CHAPTER 30

Bank Deposits, Collections, and Funds Transfers

In today's 21st-century society, most goods and services are bought and sold without a physical transfer of "money." Credit cards, charge accounts, and various deferred payment plans have made cash sales increasingly infrequent. But even credit sales must ultimately be settled—when they are, payment is usually made by check rather than with cash. If the parties to a sales transaction happen to have accounts at the same bank, a transfer of credit is easily accomplished. In the vast majority of cases, however, the parties have accounts at different banks. Then the buyer's check must journey from the seller-payee's bank (the depositary bank), where the check is deposited by the seller for credit to his account, to the buyer-drawer's bank (the payor bank) for payment. In this collection process, the check frequently passes through one or more other banks (intermediary banks), each of which must accurately record its passing, before it may be collected. Our banking system has developed a network to handle the collection of checks and other instruments.

In recent years, payments by electronic funds transfers have increased at an astounding rate. The dollar amount of commercial payments made by wire transfer far exceeds the dollar amount made by checks or credit cards. In addition, electronic funds transfers have become exceedingly popular with consumers. Consumer electronic funds transfers are covered by the Federal Electronic Fund Transfer Act (EFTA); nonconsumer (wholesale) electronic transfers are covered by Article 4A of the Uniform Commercial Code (UCC).

This chapter will cover both the bank deposit–collection system and electronic funds transfers.

BANK DEPOSITS AND COLLECTIONS

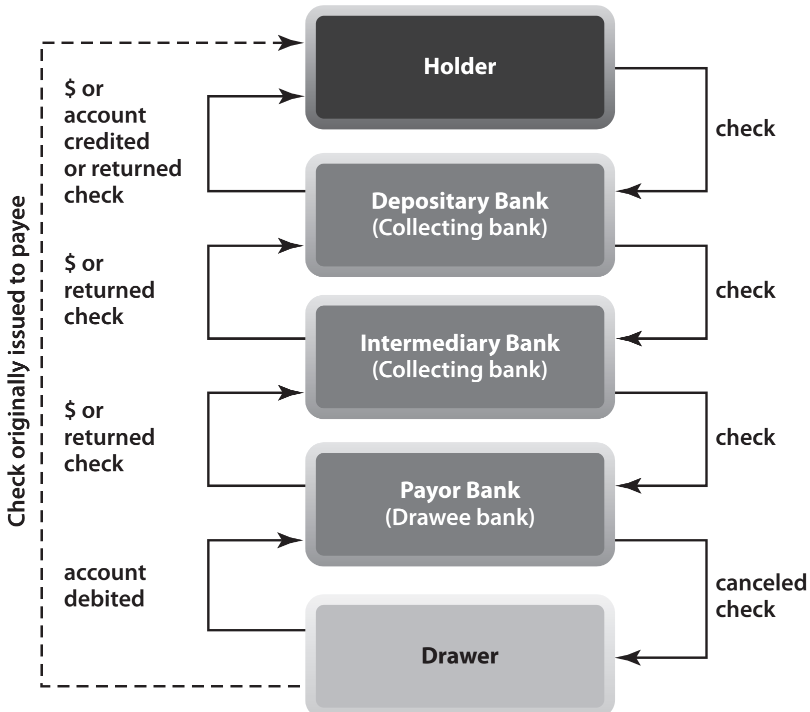
Article 4 of the UCC, entitled "Bank Deposits and Collections," provides the principal rules governing the bank collection process. The end result of the collection process is either the payment of the check or the dishonor (refusal to pay) of the check by the drawee bank. As items in the bank collection process are essentially those covered by Article 3, "Commercial Paper," and to a lesser extent by Article 8, "Investment Securities," these Articles often apply to a bank collection problem. In addition, Articles 3 and 4 are supplemented and, at times, preempted by Federal law: the Expedited Funds Availability Act and its implementing Federal Reserve Regulation (Regulation CC). This section will cover the collection of an item through the banking system and the relationship between the payor bank and its customer.

COLLECTION OF ITEMS

When a person deposits a check in his bank (the depositary bank), the bank credits his account by the amount of the check. This initial crediting is **provisional**. Normally, a bank does not permit a customer to draw funds against a provisional credit; by permitting its customer to thus draw, the bank will have given *value* and, provided it meets the other requirements, will be a holder in due course. Under the customer's contract with his bank, the bank is obligated to make a reasonable effort to obtain payment of all checks deposited for collection. When the amount of the check has been collected from the payor bank (the drawee), the credit becomes a **final credit**.

The Competitive Equality Banking Act has expedited the availability of funds by establishing maximum time periods for which a bank may hold (and thereby deny a customer access to the funds represented by) various types of instruments. Under the Act, (1) cash deposits, wire transfers, government checks, the first $100 of a day's check deposits, cashier's checks, and checks deposited in one branch of a depositary institution and drawn on the same or another branch of the same institution must clear by the next business day; (2) local checks must clear within one intervening business day; and (3) nonlocal checks must clear in no more than four intervening business days.

◆ **FIGURE 30-1: Bank Collections**



If the payor bank (the drawee bank) does not pay the check for some reason, such as a stop payment order or insufficient funds in the drawer's account, the depositary bank reverses the provisional credit to the account, debits his account for that amount, and returns the check to him with a statement of the reason for nonpayment. If, in the meantime, the customer has been permitted to draw against the provisional credit, the bank may recover the payment from him.

In some cases, the bank involved is both the depositary bank and the payor bank. In most cases, however, the depositary and payor banks are different, in which event the bank collection aspects of Article 4 come into play. Where the depositary and payor banks differ, it is necessary for the item to pass from one to the other, either directly through a clearinghouse or through one or more **intermediary banks** (banks, other than the depositary payor bank, that are involved in the collection process, such as one of the twelve Federal Reserve Banks). A **clearinghouse** is an association, composed of banks or other payors, whose members settle accounts with each other on a daily basis. Each member of the clearinghouse forwards all deposited checks drawn on other members and receives from the clearinghouse all checks drawn on it. Balances are adjusted and settled each day.

◆ **SEE FIGURE 30-1: Bank Collections**

COLLECTING BANKS

A **collecting bank** is any bank, other than the payor bank, the depositary and payor banks are different, the depositary bank gives a provisional credit to its customer, transfers the item to the next bank in the chain, and receives a provisional credit or "settlement" from it; the process repeats until the item reaches the payor bank, which gives a provisional settlement to its transferor. When the item is paid, all the provisional settlements given by the respective banks in the chain become final, and the particular transaction has been completed. Because this procedure simplifies bookkeeping by necessitating only one entry if the item is paid, no adjustment is necessary on the books of any of the banks involved.

If, however, the payor bank does not pay the check, it returns the item, and each intermediary or collecting bank reverses the provisional settlement or credit it previously gave to its forwarding bank. Ultimately, the depositary bank will charge (remove the provisional credit from) the account of the customer who deposited the item. The customer must then seek recovery from the indorsers or the drawer.

A collecting bank is an **agent** or subagent of the owner of the item until the settlement becomes final. Section 4–201(a). Unless otherwise provided, any credit given for the item initially is provisional. Once settled, the agency relationship changes to one of **debtor-creditor**. The effects of this agency rule are that the risk of loss remains with the owner and any chargebacks go to her, not to the collecting bank.

All collecting banks have certain responsibilities and duties in collecting checks and other items. These will now

Duty of Care A collecting bank must exercise ordinary care in handling an item transferred to it for collection. Section 4–202(a). The steps it takes in presenting an item or sending it for presentment are of particular importance. It must act within a reasonable time after receipt of the item and must choose a reasonable method of forwarding the item for presentment. It also is responsible for using care in routing and in selecting intermediary banks or other agents.

◆ **SEE CASE 30-1**

Duty to Act Timely Closely related to the collecting bank's duty of care is its duty to act in a timely manner. A collecting bank acts timely in any event if it takes proper action, such as forwarding or presenting an item before the "midnight deadline" following its receipt of the item, notice, or payment. If the bank adheres to this standard, the timeliness of its action cannot be challenged; should it, however, take a reasonably longer time, the bank bears the burden of proof in establishing timeliness. Section 4–202(b). The **midnight deadline** is the midnight of the banking day following the banking day on which the bank received the item or notice. Section 4–104(a)(10). Thus, if a bank receives a check on Monday, it must take proper action by midnight on the next banking day, or Tuesday. A banking day means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions. Section 4–104(a)(3). The midnight deadline presents a problem because it takes time to process an item through a bank—whether it be the depositary, intermediary, or payor bank. If a day's transactions are to be completed without overtime work, the bank must either close early or fix an earlier cutoff time for the day's work. Accordingly, the Code provides that for the purpose of allowing time to process items, prove balances, and make the bookkeeping entries necessary to determine its position for the day, a bank may fix an afternoon hour of 2:00 P.M. or later as a cutoff point for handling money and items and for making entries on its books. Section 4–108. Items received after the cutoff hour fixed as the close of the banking day are considered to have been received at the opening of the next banking day, and the time for taking action and for determining the bank's midnight deadline begins to run from that point.

Recognizing that everyone involved will be greatly inconvenienced if an item is not paid, Section 4–109 provides that unless otherwise instructed, a collecting bank in a good faith effort to secure payment may, in the case of a specific item drawn on a payor other than a bank, waive, modify, or extend the time limits, but not in excess of two additional banking days. This extension may be made without the approval of the parties involved and without discharging drawers or indorsers. This section does not apply to checks and other drafts drawn on a bank. The Code also authorizes delay when communications or computer facilities are disaster; the suspension of payments by another bank; war; emergency conditions; failure of equipment; or other circumstances beyond the bank's control. Nevertheless, such delay will be excused only if the bank exercises such diligence as the circumstances require.

Indorsements An item restrictively indorsed with words such as "pay any bank" is locked into the bank collection system, and only a bank may acquire the rights of a holder. When forwarding an item for collection, a bank normally indorses the item "pay any bank," regardless of the type of indorsement, if any, that the item carried at the time of receipt. This protects the collecting bank by making it impossible for the item to stray from regular collection channels.

If the item had no indorsement when the depositary bank received it, the bank nonetheless becomes a holder of the item at the time it takes possession of the item for collection if the customer was a holder at the time of delivery to the bank and, if the bank satisfies the other requirements of a holder in due course, it will become a holder in due course in its own right. Section 4–205(1). In return, the bank warrants to the collecting banks, the payor, and the drawer that it has paid the amount of the item to the customer or deposited that amount to the customer's account. Section 4–205(2). This rule speeds up the collection process by eliminating the necessity of returning checks for indorsement when the depositary bank knows they came from its customers.

Warranties Customers and collecting banks give substantially the same warranties as those given by parties under Article 3 upon presentment and transfer, which were discussed in *Chapter 29*. In addition, under Article 4 customers and collecting banks may give encoding warranties. Each customer or collecting bank who transfers an item and receives a settlement or other consideration warrants to his transferee and any subsequent collecting bank that (1) he is a person entitled to enforce the item; (2) *all* signatures are authentic and authorized; (3) the item has not been altered; (4) he is not subject to any defense or claim in recoupment; and (5) he has no knowledge of any insolvency proceeding involving the maker or acceptor or the drawer of an unaccepted draft. Section 4–207(a). Moreover, each customer or collecting bank who obtains payment or acceptance from a drawee on a draft as well as each prior transferor warrants to the drawee who pays or accepts the draft in good faith that (1) she is a person entitled to enforce the draft; (2) the item has not been altered; and (3) she has no knowledge that the signature of the drawer is unauthorized. Section 4–208.

Processing of checks is now done by Magnetic Ink Character Recognition (MICR). When a check is deposited, the depositary bank magnetically encodes the check with the amount of the check (all checks are pre-encoded with the drawer's account number and the designation of the drawee bank), after which the processing occurs automatically, with-magnetic encoding of checks has created several problems. The first is the problem a bank encounters when paying a postdated instrument prior to its date. The Revision changes prior law by providing that the drawee may debit the drawer's account, unless the drawer timely informs the drawee that the check is postdated. Section 4–401(c). A second difficulty arises when a depositing bank or its customer who encodes her own checks miscodes a check. Revised Article 4 provides that such an encoder **warrants** to any subsequent collecting bank and to the payor that information on a check is properly encoded. Section 4–209(a). If the customer does the encoding, the depositary bank also makes the warranty. Section 4–209(a).

Final Payment The provisional settlements made in the collection chain are all directed toward final payment of the item by the payor bank. From this turnaround point in the collection process, the proceeds of the item begin their return flow, and provisional settlements become final. For example, a customer of the California Country State Bank may deposit a check drawn on the State of Maine Country National Bank. The check may then take a course such as follows: from the California Country State Bank to a correspondent bank in San Francisco, to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to the payor bank. Provisional settlements are made at each step. When the payor bank finally pays the item, the proceeds begin to flow back over the same course.

The critical question, then, is the point at which the payor bank has **paid** the item, as this not only commences the payment process but also affects questions of priority between the payment of an item and actions such as the filing of a stop payment order against it. Under the Code, *final payment* occurs when the payor bank first does any of the following: (1) pays an item in cash; (2) settles an item and does not have the right to revoke the settlement through statute, clearinghouse rule, or agreement; or (3) makes a provisional settlement and does not revoke it within the time and in the manner permitted by statute, clearinghouse rule, or agreement. Section 4–215(a).

PAYOR BANKS

The **payor** or drawee **bank**, under its contract of deposit with the drawer, agrees to pay to the payee or his order a check issued by the drawer, provided that the order is not countermanded and that there are sufficient funds in the drawer's account.

The tremendous increase in volume of bank collections has necessitated deferred posting procedures, whereby items are sorted and proved on the day of receipt but are not posted to customers' accounts or returned until the next banking day. The UCC not only approves such procedures but also establishes specific standards to govern their application to the actions of payor banks.

When a payor bank that is not also a depositary bank receives a demand item other than for immediate payment over the counter, it must either return the item or give its transferor a provisional settlement before **midnight** of the banking day on which the item is received. Otherwise, the bank becomes liable to its transferor for the amount of the item, unless it has a valid defense, such as breach of a presentment warranty. Section 4–302.

If the payor bank gives the provisional settlement as required, it has until the midnight deadline to return the item or, if the item is held for protest or is otherwise unavailable for return, to send written notice of dishonor or nonpayment. Section 4–301(a). After doing this, the bank is entitled to revoke the settlement and recover any payment it has made. Should it fail to return the item or send notice before its midnight deadline, the payor bank will be accountable for the amount of the item unless it has a valid defense for its inaction. If a check is for $2,500 or more, Federal law (Regulation CC) requires special notice of nonpayment—the paying bank must give notice to the depositary bank by 4:00 P.M. on the second business day following the banking day on which the check was presented to the paying bank. This regulation does not, however, relieve the paying bank of returning the check in compliance with Article 4.

A bank may dishonor an item and return it or send notice for innumerable reasons. The following situations are the most common: the drawer or maker may have no account or may have funds insufficient to cover the item, a signature on the item may be forged, or the drawer or maker may have stopped payment of the item.

If the funds in a customer's account are insufficient to pay all of the items that the bank receives on that account on any given day, the bank may charge them against the account in any order it deems convenient. The owner of the account from which the item was payable also has no basis for complaint when the bank pays one item rather than another. It is his responsibility to have enough funds on deposit to pay all of the items chargeable to his account at any time.

◆ **SEE CASE 29-2**

RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

The relationship between a payor bank and its checking account customer is primarily the product of their contractual arrangement. Although the parties have relatively broad latitude in establishing the terms of their agreement and in altering the provisions of the Code, a bank may not validly (1) disclaim responsibility for its lack of good faith, (2) disclaim responsibility for its failure to exercise ordinary care, or (3) limit its damages for a breach comprising such lack or failure. Section 4–103(a). The parties by agreement, however, may determine the standards by which the bank's responsibility is to be measured, if these standards are not clearly unreasonable.

PAYMENT OF AN ITEM

A payor bank owes a duty to its customer, the drawer, to pay checks properly drawn by him on an account having funds sufficient to cover the items. A check or draft, however, is not an assignment of the drawer's funds that are in the drawee's possession. Moreover, as discussed in *Chapter 29*, the drawee is not liable on a check until it accepts the item. Section 3–408. Therefore, the *holder* of a check has no right to require the drawee bank to pay it, whether the drawer's account contains sufficient funds or not. But if a payor bank improperly refuses payment when presented with an item, it will incur a liability to the *customer* from whose account the item should have been paid. Section 4–402. If the customer has adequate funds on deposit, and there is no other valid basis for the refusal to pay, the bank is liable to its customer for damages proximately caused by the *wrongful dishonor*. Liability is limited to actual damages proved and may include damages for arrest, prosecution, or other consequential damages. Section 4–402.

When a payor bank receives an item properly payable from a customer's account but the funds in the account are insufficient to pay it, the bank may (1) dishonor the item and return it or (2) pay the item and charge its customer's account, even though the actions create an overdraft. Section 4–401(a). The item authorizes or directs the bank to make the payment and hence carries with it an enforceable implied promise to reimburse the bank. Furthermore, the customer may be liable to pay the bank a service charge for its handling of the overdraft or to pay interest on the amount of the overdraft. A customer, however, is not liable for an overdraft if the customer did not sign the item or benefit from the proceeds of the item. Section 4–401(b).

A payor bank is under no obligation to its customer to pay an uncertified check that is more than six months old. Section 4–404. This rule reflects the usual banking practice of consulting a depositor before paying a "*stale*" item (one more than six months old) on her account. The bank is not required to dishonor such an item, however; and if the bank makes payment in good faith, it may charge the amount of the item to its customers' account.

◆ **SEE CASES 30-2 and 29-2**

SUBSTITUTE CHECK

The Check Clearing for the 21st Century Act (also called Check 21 or the Check Truncation Act) permits banks to truncate original checks, which means removing an original paper check from the check collection or return process and sending in lieu of it (1) a substitute check or, (2) *by agreement*, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check). The Act sets forth a statutory framework under which a substitute check is the legal equivalent of an original check for all purposes, if the substitute check (1) accurately represents all of the information on the front and back of the original check as of the time the original check was truncated; and (2) bears the legend, "This is a legal copy of your check. You can use it the same way you would use the original check." The Act defines a **substitute check** as a paper reproduction of the original check that (1) contains an image of the front and back of the original; (2) bears an MICR containing all the information appearing on the MICR line of the original check; (3) conforms, in paper stock, dimension, and otherwise, with generally applicable industry standards for substitute checks; and (4) is suitable for automated processing in the same manner as the original. Thus, a substitute check is basically a copy of the original check that shows both the front and back of the original check.

The law does not require banks to accept checks in electronic form nor does it require banks to use the new authority granted by the Act to create substitute checks. On the other hand, parties cannot refuse to accept a substitute check that meets the Act's requirements.

The Act permits banks to replace paper checks during the check collection process with either digital or paper substitutes. Thus, banks can employ digital images or image replacement documents (IRDs), which are documents that include the front, rear, and all MICR data in one image. However, the Act does not provide legal equivalence for electronic check or image presentment.

The ultimate objective of the Act is to make the collection process more efficient and much faster (transferring digital files within seconds rather than days) and to enhance fraud detection by accelerating return of dishonored checks.

STOP PAYMENT ORDERS

A check drawn on a bank is an order to pay a sum of money and an authorization to charge the amount to the drawer's account. The customer, or any person authorized to draw on the account, may countermand this order, however, by means of a **stop payment order**. Section 4–403. If the order does not come too late, the bank is bound by it. If the bank inadvertently pays a check over a valid stop order, it is *prima facie* liable to the customer, but only to the extent of the customer's loss resulting from the payment. The burden of establishing the fact and amount of loss is on the customer.

To be effective, a stop payment order must be received in time to provide the bank a reasonable opportunity to act on it. Section 4–403(a). An oral stop order is binding on the bank for only fourteen calendar days. Section 4–403(b). If the customer confirms an oral stop order in writing within the fourteen-day period, the order is effective for six months and may be renewed in writing for additional six-month periods.

The fact that a drawer has filed a stop payment order does not automatically relieve her of liability. If the bank honors the stop payment order and returns the check, the holder may bring an action against the drawer. If the holder qualifies as a holder in due course, personal defenses that the drawer might have to such an action would be of no avail.

◆ **SEE CASE 30-2**

BANK'S RIGHT TO SUBROGATION ON IMPROPER PAYMENT

If a payor bank pays an item over a stop payment order, after an account has been closed, or otherwise in violation of its contract with the drawer or maker, the payor bank is subrogated to (obtains) the rights of (1) any holder in due course on the item against the drawer or maker, (2) the payee or any other holder against the drawer or maker, and (3) the drawer or maker against the payee or any other holder. Section 4–407. For instance, over the drawer's stop payment order a bank pays a check presented to the bank by a holder in due course. The drawer's defense is that the check was obtained by fraud in the inducement. The drawee bank is subrogated to the rights of the holder in due course, who would not be subject to the drawer's personal defense, and thus can debit the drawer's account. Section 4–407(1). The same would be true if the presenter were the payee, against whom the drawer did not have a valid defense. Section 4–407(2).

◆ **SEE CASE 30-3**

DISCLOSURE REQUIREMENTS

Congress enacted the Truth in Savings Act, which requires all depositary institutions (including commercial banks, savings and loan associations, savings banks, and credit unions) to disclose in great detail to consumers the terms and conditions of their deposit accounts. The stated purpose of the Act is to allow consumers to make informed decisions regarding deposit accounts by mandating standardized disclosure of rates of interest and fees to facilitate meaningful comparison of different deposit products.

More specifically, the Act provides that the disclosures must be made in a clear and conspicuous writing and must be given to the consumer when an account is opened or service is provided. These disclosures must include the following: (1) the annual percentage yield (APY) and the percentage rate; (2) how variable rates are calculated and when the rates may be changed; (3) balance information (including how the balance is calculated); (4) when and how interest is calculated and credited; (5) the amount of fees that may be charged and how they are calculated; and (6) any limitation on the number or amount of withdrawals or deposits. In addition, the Act requires the depositary institution to disclose the following information with periodic statements it sends to its customers: (1) the APY earned; (2) any fees debited during the covered period; (3) the dollar amount of the interest earned during the covered period; and (4) the dates of the covered period.

CUSTOMER'S DEATH OR INCOMPETENCE

The general rule is that death or incompetence revokes all agency agreements. Furthermore, adjudication of incompetency by a court is regarded as notice to the world of that fact. Actual notice is not required. Section 4–405 of the Code modifies these stringent rules in several ways with respect to bank deposits and collections.

First, if either a payor or collecting bank does not know that a customer has been adjudicated incompetent, the existence of such incompetence at the time an item is issued or its collection is undertaken does not impair either bank's authority to accept, pay, or collect the item or to account for proceeds of its collection. The bank may pay the item without incurring any liability.

Second, neither death nor adjudication of incompetence of a customer revokes a payor or collecting bank's authority to accept, pay, or collect an item until the bank knows of the condition and has a reasonable opportunity to act on this knowledge.

Finally, even though a bank knows of the death of its customer, it may for ten days after the date of his death pay or certify checks drawn by the customer unless a person claiming an interest in the account, such as an heir, executor, or administrator, orders the bank to stop making such payments. Section 4–405(b).

CUSTOMER'S DUTIES

The Code imposes certain affirmative duties on bank customers and fixes time limits within which they must assert their rights. The duties arise and the time starts to run from the point at which the bank either sends or makes available to its customer a statement of account showing payment of items against the account. The statement of account will suffice provided it describes by item the number of the item, the amount, and the date of payment. The customer must exercise reasonable promptness in examining the bank statement or the items to discover whether any payment was unauthorized due to an *unauthorized signature* on or any *alteration* of an item. Section 4–406(c). Because he is not presumed to know the signatures of payees or indorsers, this duty of prompt and careful examination applies only to alterations and the customer's own signature, both of which he should be able to detect immediately. If he discovers an unauthorized signature or an alteration, he must notify the bank promptly. Section 4–406(c). A failure to fulfill these duties of prompt examination and notice precludes the customer from asserting against the bank his unauthorized signature or any alteration if the bank establishes that it suffered a loss by reason of such failure. Section 4–406(d).

Furthermore, the customer will lose his rights in a potentially more serious situation. Occasionally a forger, possibly an employee who has access to his employer's checkbook, carries out a series of transactions involving the account of the same individual. He may forge one or more checks each month until he is finally detected. The bank, noticing nothing suspicious, might pay one or more of the customer's checks bearing the false signatures before the customer detects the forgery, months or even years later. Section 4–406(d) of the Code deals with these situations by stating that once the statement and items become available to him, the customer must examine them within a reasonable period—which in no event may exceed thirty calendar days and which may, under certain circumstances, be less—and notify the bank. Any instruments containing alterations or unauthorized signatures by the same wrongdoer that the bank pays during that period will be the bank's responsibility, but any paid thereafter but before the customer notifies the bank may not be asserted against it. This rule is based on the concept that the loss involved is directly traceable to the customer's negligence and that, as a result, he should stand the loss.

These rules depend, however, on the bank's exercising ordinary care in paying the items involved. If it does not, and that failure by the bank substantially contributed to the loss, the loss will be allocated between the bank and the customer based on their comparative negligence. Section 4–406(e). But whether the bank exercised due care or not, the customer must in all events report any alteration or his unauthorized signature within one year from the time the statement or items are made available to him or be barred from asserting them against the bank. Section 4–406(f). Any *unauthorized indorsement* must be asserted within three years under the Article's general Statute of Limitations provisions. Section 4–111.

Consistent with modern automated methods for processing checks, Articles 3 and 4 provide that "ordinary care" does not require a bank to examine every check if the failure to do so does not vary unreasonably from general banking usage. Section 3–103(7).

◆ **SEE CASE 30-4**

ELECTRONIC FUNDS TRANSFERS

As previously mentioned, the use of negotiable instruments for payment has greatly reduced the use of *cash* in the United States. The advent and technological advances of interconnected computers have resulted in electronic fund transfer systems (EFTS) that have greatly reduced the use of *checks*. Financial institutions seek to substitute EFTS for checks for two principal reasons. The first is to eliminate the ever-increasing paperwork involved in processing the billions of checks issued annually. The second is to eliminate the "float" that a drawer of a check currently enjoys by maintaining the use of his funds during the processing period between the time at which he issues the check and final payment.

An electronic fund transfer (EFT) has been defined as "any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct or authorize a financial institution to debit or credit an account." For example, with an EFT, William in New York would be able to pay a debt he owes to Yvette in Illinois by entering into his computer an order to his bank to pay Yvette. The drawee bank would then instantly debit William's account and transfer the credit to Yvette's bank, where Yvette's account would immediately be credited in that amount. The entire transaction would be completed in minutes.

The use of EFTs generated considerable confusion concerning the legal rights of customers and financial institutions. Congress provided a partial solution to the legal issues affecting consumer EFTs by enacting the EFTA, discussed below. Transactions not covered by the EFTA—primarily wholesale electronic transfers—are covered by Article 4A—Funds Transfers of the UCC.

TYPES OF ELECTRONIC FUNDS TRANSFERS

Although new EFTs may appear in the coming years, six main types of EFTs are currently in use: (1) automated teller machines, (2) point-of-sale systems, (3) direct deposit and withdrawal of funds, (4) pay-by-phone systems, (5) personal computer (online) banking, and (6) wholesale EFTs.

AUTOMATED TELLER MACHINES

Automated teller machines (ATMs) permit customers to conduct various transactions with their banks through the use of electronic terminals. After activating an ATM with a plastic identification card and a personal identification number, or PIN, a customer can deposit and withdraw funds from her account, transfer funds between accounts, obtain cash advances, and make payments on loan accounts.

POINT-OF-SALE SYSTEMS

Computerized point-of-sale (POS) systems permit consumers to transfer funds from their bank accounts to a merchant automatically. The POS machines, located within the merchant's store and activated by the consumer's identification card and code, instantaneously debit the consumer's account and credit the merchant's account.

DIRECT DEPOSITS AND WITHDRAWALS

Another type of EFT involves deposits, authorized in advance by a customer, that are made directly to his account. Examples include direct payroll deposits, deposits of Social Security payments, and deposits of pension payments. Conversely, automatic withdrawals are preauthorized EFTs from the customer's account for regular payments to some party other than the financial institution at which the funds are deposited. Automatic withdrawals to pay insurance premiums, utility bills, or automobile loan payments are common examples of this type of EFT.

PAY-BY-PHONE SYSTEMS

Financial institutions provide a service that permits customers to pay bills by telephoning the bank's computer system and directing a transfer of funds to a designated third party. This service also permits customers to transfer funds between accounts.

PERSONAL COMPUTER (ONLINE) BANKING

Personal computer (online) banking enables the customer to execute many banking transactions via an Internet-connected computer. For instance, customers may view account balances, request transfers between accounts, and pay bills electronically.

WHOLESALE ELECTRONIC FUNDS TRANSFERS

Wholesale EFTs, commonly called wholesale wire transfers, involve the movement of funds between financial institutions, between financial institutions and businesses, and between businesses. More than $1 *trillion* is transferred this way each business day over the two major transfer systems—the Federal Reserve wire transfer network system (Fedwire) and the New York Clearing House Interbank Payment System (CHIPS). In addition, a number of private wholesale wire systems exist among the large banks. Limited aspects of wholesale wire transfers are governed by uniform rules promulgated by the Federal Reserve, CHIPS, and the National Automated Clearing House Association.

CONSUMER FUNDS TRANSFERS

Congress determined that the use of electronic systems to transfer funds provided the potential for substantial benefits to consumers. Existing consumer protection legislation failed to account for the unique characteristics of such systems, however, leaving the rights and obligations of consumers and financial institutions undefined. Accordingly, Congress enacted Title IX of the Consumer Protection Act, the EFTA, to "provide a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfers" with primary emphasis on "the provision of individual consumer rights." Because the EFTA deals exclusively with the protection of **consumers**, it does not govern electronic transfers between financial institutions, between financial institutions and businesses, and between businesses. The Act is similar in many respects to the Fair Credit Billing Act (see *Chapter 42*), which applies to credit card transactions. The EFTA is administered by the Board of Governors of the Federal Reserve System, which is mandated to prescribe regulations to carry out the purposes of the Act. Pursuant to this congressional mandate, the Federal Reserve has issued Regulation E.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (CFPA), discussed in *Chapter 42*, requires that the amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction must be reasonable and proportional to the cost incurred by the issuer, as determined by the Federal Reserve. Debit cards issued by small banks and prepaid reloadable cards are exempt from this rule.

DISCLOSURE

The EFTA is primarily a disclosure statute and as such requires that the terms and conditions of electronic funds transfers involving a consumer's account be disclosed in readily understandable language at the time the consumer contracts for such services. Included among the required disclosure are the consumer's liability for unauthorized transfers, the kinds of EFTs allowed, the charges for transfers or for the right to make transfers, the consumer's right to stop payment of preauthorized EFTs, the consumer's right to receive documentation of EFTs, rules concerning disclosure of information to third parties, procedures for correcting account errors, and the financial institution's liability to the consumer under the Act.

DOCUMENTATION AND PERIODIC STATEMENTS

The Act requires the financial institution to provide the consumer with written documentation of each transfer made from an electronic terminal at the time of transfer—a receipt. The receipt must clearly state the amount involved, the date, the type of transfer, the identity of the account(s) involved, the identity of any third party involved, and the location of the terminal involved.

In addition, the financial institution must provide each consumer with a periodic statement for each account of the consumer that may be accessed by means of an EFT. The statement must describe the amount, date, and location for each transfer; the fee, if any, to be charged for the transaction;

and an address and phone number for questions and information.

PREAUTHORIZED TRANSFERS

A preauthorized transfer from a consumer's account must be authorized in advance and in writing by the consumer, and a copy of the authorization must be provided to the consumer when the transfer is made. Up to three business days before the scheduled date of the transfer, a consumer may stop payment of a preauthorized EFT by notifying the financial institution orally or in writing, though the financial institution may require the consumer to provide written confirmation of an oral notification within fourteen days.

ERROR RESOLUTION

The consumer has sixty days after the financial institution sends a periodic statement in which to notify the institution of any errors appearing on that statement. The financial institution is required to investigate alleged errors within ten business days and to report its findings within three business days after completing the investigation. If the financial institution needs more than ten days to investigate, it may take up to forty-five days, provided it recredits the consumer's account for the amount alleged to be in error. The institution must correct an error within one business day after determining that the error has occurred. Failure to investigate in good faith makes the financial institution liable to the consumer for treble damages (three times the amount of provable damages).

CONSUMER LIABILITY

A consumer's liability for an unauthorized electronic fund transfer is limited to a maximum of $50 if the consumer notifies the financial institution within two days after he learns of the loss or theft. If the consumer does not report the loss or theft within two days, he is liable for losses up to $500 but no more than $50 for the first two days. If the consumer fails to report the unauthorized use within sixty days of transmittal of a periodic statement, he is liable for losses resulting from any unauthorized EFT that appeared on the statement if the financial institution can show that the loss would not have occurred had the consumer reported the loss within sixty days; thus there is unlimited liability on unauthorized transfers made after sixty days following the bank's sending the periodic statement.

LIABILITY OF FINANCIAL INSTITUTION

A financial institution is liable to a consumer for all damages proximately caused by its failure to make an EFT in accordance with the terms and conditions of an account, in the correct amount, or in a timely manner when properly instructed to do so by the consumer. There are, however, exceptions to such liability. The financial institution will not be liable if—

1. the consumer's account has insufficient funds through no fault of the financial institution,
2. the funds are subject to legal process,
3. the transfer would exceed an established credit limit,
4. an electronic terminal has insufficient cash, or
5. circumstances beyond the financial institution's control prevent the transfer.

The financial institution is also liable for failure to stop payment of a preauthorized transfer from a consumer's account when instructed to do so in accordance with the terms and conditions of the account.

WHOLESALE FUNDS TRANSFERS

Article 4A, Funds Transfers, is designed to provide a statutory framework for payment systems that are not covered by existing Articles of the UCC or by the EFTA. The typical wholesale wire transfer involves sophisticated parties who desire great speed in transferring large sums of money. Article 4A has been universally adopted by the States and Territories. In general, "Article 4A governs a method of payment in which the person making payment (the 'originator') directly transfers an instruction to a bank to either make a payment to the person receiving the payment (the 'beneficiary') or to instruct some other bank to make payment to the beneficiary." Article 4A–102, Comment 1.

Although checks and credit cards are more common forms of payment as measured by number of transactions per day, commercial electronic transfers (commercial or wholesale wire transfers) far exceed these transactions as measured by their dollar volume, which is much greater than $1 trillion a day.

Article 4A provides that the parties to a funds transfer generally may by agreement vary their rights and obligations. Moreover, funds-transfer system rules governing banks that use the system may be effective even if such rules conflict with Article 4A. Section 4A–501. Rights and obligations under Article 4A can also be changed by Federal Reserve regulations and operating circulars of Federal Reserve Banks. Section 4A–107.

SCOPE OF ARTICLE 4A

Article 4A, which covers wholesale funds transfers, defines a funds transfer as a

> series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out

the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order. Section 4A– 104(a).

The Article, therefore, covers the transfers of credit that move from an originator to a beneficiary through the banking system. If any step in the process is governed by the EFTA, however, the entire transaction is excluded from the Article's coverage. Section 4A–108.

The following examples illustrate the coverage of the Article:

1. Johnson Co. instructs its bank, First National Bank (FNB), to pay $2 million to West Co., also a customer of FNB. FNB executes the payment order by crediting West's account with $2 million and notifying West that the credit has been made and is available.
2. Assume the same facts as those in the first example except that West's bank is Central Bank (CB). FNB will execute the payment order of Johnson Co. by issuing to CB its own payment order instructing CB to credit the account of West.
3. Assume the facts presented in the second example with the added fact that FNB does not have a correspondent relationship with CB. In this instance, FNB will have to issue its payment order to Northern Bank (NB), a bank that does have a correspondent relationship with CB, and NB will then issue its payment order to CB.

Payment Order **Payment order** is a sender's instruction to a receiving bank to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary. Section 4A–103. The instruction may be communicated orally, electronically, or in writing. To be a payment order, the instruction must—

1. not contain a condition to payment other than the time of payment;
2. be sent to a receiving bank that is to be reimbursed either by debiting an account of the sender or by otherwise receiving payment from the sender; and
3. be transmitted by the sender directly to the receiving bank or indirectly through an agent, a funds-transfer system, or a communication system.

The payment order is issued when sent and, if more than one payment is to be made, each payment represents a separate payment order. Section 4A–104(b)(c). In the examples above, one payment order is issued in the first example (from Johnson Co.), two in the second example (from Johnson Co. and from First National Bank), and three in the third example (from Johnson Co., from First National Bank, and from Northern Bank).

Parties The **originator** is either the sender of the payment order or, in a series of payment orders, the sender of the first payment order. Section 4A–104(c). A **sender** is the party who gives an instruction to the **receiving bank**, or the bank to which the sender's instruction is addressed. Section 4A–103(4). The receiving bank may be the **originator's bank**, an intermediary bank, or the **beneficiary's bank**. The originator's bank is either the bank that receives the original payment order or the originator if the originator is a bank. Section 4A–104(d). The beneficiary's bank, the last bank in the chain of a funds transfer, is the bank instructed in the payment order to credit the beneficiary's account. Section 4A–103(a)(3). The **beneficiary** is the person to be paid by the beneficiary bank. Section 4A–103(a)(2). An **intermediary bank** is any receiving bank, other than the originator's bank or the beneficiary's bank, that receives the payment order. Section 4A–104(b). Thus, in the above examples,

1. Johnson Co. is the *originator* in all three examples;
2. Johnson Co. is a *sender* in all three examples, FNB is a sender in examples 2 and 3, and NB is a sender in example 3;
3. FNB is the *receiving bank* of Johnson Co.'s payment order in all three examples; in example 2, CB is the receiving bank of FNB's payment order; and, in example 3, CB is the receiving bank of NB's payment order and NB is the receiving bank of FNB's payment order;
4. FNB is the *originator's bank* in all three examples;
5. FNB is the *beneficiary's bank* in example 1; CB is the beneficiary's bank in examples 2 and 3;
6. West is the *beneficiary* in all three examples; and
7. NB is an *intermediary bank* in example 3.

See *Figure 30-2* for a summary of the parties in these three examples. In some instances, the originator and the beneficiary may be the same party. For example, a corporation may wish to transfer funds from one account to another account that is in the same or a different bank.

◆ **SEE FIGURE 30-2: Parties to a Funds Transfer**

Excluded Transactions As previously mentioned, Section 4A–108 provides that if any part of a funds transfer is governed by the EFTA, then the transfer is excluded from Article 4A coverage. In addition, Article 4A covers only credit transactions; it therefore excludes debit transactions. If the person making the payment gives the instruction, the transfer is a credit transfer. If, however, the person receiving the payment gives the instruction, the transfer is a debit transfer. For example, a seller of goods obtains authority from the purchaser to debit the purchaser's account after the seller ships the goods. Article 4A does not cover this transaction because the instructions to make payment issue from the beneficiary (the seller), not from the party whose account is to be debited (the purchaser).

◆ **SEE FIGURE 30-3: Credit Transaction**

◆ **FIGURE 30-2: Parties to a Funds Transfer**

	Example 1	Example 2	Example 3
Originator	Johnson Co.	Johnson Co.	Johnson Co.
Sender(s)	Johnson Co.	Johnson Co.	Johnson Co.
		FNB	FNB
			NB
Receiving Bank(s)	FNB	FNB	FNB
		CB	CB
			NB
Originator's Bank	FNB	FNB	FNB
Beneficiary's Bank	FNB	CB	CB
Beneficiary	West	West	West
Intermediary Bank	—	—	NB

Note: CB = Central Bank; FNB = First National Bank; NB = Northern Bank.

ACCEPTANCE

Rights and obligations arise as a result of a receiving bank's acceptance of a payment order. The effect of acceptance depends upon whether the payment order was issued to the beneficiary's bank or to a receiving bank other than the beneficiary's bank.

If a receiving bank is not the beneficiary's bank, the receiving bank does not subject itself to any liability until it accepts the instrument. Acceptance by a receiving bank other than the beneficiary's bank occurs when the receiving bank executes the sender's order. Section 4A–209(a). Such execution occurs when the receiving bank "issues a payment order intended to carry out" the sender's payment order. Section 4A–301(a). When the receiving bank executes the sender's payment order, the bank is entitled to payment from the sender and can debit the sender's account. Section 4A–402(c).

The beneficiary's bank may accept an order in any of three ways, and acceptance occurs at the earliest of these events: (1) when the bank (a) pays the beneficiary or (b) notifies the beneficiary that the bank has received the order or has credited the beneficiary's account with the funds; (2) when the bank receives payment of the sender's order; or (3) the opening of the next funds-transfer business day of the bank after the payment date of the order if the order was not rejected and funds are available for payment. Section 4A–209(b).

If a beneficiary's bank accepts a payment order, the bank is obliged to pay the beneficiary the amount of the order. Section 4A–404(a). The bank's acceptance of the payment order does not, however, create any obligation to either the sender or the originator.

ERRONEOUS EXECUTION OF PAYMENT ORDERS

If a receiving bank mistakenly executes a payment order for an amount greater than the amount authorized, the bank is entitled to payment only in the amount of the sender's correct order. Section 4A–303(a). To the extent allowed by the law governing mistake and restitution, the receiving bank may then recover from the beneficiary of the erroneous order the amount in excess of the authorized amount. If the

◆ **FIGURE 30-3: Credit Transaction**

wrong beneficiary is paid, however, the bank that issued the erroneous payment order is entitled to payment neither from its sender nor from prior senders and has the burden of recovering the payment from the improper beneficiary. Section 4A–303(c).

UNAUTHORIZED PAYMENT ORDERS

If a bank wishing to prevent unauthorized transactions establishes commercially reasonable security measures, to which a customer agrees, and the bank properly follows the process it has established, the customer must pay an order even if it was unauthorized. Section 4A–202. The customer, however, can avoid liability by showing that the unauthorized order was not caused directly or indirectly by (1) a person with access to confidential security information who was acting for the customer or (2) a person who obtained such information from a source controlled by the customer. Section 4A–203.

CHAPTER SUMMARY

BANK DEPOSITS AND COLLECTIONS

COLLECTION OF ITEMS

Depositary Bank the bank in which the payee or holder deposits a check for credit
Provisional Credit tentative credit for the deposit of an instrument until final credit is given
Final Credit payment of the instrument by the payor bank; if the payor bank (drawee) does not pay the check, the depositary bank reverses the provisional credit
Intermediary Bank a bank, other than the depositary or payor bank, involved in the collection process
Collecting Bank any bank (other than the payor bank) handling the item for payment
- ***Agency*** a collecting bank is an agent or subagent of the owner of the check until the settlement becomes final
- ***Duty of Care*** a collecting bank must exercise ordinary care in handling an item
- ***Duty to Act Timely*** a collecting bank acts timely if it takes proper action before its midnight deadline (midnight of the next banking day)
- ***Indorsements*** if an item is restrictively indorsed "for deposit only," only a bank may be a holder
- ***Warranties*** customers and collecting banks give warranties on transfer, presentment, and encoding
- ***Final Payment*** occurs when the payor bank does any of the following, whichever happens first: (1) pays an item in cash; (2) settles and does not have the right to revoke the settlement; or (3) makes a provisional settlement and does not properly revoke it

Payor Bank under its contract with the drawer, the payor or drawee bank agrees to pay to the payee or his order checks that are issued by the drawer, provided the order is not countermanded by a stop payment order and provided there are sufficient funds in the drawer's account

RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

Contractual Relationship the relationship between a payor bank and its checking account customer is primarily the product of their contractual arrangement
Payment of an Item when a payor receives an item for which the funds in the account are insufficient, the bank may either dishonor the item and return it or pay the item and charge the customer's account even though an overdraft is created

Substitute Check a paper reproduction of the original check that is the legal equivalent of an original check for all purposes
Stop Payment Orders an oral stop payment order (a command from a drawer to a drawee not to pay an instrument) is binding for fourteen calendar days; a written order is effective for six months and may be renewed in writing
Bank's Right to Subrogation on Improper Payment if a payor bank pays an item over a stop payment order or otherwise in violation of its contract, the payor bank is subrogated to (obtains) the rights of (1) any holder in due course on the item against the drawer or maker; (2) the payee or any other holder against the drawer or maker; and (3) the drawer or maker against the payee or any other holder
Disclosure Requirement all depositary institutions must disclose in great detail to their consumers the terms and conditions of their deposit account
Customer's Death or Incompetence a bank may pay an item if it does not know of the customer's incompetency or death
Customer's Duties the customer must examine bank statements and items carefully and promptly to discover any unauthorized signatures or alterations

ELECTRONIC FUNDS TRANSFERS

NATURE AND TYPES OF ELECTRONIC FUNDS TRANSFERS

Definition any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account
Purpose to eliminate the paperwork involved in processing checks and the "float" available to a drawer of a check
Types of Electronic Funds Transfers
- ***Automated Teller Machines***
- ***Point-of-Sale Systems***
- ***Direct Deposits and Withdrawals***
- ***Pay-by-Phone Systems***
- ***Personal Computer (Online) Banking***
- ***Wholesale Electronic Funds Transfers***

CONSUMER FUNDS TRANSFERS

Electronic Fund Transfer Act provides a basic framework establishing the rights, liabilities, and responsibilities of participants in consumer electronic funds transfers
Financial Institution Responsibility liable to a consumer for all damages proximately caused by its failure to properly handle an electronic fund transfer transaction

WHOLESALE FUNDS TRANSFERS

Scope of Article 4A
- ***Wholesale Funds Transfers*** the movement of funds through the banking system; excludes all transactions governed by the Electronic Fund Transfer Act
- ***Payment Order*** an instruction of sender to a receiving bank to pay, or to cause another bank to pay, a fixed amount of money to a beneficiary
- ***Parties*** include originator, sender, receiving bank, originator's bank, beneficiary's bank, beneficiary, and intermediary banks

Acceptance rights and obligations that arise as a result of a receiving bank's acceptance of a payment order

CASES

CASE 30-1

Duty of Care
HONEYCUTT v. HONEYCUTT

Court of Special Appeals of Maryland, 2002
150 Md.App. 604, 822 A.2d 551, cert. denied, 376 Md. 544, 831 A.2d 4 (2003)
http://caselaw.lp.findlaw.com/data2/marylandstatecases/cosa/2003/68s02.pdf

Thieme, J.

In this appeal, we review two orders entered by the Circuit Court for Baltimore City, which granted two separate Motions for Summary Judgment filed by Bank of America, N.A., appellee, against Sheldon, Inc., appellant (“Sheldon”), and Nancy Honeycutt, Personal Representative of the Estate of Ron Honeycutt, appellant (“the Estate”). Appellants’ claims arose when Christine Honeycutt (“Christine Honeycutt”) withdrew approximately $13,000 from the account of Sheldon maintained with the Bank. Christine Honeycutt was a former officer of Sheldon and, at the time of the withdrawal, was an authorized signatory on Sheldon’s account.

On March 13, 2000, Sheldon commenced an action against Christine Honeycutt, the former vice-president and secretary of Sheldon, in the District Court of Maryland for Baltimore City in connection with her withdrawal of funds from Sheldon’s account with the Bank * * *. On May 4, 2000, Sheldon amended its original Complaint in the District Court to assert additional claims against Christine Honeycutt and to add the Bank as a defendant. In its Amended Complaint, Sheldon asserted claims for conversion, breach of contract, and negligence against the Bank for permitting the allegedly unauthorized withdrawal.

* * *

On May 22, 2001, the Bank filed a Motion for Summary Judgment * * *. In its Motion, the Bank argued that * * * (ii) at the time Christine Honeycutt withdrew funds from Sheldon’s account, she was an authorized signatory on the account and, therefore, the Bank committed no legal wrong when it permitted the withdrawal. * * *

* * *

Appellants’ claims against Christine Honeycutt in the Circuit Court action were tried without a jury on February 15, 2002. The Honorable William D. Quarles presided and rendered a verdict in favor of the Estate and against Christine Honeycutt on the breach of contract claim.

The Estate and Sheldon filed a timely Notice of Appeal, on March 13, 2002, and now present two questions for our review:

> I. WAS THE LOWER COURT LEGALLY CORRECT IN GRANTING THE MOTION FOR SUMMARY JUDGMENT OF APPELLEE, BANK OF AMERICA, N.A. (“APPELLEE BANK”) AGAINST ESTATE, ON THE BASIS THAT THERE WAS NO FACTUAL EVIDENCE TO SUPPORT THE CONTENTION THAT APPELLEE BANK HAD BREACHED ITS AGREEMENT AND/OR HAD BEEN NEGLIGENT IN THIS MATTER?

* * *

For the reasons that follow, we shall affirm the judgment of the circuit court.

Factual Background

Ron Honeycutt was the president, treasurer, and sole stockholder of Sheldon, Inc., which trades as Sheldon’s Lounge, a bar located in Baltimore City. Christine Honeycutt was, at one time, Ron Honeycutt’s wife and held the position of vice-president and secretary of Sheldon. On July 1, 1984, Ron Honeycutt and Christine Honeycutt opened a business checking account with Maryland National Bank, now known as Bank of America, N.A., in the name of Sheldon’s Lounge. At that time, Ron Honeycutt and Christine Honeycutt executed a signature card for the account. The signature card read, in pertinent part:

> In consideration of the opening of this account and the maintenance thereof by Maryland National Bank (hereinafter “Bank), the signer(s) (hereinafter “depositor”) by the signature(s) subscribed below agree(s) to the Rules and Regulations of Contract provided to depositor herewith. Bank is authorized to recognize and rely upon any of the signature(s) below on checks, drafts and orders for the payment of money, the withdrawals of funds, or the transaction of any business to this account. Depositor acknowledges receipt of a copy of the Rules and Regulations governing this account.

On the signature card, Ron Honeycutt and Christine Honeycutt checked off the box requiring only one signature to transact any business on the account. Ron Honeycutt and Christine Honeycutt were the only authorized signatories on the account and remained the only authorized signatories throughout the entire time that the Bank maintained the account.

Ron Honeycutt died February 10, 2000. On February 15, 2000, Christine Honeycutt withdrew funds in the amount of $13,066.48 from Sheldon’s account. At the time of withdrawal, an employee of the Bank retrieved and reviewed the signature card on file with the Bank in order to transactions on Sheldon's account. The Bank did not inquire as to Christine Honeycutt's status with respect to Sheldon, nor did they inquire of anyone at Sheldon as to her status. At the time, the Bank was unaware that Ron Honeycutt had died. The withdrawal took the form of a cashier's check made payable to Christine Honeycutt. According to the signature card on file at the Bank at the time Christine Honeycutt withdrew the funds, she was an authorized signatory on the account and the Bank was authorized to recognize and rely upon her signature on orders for the withdrawal of funds or the transaction of any business to the account. It was Christine Honeycutt's contention that the bank employees told her that the "money belonged to her."

Discussion

* * *

Sheldon argues that the Bank breached its duty of care "by failing to make an adequate inquiry as to the authority of Christine Honeycutt to conduct banking on behalf of the business." We disagree.

"A bank and its customers enjoy a debtor/creditor relationship in which the rights and liabilities of each are contractual." [Citations.] "Implicit in the contract [between the bank and customer] is the duty of the bank to use ordinary care in disbursing the depositor's funds." [Citations.] * * *

A signature card may constitute a contract between a bank and its customer. [Citation.] "The signature card constituted the contract between the parties and, subject to the statutory schemes, regulates their rights and duties." [Citations.]

* * *

Here, Ron and Christine Honeycutt, on July 1, 1984, opened a business checking account in the name of Sheldon's Lounge with the Bank's predecessor. On that same day, Ron and Christine Honeycutt executed a signature card and checked off the box requiring only one signature to transact any business on the account. * * * [T]he signature card created a contractual obligation on the part of the Bank to pay the depositor's funds only as authorized by the signature card. The plain language of the signature card established that both Ron and Christine Honeycutt were authorized signatories able to transact business on Sheldon's account. Moreover, the signature card expressly and unambiguously provided that the Bank is authorized to recognize and rely upon either of Ron or Christine Honeycutt's signatures on checks, drafts and orders for the payment of money, the withdrawal of funds, or the transaction of any business to Sheldon's account.

When Christine Honeycutt withdrew funds from Sheldon's account, we find, the Bank did not breach any standard of care owed to appellants. The Bank exercised reasonable care when it inspected the signature card on file for Sheldon's account and verified that Christine Honeycutt was an authorized signatory on the account. Moreover, we are persuaded that no further inquiry was required as the Bank was legally entitled to release the funds to Christine Honeycutt based upon the express authority created by the signature card. Thus, because there was no genuine dispute as to any material fact, *i.e.*, that the 1984 signature card was the authoritative document on file with the Bank, we find that the lower court was correct to conclude, as a matter of law, that the signature card controlled the transaction and was correct to enter summary judgment in favor of appellee.

* * *

JUDGMENT AFFIRMED; * * *.

CASE 30-2

Payment of an Item/Stop Payment Order
LEIBLING, P.C. v. MELLON PSFS (NJ) NATIONAL ASSOCIATION

Superior Court of New Jersey, Law Division, Special Civil Part, Camden County, 1998
710 A.2d 1067, 311 N.J. Super. 651, 35 UCC Rep. Serv.2d 590

Rand, J.

Facts

Mr. Scott D. Liebling, P.C. (hereinafter "Plaintiff") is an attorney at law. Plaintiff maintains an attorney trust account ("Account") at Mellon Bank (NJ) National Association ("Mellon") * * *. Mellon uses a computerized system to process checks for payment.

Plaintiff represented defendant Fredy Winda Ramos ("Ramos") in a personal injury action which resulted in a settlement. On or about May 19, 1995, plaintiff issued Check No. 1031 in the amount of $8,483.06 to Ramos representing her net proceeds from the On or about May 24, 1995, plaintiff mistakenly issued another check, Check No. 1043, to Ramos in the same amount of $8,483.06. Realizing his error, on or about May 30, 1995, Plaintiff called Ramos in Puerto Rico and advised her that the Check No. 1043 was issued by mistake and instructed her to destroy the check. Thereafter, Plaintiff called Mellon and ordered an oral stop payment on the check.

On December 21, 1996, some nineteen months after plaintiff issued the Check No. 1043, Ramos cashed the check from Puerto Rico.

Plaintiff filed this complaint against both Ramos and Mellon. Ramos was served and defaulted. Plaintiff's com-negligence, breach of fiduciary duty, payment of a stale check, and breach of contract as a result of Mellon honoring the second check, Check No. 1043.

* * *

Issue

Whether the defendant bank acted in good faith when it honored a check that was presented for payment nineteen months after it was issued and subsequent to the expiration of an oral stop payment order.

Discussion

It is important to consider the relevant New Jersey statute sections before discussing what actions constitute "good faith." Under [UCC] 4–403(b):

> [a] stop-payment order is effective for six months, but it lapses after 14 calendar days if the original order was oral and was not confirmed in writing within that period. A stop-payment order may be renewed for additional six-month periods by a writing given to the bank within a period during which the stop-payment order is effective.

In addition, [UCC] 4–404 states:

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

Thus, the issue in the present case turns on whether Mellon acted in good faith when it honored plaintiff's check. Good faith under N.J. Uniform Commercial Code has been defined in [UCC] 3–103(a)(4) as "honesty in fact and the observance of reasonable commercial standards of fair dealing." Since there is no New Jersey case law directly on point, it is necessary to consider alternate sources. One law review article [citation] addressed the present issue. Specifically, the article explained that "Article 4 of the Uniform Commercial Code imposes on all banks the responsibility to act in good faith and to exercise ordinary care. The drafters of the Code chose not to provide an explicit definition of 'ordinary' care, stating only that the term is to be used 'with its normal tort meaning and not in any special sense relating to bank collections.'" [Citation.] * * *

In addition, the Third Circuit case of [citation] appears to be analogous to the present issue. In [that case], an insurance company brought a subrogation action against a payor bank to recover on an altered check that the bank had paid. On April 17, 1984, the plaintiff placed a written stop-payment order on a certain check, and under applicable state law the stop-payment order was good for six months. On December 26, 1984, two months after the stop payment order had expired, the bank honored the check. Before concluding that the payor bank had acted in good faith, the court analyzed the definition of "good faith." The court stated that "[UCC] §1–201 defines good faith as 'honesty in fact.' This definition must be viewed subjectively; a finding of bad faith must be predicated on a showing of dishonesty. Likewise, mere negligence does not preclude a finding of good faith." [Citation.] In holding that the bank had acted in good faith, the court stated:

> [a]s a result of the expiration of the order, [the bank] cannot be said to have the actual knowledge that would deny it the status of a good faith payor * * *. The obligations which a bank incurs as a result of its customer's imposing a stop order on a check do not continue in perpetuity * * *. [The bank] was neither negligent nor reckless and certainly cannot be said to have been subjectively dishonest * * *. A finding of bad faith requires actual knowledge on the part of the payor. An objective inquiry into what the circumstances should have revealed to [the bank] is simply not germane to the analysis.

[Citation.]

* * *

In contrast, plaintiff's argument centers on the proposition that the bank's duty of good faith required it to inquire or consult with plaintiff before honoring a stale check that had a previous oral stop payment order on it. * * *

However, in the Uniform Commercial Code Treatise, Mr. Hawkland stated that the above cases are not consistent with the Uniform Commercial Code, specifically, "[t]he duty [of inquiry] is inconsistent with the provisions of subsection 4–403(2) on the expiration of the 'effectiveness' of stop orders. Such a duty is hardly practical today." Moreover: "[t]o require that a payor bank check the date of every check received via the collection process would unreasonably increase the cost of processing every check written today."

* * *

The Commercial Code was initially adopted in November, 1961 in New Jersey. In 1990, Articles III and IV of the Code were substantially revised relating to, among other things, bank deposits and collections to become effective on June 1, 1995. The court is satisfied as pointed out by the defendant that those Amendments were enacted in order to address the effect of automated systems utilized by banks with the substantial increase in check usage after the original enactment of the Code. The Official Code Comment to the 1995 Amendments for §[UCC] 4–101, states as follows:

> **1.** The great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. 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. The Article meets that need.

2. * * * An important goal of the 1990 revision of Article 4 is to promote the efficiency of the check collection process by making the provisions of Article 4 more compatible with the needs of an automated system and, by doing so, increase the speed and lower the cost of check collection for those who write and receive checks. * * *

[Citation.]

* * *

Thus, in determining whether the defendant bank in the present action acted in good faith, the above cited material must be analyzed and applied. First, it appears clear that the Uniform Commercial Code acknowledges that computerized check processing systems are common and accepted banking procedures in the United States. [Citation.] Therefore, it cannot be said that defendant bank acted in bad faith by using a computerized system when it honored plaintiff's "stale" check. Furthermore, it appears that the test for good faith is a subjective test. Thus, based on all of the foregoing material, as long as the defendant bank used an adequate computer system for processing checks (here there is no proof to the contrary), it appears to have acted in good faith even though it did not consult the Plaintiff before it honored the "stale" check that had an expired oral stop-payment order on it * * *. [T]he obligation of a bank to stop payment on a check does not continue in perpetuity once the stop payment order expires.

The bank's conduct was fair and in accordance with reasonable commercial standards. Accordingly, it appears that the defendant bank is not liable and should prevail. A finding of no liability is entered for the defendant bank.

CASE 30-3

Bank's Right to Subrogation
SEIGEL v. MERRILL LYNCH, PIERCE, FENNER, & SMITH, INC.

District of Columbia Court of Appeals, 2000
745 A.2d 301
http://www.dcbar.org/dcca/pdf/98cv1159.pdf

Steadman J.

* * *

The events giving rise to this lawsuit arose in January and February of 1997 * * *. During that time period, plaintiff/appellant Seigel, a Maryland resident, traveled to Atlantic City, New Jersey to gamble. While there, he wrote a number of checks to various casinos, and, in exchange, received gambling chips with which to wager. The checks were drawn on Seigel's cash management account with defendant/appellee, which was established through Merrill Lynch's District of Columbia offices. There were sufficient funds in the account to cover all the checks.

Seigel eventually gambled away all of the chips he had received for the checks. Upon returning to Maryland, Seigel discussed the status of the outstanding checks with Merrill Lynch, informing his broker of the gambling nature of the transactions, and his desire to avoid realizing the apparent losses. Merrill Lynch informed Seigel that it was possible to escape paying the checks by placing a stop payment order and liquidating his cash management account. Seigel took this advice and instructed Merrill Lynch to close his account, liquidate the assets, and not to honor any checks drawn on the account. Merrill Lynch agreed, and confirmed Seigel's instructions.

Many of the checks were subsequently dishonored, and are not now at issue. However, Merrill Lynch accidentally paid several of the checks totaling $143,000, despite the stop payment order and account closure. Merrill Lynch then debited Seigel's margin account to cover the payments.

Seigel brought suit in the District of Columbia against Merrill Lynch * * * demanding a return of the $143,000 plus interest * * *. Seigel filed a motion for summary judgment * * *. He argued that D.C. Code §16–1701 precluded enforcement of the checks as a void gambling debt, or in the alternative that New Jersey law prohibited the enforcement of the checks, and that therefore Merrill Lynch had no rights by way of subrogation as a defense to its payment over the stop payment order. Merrill Lynch made a cross-motion for summary judgment, denying the applicability of the D.C. statute or any relevant New Jersey law. It contended that it stood in the shoes of the casinos to whom valid and enforceable checks were given, and therefore the plaintiff had not suffered any actual loss as a result of the payment of the checks. On June 24, 1998, the trial court issued an order granting defendant's motion, and dismissing the complaint. This appeal followed.

* * *

We begin with an examination of the statutory scheme relating to stop payment orders, because we believe these provisions are determinative of this appeal. The relevant sections are found in the Uniform Commercial Code * * * §§4403 and 4407.

The basic right of the depositor to stop payment on any item drawn on the depositor's account is set forth in Section 4403(a). However, liability on the bank for payment over a stop payment order is far from automatic. On the contrary, Section 4403(c) provides: "The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop payment order or order to close an account is on the customer."

This provision, which places the burden on the customer to show actual loss, is reinforced by the extensive rights of subrogation given to the payor bank by Section 4407. Under that section, as to the drawer or maker (that is, the depositor), the bank is subrogated both to the rights of "any holder in due course on the item" and to the rights 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." As a leading authority on the Uniform Commercial Code has noted, this section "contemplates that the bank will use its subrogation rights primarily to defend against a suit by the customer to recover payment." [Citation.]

As applied to the facts here, then, Seigel is required to bear the burden of establishing that he in fact suffered a loss as a result of the payment of the checks. In assessing whether any such loss was actually incurred, Merrill Lynch must be treated as the subrogee of any rights of the casino payees against Seigel. As the payee of a dishonored check, the casino would have a prima facie right to recover its amount from Seigel as drawer, 3414(b), and the burden would be on Seigel to establish any defense he might assert on the instrument. 3308(b); [citation]. Seigel asserts two such defenses: duress and illegality. We turn to an examination of those defenses.

* * *

The entirety of appellant's duress argument emanates from a single sentence in his affidavit: "For years I have had [a] gambling problem." If not ambiguous, the statement is conclusory. Unlike the gambler in [citation], appellant fails to produce any evidence in the record, specific or otherwise, regarding his problem and its relation to any unconscionable duress in the transactions at issue. [Citation] (describing an abusive and bizarre "marathon gambling session," that included unsolicited credit increases from the casino, the existence of an alleged psychological disorder and defendant's concomitant use of pain killers, during which the defendant lost $285,000 in little over two days) * * *. We therefore conclude that Seigel's assertion that the checks would be unenforceable in New Jersey fails. Seigel also invokes the fact that these checks were given in order to obtain chips with which to gamble, and cites us in particular to D.C. Code * * * [which] provides that:

> A thing in action, judgment, mortgage, or other security or conveyance made and executed by a person in which any part of the consideration is for money or other valuable things won by playing at any game whatsoever, or by betting on the sides or hands of persons who play, or for the reimbursement or payment of any money knowingly lent or advanced for the purpose, or lent or advanced at the time and place of the play or bet, to a person so playing or betting or who, during the play, so plays or bets, is void.

In substance, Seigel claims that this statute would serve as a defense if the casinos were to seek to enforce the checks in the first instance in a District of Columbia court, and therefore this same statute requires that he be entitled to affirmatively recover from Merrill Lynch the amount of the checks in a District of Columbia court, regardless of the checks' enforceability elsewhere.

We may assume for present purposes that this statute would prevent direct enforcement of the checks in the District of Columbia, a somewhat dubious proposition in itself given the validity of the checks where made. But that is not this case. Rather, the question is whether under the relevant provisions of the Uniform Commercial Code, Seigel has met his burden of proof to establish actual loss. We think he has not.

As already indicated, even if payment had been stopped, the casinos could have enforced the checks in New Jersey, where the transaction was entered into. Merrill Lynch therefore, under the Code scheme, conceptually has the same right. Furthermore, even if there were a problem in asserting jurisdiction over Seigel in New Jersey, Maryland would have provided an appropriate forum for enforcing the checks. The highest Maryland court has squarely held that because there is no longer a strong public policy against gambling per se, * * * and that therefore Maryland courts will enforce gambling debts if legally incurred in a foreign jurisdiction. [Citation.] Accordingly the casinos, and hence derivatively Merrill Lynch, could enforce the checks directly against Seigel in the state of his residence—Maryland.

* * *

We conclude that Seigel failed to establish that he ultimately suffered any actual loss as a result of the payment of the checks by Merrill Lynch. * * *

Affirmed.

CASE 30-4

Customer's Duties
UNION PLANTERS BANK, NATIONAL ASSOCIATION v. ROGERS

Supreme Court of Mississippi, 2005
912 So.2d 116
http://www.mssc.state.ms.us/Images/Opinions/CO25666.pdf

Waller, J.

This appeal involves an issue of first impression in Mississippi—the interpretation of [UCC] 4–406 (Rev. 2002), which imposes duties on banks and their customers insofar as forgeries are concerned. The case arises from a series of forgeries made by one person on four checking accounts maintained by Helen Rogers at the Union Planters Bank. * * *

Facts

Neal D. and Helen K. Rogers maintained four checking accounts with the Union Planters Bank in Greenville, Washington County, Mississippi. * * * The Rogers were both in their eighties when the events which gave rise to this lawsuit took place. After Neal became bedridden, Helen hired Jackie Reese to help her take care of Neal and to do chores and errands.

In September of 2000, Reese began writing checks on the Rogerses' four accounts and forged Helen's name on the signature line. Some of the checks were made out to "cash," some to "Helen K. Rogers," and some to "Jackie Reese." The following chart summarizes the forgeries to each account:

ACCOUNT NUMBER	BEGINNING	ENDING	NUMBER OF CHECKS	AMOUNT OF CHECKS
54282309	11/27/2000	6/18/2001	46	$16,635.00
0039289441	9/27/2000	1/25/2001	10	$ 2,701.00
6100110922	11/29/2000	8/13/2001	29	$ 9,297.00
6404000343	11/20/2000	8/16/2001	83	$29,765.00
TOTAL			**168**	**$58,398.00**

Neal died in late May of 2001. Shortly thereafter, the Rogerses' son, Neal, Jr., began helping Helen with financial matters. Together they discovered that many bank statements were missing and that there was not as much money in the accounts as they had thought. In June of 2001, they contacted Union Planters and asked for copies of the missing bank statements. In September of 2001, Helen was advised by Union Planters to contact the police due to forgeries made on her accounts. * * *

Subsequently, criminal charges were brought against Reese. In the meantime, Helen filed suit against Union Planters, alleging conversion (unlawful payment of forged checks) and negligence. After a trial, the jury awarded Helen $29,595 in damages, and the circuit court entered judgment accordingly. From this judgment, Union Planters appeals.

Discussion

* * *

The relationship between Rogers and Union Planters is governed by Article 4 of the Uniform Commercial Code, [citation]. [UCC] Section 4–406(a) & (c) provide that a bank customer has a duty to discover and report "unauthorized signatures"; i.e., forgeries. Section 4–406 of the UCC reflects an underlying policy decision that furthers the UCC's "objective of promoting certainty and predictability in commercial transactions." The UCC facilitates financial transactions, benefitting both consumers and financial institutions, by allocating responsibility among the parties according to whomever is best able to prevent a loss. Because the customer is more familiar with his own signature, and should know whether or not he authorized a particular withdrawal or check, he can prevent further unauthorized activity better than a financial institution which may process thousands of transactions in a single day. Section 4–406 acknowledges that the customer is best situated to detect unauthorized transactions on his own account by placing the burden on the customer to exercise reasonable care to discover and report such transactions. The customer's duty to exercise this care is triggered when the bank satisfies its burden to provide sufficient information to the customer. As a result, if the bank provides sufficient information, the customer bears the loss when he fails to detect and notify the bank about unauthorized transactions. [Citation.]

A. Union Planters' Duty to Provide Information under §4–406(a).

The court admitted into evidence copies of all Union Planters statements sent to Rogers during the relevant time period. Enclosed with the bank statements were either the cancelled checks themselves or copies of the checks relating to the period of time of each statement. The evidence shows that all bank statements and cancelled checks were sent, via United States Mail, postage prepaid, to all customers at their "designated address" each month. Rogers introduced no evidence to the contrary. We therefore find that the bank fulfilled its duty of making the statements available to Rogers and that the remaining provisions of §4–406 are applicable to the case at bar. * * *

In defense of her failure to inspect the bank statements, Rogers claims that she never received the bank statements and cancelled checks. Even if this allegation is true, it does not excuse Rogers from failing to fulfill her duties under §4–406(a) & (c) because the statute clearly states a bank discharges its duty in providing the necessary information to a customer when it "*sends* … to a customer a statement of account showing payment of items." §4–406(a) (emphasis added). [Citation.] The word "receive" is absent. The customer's duty to inspect and report does not arise when the statement is received, as Rogers claims; the customer's duty to inspect and report arises when the bank sends the statement to the customer's address. A reasonable person who has not received a monthly statement from the bank would promptly ask the bank for a copy of the statement. Here, Rogers claims that she did not receive numerous statements. We find that she failed to act reasonably when she failed to take any action to replace the missing statements.

B. Rogers' Duty to Report the Forgeries under §4–406(d).

A customer who has not promptly notified a bank of an irregularity may be precluded from bringing certain claims against the bank:

> (d) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection (c), the customer is precluded from asserting against the bank:
>
> (1) The customer's unauthorized signature … on the item, if the bank also proves that it suffered a loss by reason of the failure; …

[UCC] §4–406(d)(1).

Also, when there is a series of forgeries, §4–406(d)(2) places additional duties on the customer:

> (2) The customer's unauthorized signature … by the same wrongdoer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature … and after the customer had been afforded a reasonable period of time, not exceeding thirty (30) days, in which to examine the item or statement of account and notify the bank.

A bank may shorten the customer's thirty-day period for notifying the bank of a series of forgeries, and here, Union Planters shortened the thirty-day period to fifteen days. The statute states that a customer must report a series of forgeries within "a reasonable period of time, *not exceeding* thirty (30) days." "The 30-day period is an outside limit only. However 30 days is presumed to be reasonable and the bank bears the burden of proving otherwise." [Citation.]

Although there is no mention of a specific date, Rogers testified that she and her son began looking for the statements in late May or early June of 2001, after her husband had died. Her son felt that it was prudent to consolidate some of the five bank accounts. When they discovered that statements were missing, they notified Union Planters in June of 2001 to replace the statements. At this time, no mention of possible forgery was made, even though Neal, Jr., thought that "something was wrong." In fact, Neal, Jr., had felt that something was wrong as far back as December of 2000, but failed to do anything. Neal, Jr., testified that neither he nor his mother knew that Reese had been forging checks until September of 2001. Courts in Louisiana and Texas have held that, under similar circumstances, a customer's claims against a bank for paying forged checks are without merit. [Citations.]

Rogers is therefore precluded from making claims against Union Planters because (1) under §4–406(a), Union Planters provided the statements to Rogers, and (2) under §4–406(d)(2), Rogers failed to notify Union Planters of the forgeries within 15 and/or 30 days of the date she should have reasonably discovered the forgeries.

* * *

* * * [U]nder §4–406, Rogers is precluded from recovering amounts paid by Union Planters on any of the forged checks because she failed to timely detect and notify the bank of the unauthorized transactions and because she failed to show that Union Planters failed to use ordinary care in its processing of the forged checks. Therefore, we reverse the circuit court's judgment and render judgment here that Rogers take nothing and that the complaint and this action are finally dismissed with prejudice.

QUESTIONS

1. Identify and explain the various stages and parties to the collection of a check.
2. Discuss the duties of collecting banks.
3. Discuss the relationship between a payor bank and its customers.
4. Define a consumer electronic funds transfer and outline the major provisions of the Electronic Fund Transfer Act.
5. Define a wholesale funds transfer and identify the parties to such a transfer.

PROBLEMS

1. On November 9, Jane Jones writes a check for $5,000 payable to Ralph Rodgers in payment for goods to be received later in the month. Before the close of business on November 9, Jane notifies the bank by telephone to stop payment on the check. On December 19, Ralph gives the check to Bill Briggs for value and without notice. On December 20, Bill deposits the check in his account at Bank A. On December 21, Bank A sends the check to its correspondent, Bank B. On December 22, Bank B presents the check through the clearinghouse to Bank C. On December 23, Bank C presents the check to Bank P, the payor bank. On December 28, the payor bank makes payment of the check final. Is Jane Jones' stop payment order effective against the payor bank? Explain.

2. Howard Harrison, a longtime customer of Western Bank, operates a small department store, Harrison's Store. Because his store has few experienced employees, Harrison frequently travels throughout the United States on buying trips, although he also runs the financial operations of the business. On one of his buying trips, Harrison purchased two hundred sport shirts from Well-Made Shirt Company and paid for the transaction with a check on his store account with Western Bank in the amount of $3,000. Adams, an employee of Well-Made who deposits its checks in Security Bank, sloppily raised the amount of the check to $30,000 and indorsed the check, "Pay to the order of Adams from Pension Plan Benefits, Well-Made Shirt Company by Adams." He cashed the check and cannot be found. Western Bank processed the check, paid it, and sent it to Harrison's Store with the monthly statement. After briefly examining the statement, Harrison left on another buying trip for three weeks.

(a) Assuming the bank acted in good faith and the alteration is not discovered and reported to the bank until an audit conducted thirteen months after the statement was received by Harrison's Store, who must bear the loss on the raised check?

(b) Assume that Harrison, who was unable to examine his statement promptly because of his buying trips, left instructions with the bank to carefully examine and to notify him of any item over $5,000 to be charged to his account; assume further that the bank nevertheless paid the item in his absence. Who bears the loss if the alteration is discovered one month after the statement was received by Harrison's Store? If the alteration is discovered thirteen months later?

3. Tom Jones owed Bank of Cleveland $10,000 on a note due November 17, with 1 percent interest due the bank for each day delinquent in payment. Jones issued a $10,000 check to Bank of Cleveland and deposited it in the night vault the evening of November 17. Several days later, he received a letter saying he owed one day's interest on the payment because of a one-day delinquency in payment. Jones refused because he said he had put the payment in the vault on November 17. Who is correct? Why?

4. Assume that Dinah draws a check on Oxford Bank, payable to the order of Pam; that Pam indorses it to Amy; that Amy deposits it to her account in Houston Bank; that Houston Bank presents it to Oxford Bank, the drawee; and that Oxford Bank dishonors it because of insufficient funds. Houston Bank receives notification of the dishonor on Monday but, because of an interruption of communication facilities, fails to notify Amy until Wednesday. What result?

5. Jones, a food wholesaler whose company has an account with City Bank in New York City, is traveling in California on business. He finds a particularly attractive offer and decides to buy a carload of oranges for delivery in New York. He gives Saltin, the seller, his company's check for $25,000 to pay for the purchase. Saltin deposits the check, with others he received that day, with his bank, the Carrboro Bank. Carrboro Bank sends the check to Downs Bank in Los Angeles, which in turn deposits it with the Los Angeles Federal Reserve Bank. The L.A. Fed sends the check, with others, to the N.Y. Fed, which forwards the check to City Bank, Jones's bank, for collection.

(a) Is City Bank a depositary bank? A collecting bank? A payor bank?

(b) Is Carrboro Bank a depositary bank? A collecting bank?

(c) Is the N.Y. Fed an intermediary bank?

(d) Is Downs Bank a collecting bank?

6. On April 1, Moore gave Pipkin a check properly drawn by Moore on Zebra Bank for $5,000 in payment of a painting to be framed and delivered the next day. Pipkin immediately indorsed the check and gave it to Yeager Bank as payment in full of his indebtedness to the bank on a note he previously had signed. Yeager Bank canceled the note and returned it to Pipkin.

On April 2, upon learning that the painting had been destroyed in a fire at Pipkin's studio, Moore promptly went to Zebra Bank, signed a printed form of stop payment order, and gave it to the cashier. Zebra Bank refused payment on the check upon proper presentment by Yeager Bank.

(a) What are the rights of Yeager Bank against Zebra Bank?

(b) What are the rights of Yeager Bank against Moore?

(c) Assuming that Zebra Bank inadvertently paid the amount of the check to Yeager Bank and debited Moore's account, what are the rights of Moore against Zebra Bank?

7. As payment in advance for services to be performed, Acton signed and delivered the following instrument:

> December 1, 2011
> LAST NATIONAL BANK
> MONEYVILLE, STATE X
> Pay to the order of Olaf Owen $10,500.00
> Ten Thousand Five Hundred Dollars for services to be performed by Olaf Owen starting on December 6, 2011.
> (signed) Arthur Acton

Owen requested and received Last National Bank's certification of the check even though Acton had only $9,000 on deposit. Owen indorsed the check in blank and delivered it to Dan Doty in payment of a preexisting debt.

When Owen failed to appear for work, Acton issued a written stop payment order ordering the bank not to pay the check. Doty presented the check to Last National Bank for payment. The bank refused payment.

What are the bank's rights and liabilities relating to the transactions described?

8. Jones drew a check for $1,000 on The First Bank and mailed it to the payee, Thrift, Inc. Caldwell stole the check from Thrift, Inc., chemically erased the name of the payee, and inserted the name of Henderson as payee. Caldwell also increased the amount of the check to $10,000 and, by using the name of Henderson, negotiated the check to Willis. Willis then took the check to The First Bank, obtained its certification on the check, and negotiated the check to Griffin, who deposited the check in The Second National Bank for collection. The Second National Bank forwarded the check to the Detroit Trust Company for collection from The First Bank, which honored the check. Griffin exhausted her account in The Second National Bank, and the account was closed. Shortly thereafter, The First Bank learned that it had paid an altered check. What are the rights of each of the parties?

9. Jason, who has extremely poor vision, went to an automated teller machine (ATM) to withdraw $200 on February 1. Joshua saw that Jason was having great difficulty reading the computer screen and offered to help. Joshua obtained Jason's personal identification number and secretly exchanged one of his old credit cards for Jason's ATM card. Between February 1 and February 15, Joshua withdrew $1,600 from Jason's account. On February 15, Jason discovered that his ATM card was missing and immediately notified his bank. The bank closed Jason's ATM account on February 16, by which time Joshua had withdrawn another $150. What is Jason's liability, if any, for the unauthorized use of his account?

10. On July 21, Boehmer, a customer of Birmingham Trust, secured a loan from that bank for the principal sum of $5,500 to purchase a boat allegedly being built for him by A.C. Manufacturing Company, Inc. After Boehmer signed a promissory note, Birmingham Trust issued a cashier's check to Boehmer and A.C. Manufacturing Company as payees. The check was given to Boehmer, who then forged A.C. Manufacturing Company's indorsement and deposited the check in his own account at Central Bank. Central Bank credited Boehmer's account and then placed the legend "P.I.G.," meaning "Prior Indorsements Guaranteed," on the check. The check was presented to and paid by Birmingham Trust on July 22. When the loan became delinquent in March of the following year, Birmingham Trust contacted A.C. Manufacturing Company to learn the location of the boat. They were informed that it had never been purchased, and they soon after learned that Boehmer had died on January 24 of that year. Can Birmingham Trust obtain reimbursement from Central Bank under Central's warranty of prior indorsements? Explain.

11. Advanced Alloys, Inc., issued a check in the amount of $2,500 to Sergeant Steel Corporation. The check was presented for payment fourteen months later to the Chase Manhattan Bank, which made payment on the check and charged Advanced Alloy's account. Can Advanced Alloys recover the payment made on the check? Why?

12. Laboratory Management deposited into its account at Pulaski Bank a check issued by Fairway Farms in the amount of $150,000. The date of deposit was February 5. Pulaski, the depositary bank, initiated the collection process immediately by forwarding the check to Worthen Bank on the sixth. Worthen sent the check on for collection to M Bank Dallas, and M Bank Dallas, still on February 6, delivered the check to M Bank Fort Worth. That same day, M Bank Fort Worth delivered the check to the Fort Worth Clearinghouse. Because TAB/West Side, the drawee/payor bank, was not a clearinghouse member, it had to rely on TAB/Fort Worth for further transmittal of the check. TASI, a processing center used by both TAB/Forth Worth and TAB/West Side, received the check on the sixth and processed it as a reject item because of insufficient funds. On the seventh, TAB/West Side determined to return the check unpaid. TASI gave M Bank Dallas telephone notice of the return on February 7 but physically misrouted the check. Because of this, M Bank Dallas did not physically receive the check until February 19. However, M Bank notified Worthen by telephone on the fifteenth of the dishonor and return of the check. Worthen received the check on the twenty-first and notified Pulaski by telephone on the twenty-second. Pulaski actually received the check from Worthen on the twenty-third. On February 22 and 23, Laboratory Management's checking account with Pulaski was $46,000. Pulaski did not freeze the account because it considered the return to be too late. The Laboratory Management account was finally frozen on April 30, 1985, when it had a balance of $1,400. Pulaski brings this suit against TAB/Fort Worth, TAB/Dallas, and TASI alleging their notice of dishonor was not timely relayed to Pulaski. Explain whether Pulaski is correct in its assertion.

13. On Tuesday, June 11, Siniscalchi issued a $200 check on the drawee, Valley Bank. On Saturday morning, June 15, the check was cashed. This transaction, as well as others taking place on that Saturday morning, was not recorded or processed through the bank's bookkeeping system until Monday, June 17. On that date, Siniscalchi arrived at the bank at 9:00 A.M. and asked to place a stop payment order on the check. A bank employee checked the bank records, which at that time indicated the instrument had not cleared the bank. At 9:45 A.M. she gave him a printed notice confirming his request to stop payment. Siniscalchi sought to recover the $200 paid on the check. Explain whether the stop payment order was effective.

14. Morvarid Kashanchi and her sister, Firoyeh Paydar, held a savings account with Texas Commerce Medical Bank. An unauthorized withdrawal of $4,900 from the account was allegedly made by means of a telephone conversation between some other unidentified individual and a bank employee. Paydar learned of the transfer of funds when she received her bank statement and notified the bank that the withdrawal was unauthorized. The bank, however, declined to recredit the account for the $4,900 transfer. Kashanchi brought an action against the bank, claiming that the bank had violated the Electronic Fund Transfer Act (EFTA). The bank defended by arguing that the Act did not apply. Is the transaction governed by the EFTA? Explain.

15. Tally held a savings account with American Security Bank. On seven occasions, Tally's personal secretary, who received his bank statements and had custody of his passbook, forged Tally's name on withdrawal slips that she then presented to the bank. The secretary obtained $52,825 in this manner. Three years after the secretary's last fraudulent withdrawal she confessed to Tally who promptly notified the bank of the issue. Can Tally recover the funds from American Security Bank?

16. For a period of sixteen months, Great Lakes Higher Education Corp. (Great Lakes), a not-for-profit student loan servicer, issued 224 student loan checks totaling $273,152.88. The checks were drawn against Great Lakes' account at First Wisconsin National Bank of Milwaukee (First Wisconsin). Each of the 224 checks was presented to Austin Bank of Chicago (Austin) without indorsement of the named payee. Austin Bank accepted each check for purposes of collection and without delay forwarded each check to First Wisconsin for that purpose. First Wisconsin paid Austin Bank the face amount of each check even though the indorsement signature of the payee was not on any of the checks. Has Austin Bank breached its warranty to First Wisconsin and Great Lakes due to the absence of proper indorsements? Explain.

17. Plaintiff, Mary Mansi, claims that eighteen checks on her account contain forgeries but were paid by the defendant bank, Sterling National Bank. These checks bore signatures which, according to the plaintiff's handwriting expert, were apparently "written by another person who attempted to simulate her signature" and thus were not considered obvious forgeries. The plaintiff stated at a deposition that she did not review her monthly bank statements. Sterling National Bank acknowledges that while it did honor those eighteen checks, nine of them were returned to the plaintiff more than one year prior to this action. The defendant also asserts that the plaintiff's claims on the remaining nine checks are barred due to her failure to examine her monthly bank statements. Who should prevail? Explain.