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BANK-DEPOSITOR RELATIONS UNDER ARTICLE FOUR OF THE UNIFORM COMMERCIAL CODE *

I. INTRODUCTION

Article Four of the Uniform Commercial Code,¹ has, in the main, aided the flow of the tremendous number of checks through the collection process.² The majority of checks clear without incident, and therefore litigation is rarely involved. Many of the problems that arise deal with situations in which there are insufficient funds in the drawer’s account. These checks are normally returned promptly through the collection chain back to the depositor or payee of the check, who initiates further action against the drawer.³

Many of the problems which have reached courts deal with the provisions of Article Four concerning the relationship between the payor bank and its depositor; more specifically the provisions dealing with the concept of final payment, liability for failure to act promptly, wrongful dishonor, and stop payment orders. The purpose of this article is to examine these problems from the standpoint of the payor (sometimes called the drawee) bank, in an attempt to define its various rights and obligations.

II. THE CONCEPT OF FINAL PAYMENT

Section 4-213 provides in part:

(1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:
(a) paid the item in cash; or
(b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or

¹ We recommend this article as a general overview of the area of bank-depositor relations. For an in depth study of the many problems in this area, we refer the reader to other sources dealing with these areas specifically.

² Hereinafter, all citations to the Code will refer to the 1962 official version.

³ Uniform Commercial Code §4-101, Comment (hereinafter U.C.C.).

Wright, Bank Deposits and Collections and Letters of Credit, 43 Neb. L. Rev. 742, 746 (1964).
(c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or

(d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

The moment of final payment is important for a number of reasons: (1) by virtue of Section 4-303, it may determine priorities between items and notices, stop order, legal process and setoffs; (2) under Section 4-213(2) final payment marks the point at which provisional debits or credits, including the credits of the original depositor, become final or "firm up"; (3) under Section 4-214 final payment fixes preferential rights in the event of a bank's insolvency; (4) under Section 4-201 a series of agency relationships are replaced with a series of debtor-creditor relationships along the chain of collecting banks; (5) the final, and perhaps most important consequence of final payment is the payor bank's accountability for the amount of the item by virtue of Sections 4-213 (1) and 3-603(1)—this simply means that the drawer of the check is discharged and the payor bank is replaced as the party responsible for the amount of the item.

This discussion is limited primarily to the determination of priorities between items and notices, stop orders, legal process and setoffs, for this area has given rise to the majority of litigation. Professor Clark has described this priority struggle as a "great race" between the payee or holder of the check, and these possible parties: (1) the drawer seeking to protect his account by a stop payment order; (2) the drawer's judgment creditor in possession of a writ of attachment; (3) the drawee bank seeking to exercise its right of setoff; (4) the executor of the deceased drawer, seeking to notify the bank to freeze the account; (5) the incompetent drawer's conservator; and finally, (6) the drawer's trustee in bankruptcy.5

A discussion of each method of final payment under Section 4-213 now follows.

4. U.C.C. §4-213(3).
A. Payment in Cash. The Code has, in Section 4-213(1) (a), adopted the traditional view that payment in cash constitutes final payment. Such a rule is, however, deceptively simple, as illustrated by the case of Kirby v. First and Merchants National Bank. Here, on December 30, the defendant payee, Mrs. Kirby, presented a check in the amount of $2,500.00 to the plaintiff payor bank. The check had been drawn on the bank by a local engineering company. The defendant payee, who also had an account with the plaintiff, made out a deposit slip, entering $2,300.00 in the "currency column" and, depositing that amount, received the $200.00 balance in cash from the teller. On the following business day the bank credited the payee's account in the amount of $2,300.00. The next day the bank discovered there were insufficient funds in the drawer's account to cover the check, and subsequently, upon the payee's refusal to make the check good, charged the entire amount of $2,500.00 against the payee's account. The Supreme Court of Appeals of Virginia held that the $200.00 cash payment was a final payment under Section 4-213(1) (a) as to the entire amount. Therefore, the payee was relieved of any liability and the charge against her account was improper. The court followed the basic pre-code rule that a drawee who mistakenly pays a check has recourse only against the drawer. The dissent, by two justices, stated that in order to follow the majority's logic it would have to be imagined that the defendant presented the check and received $2,500.00 in cash and afterwards deposited $2,300.00 in her account. The more logical analysis, according to the dissent, was that the check was accepted for deposit and clearance as any other check and the bank merely permitted a withdrawal of $200.00 as an accommodation to its customer.

It should be noted that the majority opinion also emphasized that even if payment had not been in cash, the bank had no right to charge the item to the payee's account since it had failed to return the item or send written notice of dis-

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8. Id. at 92, 168 S.E.2d at 276.
9. Id. at 94, 168 S.E.2d at 278 (dissenting opinion).
honor prior to its “midnight deadline” as required by Sections 4-212(3) and 4-301. Had the bank complied with these provisions, perhaps the outcome would have been different.

B. Settlement Without Right to Revoke. Section 4-213 (1) (b) provides that an item is finally paid if the payor bank settles without reserving a right to revoke, and without having such a right by virtue of a statute, clearing house rule, or agreement. In other words, if the settlement is in the first instance final, then final payment has occurred. This section would seem to apply only rarely, since Section 4-301 provides a payor bank the right to revoke settlements for demand items other than documentary draft.

C. Completion of the Process of Posting. The most important and controversial method of final payment under Section 4-213 is the completion of the “process of posting.” Whereas the two methods of payment discussed above deal with external acts between the payor and the holder of the item, the “process of posting” method pertains strictly to the internal procedures of the payor bank. The mechanical step of posting the amount of the item to the drawer’s account is said to represent the point in time in which the decision of the bank to pay or dishonor is made.

Section 4-109 defines the process of posting as:

the usual procedure followed by a payor bank in determining to pay an item and in recording the payment, including one or more of the following or other steps as determined by the bank;
(a) verification of any signature;
(b) ascertaining that sufficient funds are available;
(c) affixing a “paid” or other stamp;
(d) entering a charge or entry to a customer’s account;
(e) correcting or revising an entry of erroneous action with respect to the item.

The Comment to Section 4-109 states that the procedures followed by banks in making a determination to pay may vary, but that they all involve the two basic elements of (1) some decision to pay, and (2) some recording of the payment. The case of Gibbs v. Gerberich illustrates that both of these elements must exist. In this case the payor bank had received

10. See also U.C.C. §4-303(1) (d).
11. U.C.C. §4-213, Comment 5.
a check drawn on a realtor's escrow account. The same day, however, the bank received a restraining order prohibiting any payments from that account. Thus, the question was whether the check was "finally paid" prior to the receipt of the restraining order. The payor bank's vice-president testified that the check had been charged against and posted to the escrow account. However, he also testified that the check was not voided or cancelled, for as a matter of routine, this was not done until "the posting run is completed and the day's posting is in balance." 13 Under these circumstances the court found that the process of posting had not been completed since there was no evidence to indicate "a decision by the bank to pay." The court stated:

[i]he mere debiting of a customer's account does not per se indicate a decision to pay. The key point in a bank's completion of the "process of posting" is the completion of all the steps followed in the particular bank's payment procedure. In the instant case, the "posting run" was not completed, and the day's posting had not been found to be in balance prior to the receipt of the restraining order. The check had not been "voided or cancelled" as it would have been if the "process of posting" had been completed. It appears, therefore, that the statutory "process of posting" had not been completed, and as a consequence, the check had not been paid. 14

The most controversial and widely criticized case concerning the concept of final payment is West Side Bank v. Marine National Exchange Bank. 15 It has been said that this case had vitiated "for all practical purposes the Code provision that payment takes place upon completion of the process of posting." 16 The facts are briefly stated. On a Thursday the drawer gave to Byron Swidler a check in the amount of $262,000.00 and he in turn deposited it in the West Side Bank on the same day. The next morning West Side sent the check through the collection chain to the Marine National Exchange Bank, the payor. That night the check was charged to the drawer's account. On the next business day the item was copied, stamped "paid," cancelled and placed in the drawer's

13. Id. at 96, 203 N.E.2d at 854.
14. Id.
That afternoon the drawer issued a stop payment order to Marine who subsequently returned the check. West Side sued, contending that final payment had occurred by virtue of the completion of the process of posting, and therefore, the stop payment order was not effective. However, the court held that the item had not been finally paid since Section 4-109(e) includes as a step in the process of posting "correcting or reversing an entry or erroneous action with respect to the item." Therefore, the court concluded that the process of posting continued until the statutory time for reversal of entries had expired; in other words, the "midnight deadline." In an excellent analysis it has been said that:

17. This is essentially the procedure of "deferred posting" authorized by §4-301.
18. The "midnight deadline" is defined in Section 4-104(h).
20. See U.C.C. §4-301(2).
E. Section 4-303 provides several additional factors which may equally affect the outcome of "the great race," although not amounting to "final payment." These additional events are: acceptance of certification;\textsuperscript{22} examination and decision to pay;\textsuperscript{23} and accountability under Section 4-302 dealing with the responsibility for the late return of items.\textsuperscript{24} It has been said that Section 4-213(1) states the general rule for final payment for all purposes,\textsuperscript{25} whereas Section 4-303(1) was meant to deal specifically with the narrow area concerning the relationship between the rights of the payee or holder as against the rights of the drawer or his creditors.\textsuperscript{26}

Section 4-303(1)(d) provides in part that any of the "four legals" has come too late if the payor bank has evidenced by examination of its customer's account and by action, its decision to pay. This section has given the payor bank a great deal of discretion in determining the winner of the "great race," as evidence by the case of\textit{Yandell v. White City Amusement Park, Inc.}\textsuperscript{27} Here two closely associated corporations maintained several accounts in their respective names at the Commerce Bank. In order to insure that none of the checks would be dishonored, the bank was given the authority to transfer funds among the several accounts whenever it was necessary to cover any particular check. On July 29, 1960, the bank inspected the balance of one of the corporations before determining whether to honor four of its checks totaling $7,998.75. The checks were then withdrawn from the machine posting process and a bank officer entered a pencilled notation on the corporation's ledger card, indicating that there were sufficient funds in the account to cover the checks. The checks were then posted by hand, a procedure which was said to have manifested the bank's present intention to honor the checks. On August 1, the plaintiff creditor served a trustee writ on the bank in an effort to tie up the funds in the cor-

\footnotesize{\begin{enumerate}
\item U.C.C. \textsection 4-303(1)(a).
\item U.C.C. \textsection 4-303(1)(d).
\item U.C.C. \textsection 4-303(1)(e).
\item Davis, \textit{Article Four: Bank Deposits and Collections}, 44 N.C.L. Rev. 627, 633 (1966).
\end{enumerate}}
poration's account. The court held, inter alia, that the writ did not reach the funds. The basis of the decision was that by virtue of the pencilled notation and the hand posting, the bank had "evidenced its intent" to honor the four checks prior to the service of the trustee writ, even though final payment (through machine posting) did not actually occur until after the service of the writ. It is interesting to note that, as against the owner of the item, the bank could have changed its position any time before final payment without incurring liability.28

III. FAILURE TO ACT PROMPTLY

Code Section 4-302 follows the basic pre-code law29 in providing that:

[i]n the absence of a valid defense . . . if an item is presented on and received by a payor bank the bank is accountable for the amount of

(a) a demand item other than a documentary draft whether properly payable or not if the bank, in any case where it is not also the depository bank, retains the item beyond midnight of the banking day of receipt without settling for it or, regardless of whether it is also the depository bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(b) any other properly payable item unless within the time allowed for acceptance or payment of that item the bank either accepts or pays the item or returns it and accompanying documents.

Although a relatively simple concept, a number of cases have emerged. The leading case interpreting this provision is Rock Island Auction Sales, Inc. v. Empire Packing Co.30 In this case the defendant payor bank held the drawer's check past the midnight deadline based on the drawer's assurance that sufficient funds would be deposited to cover the check. However, the drawer was adjudicated a bankrupt, and the check was never paid. The plaintiff, payee of the check, brought suit under Section 4-302, and the trial court, finding no valid defense, held the bank liable for the amount of the check.

30. 32 Ill.2d 269, 204 N.E.2d 721 (1965).
On appeal the defendant first contended that it should not be held liable for the face amount of the check. The defendant pointed out that, unlike other provisions of Article Four which fix liability, Section 4-302 uses the word "accountable," which could only mean that it was responsible for (1) the amount of funds in the drawer's account and, (2) the damages as measured by Section 4-103(5) which reads:

The measure of damages for failure to exercise ordinary care in handling an item is the 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 cause.

However, the court rejected this contention on the ground that Section 4-302 plainly provides that the payor bank is accountable for the full amount of the check and that "accountable" is synonymous with "liable." The court also stated that "accountable" was used in order to accommodate the other sections of Article Four relating to provisional and final settlements between banks in the collection process.

The case thus seems to stand for the proposition that the payee or other holder need not establish actual damages resulting from the bank's delay in order to take advantage of Section 4-302. The Court of Appeals of Kentucky has, in the case of Farmers Cooperative Livestock Market v. Second National Bank of London, come to a similar conclusion. The court reasoned that:

[a] realistic reading of this statute compels the conclusion that failure to meet the midnight deadline authorized the person presenting the check to assume it has been honored and will be paid. Banking practices require the prompt settlement of such items because of the chain of credit dependent thereon.

In Rock Island the defendant bank also alleged that Section 4-302 violated the equal protection clause of the Fourteenth Amendment since it imposes a liability on a payor bank for failing to act promptly which is more severe than that imposed on a depository or collecting bank. The court dismissed this contention on the basis that Section 4-302 does

32. Id.
not create an unreasonable classification since all banks variously perform the functions of a payor, collecting and depository bank.

Rock Island was relied upon by the Supreme Court of Georgia in the case of National City Bank of Rome v. Motor Contract Company of Rome.34 In this case the defendant payor bank defended on the ground that the eventual return of the checks was within the "customary" period of time. The court rejected this contention, following the traditional rule that: "Evidence of custom or usage, with the necessary requisites may be admissible to aid in constructing a contract or to add incidents thereto. But custom cannot change the positive law of the state."35

In Leaderbrand v. Central State Bank of Wichita36 the Supreme Court of Kansas held that where the defendant payor bank had on two previous occasions dishonored the plaintiff payee's check within the midnight deadline in accordance with Section 4-302, its failure to do so a third time was excused. The plaintiff twice presented the check, in person, to the defendant bank, and each time he was orally advised that there were insufficient funds in the drawer's account. The plaintiff then deposited the check in his own bank which forwarded it directly to the defendant for collection. The defendant held the check for about two weeks before returning it unpaid to the plaintiff's bank. In excusing the defendant's failure to return the check within the midnight deadline, the court carefully analyzed and applied several code provisions: Section 3-511(4) provides "[W]here a draft has been dishonored by nonacceptance a later presentment for payment and any notice of dishonor and protest for nonpayment are excused unless in the meantime the instrument has been accepted;" Section 3-104(2) provides that a writing is a "draft" if it is an order, and a "check" if it is a draft drawn on a bank and payable on demand; in accordance with Section 3-508(3) notice of dishonor may be given in any reasonable

manner, either orally or in writing; and finally, Section 4-301 (3) provides that "[u]nless previous notice of dishonor has been sent an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section." The court therefore in effect concluded that non-acceptance includes nonpayment, and that nonacceptance applies to checks as well as drafts.

The court felt that the prior dishonors were a valid defense under Section 4-302, since the above sections disclosed:

A statutory scheme designed to impose a duty upon the payor bank, where a check is presented for payment and the drawer has insufficient funds on deposit to cover the item, to give timely notice of dishonor to the party presenting the check for payment just once. Such notice of dishonor fixes the time at which the item is dishonored by the payor bank as to the party presenting such item and subsequent presentment of the item for collection . . . does not require an additional notice of dishonor . . . . Under these circumstances any further notice of dishonor is excused.37

At least one case, Wiley v. Peoples Bank and Trust Co.,38 has expressly disagreed with the reasoning of Leaderbrand, holding Section 3-511(4) inapplicable because "nonacceptance" as used therein is applicable only to time items, since payor banks do not normally "accept" demand items but rather pay or refuse payment.

IV. PAYOR BANK'S LIABILITY FOR WRONGFUL DISHONOR

Code Section 4-402 provides:

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.

The leading case interpreting this section is Loucks v. Albuquerque National Bank.39 Here the defendant bank improperly charged the funds in the plaintiff's partnership account toward the payment of a note signed by one of the

37. Id. at 459, 450 P.2d at 9.
38. 438 F.2d 513 (5th Cir. 1971).
partners as an individual. The charge reduced the plaintiff's account to a balance of only $3.66. At this time there were at least nine checks outstanding, all of which were subsequently dishonored by the bank. In the court below the jury returned a verdict in favor of the plaintiffs in the amount of $402.00, representing the amount which had been charged to the note. The plaintiff appealed on the ground that the trial judge erred in refusing to allow the jury to consider the question of punitive damages, damages to the business reputation and credit of the partnership as an entity and of the partners as individuals, and damages for personal injuries to one of the plaintiffs. The Supreme Court of New Mexico affirmed the lower court's ruling that the partners should not be allowed to recover anything as individuals. The court reasoned that the partnership was "the customer" as used in Section 4-402, and therefore it was the only party to which the defendant bank was required to respond. The defendant bank owed nothing to either partner individually because the debtor-creditor relationship existed only between the bank and the partnership.

The court then turned to consider the elements of damage alleged to have been sustained by the partnership. Section 4-402 states in part that "[w]hen the dishonor occurs through mistake liability is limited to actual damages proved."

Comment 3 to this section provides:

This 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.

40. The plaintiffs sought recovery on behalf of the partnership in the amount of $5,000.00 for damages to its credit, good reputation, and business standing in the community; $1,800.00 for its loss of income, and $14,404 as punitive damages. In addition, each partner sought to recover reputation, and business standing. The partner who defaulted on the note sought punitive damages in the amount of $10,000.00, and the other partner sought $60,000.00.

41. As a basis for this interpretation, the court turned to the definition of "customer" as found in Section 4-104(e) which reads: "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." The court then looked to Section 1-201(30) which defines a "person" as "an individual or an organization," and then to Section 1-201(28) which includes a "partnership" in its definition of an "organization."
The plaintiff in the instant case had presented some evidence which indicated that the bank had knowledge of the personal nature of the note and of the partnership's outstanding checks. The court, therefore, held that the jury should have been allowed to decide whether the subsequent dishonors were by mistake or in fact intentional. However, the court refused the claim for punitive damages, for, even though the dishonor may have been intentional, there was lacking the element of malice, which was defined by the court as "the intentional doing of a wrongful act without just cause or excuse." 42

The court further held that one of the partner's claim for damages resulting due to an ulcer which he developed during the course of events was not the type of consequential damages contemplated by Section 4-402, therefore the partnership could not recover for loss of income during his absence.

Another case concerning the question of consequential damages is Bank of Louisville Royal v. Sims, 43 in which the plaintiff sought to recover for her hurt feelings or "nerves," and for her lost time from work. The court denied her claim, stating that "these nebulous items of damage bore no reasonable relationship to the dishonor . . . and consequently they could not be classified as 'actual damages proved'" 44 under Section 4-402. The court added, however, that if there had been evidence of malice on the bank's part, such damages might have been recoverable.

A recent Indiana case 45 has held that upon a wrongful dishonor of a business check, there arises a presumption that the customer's credit and standing has been damaged. In noting the probability of such harm the court cited from an earlier case: 46

In the modern world the financial credit of a man, particularly of one engaged in commercial pursuits, is a much prized and valuable asset. Although laboriously built it is easily destroyed. The banks of

42. 76 N.M. 735, 747, 418 P.2d 191, 199.
43. 435 S.W.2d 57 (Ky. 1968).
44. Id. at 58.
the country, through which the great volume of our commercial business is transacted, have a deserved reputation for accuracy and care in the conduct of their affairs. Hence when a check of a depositor is refused at the counter of his bank, that comes within the sphere of his transactions, promptly imputes the blame to him rather than to the bank . . . .

V. STOP PAYMENT ORDERS: FAILURE TO HONOR

Section 4-403 is the basic provision governing stop payment orders. It provides in part:

(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.

. . . .

(3) The burden of establishing the facts and amount of loss resulting from the payment of an item contrary to a binding stop payment order is on the customer.

This discussion is limited to the payor bank's liability in the event a customer's check is paid over his stop payment order.

It has been said that a drawer has an absolute right to stop payment since a check, before it is paid, is merely the drawer's order, revocable at his will, and a payor bank making payment over such an order does so at its peril. At the common law it was generally held that a bank paying a check over a stop payment order could not charge the amount of the item to the drawer's account; nor could it ever recover the amount paid from a good faith holder. However, under the Code the bank's liability in such a situation is far from absolute, and as will be seen, if liable, it will often be able to re-

47. Id.

48. The use of the words "customer" and "item" implies that this section is not limited to drawers of checks, but extends as well to makers of notes and other instruments. See U.C.C. §4-403, Comment 4.

49. For an excellent treatment of stop payment orders in general, see Hawkland, Stop Payment Orders Under the Uniform Commercial Code, 3 U.C.C. LAW JOURNAL 103 (1970).


51. E.g., German Nat'l Bank v. Farmers' Deposit Bank, 118 Pa. St. 294, 12 A. 393 (1888).

cover from the payee or other holder on the theory of subrogation.

In Cicci v. Lincoln National Bank and Trust Company of Central New York the plaintiff gave to one Santo a check in the amount of $3,000.00. Subsequently, the plaintiff issued a written stop payment order—no issue was raised as to its timeliness or effectiveness. The defendant payor bank thereafter paid the check in violation of the stop payment order. The defendant raised two defenses: (1) that the check was issued by the plaintiff to pay off an outstanding loan and therefore the plaintiff suffered no loss when the check was paid, and (2) that the check was issued to pay an unlawful gambling transaction and therefore the plaintiff was estopped from making any claim against the bank.

The court disallowed the bank's second defense, holding that the plaintiff's action was not based upon the check itself, but upon its wrongful dishonor under Section 4-403. In short, the defendant was not allowed to raise any circumstances surrounding the issuance of the check because the plaintiff could make out his case without any reference to the nature of the transaction.

On the other hand, the defendant's first defense was found to be valid. The court recognized that Section 4-403(3) was contrary to pre-code law, for "in New York . . . a prima facie case was made out by the depositor against the bank for breach of a timely stop payment order . . . without any allegation of damage." The court held, nevertheless, that under the Code the "fact and amount of loss" was an element of the depositor's prima facie case and thus denied the plaintiff's motion for summary judgment since the plaintiff's pleading did not allege a demand for repayment and refusal from the payee of the check. The plaintiff argued that he had been damaged in that his bank account had been reduced by $3,000.00, the amount of the check. However, the court stated that if it adopted such a contention, Section 4-303(3) would become meaningless. 56

53. 46 Misc. 2d 465, 260 N.Y.S.2d 100 (1965).
54. Id. at 469, 260 N.Y.S.2d at 103.
55. U.C.C. §4-403(3).
56. See also Brewster Bumper Corp. v. Irwin Savings & Trust Co., 44 Pa. D. & Co. 2d 138 (Westmoreland County Ct., 1967).
In *Universal Credit C.I.T. Corporation v. Guaranty Bank and Trust Company*, the plaintiff depositor was likewise unable to show a loss as a result of the defendant’s disregard of a stop payment order. In this instance the payment was made to a holder in due course and the plaintiff would have been liable for the amount of the check even if the stop payment order had been honored.

The payor bank’s second advantage under the Code is that if it is held liable to the drawer for the amount of the item, it still has available the right of subrogation by virtue of Section 4-407 which provides:

If a payor bank has paid an item over the stop payment order of the drawer or maker or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor shall be subrogated to the rights of any holder in due course on the item against the drawer or maker; and

(b) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(c) of the drawer or maker against the payee or any other holder of the item with respect to the transactions out of which the item arose.

It has been stated that “[t]he aim of the code provision is clear enough: the payor bank by paying over a stop order would have paid out its own money and would be given remedies to make itself whole.” This principle was liberally applied in the New Jersey case, *South Shore National Bank v. Donner*. The action was brought by a payor bank which alleged that the defendant Mark and Bette Donner, husband and wife, had conspired with defendant Ruth Satsky Jewelry and its president, Jules Bruskin, in willfully overevaluating a burglary loss sustained by the Donners. The defendants

57. 161 F. Supp. 790 (D. Mass. 1958). Although this case arose before the Code became effective in Massachusetts, the court made reference to it, regarding it as largely a restatement and clarification of existing law.

58. The court recognized that if the payor bank had been liable to the drawer for the amount of the item, it would have had the right of subrogation by virtue of prior case law and Section 4-407(a). See U.C.C. §4-407, Comment 1.


reported a $7,000.00 loss to the insurer which promptly issued a check in that amount payable to the Donners. Upon discovering the overevaluation the insurer stopped payment of the check. However, it was subsequently mistakenly paid by the plaintiff bank upon presentment.

The defendants Bruskin and Ruth Satsky Jewelry admitted making the appraisal, but contended that it was made without payment or other valuable consideration and that they did not receive any portion of the proceeds of the $7,000.00 check. They also argued that Section 4-407 limited the plaintiff bank's cause of action to those parties who were unjustly enriched, and that the only parties so enriched were the Donners, the payees of the check. They further argued that they were not "holders of the item" as required by Section 4-407(c).

The court dismissed all of these contentions, stating that Section 4-407 must be read in light of and in conjunction with other provisions of the Code.

The sense of a law is to be gathered "from its object and the nature of the subject matter and the whole of the context and the acts in pari materia. The parts of a statute are to be viewed in relation to the whole and the motive which led to the making of the law, and reconciled, if possible, to carry out the reasonably probable legislative policy." 61

Comment 8 to Section 4-408 provides in part:

The drawee is ... entitled to subrogation to prevent unjust enrichment (Section 4-407); retains common-law rights ... in cases where the payment is not made final by Section 3-418.

The court then turned to Section 3-401.1, which states that "[n]o person is liable on an instrument unless his signature appears thereon." Comment 1 to this section provides:

Nothing in this section is intended to prevent any liability arising apart from the instrument itself. The party who does not sign may still be liable ... in tort for misrepresentation ....

61. Id. at 175, 249 A.2d at 28. The court first turned to §1-102, stating that its provisions mandated a liberal construction of the Code. The court then emphasized Section 1-103, which provides:

Unless displaced by the particular provisions of this Act, the principles of law and equity including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentations, duress, coercion, or invalidating cause shall supplement its provisions.
Applying the above provisions, the court then placed the plaintiff payor bank into the shoes of the drawer insurance company as though no stop payment order had ever been issued and proceeded to apply simple tort law and held all three defendants liable as joint tortfeasors. The court reasoned that such a result was consistent with the apparent legislative intent

... to grant to a payor bank ... a full and effective remedy by way of subrogation to the rights and remedies of the drawer or make against the payee as well as those who have, by their tortious acts in connection with him, combined to produce the single indivisible result ... the remedy being furnished not only to prevent unjust enrichment but also to the extent necessary to prevent loss to the bank by reason of its payment of this item.614

In effect, the court extracted the basic theory of subrogation from Section 4-407 and applied it in conjunction with existing common law tort principles. In doing so the court disregarded the express limitations of Section 4-407(c), which, if read together with the entire section, only subrogates the bank to the rights of the drawer against the payee or other holder for the purpose of preventing unjust enrichment. Although the defendants Bruskin and Ruth Satsky Jewelry were not payees or holders, and were not in any way enriched, the result, at least in this instance, seems justified. The result may be consistent with Comment 5 to Section 4-407 which provides, "[t]he spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1-103)."62

VI. RIGHT TO VARY BY AGREEMENT

In dealing with the various provisions of Article Four, one should be aware of Section 4-103(1) which provides:

The effect of the provisions of this title 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 damages for such lack or failure; but the parties may by

61A. Id., at 177-76, 249 A.2d at 29-30.
62. For additional cases dealing with Section 4-407, see Wells v. Washington Heights Federal Savings and Loan Ass'n, 63 Misc. 2d 424, 312 N.Y.S.2d 236 (1970), which refused to allow subrogation on the ground that the drawer had no such right against the payee; Commercial Insurance Co. v. Scalamaner, 56 Misc. 2d 628, 289 N.Y.S. on the payor bank to establish that the payee was not entitled to the proceeds of the check.
agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.63

The Code drafters felt that in light of the technical complexity of the field of bank collections, the numerous number of checks handled by each bank each day, the certainty of changing conditions, and the possibility of developing improved methods, it would be unwise to freeze the present methods of operation by mandatory statutory rules.64

Subsection (2) of Section 4-103 provides that official or quasi-official rules, such as Federal Reserve regulations, operating letters, and clearing house rules will have the effect of "agreements" under Subsection (1), above, even if not specifically assented to by all the parties concerned. This provision was included in view of the fact that more often than not the various parties within the collection chain will not have direct dealings with each other, and may not in fact have knowledge of each other's existence, therefore a specific agreement with each party would be impossible.

In drafting agreements which vary the provisions of Article Four it is important to note that a general disclaimer is prohibited, and that any standard measuring a bank's responsibility must not be "manifestly unreasonable." For example, in the case of Thomas v. First National Bank65 the Supreme Court of Pennsylvania held void as against public policy a stop payment order which contained a release providing, "Should the check be paid through inadvertence, accident or oversight, it is expressly agreed that the Bank will in no way be held responsible."66

VII. CONCLUSION

It has been said that the purpose of Article Four is:

... not to reform but to codify and simplify. It embraces more specific details than the A.B.A. Bank Collection Code and its effort is to announce definite black and white rules rather than general principles. The effort to make the rules "mechanical" may seem at times to have

63. See also U.C.C. §1-102.
64. See U.C.C. §4-103, Comment 1.
66. Although the Code was not yet in effect, the court implied that the same result would follow under Section 4-103. See U.C.C. §4-103, Comment 1.
resulted in unnecessarily complex statutory syntax, but when the full meaning and implication of the rules are understood by bankers and bank lawyers, there should be established a certainty as to the handling of bank deposits and collections which has heretofore been absent.\textsuperscript{67}

In spite of the "mechanical rules," the cases which have evolved thus far have, with only a few exceptions, interpreted the provisions of Article Four in light of and in conjunction with each other and with other applicable Articles within the Code. Such an approach allows a degree of flexibility with which to meet unusual circumstances and changing conditions without sacrificing any degree of certainty which is so necessary in the commercial world.

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\textsuperscript{67} R. Foster, INTRODUCTION TO SOUTH CAROLINA REPORTER'S COMMENTS, 2A S.C. CODE ANN. 349 (1966).