

July 1959

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Wesley W. Wertz

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Recommended Citation

Wesley W. Wertz, *Article 4: Bank Deposits and Collections*, 21 Mont. L. Rev. 42 (1959).

Available at: <http://scholarship.law.umt.edu/mlr/vol21/iss1/4>

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Article 4: Bank Deposits and Collections

By WESLEY W. WERTZ*

Uniform laws and practices concerning bank deposits and collections are considered desirable because of the tremendous number of bank items processed in the country on any one day. Banks handle between twenty-five and fifty million items each day.¹ A comment to the Code states: "There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years."² Trends toward uniformity are indicated by the practices of Uniform Practice Committees of bankers' associations, of the Bank Management Commission of the American Bankers Association, and the Operating Letters and Regulations of the Federal Reserve System. The Bank Collection Code of the American Bankers Association was proposed in 1929 in an effort toward uniformity. This proposed legislation in recommended or modified form was enacted in 22 states and is the law now in 20 states,³ but was never adopted in Montana. The legislation was declared unconstitutional in Illinois in 1935.⁴ It was repealed in Pennsylvania with the adoption there of the Uniform Commercial Code, effective July 1, 1954. The Kentucky enactment will be repealed when the Uniform Commercial Code becomes effective in 1960.

One of the principal needs at the time the Bank Collection Code was sponsored was to offset the decision in *Federal Reserve Bank of Richmond v. Malloy*⁵ to the effect that, in absence of agreement, it was negligence for a collecting bank to send an item by mail and to accept a draft in remittance. The collecting bank was thereby exposed to the risk of insolvency by the drawee bank during the time necessary to complete the drawee's payment. The A.B.A. Code provided for presentment by mail and payment by draft,⁶ and also provided that the holder might elect to take a preferred claim against the closed bank, but the preference provision was held to be in conflict with the National Bank Act.⁷ With the advent of the Federal Deposit Insurance Corporation, problems involving bank failures have lost their importance. Yet preference provisions are retained in the Uniform Commercial Code.⁸ It would appear that the principal virtue of uniform statutes relating to bank deposits and collections should be the assurance to the entire banking and business community that such matters as the duty of care of a collecting bank, the minimum days in which a check must be presented for payment, the number of days allowed a bank to return a check after dishonor or presentment for payment, and similar matters, are gov-

*Member of the Montana Bar. LL.B., Montana State University, 1931.

¹CONNECTICUT TEMPORARY COMMISSION, STUDY AND REPORT UPON THE UNIFORM COMMERCIAL CODE 27 (1959).

²1958 Official Text of the UNIFORM COMMERCIAL CODE, § 4-101, comment. (Hereinafter the UNIFORM COMMERCIAL CODE is cited UCC.)

³Alaska, Colo., Hawaii, Idaho, Ind., Ky., Md., Mich., Miss., Neb., N.J., N.M., N.Y., Okla., Ore., S.C., Wash., W. Va., Wis., and Wyo.

⁴People *ex rel.* Barrett v. Union Bank & Trust Co., 362 Ill. 164, 199 N.E. 272 (1935).
⁵264 U.S. 160 (1924).

⁶Also allowed in Montana by REVISED CODES OF MONTANA, 1947, § 5-1016. (Hereinafter REVISED CODES OF MONTANA are cited R.C.M.)

⁷Jennings v. United States Fidelity & Guaranty Co., 294 U.S. 216 (1935).

⁸UCC § 4-214.

erned by the same regulations in the various states.⁹ Objections naturally arise, therefore, with respect to section 4-103 of article 4 which states that provisions of the article may be varied by agreement except as to disclaiming a bank's responsibility for its own lack of good faith or failure to exercise ordinary care. Moreover, "Federal Reserve regulations and operating letters, clearing house rules, and *the like*, have the effect of agreements . . . whether or not specifically assented to by all parties interested in items handled."¹⁰ It has been pointed out that earlier drafts of the Uniform Commercial Code seemed to tend toward rigidity of practices. Some took the view that article 4 "presented an opportunity to settle future issues arising between banks and bank customers in such a way as to protect customers against 'unjust' contractual provisions entered into by them on forms provided by banks."¹¹ Views were vigorously expressed that banks should be virtual insurers against loss as items flowed in the collection process,¹² and the contrary views were equally vigorously expressed.¹³

Clark, Bailey, and Young state:¹⁴

The argument against rigidity might be summarized as follows: First, there is little evidence that banks have actually taken unfair advantage of their customers in agreements entered into by such parties. Furthermore, no court will sustain the terms of, or action or non-action taken under, any contract, if manifestly unreasonable. Second, a rigid Article, even though well drafted, would tend to freeze bank collection methods and procedures into substantially the pattern in existence at the time the Code is enacted and would discourage the development of new and improved procedures in that field, in the absence of special permissive legislation. Furthermore, any such new statute would contain hidden "bugs" which could not be anticipated at the time of enactment and which might lead to bad law. Such statutory defects could not be cured by agreement, if the statute were cast in a rigid form.

The argument for flexibility has also been stated as follows:¹⁵

"Why is flexibility important? Because of the complexity of the subject matter, stressed above, and the certainty that whatever may be the practice today, there is certain to be change tomorrow. In fact, the complex nature of the subject matter and the difficulty of drafting rules that today *appear* to be satisfactory suggest the extreme naivete of thinking that these rules will remain immutable and continually wise throughout the years that the Code may be law. With perhaps 25,000,000 items being handled every day and with the infinite variation in facts and parties suggested above, there is a touch of King Canute ordering back the waters in thinking that the rules

⁹Dehner, *The Uniform Commercial Code—The Effect of Its Adoption in Tennessee, Article Four—Bank Deposits and Collections*, 22 TENN. L. REV. 832, 833 (1935).

¹⁰UCC § 4-103 (2).

¹¹CLARK, BAILEY, & YOUNG, *BANK DEPOSITS AND COLLECTIONS UNDER THE UNIFORM COMMERCIAL CODE* 28 (Joint Committee on Continuing Legal Education of the A.I.L. and A.B.A. 1959).

¹²Beutel, *The Proposed Uniform [?] Commercial Code Should Not Be Adopted*, 61 YALE L.J. 334, 357 (1952).

¹³Brome, *Bank Deposits and Collections*, 16 LAW & CONTEMP. PROB. 308 (1951); Gilmore, *The Uniform Commercial Code: A Reply to Professor Beutel*, 61 YALE L.J. 364, 374 (1952).

¹⁴CLARK, BAILEY, & YOUNG, *supra* note 11, at 28.

¹⁵Malcolm, *Article 4—A Battle With Complexity*, 1952 WIS. L. REV. 265, 276.

that have been evolved with so much difficulty will remain good in all situations to which they apply throughout the period during which the Code might control, e.g., fifty and perhaps more years."

The end result follows the flexible approach of prior statutory and case law in permitting broad freedom of contract to vary the provisions of the article.

Some indefiniteness seems to result from the following provisions: "In the event of conflict the provisions of this Article (4) govern those of Article 3 but the provisions of Article 8 govern those of this article."¹⁸

Definitions and general provisions of part 1 of article 4 are clear. A cut-off hour not earlier than 2:00 o'clock p.m. may be fixed by a bank for handling of money and items, and making entries.¹⁷ Time limits prescribed by the act may be extended in certain instances.¹⁸ These provisions may raise some question whether collection will be speeded and under what facts extensions are justified. Operating convenience and the continuation of practices of some banks are two of the reasons for the cut-off provision. It is also said that it continued the trend of the American Bankers Association Model Deferred Posting Statute,¹⁹ recognizing the realities of operating problems faced by banks.²⁰ Delays of a day occurring in "a good faith effort to secure payment," as section 4-108(1) allows, may take some interpreting, as may the emergency situations enumerated in section 4-108(2) excusing such delay if "such diligence as the circumstances require" is exercised by the bank.

Damages for failure to exercise "ordinary care" are limited to the amount of the item reduced by the amount which could not have been realized by the use of ordinary care. Other consequential damages will be permitted only if there is bad faith. Again, some interpretation may be required in connection with these terms. In collecting items deposited in a bank for credit or collection the Montana statute, R.C.M. 1947, section 5-1017, declares it is "due diligence" . . . to forward en route the same not later than the following banking business day." Practices not constituting "due diligence" in this area probably would not be "ordinary care" either.

The observations thus far made, which relate to article 4 of the Uniform Commercial Code generally or to sections of part 1 thereof, are some reasons why there has been a great divergence of opinion as to the desirability of enacting the Code. Although bankers and bankers' committees have frequently criticized the Code, the writer of the preface to the Bankers' Manual on the Commercial Code²¹ states, "The Uniform Commercial Code became effective in Pennsylvania on July 1, 1954 and has operated successfully in that state since that date. . . . The Code supplies a very much needed revision of the commercial law to conform to modern needs and practices."

¹⁸UCC § 4-102(1).

¹⁷UCC § 4-107(1) and (2).

¹⁸UCC § 4-108.

¹⁹R.C.M. 1947, §§ 5-1047 to -1049. Section 5-1048 provides that "an item received by a bank . . . on a business day after regular business hours or during afternoon or evening periods when it has reopened . . . for limited functions, shall be deemed to have been received at the opening of its next business day."

²⁰CLARK, BAILEY, & YOUNG, *supra* note 11, at 25.

²¹Published by the Massachusetts Bankers Association (1953).

The subjects of collection of items and responsibility of depository and collecting banks are included in part 2. Significantly the so-called Massachusetts rule is adopted by the Code rather than the New York rule.²² The Massachusetts rule is that each bank, subject to the duty of selecting proper intermediaries, is liable only for its own negligence. The New York rule subjected the initial bank to liability for the actions of subsequent banks in the collection chain. The Massachusetts rule was adopted in Montana in 1917,²³ but it is not entirely clear that it was continued when the "Bank Act" was adopted in 1927,²⁴ although such seems to be the case. The matters of sending and presenting items, endorsements, remittances, settlements and final payment are covered by sections of part 2 of the Code, which for the most part are designed to simplify present bank practices and to provide such adequate and time-tested procedures as the American Bankers Association Collection Code, the Federal Reserve Bank Regulations, and past banking experience have found to be desirable. A proposal worthy of comment is an affirmative provision for so-called "direct returns."²⁵ A comment following the section relates: "This is a new practice that is currently developing in a few sections of the country. Its purpose is to speed up the return of unpaid items by avoiding handling by one or more intermediary banks. The subsection is bracketed because the practice is not yet well established and some bankers and bank lawyers would prefer to let the practice develop by agreement."

An interesting proposal is a provision that a deposit of money is final when made but is not available for withdrawal until the following day. This recognizes the importance of the time when record of the deposit reaches the bookkeeper rather than when it passes through the teller's window.²⁶

In the provisions relating to the bank collection process, that relating to deferred posting would be helpful and clarifying. The process and the purpose of deferred posting have been expressed as follows:²⁷

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.²⁸

Deferred posting statutes exist in many states including Montana.²⁹ As previously observed, the American Bankers Association some years ago

²²UCC § 4-202(3) and comment.

²³Laws of Montana, 1921, ch. 97, § 2, p. 168. See *Jensen v. Laurel Meat Co.*, 71 Mont. 582, 591, 230 Pac. 1081, 1083 (1924).

²⁴R.C.M. 1947, title 5. See especially R.C.M. 1947, §§ 5-1016, -1017.

²⁵UCC § 4-212(2).

²⁶UCC § 4-213(5) and comment.

²⁷Brome, *Bank Deposits and Collections*, 16 LAW & CONTEMP. PROB. 308, 321 (1951).

²⁸*Wisner v. First Nat. Bank of Gallitzin*, 220 Pa. 21, 68 Atl. 955 (1908). See also *Blackwelder v. Fergus Motor Co.*, 80 Mont. 374, 260 Pac. 734 (1927).

²⁹R.C.M. 1947, §§ 5-1047 to -1049.

prepared and urged the adoption of a Model Deferred Posting Statute. Such statutes provide that where provisional settlement is made on the day of receipt of an item, the bank is given until midnight of the following day to check its accounts and decide whether to pay or return the item without discharge of secondary parties. Section 4-301 of the Code is similar in purpose, coverage, and general effect to deferred posting statutes. It constitutes statutory approval of a practice generally followed throughout the country, even without a statute, under Federal Reserve System Regulation J.

Section 4-303 of the Code "states rules for determining the winner of a race between the owner of an item and creditors of the drawer (or the drawer himself) for the amount of the item, by providing when knowledge, notice, stop payment order, legal process (such as garnishment) or setoff with respect to the account or the item comes too late to nullify any prior act constituting final payment and certain other prior acts, as well."⁸⁰

Part 4 of article 4 deals with relations between a payor bank and its customers. Stop orders binding upon the bank for fourteen days can be oral, and a written order is effective for six months only, unless renewed.⁸¹ In Montana no difference is made between oral and written stop orders, good for ninety days, but renewals must be in writing.⁸² Many jurisdictions, including Montana, have statutes providing that a bank is not obliged to pay a check presented more than six months after its date.⁸³ The Code also adopts this rule.⁸⁴ The effect of death or incompetence of a customer is covered in the Code, as is the customer's duty to discover forgeries and alterations,⁸⁵ matters not now specifically covered by Montana statutes.

The concluding part of article 4 provides a set of rules to govern certain aspects of the collection of documentary drafts which are, under definition,⁸⁶ drafts accompanied by documents, securities, or other papers to be delivered against honor of the drafts. Uniformity of state statutes governing this subject would appear to be desirable for such drafts frequently originate great distances from where they are taken up.

It is generally agreed by supporters and critics of the Code alike, that there is a great need for reasonable uniformity and greater simplicity in the laws of the various states dealing with the transactions of banks, particularly with the matter of bank deposits and collections. Whether or not the Code is adopted in Montana, the American Law Institute and the National Conference of Commissioners on Uniform State Laws have made a significant contribution toward these ends. The advances in our economy, the ever increasing speed of mail and transportation, and the increase in our population and business, demand laws which will keep the flood of bank items flowing smoothly and quickly.

⁸⁰CLARK, BAILEY, & YOUNG, *supra* note 11, at 81.

⁸¹UCC § 4-403.

⁸²R.C.M. 1947, § 5-1043. Since the statute contemplates "service" of stop payment orders it is possible original oral orders might be insufficient. But see 9 C.J.S. *Banks and Banking* § 344, nn. 9 & 10 (1938).

⁸³R.C.M. 1947, § 5-1008.

⁸⁴UCC § 4-404.

⁸⁵UCC §§ 4-405, -406.

⁸⁶UCC § 4-104(1) (f).