BANK DEPOSITS AND COLLECTIONS

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Article 4, "Bank Deposits and Collections," is the most recent, and has been one of the most controversial, of the articles of the proposed Uniform Commercial Code. It started out as a group of sections in the Negotiable Instruments Article applicable to negotiable instruments in process of bank collection but rapidly developed into an extensive regulation endeavoring to provide a "rule" governing most situations relating to bank deposits and collections.

At least four printed drafts of this material have been submitted to the Council of the American Law Institute and the National Conference of Commissioners on Uniform State Laws. The Spring 1950 draft, like each of its predecessors, differed substantially both in form and substance from each of its predecessors. It was submitted for "discussion and approval" at the May, 1950, joint session. At that meeting the Reporters submitted further changes and revisions and no action was taken pending further study. Under date of September 8, 1950, the "September 1950 Revisions" were printed and distributed. Of the 42 sections in this draft, 26 contain revisions of substance changing one or more of the rules stated in the May, 1950, draft and all except four of the remaining sections contain substantial revisions in form. As this is written, corresponding revisions of the official Comments are not yet available. In fact, shortly before the author received the printer's proof of this paper he received a still further revision of Article 4 (hereafter called the "new draft"). The many

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7 Unless otherwise noted, all references herein to Article 4 are to the September 1950 Revisions, and all references to other articles are to the Spring 1950 Proposed Final Draft. Where substantial changes have been made in the new draft references thereto have been added.
changes contained in this new draft give added emphasis to the comments in the next paragraph.

The successive, extensive, revisions of this Article have not only rendered it difficult to follow its progress but have also rendered obsolete many of the published observations on it almost as soon as they have been published. This suggests that perhaps the Reporters have not yet sufficiently crystallized their views to submit a statute suitable for enactment. In any event the legal profession and the commercial community, including the various committees now studying the Code, have had an inadequate opportunity to acquaint themselves with the proposed provisions and to study the possible effects thereof.

PURPOSE AND SCOPE OF ARTICLE

Much of the recently published comment on Article 4 has assumed that it is intended as a uniform restatement of “existing law and practices.” There can be no doubt that it would be a fine thing to have a clear, uniform statement of the essential rules of law governing bank deposits and collections if that could be accomplished without either creating an undue number of additional problems of interpretation or practice or unduly impeding future change to accommodate changed concepts and business practices. The only way in which it can be finally established that any particular draft has accomplished this purpose is through experience with an enacted statute. Short of this, only the seasoning that comes from study of a final draft over an adequate period of time by bankers, lawyers, and businessmen in the light of their varying experience and practices can “smoke out” the maximum number of “bugs” which will lurk in any code prepared by man. Enactment of this Article without elimination of the maximum of these “bugs” would be indeed unfortunate, especially to the extent that the Code may restrict the freedom of the parties to vary or amplify its provisions by contract.

However, it is not the purpose of this paper to point out technical deficiencies. Since the current draft of the Code is to be readied for submission to the Institute and Commissioners in May, 1951, for the final action, which was postponed in May,

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Footnotes:

7 For instance, see Note, The Proposed Uniform Commercial Code: Bank Deposits and Collections, 50 Col. L. Rev. 802 (1950), in which all of the section references and most of the quotations are now obsolete, and the substance of many of the provisions commented upon has been changed or eliminated! See also Leary, Deferred Posting and Delayed Returns—The Current Check Collection Problem, 62 Harv. L. Rev. 905 (1949), commenting at length on the provisions determining priority of items, notices, etc., as of the time of receipt of the item or notice, which provisions have been completely revised as discussed infra under “VII-Deferred Posting.”


10 See Report of the Committee on the Proposed Commercial Code, supra note 1, at 143-144.

11 Gilmore, supra note 9, at 1341 and 1355.
1950, and since space limitations effectively prohibit a discussion of each section, it has seemed appropriate to limit the balance of this paper to an examination of some of those provisions which would appear to change existing law and to point out some of the instances where those provisions would appear to create future problems. These are the provisions which would presumably be of primary interest to a legislature if the Code were presented to it.

I

MODIFICATION BY AGREEMENT

Perhaps the most important and revolutionary provision of the entire proposed Code is to be found in Section 1-107, which provides:

The rules enunciated in this Act which are not qualified by the words "unless otherwise agreed" or similar language are mandatory and may not be waived or modified by agreement.\(^{10a}\)

This would substantially restrict the time-honored method whereby our commercial community has customarily kept pace with changing practices and methods and has tempered by agreement the otherwise harsh or stultifying effect of outmoded or erroneous rules of law; and in its place would be substituted a system of mandatory rules, many of them susceptible of change only by action of forty-eight legislatures.\(^{11}\)

Section 4-103 would permit the rights and obligations provided in Article 4 to be waived or modified by agreement, except that no agreement can

(a) limit a bank's liability for its own negligence or lack of good faith; or
(b) limit a collecting bank's liability for authorization or ratification of a remittance in the form of a payor bank's primary obligation; or
(c) extend a time limit fixed by this Article except as otherwise provided in the following subsections; or
(d) limit a bank's obligation on written orders to stop payment; or
(e) limit the measure of damages for improper handling.

This section has been described as permitting variation by agreement in all except "those few cases where sound public policy requires a prohibition of contrary agreement."\(^{12}\) Since our courts have always enjoyed the right to declare a contract void as against public policy, it would seem that a statute to accomplish this purpose could be justified only on the ground that the courts have abdicated this right or that banks are, in fact, overreaching their depositors and exacting unconscionable contracts.\(^{13}\) It has not been suggested that either of these conditions exists. Furthermore,

\(^{10a}\) The Reporters have apparently decided to revise §1-107 to permit freedom of contract subject to certain general restrictions, but to retain §4-103, so that any change in §1-107 will not affect Article 4.\(^{11}\) Gilmore, supra note 9, at 1359, points out that if the Code is successfully carried through "we have probably committed ourselves to basic revisions at fairly short time intervals."
\(^{12}\) Schnader, supra note 8, at 182, and 50 Col. L. Rev. 802.
\(^{13}\) See Report of the Committee on the Proposed Commercial Code, supra, note 1, at 148, suggesting that all of the bank collections provisions be subject to variation by agreement.
an examination of these prohibitions suggests that they may cut across many of the most important substantive provisions of the Code, and that they are to only a limited extent, if at all, required by public policy.

A. "... no agreement can ... limit a bank's liability for its own negligence or lack of good faith"14

"Negligence" is not defined in the Code and it is not suggested that it should be. "Good faith" is defined as including "observance by a person of the reasonable commercial standards of any business or trade in which he is engaged."15 Does public policy demand that every contract relating to bank deposits and collections be subject to determination by a court or jury that it does or does not limit the bank's liability for observance of "the reasonable commercial standards" of the banking business?

Under present law the relationship of a bank to paper delivered to it for collection rests on contract.16 In accepting an item for collection the bank assumes an agency which requires the exercise of reasonable care,17 but the parties clearly have the right to contract as to the conditions under which the bank may handle the item.18 In other words, a bank is not liable for using a method of handling or collection which is authorized or agreed to by its customer although it might be held to be negligent if it employed such method in the absence of such an agreement. For instance, in 1924 the Supreme Court of the United States held19 that it was negligence for a collecting bank in the absence of agreement to accept in payment of a check anything other than actual currency. The Court in that case was, of course, far behind the times20 and the conclusion of the case has been corrected by statute, contract, and regulation. But if the Code had been enacted prior to that decision, and if the Code had not specifically dealt with that particular problem, could anything short of amendment of the Code itself have permitted collecting banks to accept anything except actual currency in payment? In other words, is it not possible that a court might find that employment of a particular method of handling or collection, not specifically authorized by the Code, would constitute negligence in the absence of contract and may not be authorized by contract because the effect of such a contract is to limit or eliminate the bank’s liability for otherwise negligent conduct?21

This provision seems to cut across a very substantial portion of the Code and the possible danger is that it may "freeze" present bank deposit and collection practices

14 U. C. C. §4-103(1)(a).
15 U. C. C. §1-201(18).
16 Zollman, Banks and Banking §5531.
17 Ibid.
18 Id. at §5541.
21 The Reporters have taken this possibility into account to the extent of providing for certain collection practices not now in use: U. C. C. §4-108, "Direct Returns and Communications," discussed infra heading II, U. C. C. §4-204(1)(c) presentment by a "copy," and U. C. C. §4-303, presentment by notice, discussed infra heading VI.
except to the extent that changes therein may have been foreseen and specifically authorized by the Code.\footnote{1}{

B. "... no agreement can ... limit a collecting bank's liability for authorization or ratification of a remittance in the form of a payor bank's primary obligation"\footnote{2}

The reason for this provision is not stated in the official Comments,\footnote{3} but its general effect, together with the other related provisions discussed below, seems to be to force the use of remittance drafts drawn on third banks. Since such drafts are apparently intended to be treated as assignments,\footnote{4} the purpose of these sections would seem to be to enhance the possibility of payment of checks presented to banks that fail before payment is completed.

It is clear that this provision would, in effect, prohibit a collecting bank from agreeing to accept a payor bank's cashier's check or other similar obligation. Thus banks in some communities where it is customary to accept cashier's checks in payment for certain items and to collect them through a clearing house the next day would be required to discontinue this practice or assume the risk of insolvency of the payor banks. It is difficult to see what public policy requires this result, since this practice is no more detrimental to the interests of the owner of the item than the acceptance of a draft on a third bank which is the obligation only of the remitting bank.

It may be that the Reporters have in mind only those cases where the payor bank remits by an instrument payment of which can be obtained only by presentment direct to the payor bank. There is no particular reason why a collecting bank should or would agree to accept such a remittance, and if it did so agree without good reason or clear authorization from its customer it would probably be guilty of negligence. If the section were so limited it would probably not be necessary.

Article 4 does not make it clear that a collecting bank may agree to accept remittance in the form of a draft on itself or an authorization to charge the payor's account with it, or a credit on the books of the payor bank. Section 4-206, entitled "Remittance by Bank Draft or Obligation; when Proper ..." provides only that "a collecting bank may properly take in conditional settlement of an item a draft drawn by a bank on a third bank or a demand primary obligation of any bank except the payor bank ..." If a collecting bank agrees to accept a draft or authorization on itself must it accept all such drafts as unconditional payment even though the day may come when the account is insufficient and the payor bank closed? If the account

\begin{quote}
\footnotetext{22}{This possibility is substantially increased by the new draft of §4-103: "(1) No agreement can (a) limit a bank's liability or the measure of damages for its own carelessness, lack of good faith, or improper handling." "Improper handling" is not defined, but conceivably any handling in violation of the provisions of the Code would be improper.}

\footnotetext{23}{U. C. C. § 4-103(1)(b).}

\footnotetext{24}{U. C. C. Proposed Final Draft, Spring 1950, 449-450.}

\footnotetext{25}{U. C. C. Proposed Final Draft, Spring 1950, 506; and see discussion infra under heading III—"Remittance Draft as Assignment."}
\end{quote}
is sufficient should the collecting bank honor or dishonor the remittance draft received after notice of failure of the payor-remitting bank?

C. "... no agreement can ... extend a time limit fixed by this Article except as otherwise provided in the following subsections."

Many of the time limit provisions of the Code are probably merely restatements of the law today, although some are clearly new or more drastic than at present. Time limits in the present law may, of course, be waived, modified, or extended by agreement, general or special, although any collecting bank which waives, modifies, or extends a time limit without authority from its transferor would probably be liable for any damage that resulted. No reason appears, and none is suggested in the Comments, why this right should be abridged.

This provision would effectively prohibit agreements, including clearing house rules, permitting (1) the deferred posting of maturing time items or (2) the return of unpaid items by hand or through the clearings on the morning of the second business day after presentment instead of before midnight of the first business day. Other prohibited agreements include any extension of the obligation of a bank to pay a check more than six months after its date (Section 4-504), the duty of a customer to report forgery or material alteration within 90 days (Section 4-506), the necessity for making claim for breach of warranty within a reasonable time (Section 4-210), and the right of a customer to withdraw as of right any deposit in a checking account (Section 4-215).

Since the Code would permit the time limits to be varied by “particular agreement ... as to specified items,” and since there is no evidence or suggestion that the privilege of extending time limits by general agreements has been abused, it may

25 U. C. C. §4-103(1)(c) Subsection (2) permits the “affected parties” to extend a time limit by “particular agreement ... as to specified items”; and Subsection (3) provides that unless otherwise instructed a collecting bank in a good faith effort to secure payment may, with or without the approval of the customer involved” extend time limits not to exceed an additional business day provided it sends to its transferor notice of any extension beyond midnight of the day on which action was otherwise required.

26 U. C. C. §4-202: a collecting bank must present or forward an item, or send notice of dishonor, within a reasonable time after receipt of such item or notice. U. C. C. §4-203: taking proper action before its “midnight deadline” after receipt of the item (or notice?) is within a reasonable time, the bank having the burden of proof if a longer time is involved. U. C. C. §4-206(1): remittance drafts must be forwarded for collection by the “midnight deadline.” U. C. C. §4-213: the right of charge-back may be exercised only if the collecting bank returns the item or sends notice “by its midnight deadline or within a longer reasonable time after it learns the facts.” U. C. C. §210(5): claim for breach of warranty must be made within a reasonable time after the person claiming learns of the breach, but quaere whether the law would today require a “claim” to be made. U. C. C. §4-401: a payor bank on deferred posting must make “authorized settlement” on the day of receipt in order to return an item as unpaid on the next banking day, and such return must be before midnight of the next banking day.

27 U. C. C. §4-215: “When Credit is Available for Withdrawal as of Right,” discussed infra heading V. U. C. C. §4-303: “Presentment by Notice of Item not Payable by, Through or at a Bank; Liability of Secondary Parties,” discussed infra heading VI, and U. C. C. §4-506 requiring a customer to report forgery or material alteration within 90 days.


29 See RULES OF NEWARK (N. J.) CLEARING HOUSE ASSOCIATION.
be doubted whether the good, if any, to be accomplished by this provision does not outweigh the harm it may do.

D. "... no agreement can ... limit a bank's obligation on written orders to stop payment"\(^{30}\)

Such clauses are in use by many banks and a standard form thereof is recommended by the Assistant General Counsel of the American Bankers Association.\(^{31}\) A recent report of the Committee on Bank Operations of the Section of Corporation, Banking and Mercantile Law of the American Bar Association\(^{32}\) concluded that by the weight of authority such clauses are supported by adequate consideration and held not to be against public policy.\(^{33}\)

The Associate Reporter for this Article recognizes that "No case need be made for some limitation on the effectiveness of stop orders, when it is remembered that checks are presented to banks by the thousands daily, and can come in over the counter at any number of tellers' windows."\(^{34}\) But he justifies the "outraw" of any contract limiting the bank's liability, on the ground that the Code would give the bank which inadvertently pays over a stop order a right of action by way of subrogation to whatever rights the drawer might have against the holder or whatever rights the holder might have had against the drawer if the stop order had been honored and payment refused.\(^{35}\) The bank's right to bring suit on an unknown cause of action against its customer or some third party, with perhaps the necessity of making a choice at its peril, is certainly of doubtful value.

In the last published official Comments\(^{36}\) this provision is justified on the ground that the banks can protect themselves by a charge to their customers or by insurance. This philosophy has certain obvious limitations.

II

DIRECT RETURN OF UNPAID ITEMS

Section 4-108 provides that "when so instructed by its transferor" an intermediary or payor bank may return an item to the "first bank named on the item." Throughout the country tremendous volumes of checks are collected by banks from drawee banks

\(^{30}\) U. C. C. §4-103(1)(d).

\(^{31}\) 3 PATON'S DIGEST 3474-3475 (1944). See also The Proposed Uniform Commercial Code—A Symposium, supra note 1, at 170.

\(^{32}\) 5 The BUSINESS LAWYER 100-107 (1949). It is interesting to note that in the same volume the Chief Reporter is quoted as stating "our understanding is that these clauses which we agree with you are in universal use, won't stand up in any court...." Id. at 178.


\(^{35}\) Leary, supra note 34, at 368; and see U. C. C. §4-507.

in other communities or states. Sound collection practices require that a tremendous volume of these checks be collected through Federal Reserve Banks or other intermediary banks. Great numbers of these checks are sent by the depositary bank to the intermediary bank with one deposit slip known as a "cash letter." The intermediary bank credits the total amount in one entry to the forwarding bank's account on its books either immediately or on a standard deferred credit schedule, reserving the right to charge back any item returned to it as unpaid. The various checks are then sorted and forwarded in other "cash letters" either to other intermediaries or direct to the drawee, depending upon the collection channels available. The intermediary making presentment receives the remittance or the returned item. Unless the check is returned by the payor bank as unpaid, the credit received by the depositary and collecting banks becomes final automatically and without advice. If it is returned unpaid for any reason it goes from the drawee bank to the intermediary and back through the chain of collection to the bank of deposit in order that the various credits previously given may be reversed as the item is "charged back."  

Recently some bankers have been discussing the establishment of arrangements whereby the payor bank may send the unpaid item or notice of non-payment direct to the first bank of deposit, thereby in many cases reducing the latter bank's risk of paying out the funds before it receives notice of non-payment and also getting prompt word of non-payment to the depositor in order to enable him more effectively to protect himself. Although such an arrangement presents many operating problems for the bank, it probably represents a desirable objective.

One of the problems involved in setting up any such arrangement is that each bank must receive proper authorization from its prior party. Section 4-108 does not eliminate the necessity for such authorization. Under present law, if proper authorizations are obtained, unpaid items may be returned direct under any circumstances authorized. Accordingly, the only function which this Section seems to serve is to authorize agreements for direct returns which might otherwise be prohibited by Section 4-103(a) discussed above under heading IA.

III

Remittance Draft as Assignment

Section 4-206(2) provides that "A remittance draft on a third bank continues unrevoked notwithstanding any stop-order or suspension of payments by the bank issuing it." This replaces the provisions in prior drafts relating to "interbank

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38 U. C. C. §4-213.
39 In the new draft, §4-205(2), this provision is revised as follows: "In the absence of instructions to the contrary a transferor may instruct an intermediary or payor bank to return an item or send a request or notice relating to it to the first bank named on the item as indorsor or indorsor with the same effect as if it had returned or sent the item, request or notice to its transferor, if within the time allowed for acting upon the items it also sends to its transferor an item or notice sufficient to effect any necessary adjustments in credit given a prior bank."
settlement orders." In an early draft provided that such an order was an "assignment." In subsequent drafts language somewhat similar to Section 4-206(2) was described in the official Comments as intended to "make the remittance draft between banks effective as if an assignment." However, unless the Comments are held to give meaning to the language of the Code which would not otherwise follow, Section 4-206(2) would not render a remittance draft effective as an assignment. An "unrevoked" draft is not an assignment, and a drawee who dishonors an unrevoked draft has no liability to the holder of such draft.

Assuming that this difficulty can be overcome, the Reporters are still faced with a practical dilemma in trying to make remittance drafts effective as assignments. The May 1949 draft made no provision for identifying the "interbank settlement order" as such, but the Spring 1950 draft required that it be so labeled "on its face." This latter requirement was impracticable because it would have imposed an onerous burden on banks to label a special set of each of their various forms "interbank settlement order" and more particularly because the remitting bank most likely to suspend payments would be the bank most likely to omit the magic words, thereby nullifying the purpose of the provision.

On the other horn of the dilemma is an equally if not greater practical problem. If the remittance draft is not identified as such, how is the drawee bank to identify it for the purpose of refusing to honor a stop-order or picking it out of the clearings and not returning it as unpaid on the morning it learns that the bank drawing such draft has suspended? And since it is not identified as such, when does it take effect as an assignment?

The obvious purpose of this section is to create a limited preference in favor of holders of checks presented to a bank shortly before it fails and for which it remitted by a draft on a third bank drawn against sufficient funds.

It seems difficult to justify such a preference, based as it is upon the form of remittance used by the payor bank (unless, of course, payment in any other form is to be prohibited and either the collecting bank held liable for improper handling or the officers and directors of the payor bank held personally liable). The only other possible justification is that it might be held applicable in case of national

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41 U. C. C. Proposed Final Draft, Spring 1950, §4-501(3) "An interbank settlement order continues unrevoked and unimpaired by any suspension of payments by the bank issuing it."
42 U. C. C., supra note 41, Comment 2.
43 This provision is revised in the new draft, §4-212(4), to read: "A draft on or a primary obligation of a third bank used as a remittance for an item continues unrevoked notwithstanding suspension of payments by the remitting bank and if otherwise properly payable must be paid to the holder." If the remittance draft is not paid, the new draft, §4-212(5), gives the owner of the item remitted for a preferred claim against the remitting bank's cash and bank deposits.
44 See U. C. C., supra note 40, §3-719, requiring "notice to fix the order of priorities."
45 U. C. C., "Notes and Comments to Proposed Final Draft No. 1—Article 3" April 15, 1948, at 74-78 justifying this provision as a preference on the same grounds as the "preference given to the holder of an item where a bank closes with unremitted proceeds in hand."
46 See discussion supra heading I, B, and infra under heading VIII.
banks notwithstanding the *Jennings* case; and under heading VIII—"Rights of Owner of Item in Event of Insolvency of Intermediary or Payor Bank"—it is pointed out that Section 4-508(2) creating a preference in case of an insolvent intermediary bank seems clearly to raise the question of the *Jennings* case.

If a preference is considered desirable it would seem much better to make direct provision therefor and, if necessary, to propose an appropriate amendment to the National Bank Act.

IV

**Warranties of Depositor**

At present warranties made with respect to negotiable instruments depend upon the form of endorsement or lack thereof. Thus, if a person endorses at all, whether qualified, general, or restrictive, he makes certain warranties to all subsequent parties. If he delivers the instrument without endorsement his warranties are limited to his transferee. If he endorses generally he also warrants "to all subsequent holders in due course . . . that the instrument is at the time of his endorsement valid and subsisting" and engages that on due presentment it shall be accepted or paid, or both, according to its tenor. No warranty is made to the drawee or payor.

An effort to catalog the differences between the warranties of the N. I. L. and those of the Code would take more time and space than is available. The N. I. L. warranties are completely revised in Article 3, Sections 414 and 417, and further modified as to bank collections in Article 4. The more important differences in the bank collection warranties include the following:

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47 *Jennings v. United States Fidelity and Guaranty Co.*, 294 U. S. 216 (1935), discussed infra under heading VIII.

48 And see U. C. C. "Notes and Comments" supra note 45, at 78, to the effect that the effectiveness of this provision relies upon "the existence of Federal Deposit Insurance to minimize the effect of permitting remittance drafts to clear and the fact that it is anticipated that the Code will be Federally enacted."


50 N. I. L. §65.

51 Ibid.


53 U. C. C. §4-210: "Warranties of Customer and Collecting Bank on Transfer of Presentment of Items; Time for Claims."

54 (1) A customer warrants to his depositary bank, and a collecting bank warrants to all subsequent intermediary banks and to the payor that

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

(b) he has no knowledge of any stop payment order; and

(c) the item has not been materially altered and he has no knowledge that the signature of the maker or drawer is unauthorized except that the warranties of subparagraph (c) are not given by a holder in due course who has taken an item accepted after such alteration or by a collecting bank taking from such holder in due course. This exception applies even though a draft has been accepted 'payable as originally drawn' or in equivalent terms.

(2) Where a transferee (which does not include the payor) has given consideration against an item sent it for collection, the transferor in addition to the warranties set forth in subsection (1) engages that upon dishonor and any necessary notice of dishonor and protest he will pay the amount of the item to the transferee or to any subsequent holder who takes it up and also warrants that

(a) all signatures are genuine or authorized; and

(b) the transfer is rightful; and
(i) The basic warranties of the bank's "customer" under Section 4-210 run only to the bank of deposit and not to subsequent banks. The warranty against knowledge of any stop-order goes further than any of the N. I. L. warranties. It is of importance only in cases where (a) failure to give prompt notice of non-payment has resulted in loss of the right of charge back or the right to hold secondary parties, or (b) the drawee has paid in spite of a stop-order and seeks to recover such payment. Present warranties do not appear to cover the first case. The cases are in conflict under present law as to whether the payor may recover for money paid under mistake of fact in the second case; but this Section seems to add little to the solution of that conflict.

(3) The Code would outlaw the customary clause whereby banks certifying checks protect themselves against the possibility that such check may have been altered prior to certification. Banks have no obligation to certify checks. If a bank pays a raised check it may recover the amount by which it was raised from the recipient of the payment even though he is a holder in due course. Prior to enactment of the present N. I. L. an acceptance or certification did not increase the bank's liability in this respect, the bank being held by its certification to pay in accordance with the tenor of the original instrument. The N. I. L. provides that the acceptor engages that he will pay according to the tenor of his acceptance. This language has resulted in a conflict in the cases, some holding the common law rule to be un-

(c) no defense of any party is good against him; and
(d) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted item; but the transferee may recover damages from the transferor for breach of these warranties only to the extent of the consideration received by the transferor plus any financing charges and expenses.

(3) The warranties set forth in the two preceding subsections arise notwithstanding the absence of words of guaranty or warranty in the transfer or presentment.

(4) A collecting bank remains liable for breach of the warranties or of the engagement set forth in the preceding subsections despite remittance to its transferor.

(5) 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.

The new draft extends the customer's basic warranties "to all subsequent intermediary banks and to the payor." Such warranties apparently are made whether or not the customer endorses and irrespective of the form of the endorsement if he does. The balance of §4-210, supra note 54, is not substantially altered in the new draft.


The draft extends the customer's basic warranties "to all subsequent intermediary banks and to the payor." Such warranties apparently are made whether or not the customer endorses and irrespective of the form of the endorsement if he does. The balance of §4-210, supra note 54, is not substantially altered in the new draft.

See Paton's Digest 800 (1948), for the form recommended by the American Bankers Association and that used by the Federal Reserve Bank of New York.

Watchel v. Rosen, 249 N. Y. 386, 164 N. E. 326 (1928); Paton's Digest op. cit. supra note 56, at 815. To the same effect see U. C. C. §3-411(2).

See Paton's Digest §4A:1 and cases therein cited; and see 50 Col. L. Rev., supra note 7, at 823.

BRANNAN, NEGOTIABLE INSTRUMENTS LAW 917 (7th ed., Beutel, 1948).

N. I. L. §62.
changed, and others that the acceptor engages to pay the item according to its tenor at the time of acceptance. The Code adopts the position of the latter cases. In addition, the Code would prohibit a bank certifying a check at the request of a holder from imposing as a condition to its certification that its liability for prior alterations be not thereby increased.

(4) Section 4-210(2) provides that when a transferee "has given consideration against an item sent it for collection" the transferor also gives warranties similar to those contained in Section 3-417. Some undesirable results are conceivable. In the first place, "consideration against an item sent it for collection" invites continuation of the conflict in the cases as to when credit in an account is "value." In view of the current practices of giving credit for cash items it is possible, at least under the "first-in-first-out" rule, that an intermediary bank would have an action for breach of warranty under this section against the depositary bank but that the latter would have no such right against its customer. It is also possible that the customer may have drawn out the entire credit, but that the intermediary bank would have no right of action under this section against either the depositary bank or its customer, because the depositary bank had received no consideration and the warranties of Section 4-210(2) appear to run only to the depositary.

(5) The warranty that "the transfer is rightful" introduces a new and undefined concept of "rightfulness."

V

Withdrawal from Checking Accounts

One of the mandatory time provisions is that "credit for any deposit in the checking account" of a non-bank depositor "becomes available for withdrawal as of right (a) at the opening of its second banking day if the bank of deposit is also the payor, (b) at the opening of its next banking day if the deposit is 'money,' and (c) in all other cases when the bank learns that it has received final payment." This may be varied by particular agreement as to specified items only. Checking

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63 See Parson's Digest 807 and cases therein cited.
64 See Brannan, op. cit. supra note 61, at 917-918.
65 U. C. C. §3-413(1): "The maker or acceptor engages that he will pay the instrument according to its tenor at the time of his engagement."
66 See note 54 supra.
67 See Brannan, op. cit. supra note 61, at 498-508, and cases therein cited. Cf. U. C. C. §4-211.
68 Described supra under heading II, "Direct Return of Unpaid Items."
69 Merchants National Bank of St. Paul v. Santa Maria Sugar Co., 162 App. Div. 248, 147 N. Y. Supp. 498 (1st Dep't 1914), affirmed without opinion, 220 N. Y. 732; and Brannan, op. cit. supra note 61, at 506 and 507, and see U. C. C. §4-211(3).
70 The new draft, §4-208(2), still does not make it clear to whom these warranties run.
71 U. C. C. §4-210(2)(b).
72 U. C. C. §4-215.
73 U. C. C. §4-210(3). In the new draft (c) is amended to read: "(c) in all other cases when the bank has received final payment." This would appear to be untenable. In a vast number of cases the depositary bank never knows when the item is paid (see new draft §4-213(2) and discussion supra under II—"Direct Return of Unpaid Items") and will not learn of non-payment until some time after the credit should have been available for withdrawal under this section. In other words, this new draft
accounts are customarily demand deposits, so that this Section states the present rule generally applicable to the conventional checking account by agreement, with modification in (a) and (b) necessitated by “deferred posting.”

The prohibition against restriction of the right of withdrawal by general contract would seem to freeze all checking accounts into the pattern of the conventional commercial demand account and to prohibit, and preclude development of, special checking accounts in so far as they may require maintenance of minimum balances not subject to check, retention of collection proceeds for one or two days, or other limitations on the prompt withdrawal of deposits.

VI

Presentment by Notice

Under present law, presentment must be made at the place specified in the instrument, or, if none is specified, at the address of the payor, or, if no address is given, at the usual place of business or residence of the payor, and the instrument must be exhibited. The Code would modify this requirement as to non-bank paper by authorizing collecting banks “unless otherwise instructed” to make presentment by notice, but would give the party to whom such presentment is made the right to require, among other things, “that the instrument be produced for acceptance or payment at a place specified in it or, if there be none, at any place reasonable in the circumstances.” The collecting bank making presentment by notice would have to comply with this and any other requirement of the payor under Section 3-505 by the next business day after it knows of the requirement. If “neither honor nor request” under Section 3-505 is received by the day after maturity, or, if a demand item, the third business day after notice was sent, “the presenting bank may treat the item as dishonored and charge any secondary party by sending him notice of the facts.”

If protest is necessary presumably this can be furnished by a notary’s certificate stating the facts “based upon evidence satisfactory to such” notary, which in this case would presumably have to be the statement of the bank’s clerks.

Presumably this section is intended to formalize and extend the practice of some
banks of communicating (usually by telephone) with obligors on items payable at a street address in the same community and asking the obligor to come to the bank to make payment. Under this practice, if the obligor does not come in, the bank must make due presentment at the street address on the due date. Under the proposed section, however, presentment could be delayed for several days.

The net effect of this section would be to permit a substantial slowing down of the collection process in the case of items not payable at a bank. The owner of any item would be specifically authorized to prohibit the use of this method of collection in his instructions, and he would be well advised to do so.

VII

Deferred Posting

“Deferred posting” is a bank operating method devised to meet problems created by the manpower shortage during World War II, and has been widely adopted since then. Briefly stated, it is a practice whereby all checks received by a payor bank on one business day are accumulated and “posted” to the ledger accounts of the drawers at one time during the next day, as contrasted with the practice of “dribble posting” whereby checks are posted from time to time during the day of receipt. Since examination for sufficiency of balance, endorsements, stop-orders, etc., is normally and most efficiently made at the time of posting, this practice necessarily results in the postponement of the drawee’s decision to pay or return the item, thus “delaying” the return thereof, possibly beyond the 24 hours permitted under the rule of the *Wisner* case.

Upon recommendation of the American Bankers Association, Regulation J of the Board of Governors of the Federal Reserve System and the circulars of the Federal Reserve Banks were amended, effective January 1, 1949, to recognize this practice by providing that a bank forwarding cash items to a Federal Reserve Bank would be deemed thereby to authorize the Federal Reserve Bank to accept, as conditional, payment for such cash items made on the day such items are received by a drawee bank and to permit the drawee bank to return items as unpaid, for credit or refund, at any time up to midnight of the drawee’s next business day.

As a part of this program, the A.B.A. prepared a form of deposit contract which it urged banks to use in order to make sure that they had authority from their depositors to send items for collection subject to the Federal Reserve Bank rules

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84 *Wisner v. First National Bank of Gallitzin*, 220 Pa. 21, 68 Atl. 955 (1908), holding a drawee bank liable as acceptor for not returning within 24 hours after receipt checks presented for payment, and citing N.J.L. Sec. 137. Although the Pennsylvania N.J.L. was promptly amended (56 P. S. Sec. 326) after this decision was rendered, this rule has been adopted by a large majority of the cases. See BRANNAN, *NEGOTIABLE INSTRUMENTS LAW* 1249 (7th ed., Beutel, 1948).

and procedures, and also sponsored a "Model Deferred Posting Statute" intended to permit this practice by all drawee banks with respect to all demand items except those presented for payment over the counter. The model statute, with variations in some instances, has been enacted in at least thirty-nine states and the District of Columbia. This astonishing record is mute evidence of the widespread acceptance of the deferred posting practice.

The model statute provides, in substance, that a drawee bank which receives a demand item other than for payment over the counter and which remits or gives credit for such item on the day of receipt may return such item for credit or refund at any time before midnight on the next succeeding business day. The Code would adopt the substance of the model statute with some refinements, except that the model statute specifically provides for freedom of contract.

Even before the adoption of this practice there was confusion among the cases as to when the drawee bank had paid a check so as to preclude it from thereafter returning the check as unpaid or recognizing a stop-order, notice of death or insolvency, or attachment against funds in the drawer's account represented by such check. The courts found that the item had been paid if cash or irrevocable credit had been given. Most courts also found that even though conditional remittance or credit had been given, the check was paid when the appropriate employee of the bank made the decision of the bank to pay the item, usually evidenced by marking the item "paid" and debiting the drawer's account, and some cases so held even though no remittance or credit had been given.

The model statute contains no provisions dealing with these problems, and it does not appear to change the law in this respect. It does, however, increase the

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88 See letter dated May 21, 1948, from A. B. A. to all member banks. Also see Collection Agreements; Text of Standard Form; Explanation, Paton's Digest, Supplement §26:2 (July, 1948).
89 For text of A. B. A. Model Deferred Posting Statute, see Paton's Digest, Supplement §27 (November, 1949).
90 Banking, November, 1950, p. 86.
92 Clearing house credit: First National Bank of Philadelphia v. National Park Bank, 165 N. Y. S. 15, reversed, 165 N. Y. Supp. 422 (1917), Note, 18 Col. L. Rev. 480. Cf. In re Smith, Loeckhard & Co. 3 F.2d 444 (D. C. Md. 1924). Conditional remittance: Seaboard National Bank v. Central Trust & Savings Co., 253 Pa. 412, 98 Atl. 607 (1916), and see First National Bank of Portage v. Wisconsin National Bank of Watertown, 210 Wis. 533, 245 N. W. 593 (1933). However, where a collecting bank is authorized to accept a remittance draft, payment is conditional and if the draft is not paid the item may be charged back even though marked "paid" and charged to the drawer's account, Parvin v. Midland National Bank and Trust Co. of Minneapolis, 176 Minn. 538, 224 N. W. 147 (1929).
93 Nineteenth Ward Bank v. First National Bank, 184 Mass. 49, 67 N. E. 670 (1903), and Baldwin's Bank v. Smith 215 N. Y. 76, 83-84, 109 N. E. 138 (1915); contra: Hanna v. McCloy, 19 N. M. 183, 141 Pac. 996 (1914). These cases may probably be distinguished on the ground that the bank was considered to be the collecting agent in the first two cases but presentment appears to have been made over the counter in the last case.
94 It might be argued that, since the statute authorizes return of any item up to midnight of the business day after its receipt, the drawer should recognize a stop-order, notice, etc., and exercise its
possibility of these questions arising because of the increased period of time during which the drawee may hold the item. For this reason, the model statute was modified when enacted in New York to provide, among other things, that when “the bank finally charges the item to the account of the drawer . . . or gives irrevocable credit therefor, the item shall be deemed to have been finally paid and the bank effecting such charge or giving such credit shall be accountable for the amount thereof.”

In earlier drafts the Code contained provisions designed to make mere receipt by the payor bank of a “properly payable” item constitute “payment,” the payor bank having the right to return, within the time allowed, all items found to be not properly payable. These provisions were supported on the basis of “shifting of risks between seller-payee and buyer-drawer.”

The September 1950 Revisions provide that an item is “subject to any notice, stop-order or legal process received by a payor bank at any time up to midnight of the day of receipt of the item and before the bank settles for the item, accepts it, or posts it to the customer’s account.”

This would seem to apply the common law rule to all items paid on the day of their receipt and also to items held over for deferred posting provided the necessary conditional “settlement” was made before receipt of the notice, stop-order, or legal process. The position of the Reporters apparently is that holders of checks should be protected against the consequences of the fact that deferred posting extends the time during which notes, stop-orders, and legal process might defeat payment, because most holders of checks are “seller-payees” whose rights should be superior to the “buyer-drawer” who seeks to stop payment, other creditors, other payees who present over the counter for cash, or receivers.

Under current banking practice stop-orders, notices, etc., are noted on the customer’s ledger card so that at the time each item is posted the clerk can decide whether or not it should be paid. Under the Code any bank, whether on deferred posting or not, would have to note the time of receipt of the notice, etc., and all items posted that day or the next would have to be traced back through the bank’s work to ascertain, if possible, the time when settlement was made. This imposes a substantial administrative burden on most banks even if the time of settlement could be ascertained. Except in the case of items received through a clearing house, however, it is practically impossible for most banks to determine at what hour they “settled” for a particular item (i.e., gave credit in an account or settled by mailing a remittance).

right of return even after having finally charged the drawer’s account. The cases cited in notes 89 and 90 would indicate that this argument would not be sustained, but see Paino Bros. Inc. v. Central National Bank of Yonkers, 270 N. Y. 585, 1 N. E. 2d 342 (1936).

U. C. C. Proposed Final Draft, May 1949, Sec. 3-629, discussed in Leary, supra notes 7 and 83, at 930.

“Settlement” for any demand item may be recovered under the deferred posting section, U. C. C. 54-401(1).

Leary, supra note 83, at 930 et seq.
The good to be accomplished by the special benefits thus accorded to the holders of checks is not sufficient to justify this very substantial administrative burden on banks.\footnote{ \textit{\textsuperscript{98a}}}  

VIII

\textbf{RIGHTS OF OWNER OF ITEM IN EVENT OF INSOLVENCY OF INTERMEDIARY OR PAYOR BANK}

The general rule at common law is that when a bank fails holding the unremitted proceeds of a collection item the rights of the owner of the item depend upon whether the closed bank (whether depositary, intermediary, or payor) is a trustee or a debtor.\footnote{ \textit{\textsuperscript{99}}} Unfortunately, there is considerable confusion and conflict in the cases as to which status is created under a given set of circumstances.\footnote{ \textit{\textsuperscript{100}}} Notwithstanding the extremely substantial reduction in the number of bank failures in recent years, a uniform statute dealing clearly and equitably with the rights of the holders of uncollected items in the event of bank insolvency would serve a very useful purpose.

The A. B. A. Bank Collection Code sought to deal with this problem by giving the holder of such an item a preferred claim against the closed bank and providing that the assets of the closed bank should be impressed with a trust in favor of the owner.\footnote{ \textit{\textsuperscript{101}}} In \textit{Jennings v. United States Fidelity and Guaranty Co.},\footnote{ \textit{\textsuperscript{102}}} however, the

\footnote{\textit{\textsuperscript{98a}}} The new draft appears to eliminate this burden by providing in §4-404(1): "Any notice, stop order or legal process received and any valid set-off exercised by a payor bank is entitled to priority over any item drawn on and received by the bank until but not after the item is accepted, certified, paid in cash, paid by remittance, or posted to the indicated account of its customer or reaches that point of time in the processing of the item when the bank evidences by action its decision to pay the item, whichever happens first."

\footnote{\textit{\textsuperscript{99}}} Paton's Digest 326-350 and cases therein cited.

\footnote{\textit{\textsuperscript{100}}} \textit{Ibid.}

\footnote{\textit{\textsuperscript{101}}} Section 13 of the Bank Collection Code provides as follows:

"Insolvency and preferences. 1. When the drawee or payor, or any other agent collecting bank shall fail or be closed for business by (official to be designated) or by action of the board of directors or by other proper legal action, after an item shall be mailed or otherwise entrusted to it for collection or payment but before the actual collection or payment thereof, it shall be the duty of the receiver or other official in charge of its assets to return such item, if same is in his possession, to the forwarding or presenting bank with reasonable diligence.

2. Except in cases where an item or items is treated as dishonored by non-payment as provided in Section 11, when a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to such item or items and such drawee or payor shall fail or close for business as above, after having charged such item or items to the account of the maker or drawer thereof or otherwise discharged his liability thereon but without such item or items having been paid or settled for by the drawee or payor either in money or by an unconditional credit given on its books or on the books of any other bank, which has been requested or accepted so as to constitute such drawee or payor or other bank debtor therefor, the assets of such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.

3. Where an agent collecting bank other than the drawee or payor shall fail or be closed for business as above, after having received in any form the proceeds of an item or items entrusted to it for collection, but without such item or items having been paid or remitted for by it either in money or by an unconditional credit given on its books or on the books of any other bank which has been requested or accepted so as to constitute such failed collecting or other bank debtor therefor, the assets of such agent collecting bank which has failed or been closed for business as above shall be impressed with a trust in favor of the owner or owners of such items or items for the amount of such proceeds and such
Supreme Court of the United States held that provisions of the National Bank Act\textsuperscript{103} required ratable distribution of the assets of insolvent national banks, and because the trust provisions of the state law created "a preference under another name,"\textsuperscript{104} at least to the extent that the assets of the closed bank had not been augmented by the collection, they were overridden by the national act and invalid.\textsuperscript{105} In Illinois the entire Code was held unconstitutional on the ground that these insolvency provisions were not separable.\textsuperscript{106}

Accordingly, any code should take these decisions into account and either create no preferences applicable to national banks or provide for appropriate federal legislation applicable to national banks.

Earlier drafts of the Code adopted the preference approach, apparently counting on federal enactment to make the provisions applicable to national banks. The September 1950 Revisions\textsuperscript{107} would create a direct preference only as to items handled by the closed bank as an intermediary. It contains no provision applicable to items handled as depositary, but does make an abortive effort to create a limited preference as to items handled as payor to the extent that they are remitted for by drafts intended to be assignments (see \textit{supra} under III—"Remittance Draft as an Assignment").

The Bank A.B.A. Collection Code deals with depositary banks as with intermediary banks.\textsuperscript{108} This seems to be appropriate. At common law, to the extent that collection is received by the collecting bank \textit{after} it has closed, the proceeds are held in trust for the owner.\textsuperscript{109} In cases where the bank receives the proceeds before it closes but fails before making "final payment therefor," there seems to be no good reason why a preference should be given to the owners of those items as to which the insolvent was an intermediary collecting bank but not to the owners of items as to which the insolvent was the first collecting bank.\textsuperscript{109}

\begin{footnotesize}
\begin{enumerate}
\item owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.\textsuperscript{101}
\item \textsuperscript{294} U. S. 216 (1935).
\item \textsuperscript{rev. stat.} §5236 (1875), 12 U. S. C. §194 (1946).
\item \textsuperscript{294} U. S. 216, 226 (1935).
\item People ex rel. Barrett v. Union Bank & Trust Co., 362 Ill. 164, 199 N. E. 272 (1935).
\item U. C. C. §4-508: "Rights of Owner of Item Against Insolvent Intermediary or Payor Bank."
\begin{enumerate}
\item Except as provided in subsection (2) the owner of a properly payable item
\item (a) may recover its amount from a payor bank which after receipt of the item suspends payments before settling for it or which sends in remittance a draft drawn on a third bank which is not paid; or
\item (b) has a preferred claim against the cash on hand, bank deposits and outstanding remittance drafts payable of an intermediary bank which suspends payments either before or after it receives final payment for the item and itself makes no final payment therefor.
\end{enumerate}
\item The owner of an item may not recover under this section if he has breached a warranty under Section 4-210 or if he elects to treat an item as unpaid and hold secondary parties.
\item An election to treat an item as unpaid is effective only if written notice thereof is given to the payor bank and to prior parties within ten days after the owner has received notice of the facts giving rise to his right to an election.\textsuperscript{102}
\item People ex rel. Barrett v. Union Bank & Trust Co., 362 Ill. 164, 199 N. E. 272 (1935).
\item In the new draft the insolvency provisions are completely revised. The same rules appear applicable to depositary as to intermediary banks. §§4-212(5) and 4-213(4).
\end{enumerate}
\end{footnotesize}
As to intermediary banks, the Code is apparently designed to avoid application of the *Jennings* case by giving a preferred claim only against "cash on hand, bank deposits and outstanding remittance drafts payable."\(^{109}\) In the Comments the Reporters state:

... as the collection work of an intermediary bank is really that of a conduit, cash on hand and accounts in correspondent banks are the proper fund to be earmarked for such protection. The lien theory eliminates necessity for tracing or showing augmentation of assets, both concepts being somewhat unrealistic in present-day banking operations.

But *quaere* whether this is not, as the court ruled in the *Jennings* case, "a preference by another name." In fact, the Code calls it a "preferred claim."\(^{110}\)

The provisions of the Code dealing with the insolvent payor bank include the following.

1. If the bank suspends after receiving a "properly payable" item but before "settling" for it, the owner of the item would have a general claim against the closed bank.\(^{111}\) Under existing law, including the Bank Collection Code,\(^{112}\) the owner of such an item would have no claim unless the item were held to have been paid by charge to the drawer’s account or accepted by the drawee’s failure to return within 24 hours under the rule of the *Wisner* case.\(^{113}\)

2. If the payor bank suspends after having sent a remittance draft on a third bank which is not paid, the owner of the item so remitted for would have a general claim against the closed bank,\(^{114}\) and would also have what is intended to be a preferred claim against the account of the closed bank with the third bank.\(^{115}\)

3. If the payor bank had "settled" for the item with its own "primary obligation" authorized or ratified by the collecting bank, the latter would presumably be liable for improper handling,\(^{116}\) and would have, in turn, a general claim against the closed bank on its "primary obligation."

4. If the payor bank had "settled" for the item with its "unauthorized primary obligation," the Code is silent as to the rights of the owner of the item against the closed bank on such obligation,\(^{117}\) but provides that any officer or

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\(^{109}\) The new draft extends this preference to both "collecting banks" and "remitting banks," §§4-212-(5) and 4-213(4), and revises the language as indicated *supra* note 109a.


\(^{111}\) U. C. C. §§4-508(1)(a), *supra* note 107. The new draft appears to have eliminated this provision.

\(^{112}\) B. C. C. §§111 and 13(1), *supra* note 101.

\(^{113}\) *Supra* note 84.

\(^{114}\) U. C. C. §§4-508(1)(a) *supra* note 107. The new draft extends this provision to cashier’s checks and primary obligations and gives the owner a preference against the cash, etc., of the remitting bank.

\(^{115}\) See discussion *supra* under heading III, "Remittance Draft as Assignment."

\(^{116}\) U. C. C. §§4-206(1) and 4-109. The new draft authorizes collecting banks to accept the primary obligation of a remitting bank which clears through the same clearing house as the collecting bank. §4-212(2)(b).

\(^{117}\) Since such remittance was “unauthorized” the collecting bank could presumably treat the items thus remitted for as unpaid and charge them back. U. C. C. §§4-213 and 4-214. And see Farvin v. Midland National Bank & Trust Co., 176 Minn. 538, 224 N. W. 147 (1929).
director of such bank who authorized such remittance “with knowledge that it was improper is liable as a surety for the bank to all prior parties for the amount.”

Since the Code deals only with remittance in the form of either a “primary obligation” of the payor or a draft on a third bank, either the Code makes no provision to cover a draft on the collecting bank or an authorization to charge the payor’s account with the collecting bank, or such draft or authorization is considered to be a “primary obligation” of the payor. The latter construction would mean that a collecting bank authorizing such remittance would, in effect, guarantee payment of such remittance notwithstanding that any such remittance not paid prior to notice of the remitting bank’s insolvency would appear to be revoked by such notice irrespective of the sufficiency of the account.

Neither does the Code contain any provision covering the items for which the closed payor bank has “settled” by conditional credit in an account. Especially if such items have not been charged to the drawer’s accounts, it would seem that the receiver would be entitled to return them as unpaid at least within the time allowed for deferred posting. But contrast this with the right of the owner of an item for which the payor bank did not “settle” before it suspended.

Recovery against the insolvent intermediary or payor bank is also denied if the owner “elects to treat an item as unpaid and hold secondary parties.” This provision raises a number of questions. What if the item is a note payable at a bank and the owner “elects” to hold the maker, who is a primary party? If the owner “elects to treat an item as unpaid” but his election is not “effective” because of failure to give all the necessary notices, is his recovery from the insolvent bank also prohibited? In case of an insolvent intermediary, why must notice of election be given to the payor bank?

CONCLUSIONS

The general conclusion is inescapable that the Bank Deposits and Collections Article of the proposed Code would, if enacted in its present form, result in sub-

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318 U. C. C. §4-205. The new draft contains a similar provision.
319 See discussion supra under heading I, B.
320 U. C. C. §3-409: “Draft not an Assignment.”
321 U. C. C. §4-508(2) supra note 107.
321a The new draft provides, §4-213(1), that a collecting bank may accept credit in its deposit account with another bank or “appropriate authority to debit another bank’s account with it”; and it further provides, §4-213(3), that if a payor bank closes after such settlement and before expiration of time to revoke under the “deferred posting” provisions (a) the collecting bank may revoke the settlement and obtain refund from its customer, whether or not the item is returned or notice of dishonor received, provided it returns the items or sends notice, in which event the item is unpaid, and (b) if the item is not returned the owner or collecting bank may send written demand for return and if the demand is sent “before expiration of the midnight deadline of the payor bank, the item must be returned within a reasonable time after receipt of the demand and if no payment is made the item shall be treated as paid if it is otherwise properly payable.” These new provisions seem to be confusing and inconsistent, e.g., (1) if the collecting bank revokes the credit and sends notice “the item shall be unpaid,” but if the collecting bank or the owner also demands return of the item and “no payment is made the item shall be treated as paid,” and (2) from when is the payor bank’s “midnight deadline” computed?
stantial changes in many of the rules which govern the relation of bank and depositor, and that the apparently undesirable consequences of many of such changes appear to outweigh the good sought to be achieved.

In fact, some of the changes which the Code would make in existing law and practice are so illogical and the consequences so grave as to suggest that either the change or the consequence, or both, are unintentional. At the very least these suggest that the Reporters are not yet ready to submit a truly "final" draft.\textsuperscript{121b}

Perhaps the most important change that would be wrought by the Code in this field is the transformation of the bank-depositor relationship from a contractual one to a statutory, or part statutory and part contractual, relationship. The ostensible reason for the proposed change is that the contracts which the Code would prohibit violate sound public policy, but it is not at all clear that this is so. In fact, it would seem that the good sought to be accomplished by such prohibitions is not worth the price in the form of the restrictions thereby imposed upon future developments of new collection methods and upon certain present collection practices.

Some of the other changes, such as the order of priority of stop-orders, notices, and legal processes over items presented for payment, depending upon receipt of the former before the bank has "settled" for the item, would place substantial administrative burdens on banks without accomplishing any very substantial good.\textsuperscript{121c} Still other changes, such as the direct return of unpaid items and presentment by notice, look to the possible development of new collection methods. Since these methods have not yet been put into practice it is difficult to determine whether or not the provisions of the Code are adequate.

What should be the most important provisions of the Code—those applicable in the event of bank insolvency—seem to be incomplete and inconsistent. The new draft contains substantial improvements in these provisions; but they are complicated and deal with complicated circumstances and will require considerable study before their adequacy can be determined. It is doubtful that they would be held applicable to national banks without appropriate amendment to the National Bank Act.

The author is acutely aware that this paper fails utterly to give due credit to the many admirable provisions of Article 4 which have been produced after many months and years of study and frequent consultation with bankers, bank lawyers, bar groups, and other informed groups and individuals. The justification for this omission lies in the limitations of space and the fact that the Code is presumably approaching its final forms. Under the circumstances, it seems most appropriate to

\textsuperscript{121b} The substantial changes in the new draft emphasize this conclusion. They represent painstaking efforts to rectify the impractical and unintentional consequences in the prior draft and they succeed in many instances; but as indicated in the brief footnotes which have been added to this paper, these changes, in turn, have created additional areas of ambiguity.

\textsuperscript{121c} This example given is corrected in the new draft, but see \textit{supra} note 74a pointing out that the new draft requires a depositary bank to act at its peril in paying or dishonoring checks drawn against cash items in process of collection between the day when, in the normal course, such items should be paid or dishonored by a distant payor and the day when time to receive timely notice of dishonor of such items has obviously passed.
stress that which is yet to be done. The great number of drafts of this Article which have been prepared and circulated, both officially and unofficially, is mute evidence of the tremendous amount of time and effort spent on this subject by the Reporters and those whom they have consulted. The continued improvement in each successive draft gives room for the hope that an adequate bank collections part may yet be presented.