neal} with respect to such warranties, that is that a payor which pays an item containing a forged drawer's signature cannot recover from the person receiving payment. Section 3-417 of article 3, Commercial Paper, makes a similar distinction. Other points to be noted about the section which are peculiar to the bank collection process are the following: (a) subsection 4-207(3) specifies that the warranties run automatically without the necessity for an indorsement or words of guaranty, thus obviating the need for the stamp presently used reading "prior indorsements guaranteed"; (b) subsection 4-207(3) also contains a limitation on damages recoverable for breach of warranty; and (c) subsection 4-207(4), in conjunction with section 4-406 (placing burden on maker whose account is charged to notify the payor promptly of forgeries and alterations), prevents a collecting bank from being contingently liable for a period as long as the period of the statute of limitations.\textsuperscript{45} For a detailed discussion of the purpose and effect of these warranties, see the article in this series on the Uniform Commercial Code dealing with article 3, Commercial Paper.

3 \textit{TIME LIMITATIONS UPON WITHDRAWAL OF DEPOSITS}

It has long been the practice in bank collections that the credit given a depositor initially upon receipt of an item for collection is only provisional, subject to revocation and charge back in the event final settlement for the item is not received by the collecting bank upon a timely forwarding of the item for presentment. The collecting bank, and each intermediary bank in the

\textsuperscript{44} See \textit{CLARK, BAILEY & YOUNG} 132.

\textsuperscript{45} \textit{Id} at 143.
chain of collection, receives only a provisional settlement or credit from its transferee, with all these provisional credits firming up into final settlements if the payor honors the item and remits in an acceptable medium.66 ABA Code, section 2, states that the credit given by the collecting bank and subsequent banks upon receipt of an item for collecting is revocable until final settlement is received in money or a requested or accepted bank credit. ABA Code, section 3, provides that the credit given a depositor upon the day of receipt is only provisional where the deposit consists of a demand item payable at, by or through the depository bank, that bank being given until midnight of the next business day to dishonor or refuse payment. This practice of provisional settlements becoming final settlements upon final payment (and converting the depository bank from an agent to a debtor) is codified in great detail in various sections of article 4, e.g., sections 4-211, 4-212 and 4-213, which affect the customer's privilege of making a withdrawal as of right against a deposited item. Subject to the bank's right to apply the credit against an obligation of the customer, withdrawal as of right against the credit for a deposited item arises at the opening of the next banking day with respect to a cash deposit,67 and at the opening of the second banking day with respect to an item drawn or made by another customer of the same depository bank (in which case the bank is also payor) provided the item is good, i.e., posted to the customer-drawer's account.68 As respects any other type deposit, withdrawal as of right against the credit arises only after the provisional settlement received by the depository bank from its immediate transferee is firmed into a final settlement and the depository bank has had a reasonable time to learn of such final settlement.69 In the event final settlement is not made with the depository bank, due to dishonor or otherwise, it has the right to revoke the customer's provisional settlement, charge back the credit given his account or obtain a refund.70 If the depository bank is also the payor, however, it becomes accountable for the amount of a demand item deposited unless it pays or returns the item or sends notice of dishonor before its "midnight deadline" (midnight of next banking day after receipt).71 Likewise a collecting bank must take proper ac-

66 Id at 1-5.
67 U.C.C. § 4-213(5).
68 U.C.C. § 4-213(4)(b).
69 U.C.C. § 4-213(4)(a).
70 U.C.C. § 4-212(1).
71 U.C.C. § 4-302(a). "Deferred posting," now permitted by ABA Code, section 4, is incorporated into Article 4 in § 4-301.
tion before its “midnight deadline” in order to act seasonably with respect to an item; otherwise, it has the burden of proving that proper action taken within a reasonably longer time is seasonable.\footnote{U.C.C. § 4-202(2).}

4 Rules of Priority for Stop-Orders, Attachments, Etc.; Order for Charging Items Against Account

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

(1) Any knowledge, notice or stop-order received by, legal process served upon or setoff exercised by a payor bank, whether or not effective under other rules of law to terminate, suspend or modify the bank’s right or duty to pay an item or to charge its customer’s account for the item, comes too late to so terminate, suspend or modify such right or duty if the knowledge, notice, stop-order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the bank has done any of the following:

(a) accepted or certified the item;
(b) paid the item in cash;
(c) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement;
(d) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item; or
(e) become accountable for the amount of the item under subsection (1) (d) of Section 4-213 and Section 4-302 dealing with the payor bank’s responsibility for late return of items.

(2) Subject to the provisions of subsection (1) items may be accepted, paid, certified or charged to the indicated account of its customer in any order convenient to the bank.
There is no provision in the ABA Code respecting the subject matter of section 4-303. Note that the knowledge, notice, stop-order, etc., comes too late if "received or served and a reasonable time for the bank to act thereon expires" before the bank has done any of the things enumerated in subsection 4-303(1). This concept of "reasonable time to act thereon" may modify Code 31-8-28, dealing with adverse claims against bank credits and fiduciary accounts. Code 31-8-28 requires the bank to hold the funds "on . . . delivery of" the bond therein specified and permits the bank to freeze the fiduciary account "upon receipt by it" of an affidavit of the adverse claimant. Code 31-8-28 would survive adoption of article 4 which has no provisions respecting procedure for adverse claims other than the priority rules of section 4-303.

At first glance the language in subsection 4-403 (1)(d) stating "or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item" seems ambiguous. The Comment points out, however, that it is intended to be an omnibus clause to pick up other types of action impossible to specify particularly but where the bank has examined the account to see if there are sufficient funds and has taken some action indicating an intention to pay. An example given by the Comment is the procedure of "sight posting" whereby the bookkeeper examines the account and makes a decision to pay but postpones posting to the account. According to the Comment, the language is not intended to apply to other preliminary acts not indicating a decision to pay, such as receiving the item over the counter for collection, or entering a provisional credit in a passbook, or making a provisional settlement through the clearing house.

Subsection 4-303(2) permits the bank to suit its own convenience in determining the order in which several items on hand at one time are to be accepted, paid, certified or charged to the customer's account. The Comment states the adopted rule is justified by the impossibility of stating a rule otherwise uniformly fair and by the application of the principle of estoppel against the drawer who created the difficulty. In addition, the Comment would follow the bank to give preference to items upon which it is liable in fixing the order for charging items against the customer's account. The ABA Code contains no provisions respecting the subject matter of section 4-303 and no West Virginia case was found which deals with section 4-403 matters.
5 When Bank May Charge Customer's Account

Section 4-401. When Bank May Charge Customer's Account.

(1) As against its customer, a bank may charge against his account any item which is otherwise properly payable from that account even though the charge creates an overdraft.

(2) A bank which in good faith makes payment to a holder may charge the indicated account of its customer according to

(a) the original tenor of his altered item; or

(b) the tenor of his completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper.

The purpose and practicality of subsection 4-401(1) has been explained by one of the draftsmen as follows:63

"... This does not repeal any law prohibiting the doing of business on overdraft, or the certification of checks against uncollected funds. It merely prevents a claim by a customer that overdrawing his account should operate as a stop order."

The same draftsman justifies the provisions of subsection 4-401(2) in the following language:64

"This [subsection 4-401(2)] ... gives us an illustration of the application of our first principle, that rules of protection for the few bad items should not render it substantially more costly to process the great bulk of good items. The average bookkeeper must process about 2,600 items a day. You cannot expect, in the first instance, such a work load to permit so detailed an examination of a check to determine whether an item has been completed in a different handwriting, or upon a different typewriter, even though at a later date, in a courtroom, with the aid of enlarged photographs, a jury might find the difference to be "obvious." In the eight seconds allotted per item, the average bookkeeper has enough to do, even with mechanized equipment. No person would be willing to pay the resultant service charges if the rules of law compelled the banks to hire bookkeepers capable of exercising judgment and discrimination in matters of this sort and slowed operations to

63 Leary, op. cit. supra note 24, at 573.
64 Ibid.
the extent necessary to provide sufficient time. Furthermore, the known loyalty and honesty of the very vast majority of agents entrusted with filling out checks also compels the vote of confidence given fiduciaries in general throughout the Code.”

The Comment points out that subsection 4-401(2) follows the policy of sections 3-115 and 3-407(c) of article 3, Commercial Paper. Reference should be made to the article in this series devoted to Article 3 where the matter is discussed in detail. It is possible that subsection 4-401(2) might change the result of Hays v. Lowndes Sav. Bank & Trust Co., 6 where the bank was held liable in paying a fictitious payee without requiring proper identification in a case where the customer signed a check in blank with instructions to his secretary to fill in a designated amount and a designated payee. The ABA Code is silent with respect to the rights of a bank to charge a customer’s account.

6 Bank Liability for Dishonor

Section 4-402. Bank’s Liability to Customer for Wrongful Dishonor.

A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. When the dishonor occurs through mistake liability is limited to actual damages proved. If so proximately caused and proved damages may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

Existing West Virginia law on the subject is found in Code 3-8-21, which is relevant part reads:

“No banking institution shall be liable to a depositor because of the nonpayment through mistake or error and without malice of a check which should have been paid, unless the depositor shall allege and prove actual damages by reason of such nonpayment, and in such event the liability shall not exceed the actual damages so proved.”

No West Virginia cases were found involving the subject matter of section 4-402 and Code 31-8-21.

65 118 W. Va. 360, 190 S.E. 543 (1937).
Comment 2 states out that the section does not attempt to specify a theory upon which the bank's liability is based, pointing out that the liability may be based either upon breach of contract, negligence or defamation. According to Comment 3, the section "rejects decisions which have held that where the dishonored item has been drawn by a merchant, trader or fiduciary he is defamed in his business, trade or profession by a reflection on his credit and hence that substantial damages may be awarded on the basis of defamation 'per se' without proof that damage has occurred." The wording of Code 31-8-21 presently reaches the same result. Comment 5 indicates that the fourth sentence of the section is intended to reject decisions holding that the dishonor of a check is not the proximate cause of the arrest and prosecution of the drawer, and leaves to a determination in each case as a question of fact whether the dishonor is or may be the "proximate cause."

It should be noted, as indicated in Comment 4, that "wrongful dishonor" is to be distinguished from "failure to exercise ordinary care in handling an item" with respect to the applicable measure of damages. The measure of damages for "wrongful dishonor" is as stated in this section 4-402, whereas subsection 4-103(5) specifies that the measure of damages for "failure to exercise ordinary care in handling an item" is the amount of the item reduced by an amount which could not have been realized by the use of ordinary care, plus consequential damages if bad faith exists.

7 Stop-Payment Orders

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

(1) A customer may by order to his bank stop payment of any item payable for his account but the order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in Section 4-303.

(2) An oral order is binding upon the bank only for fourteen calendar days unless confirmed in writing within that period. A written order is effective for only six months unless renewed in writing.

(3) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a binding stop payment order is on the customer.
Code 31-8-26 provides as follows:

“No revocation, countermand or stop-payment order relating to the payment of any check or draft drawn on any banking institution doing business in this State, including national banking associations, shall remain in effect for more than six months after the service thereof on such banking institution, unless the same be renewed, which renewal shall be in writing and be in effect for not more than ninety days from the date of service thereof on such banking institution, after which time such check or draft may be paid by such banking institution.

Service of the notice herein provided for may be made upon any employee of such bank or trust company who may be found at its place of business.”

Section 4-403 differs from Code 31-8-26 in the following material respects:

(a) Section 4-403 does not limit the right to stop payment to checks and drafts, as does Code 31-8-26, but extends the right to any item payable by any bank, such as a note payable at a bank. See Comment 4.

(b) Section 4-403 permits an oral stop payment order but limits its effectiveness to 14 days. Code 31-8-26 makes no explicit provision permitting oral orders, but the use of the phrase “after service thereof on such banking institution” would seem to require a writing to be served. In this connection, Comment 6 points out there are decisions holding that a bank has waived the statutory requirement of a writing by accepting oral stop-payment orders.

(c) Comment 3 points out that subsection 4-403(1) is so worded to follow the decisions holding that a payee or indorsee has no right to stop payment. Code 31-8-26 is not clear on the matter.

(d) Code 4-403 presumably permits the written renewal to be effective for an additional six months as a second stop-payment order. Code 31-8-26 likewise requires the renewal be in writing but limits its effectiveness to an additional ninety days.

(e) Subsection 4-403(1) specifies the order “must be received at such time and in such manner as to afford the bank a reason-

66 See Leary, op. cit. supra note 24, at 580.
able opportunity to act on it prior to any action by the bank with respect to the item described in section 4-303” (specifying when the bank has taken steps indicating a decision to pay the item after which a stop-order comes too late). Code 31-8-26 permits service upon any employee of the bank who may be found at its place of business and allows no “reasonable opportunity to act upon it.” That the subsection 4-403(1) solution in this respect is preferable, from the bank’s viewpoint, to that of Code 31-8-26 is better realized from a reading of the following general definition set forth in subsection 1-201(27):

“Notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence.”

From the definition it would appear that a stop order is effective only when it is brought to the attention of the individual responsible for handling stop-orders or should in the exercise of due diligence have been brought to his attention. Section 4-403 does not solve all the problems, however, for it is believed that the bank cashier receiving an oral stop order at home on Sunday must telephone the bank early on Monday before banking hours or the bank will be liable for cashing the stopped check before the cashier comes to work on Monday.67

(f) Code 31-8-26 contains no language making it clear that the stop order must identify the item with particularity. Subsection 4-403(1) states that the order must be received “in such manner” as to afford the bank a reasonable opportunity to act on it. One commentator interprets the phrase “in such manner” to require that the item be adequately identified by the stop order, citing pre-Commercial Code cases holding the bank not liable for payment where the stop order omitted the check number or date or used the wrong date or amount.68

(g) Code 31-8-26 is silent respecting burden of proof while subsection 4-403(3) places the burden on the customer to establish the fact and amount of loss resulting from payment contrary to a binding stop payment order.

67 Id. at 579.
68 Id. at 578.
With respect to burden of proof as to the amount of loss resulting from improper payment in disregard of binding stop-payment order, the question arises as to whether the bank has an obligation to recredit the customer's account to avoid liability for the dishonor of other items due to insufficient funds caused by the payment contrary to the stop order. In the 1952 version of article 4, section 4-403, there was a Comment 9, omitted from the 1958 version, stating that the bank had no such obligation to recredit the account until the customer had maintained the burden of proof and was not liable for the dishonor of other items due to the insufficiency of funds caused by the improper payment. One of the draftsmen suggests the following solution to the problem:

"... It is one thing to determine whether an item has been paid in disregard of a stop order. It is another thing to fix the loss caused, including its amount, by such failure to observe a stop order. But, taken in conjunction with section 4-407, subrogating a bank which has made an improper payment to the rights of one entitled to the money, the provision on burden of proof may have the following effect: If the bank can establish that the payee was really owed the money, or that the item was presented on behalf of a holder in due course, then the customer cannot establish that he suffered any loss by the payment, and cannot claim, further, that additional checks were improperly dishonored causing further loss. On the other hand, should the customer establish that as between himself and the payee, he, the drawer, was entitled to the money and that there is no holder in due course involved, then it would seem to follow that he has suffered loss and the dishonor of the other items, caused by the improper debit, will be an element of damages. To the extent that the Comment [Comment 9 to 1952 version of section 4-403] can be taken to mean that a bank which has charged an item to an account in disregard of a valid stop order will not be liable for the dishonor of items that would have otherwise been paid, the Comment goes beyond the text and cannot control the text."

Inasmuch as Comment 9 has been omitted from the 1958 version of article 4, section 4-403, it would appear that the analysis contained in the foregoing quotation has been accepted as correct.

It is indicated in Comment 8, that the bank making improper

69 Id. at 581.
payment in violation of an effective stop order, in addition to the right of subrogation given by section 4-407 to prevent unjust enrichment, retains common law defenses, e.g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop payment order; and retains common law rights, e.g., to recover money paid under a mistake in cases where the payment is not made final by section 3-418.

It has been pointed out that the six months effective period of a stop order might not afford complete protection to a bank if it should, after expiration of the period and non-renewal of the order, pay the check, since the check would then be stale and, although case authority is divided, it might be questionable whether the bank acted in good faith in making payment. In this connection, however, section 4-404 (relating to stale checks) specifically states that a bank may charge its customer's account for a good faith payment of a check presented more than six months after its date. Moreover, Comment 7 to section 4-403 states that sections 4-403(2) and 4-404 reject the reasoning of case law questioning whether the bank could have acted in good faith in paying a then stale check after the six month stop order had expired without renewal.

Utilizing the right given by subsection 4-103(1) to vary the provisions of article 4 by agreement, a bank, through legends on deposit slips and the like, could avoid the trouble areas of stop payment in section 4-403, e.g., verbal orders and inadequate identification of the item. Subsection 4-103(1), however does not permit exculpatory clauses, so the bank could not by contract avoid the duty to exercise ordinary care in stopping payment.

No West Virginia case was found construing Code 31-8-26 or dealing with stop payments.

8 Stale Checks

Section 4-404. Bank Not Obligated to Pay Check More Than Six Months Old.

A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith.

70 See CLARK, BAILEY & YOUNG 155.
Code 3-8-27 provides:

"Any banking institution in this State, including national banking associations, may refuse to honor any check or draft drawn on it, after the expiration of twelve months from the date payable, or date of demand check or draft, unless, after presentation thereof, it is directed by the drawer to pay the same. No such banking institution shall incur any liability to the drawer, holder or any other person, because of the refusal to pay a check or draft, as authorized by this section."

Two major differences between section 4-404 and Code 31-8-27 are apparent:

(a) In determining when a check becomes stale, section 4-404 uses a period of six months whereas Code 31-8-27 employs a period of twelve months. The Comment states the period of six months reflects current banking and commercial practice. Inasmuch as the provisions of Code 31-8-27 have not been substantially modified since enactment in 1923, the twelve month period probably reflects the banking practice of that era.

(b) Section 4-404 affirmatively provides that the bank may charge the customer's account for a good faith payment of a check presented more than six months after its date whereas Code 31-8-27 is silent in this respect except in so far as the use of the phrase "may refuse to honor" indicates that payment of the twelve month old item is permissive. It is important that the bank be given the option to pay stale checks, because it is often in the position to know that the drawer desires that payment be made, e.g., dividend checks. See Comment to section 4-404.

In addition it should be noted that section 4-404 expressly excludes certified checks. The exclusion is justified by the Comment because upon certification the check becomes the primary obligation of the certifying bank, running direct to the holder of the check, and the customer's account has then been charged. Code 31-8-27 does not expressly state that certified checks are not within its scope, but such a result could be inferred from the language which requires the bank to honor the stale check, upon presentment, if directed to do so by the drawer. As has been pointed out, the drawer's account was charged upon certification, thus he should no

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71 See U.C.C. §§ 3-411, 3-413. See also W. Va. Code, ch. 46, art. 16, § 5 (Michie 1961).
longer have any control over the certified check, the bank's primary obligation, so as to direct that it be paid. In the only case found in West Virginia touching upon stale certified checks, the principles of the negotiable Instrument Law, rather than Code 31-8-27, were used to find that (1) the statute of limitations operates against a holder of a certified check from the date of certification and (2) the holder is not deemed a holder in due course where the certified check is negotiated an unreasonable length of time after certification. In deciding the second point, however, the court did refer to Code 31-8-27 as an indication of legislative intent respecting the period of time deemed unreasonable.

9 Death or Incompetence of Customer

Section 4-405. Death or Incompetence of Customer.

(1) A payor or collecting bank's authority to accept, pay or collect an item or to account for proceeds of its collection if otherwise effective is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes such authority to accept, pay, collect or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(2) Even with knowledge a bank may for ten days after the date of death pay or certify checks drawn on or prior to that date unless ordered to stop payment by a person claiming an interest in the account.

There is no express statutory provision in West Virginia with respect to the effect of death or incompetency of the bank customer except for Code 31-8-24 which permits the bank to make a valid payment of his deposit to a minor customer unless directed otherwise in writing by the parent or guardian. According to the general rule, with exceptions where the check operates as an assignment and in the case of fiduciary, the death of the drawer of a check revokes the authority of the drawee bank to pay it, and the money becomes the property of the drawer's estate, payable to his personal representative, and may be recovered from the payee.

73 Id. at 414, 173 S.E. at 610.
to whom the bank has paid it, or from the bank itself, except where
the bank has paid without notice of the death.74 Where the drawer
of a check becomes insane, the bank is generally protected in pay-
ment unless it has actual notice, but one case held the bank liable
for payment made after the drawer had been adjudicated insane
even though the bank was unaware of the adjudication which had
occurred in another state.75

No West Virginia cases have been found respecting this prob-
lem, but it is common bank practice in West Virginia to check the
local daily death notices and adjudications of incompetency and
freeze the accounts of persons dying or adjudicated incompetent.

Subsection 4-405(1) makes it clear that the bank’s authority
continues until the bank knows of the fact of death or adjudication
of incompetency and has reasonable opportunity to act on it.

The ten-days-after-death rule of subsection 4-405(2) is modeled
after statutes existing in seven states.76 The provisions of the rule
and the reasons for its adoption into article 4 have been explained
by one of the draftsmen as follows:77

“There are several points to be noted here. The permission
to pay or certify is limited to checks, and does not extend to
items generally. Action may only be taken upon checks for
ten days after the date of death, not after the date of the
bank’s receipt of knowledge of death. Payment may be stopped
by any person claiming an interest in the account, and
this may be for all checks or only as to particular items, since
the power to stop all obviously includes the power to stop less
than all. The interest may be fictitious or real; it is the claim
that is sufficient. Tax authorities could claim an interest and
order payment stopped. In accordance with the decisions
under the parent statutes, the Comment [Comment 3] states
that the statute merely protects the bank in making payments,
it does not affect the right of the personal representative of the
decedent to recover any improper payment, or affect the law
of gifts. The basis of the rule is, again, the convenience of
the great bulk of good transactions. Most people die solvent,

74 Zollman, Banks and Banking, § 3791 (1936).
75 Id. § 3793.
76 See Leary, Article 4: Bank Deposits And Collections Under The Uni-
77 Ibid.
and most of their outstanding checks represent debts that must be paid, or allowances to children for living expenses that should be disbursed. The occasional check obtained by the beautiful blonde nurse during the last illness by devious devices that enlivened the discussion of this section during the drafting sessions is not a sufficient risk to outweigh the benefits. In most areas, the bank can police the exercise of this privilege through an officer, who will, probably refrain from paying sizeable checks, or unusual checks. In large metropolitan centers, banks may decide not to avail themselves of the privilege. But if used, the section should save the servant, wage earner, the grocer, baker, butcher and other service trades the nuisance of receiving a returned check and asking the executors to make good. The section does not, of course, solve the problem of how to meet the payroll of an individually owned business that falls due the day after a death known to a bank. Clearly all agencies to draw checks are revoked by death, and the bank's authority is gone because it knows of the death and, perforce, the checks must be drawn after death, so the provisions of section 4-405(2) do not give any comfort. The situation remains as it was before the Code, as perhaps it should, for it is clearly dangerous to permit the general drawing of checks after death. . . ."

10 Bank Customer's Duty To Discover and Report Forgeries and Alterations

Section 4-406. Customer's Duty to Discover and Report Unauthorized Signature or Alteration.

(1) When a bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries or holds the statement and items pursuant to a request or instructions of its customer or otherwise in a reasonable manner makes the statement and items available to the customer, the customer must exercise reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof.

(2) If the bank establishes that the customer failed with respect to an item to comply with the duties imposed on the customer by subsection (1) the customer is precluded from asserting against the bank
(a) his unauthorized signature or any alteration on the item if the bank also establishes that it suffered a loss by reason of such failure; and

(b) an unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank after the first item and statement was available to the customer for a reasonable period not exceeding fourteen calendar days and before the bank receives notification from the customer of any such unauthorized signature or alteration.

(3) The preclusion under subsection (2) does not apply if the customer establishes lack of ordinary care on the part of the bank in paying the item(s).

(4) Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.

(5) If under this section a payor bank has a valid defense against a claim of a customer upon or resulting from payment of an item and waives or fails upon request to assert the defense the bank may not assert against any collecting bank or other prior party presenting or transferring the item a claim based upon the unauthorized signature or alteration giving rise to the customer's claim.

With respect to the duty outline in section 4-406, Code 31-8-21 now provides as follows:

"No banking institution, including national banking associations which has paid and charged to the account of a depositor any money on a forged or raised check issued in the name of such depositor, shall be liable to such depositor for the amount paid thereon, unless either, (a) within six months from the notice to such depositor that the vouchers representing payments charged to the account of such depositor, for
the period during which such payment was made, are ready for delivery, or (b) in case no such notice has been given, within six months after the return to such depositor of the voucher representing such payment, the depositor shall notify the banking institution that the check so paid is forged or raised. The notice referred to may be given by mail to such depositor at his last known address with postage prepaid . . . ."

No case has been found construing Code 31-8-21. An early case held that as between banker and customer some superior equity must intervene to preclude the customer from objecting to an illegal and unauthorized charge against him even though the account rendered to the customer may have been retained for a long time without objection, for the general rule that an account rendered and retained for a long time becomes an account stated is inapplicable to transactions between banker and customer.76 A later decision recognized that the bank statement and cancelled checks could become an account stated if retained by the customer without objection within a reasonable time, but permitted such account stated to be impeached for the mistake of the bank in not charging honored checks against the customer's account.79

Because section 4-406 is so much more comprehensive than Code 31-8-21, detailed comparison is inappropriate. Space could be more fruitfully used to explain the basic features of section 4-406.

Subsection 4-406(1) states the customer's duty to exercise reasonable care and promptness to examine his bank statement and accompanying items (paid in good faith by the bank) to discover forgeries of his own signature or any alterations and to notify the bank promptly of any such forgeries or alterations found. The duty arises when the bank has either (1) sent the statement and items to the customer, or (2) held the statement and items available to the customer pursuant to his request or instructions, or (3) has otherwise in a reasonable manner made the statement and items available to the customer. Comment 2 states that the third type of bank action specified is intended to cover unusual situations as where a bank knows a customer has left a former address but does not known any new address to which to send

the statement or item or to obtain instructions from the customer. Note that in such a situation the bank's action must be reasonable.

When the customer makes a claim against the bank for making payment of an item containing a forgery of his own signature or any alteration, subsection 4-406(2) places the burden on the bank to establish that the customer failed to carry out the duties imposed upon him by subsection 4-406(1). If the bank successfully carries such burden, the two preclusionary rules of subsection 4-406(2) then come into play against the customer: (a) he is precluded from asserting a forgery of his own signature or any alteration provided the bank also establishes that it suffered a loss because of the customer's failure, such as showing that restitution could have been obtain from the wrongdoer had the customer acted with reasonable promptness in giving notice to the bank;60 and (b) he is precluded from asserting any subsequent forgery or alteration by the same wrongdoer on any item paid in good faith by the bank after the first item and the statement was available to the customer for a period of fourteen calendar days and before the bank receives notification from the customer of the prior forgery or alteration by the same wrongdoer. The second preclusionary rule adopts the reasoning of the case law that payment of an additional item or items bearing an unauthorized signature or alteration is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care in examining his statement and notifying the bank of an objection to it.61

Subsection 4-406(3) provides that the two preclusionary rules are not applicable, however, if the customer establishes that the bank did not use ordinary care in paying the disputed items.

According to subsection 4-406(4), regardless of the care or lack of care of either party, the customer is absolutely barred from asserting rights against the payor bank after the expiration of specified time limits which commence to run from the date the statement and items are made available to the customer. After one year he may not assert a forgery of his own signature or any alteration on the front or back of an item. After three years he may not assert a forged indorsement. The difference in time limits is justified by Comment 5 on the ground that there is little excuse for a customer not detecting a forgery of his own signature whereas

60 See CLARK, BAILEY & YOUNG 163.
61 See Comment 3, U.C.C. § 4-406.
he could not be expected to know the signatures of indorsers and may be delayed in learning the indorsements were forged. It should be noted that the specified time limits are not statutes of limitation on the customer's right of action but relate to the periods within which he must have notified the bank of a detected forgery or alteration.

The purpose of subsection 4-406(5), is embracing collecting banks and prior parties within the protective features of subsection 4-406(4), is to reject case law which sanctioned a device whereby the customer, after the notification period had elapsed, persuaded the payor bank to waive any defenses it might have and implead the collecting bank or a prior party as a third-party defendant for breach of warranty. It has been pointed out that subsection 4-406(5) does not explicitly bar any possible right of action by the drawer of a check bearing a forged indorsement directly against a collecting bank, nor does it bar any possible right of action by the "owner" of the item (such as the payee whose indorsement is forged) against a collecting or payor bank under section 3-419.

It should be noted that the time limits specified throughout section 4-406 could be varied by agreement as permitted by subsection 4-103(1). If the agreed time limits were unreasonably short, however, it is believed by some that the courts would follow decisions under prior law to the effect that no such agreement had been actually entered into by the bank and the customer, and that the shortened period was therefore not binding on the customer.

11 Collection of Documentary Drafts

In the interest of completeness and to provide a definite set of rules for an important function in the bank collection process, article 4 includes a part 5 dealing with collection of documentary drafts, which consists of the following four sections:

Section 4-501. Handling of Documentary Drafts; Duty to Send for Presentment and to Notify Customer of Dishonor.

A bank which takes a documentary draft for collection must present or send the draft and accompanying documents for presentment and upon learning that the draft has not been

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82 See Clark, Bailey & Young, 165; Comment 7, U.C.C. § 4-406.
83 See Clark, Bailey & Young 165-66.
84 Ibid. at 166-67.
paid or accepted in due course must seasonably notify its customer of such fact even though it may have discounted or bought the draft or extended credit available for withdrawal as of right.


When a draft or the relevant instructions require presentment “on arrival”, “when goods arrive” or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of such refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods.

Section 4-503. Responsibility of Presenting Bank for Documents and Goods; Report of Reasons for Dishonor; Referee in Case of Need.

Unless otherwise instructed and except as provided in Article 5 a bank presenting a documentary draft
(a) must deliver the documents to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment; and
(b) upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or if the presenting bank does not choose to utilize his services it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor and must request instructions.

But the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for such expenses.

Section 4-504. Privilege of Presenting Bank to Deal With Goods; Security Interest for Expenses.

(1) A presenting bank which, following the dishonor of a documentary draft, has seasonably requested instructions but
does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(2) For its reasonable expenses incurred by action under subsection (1) the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien.

Only two West Virginia cases have been found dealing with the rights and duties of a bank in dealing with documentary drafts. It has been held that a bank discounting a draft and receiving therewith a bill of lading for the goods, against the purchase price of which the draft is drawn, acquires a special property in such goods, and has a complete right to have them held as security for the payment of the draft.85 And a correspondent bank to which a draft, with bill of lading attached, has been sent for collection has no right, in the absence of special instructions, to deliver the draft and bill of loading to the consignee upon an understanding that he can have his money back if he determines to reject the goods.86 Given such a paucity of case law, it is clear that it would be to the interest of banks and their customers to enact the more complete and definitive set of rules for this area provided by part 5 of article 4.

CONCLUSIONS

If article 4 of the Uniform Commercial Code were enacted in West Virginia, its exclusively inter-bank rules for bank collections would in most instances do no more than give statutory sanction to existing bank practices. On the other hand, the aspects of article 4 dealing principally with the customer-payor bank relationship would represent an extensive and desirable modification of existing law with respect to such matters as stop payment orders, stale checks, death of a customer, and the customer's duty to discover and report forgeries and alterations. Because the bank collection process commonly extends across state lines, the overriding interest of national uniformity should prevent legislative meddling with the sections of article 4 dealing exclusively with inter-bank relationships in the collection process. But the customer-payor bank relationship, at least in some aspects, does not always have an im-

86 Old Nat'l Bank v. Peoples Bank, supra note 85.
pact beyond state borders. Accordingly, one should not be too surprised to find the Legislature extending more certain protection to the customer by refusing to permit variation by agreement with respect to some sections of article 4 primarily concerned with the customer-payor bank relationship, \textit{e.g.}, sections 4-402 (wrongful dishonor), 4-403 (stop payment orders), 4-404 (stale checks), 4-405 (payment after death), and 4-406 (duty to examine statement, etc.).