NCCUSL Articles 3, 4, and 4A Drafting Committee Highlights Current Payment System and Negotiable Instrument Issues

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By Alvin C. Harrell

1. Introduction

As noted in a previous issue, the sponsors of the Uniform Commercial Code (UCC) recently appointed a Drafting Committee to consider and draft possible revisions to UCC Articles 3, 4, and 4A. The Drafting Committee met twice during 2000, including a Chicago meeting in December 2000 that focused on a wide range of current payment system and negotiable instrument issues and developments. This article describes some of the matters discussed at the Chicago meeting.

The Articles 3, 4, and 4A Drafting Committee (Drafting Committee) was formed initially in response to enhanced prospects for “repatration” of Federal Reserve Board (FRB) Regulation CC into UCC Article 4. As noted previously, lack of support from banking industry representatives apparently doomed this effort. But once the Drafting Committee was constituted, a number of other negotiable instrument, checking account and payment system issues were presented for the Drafting Committee’s consideration.

Most of the December 2000 meeting was devoted to these issues. Nearly all represent areas where current Article 3, 4, or 4A is alleged by someone to be in need of revision, either because of problems that are said to have arisen since the previous revision effort in the late 1980s, or because of technology developments, or perhaps in some cases from a desire to reverse previous policy judgements made or confirmed too long ago.

Such a process inherently represents a risk of reigniting old disputes that were thought to have been settled years ago. The Drafting Committee seems cognizant of the need to avoid reopening old wounds or reinventing the wheel, and has sought to limit the scope of the project accordingly. From the outset the Drafting Committee agenda has been limited to revisions likely to be enacted in a uniform manner, e.g., needed updates on which there is a broad consensus.

In response to these developments, in mid-January 2001 the Executive Committee of NCCUSL approved the following resolution:

The Chair of the Committee on Scope and Program presented the recommendations of that Committee concerning the UCC Articles 3,
seems likely to be included in any new package of revisions.

IV. Telephone Checks

Perhaps a more practical problem is telephonically generated drafts. These are drafts generated by a telephone call or similar communication in which the customer provides information about his or her bank account (including the account number) sufficient to allow the caller to draw a draft on that account. Such a draft may or may not be authorized; perhaps it is, but probably there are also instances where the customer thought she or he was providing the account information merely as a credit reference or for some other purpose unrelated to the drawing of a draft on the account.

Such a draft may nonetheless be drawn and sent through the banking system as a preauthorized cash item. For a drawer’s signature the draft may bear a stamp or even a manual signature designed to suggest the signature or authorization of the customer, but which in reality is the signature or stamp of the payee. Because the volume of checks presents effective manual inspection of every drawer signature, such drafts likely will be paid by the payor bank and charged to the customer’s account. The customer will discover the unauthorized use of his or her signature and either refuse to use the telephone, but would place the risk of loss for improper ones on the payor bank. This is also supported by the argument that the costs of this copy will fall on the payor who is accused of negligence (again, the depository).

Most banks will, on both sides of this issue, acting as both depository and payor bank in roughly equal measure, if this is what the industry wants there will likely be public opposition to it there. Theoretically, this could provide some benefit to the customer of the payor bank, since the payor would pass these items up to the payor bank rather than possibly seek recovery from the payor bank’s customer under section 4-406. A new package under section 4-406 could be asserted by the payor bank against the payor bank’s customer under pro

4. Proposed revisions in the August 2000 draft would also add a new section 4-208(a)(4), to create a new presentment warranty to the effect that the item has been presented to the payor bank’s customer in person or mailed by registered or certified mail.

5. In order, it is necessary, in order potentially allocate some measure to those who, after all, may have initiated the problem by foolishly releasing his or her personal account information.

So the proposal seems overall neutral from the standpoint of banks and bank customers. It works in terms of deterrence, and likely to make it more difficult for depository banks to "know their customers" than perhaps it is a good proposal. One the other hand, depository banks already have an incentive to spots and scrutinize these items, as there is always a risk the item will be disregarded and returned unpaid. However, this new proposal would not allow the depository bank to withdraw the funds. So the idea that depository banks need more incentive to police their customers is not necessarily valid.

And there should be some hesitancy to overturn a precedent that has withstood the test of time, like Price v. Neal, whenever it is seen that everyone loves to pick on this case and its doctrine, because the volume of check transactions obviously has increased greatly, and banks and others have review most of the checks they process.

But the presentment is conceptual is essentially: All the parties who handle checks the payor bank is the only one who has a realistic hope of stopping an unauthorized drawer’s signature, since it is the only one who knows the drawer’s signature. The day a draw by the payor, the payor bank is also the party to whom the account holder must provide preauthorization for payment. In contrast the payor bank has no way of knowing whether a draft drawn by the payor was authorized by the payor bank’s customer (or vice versa). As technology advances, depository banks in the future may develop enhanced means to examine and confirm their customer’s signatures. Finally, the rule of Price v. Neal allows each payor bank to sightexamine checks or not based on its own level of tolerance for the risks involved.

35. Section 4-208(b) defines "payor bank’s customer."
A pay bank that is very risk-averse may choose to adopt a more costly policy of examining more checks, while another bank may accept a higher risk to achieve a lower cost. There are many intermediate choices, and the rule of price vs. need provides appropriate incentives to pay banks to weigh the alternatives. If a bank has received a loan and is solvent, it has management discretion to make critical choices. In the end, the conclusion of the case does not necessarily impose a judgment on the banks as a whole, but rather on how the banks handled specific actions.

One risk in all of this is that under current law, pay banks may be treated as banks by the federal banking agencies. Thus, a bank may be treated as a bank for the purposes of section 4-302, requiring critical deadlines that do not allow additional time for the FED to act. But the dual law of the land allows a bank (collecting bank and processing agent for the FED) should not obscure the status of the funds as a non-bank payor of a payable-through draft, subject not only to its own payment deadline (separate from that of the collecting bank) but to the 30-day non-bank deadline at section 4-303(c).19 Thus, the FED's stated desire to be treated as a separate pay bank with its own midnitght deadline would be a major step backward from the favorable position such a fund now occupies as a non-bank payor (though it also could possibly qualify as a pay bank subject to section 4-302). Moreover, if the FED is a non-bank payor of a payable-through draft, the item is not a check subject to the expedited return requirements in Regulation CC. This might change if the FED is deemed a pay bank, as requested by the Fund representatives.

A related issue is whether a Fund must disclose on its payable-through drafts that the items are payable through drafts in stead of checks. The Fund representatives at the Chicago meeting indicated that it is important that their drafts not be labeled as payable-through drafts, because this would impede their acceptance as checks in commerce. Once again, however, the Funds appear to be better off than they realized. Under section 4-106(c), if a payable-through draft names the non-bank payor and the payor's collecting bank without designating the status of the bank, the bank is deemed a collecting bank. This appears to allow such drafts to be treated as checks, enabling a collecting bank to not label the bank as a non-paying (i.e., merely collecting) entity.

VI. Dispute Resolution Procedure

Although it was discussed supra in the context of telephone checks,20 there is a related issue separate from the question of who is responsible for unauthorized telephone checks and that is the issue of the appropriate dispute resolution procedure, if any. If the account holder objects to a Fund's failure to pay, the account holder can assert a claim for non-payment, pending an investigation into that objection, there is a risk the bank will be unable to recover the money from the customer if the customer’s objection proves unfounded. This would provide an invitation for unscrupulous parties to assert spurious objections and then abscond with the money.

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The proposals change this would do so largely by expanding the personal warranty at section 4-208, to have the depositary bank make a warranty to the payor bank (that the drawer's signature is genuine and authorized. The current statute warrants only a lack of knowledge with respect to this signature, raising the question of whether it is a forged item or has no recourse against one who presented it without knowledge of the forgery. The current statute reflects not only the theory of payor bank knowledge to as its customer's signature, but also the rule of uniformity—no responsibility at fault if loss results from the payor bank to another innocent payor party despite their loss. Previous courts did not seem to care much about this issue, because they regularly treat it as both depositary and payor bank; but some bank representatives favor a change on grounds that the depositary bank is in a better position to prevent the fraud. The depositary bank would also be able to go against its deposit (to the extent that is viable) because the depositary's transfer would avoid the payment.

The proposal also seeks to give the counterparty a real possibility of being paid by the payor bank, not the depositary bank. This is because banks frequently make counterfeit checks easier to make and the depositary bank is supposed to know its customer. Still another reason for the change is said to be that Price v.Neal implores new types of transactions at the point-of-sale (POS), such as POS transfer and check cashing electronic funds transfers.

The proposal would the shift to the depositary bank and limit its recourse to claims against its depositor or rights against the wrongdoer or negligent parties under sections 4-305 and 4-318. This would shift the basic right of the automated channels or counterfeiting items under sections 4-305 and 4-318 from the payor bank to the depositary bank (and eliminate some of the advantages of preparing a paper check to the payor). The theory is that both the depositary bank and the payor bank are now automated, eliminating the validity of Price v. Neal and "know your customer" rules that could add more liability to the initial (depository) level. If not the depositary bank, the payor bank can realistically detect any fraud, why change the rule? Price v. Neal still allows the payor bank to check the signature against the drawer's signature when the amount is large enough to matter, it is the only bank able to do that. This provides an incentive to confirm signatures in proportion to the ability and need to do so. Also, it provides finially by leaving it where the loss falls. The proposal would increase litigation as payor banks seek to shift their losses onto the deposit (though the proposed rule already applies for forged endorsements and alterations).

Also, the depositary bank will be able to shift to the bank the loss to its customer, the depositor, etc., through warranty actions and the deposit agreement; thus one cannot effectively offset liability at the depositary bank level. Often this will shift the loss to another innocent party, through more litigation. And of course payor banks would be liable to the depositary bank for any counterparty negli-
gence. Another possible solution is to change the proposal to the warranty of the depositary bank to the payor bank if it has "reason to know" of the drawee's signature, in lieu of the current warranty. This would have the advantage of increasing litigation even more over this uncertain issue, as there would be no other means to allocate the liability, and to ensure the issue of outside liability. It all sounds a little like a potential litigation circus.

Still another possible solution is that payor banks' abilities to confirm signatures and may add more as technology changes, to that extent the problem may resolve itself if left alone. At this point there does not seem to be a specific proposal on the table to eliminate Price v. Neal by generally expanding the depositary bank's warranties to cover drawer signatures, outside the context of worthless checks (see supra Part IV). However, as noted that proposal is technologically controversial and it is not clear how far it might be extended.

VIII. Duplicate Checks and HDC Defenses: Sections 3-302(c) and 3-303(b)

If a drawer is dropped into issuing duplicate checks, the check is lost in order to procure another, or otherwise improperly induces duplicate checks to be issued (and the checks are negotiated to holders in due course), the drawer may not be paid under due course of business. The quoted language at section 3-303(b) replaced prior language in the earlier version of Article 3 that limited to certain HDC protections to defenses of parties ("with whom the holder has not dealt.") The change was not intended to be substantive. Some observers have noted that the language is somewhat more opaque, and has suggested a return to the original language of the Article 3. These have also been

gestions that this remoteness test is effectively a fourth requirement for HDC status that should be included with the other HDC requirements at section 3-302. The last, however, would change the law by prohibiting HDC status for this reason, and thereby go beyond a clarification.

The Drafting Committee agreed that it is best to reserve current law, allowing no funding to sections 3-303 and 3-302 but not to have the protections of section 3-305(b) unless the remoteness test at that section can be met. The current proposal includes language intended to clarify those points, and has also been deemed uncontroversial, though "further polishing" of the precise language is expected.

X. Comparative Negligence

Article 3 currently has a comparative negligence standard for allocating losses at sections 4-304, 4-305, 4-306, 4-208, 4-209, 4-307 and 4-308(b), and it has to be compared to warranty, and the drafters have been asked to draft a new section 3-307(c) to cover drawer liability under a new section 3-307(c) which the instrument be taken with notice of a breach of fiduciary duty. This article was also intended to expressly incorporate a comparative negligence standard in that scenario. Since the proposal, if a payor/drawer claim a breach of warranty or trans-

In order for a payor/drawer to be held liable, the warrantor to assert that the drawer was also (responsible for the loss under section 3-305(b)). If this de-

XII. Direct Actions for Comparative Negligence

Proposed revisions to sections 3-404(d) and 3-406(d) would allow any person who become liable under those sections (for failure to exercise ordinary care) to proceed directly against any other person who took or paid the instrument unless the lack of ordinary care also contributed to the loss. In other words, any person bearing a loss due to his or her negligence could recover from others who also failed to exercise ordinary care, allowing a direct appor-
tionment of the loss among negligent parties based on their comparative fault.

A safe harbor provision that whether the drawer should be able to sue the depositary bank directly, for a lack of ordinary care. Under current law the drawer and
XIII. Comparative Negligence
Under Section 3-407(c)

As noted supra at Part X, there is a proposal to extend the comparative negligence rule to a new section 3-407(c) to cover losses due to breach of fiduciary duty. The person bearing the loss under sections 3-307(b) and 3-420 could recover on a comparative negligence standard from any person who failed to exercise ordinary care that contributed to the loss. This would also require a comparison amendment to section 3-420. Current section 3-307 already says one takes with notice of a possible breach of fiduciary duty, and this may be conversed under section 3-420. The proposal would introduce negligence liability into what was previously a notice section (section 3-307). An alternative is to make section 3-307 subject to section 3-404 and section 4-06, or to create a new section. The August 2000 draft creates a new cause action in the notice section (section 3-307). It has the intended effect to incorporate sections 3-404 and 3-406 into section 3-307, as a counterpart to a depositary bank’s liability under sections 3-307 and 3-420. To be effective this would also require a companion amendment to section 3-420, to incorporate the warning rule in the notice section create a substantive right of the surviving person, i.e., the drawer). The Reporter’s Note indicates this change is contrary to the Uniform Fiduciaries Act. Since section 3-420 allows only the payee to bring a conversion action, if the drawer brings such an action against the depositary bank there would be to a common law theory; however, the payee plaintiffs cases are prevalent. The question was raised. Why isn’t this a suggestion under section 3-307 or 3-420 currently subject to a comparative negligence defense under sections 3-404 through 3-406? Perhaps this is not clear, but other sections specify a comparative negligence rule so it would be more clear if such was also specifically included in sections 3-307 and 3-420. The White & Summers treatise states that there is no comparative negligence defense in these circumstances under current law, so there is some disagreement; some believe section 3-420 conversion liability is absolute and not subject to a comparative negligence standard. The proposal might be helpful.

C. Effects of Check Truncation

The August 2000 draft includes proposed language specifying that a bank that provides only a statement description would be liable to the payee on a comparative negligence standard.

D. Drafting Committee Discussion

The Committee recommended notes that Rauwolf v. First Bank (which held that a bank’s conversion or negligence liability should be expanded to protect parties.

Reducing the Notice Period

A related issue is the impact on the use of the notice period if the payee in the deposit context is reduced to a lesser period, say 14 days. In other words, can the bank do this by contract? Is it enforceable? Alternatively, can the payor bank contractually reduce the period of non-liability for a breach of fiduciary duty by a person directly, lack of a private right.

There was no consensus on this issue. There are some possibilities a UCC comment indicating that ordinary customer rules can be used in such a situation. Because there is no privacy between the drawer and the depositary bank, there can be no contract or warranty claim between them, and thus the only alternative would be for Article 4 to create a new negligence claim as a direct action against the depositary bank. While this is feasible, it would represent a significant change, and would increase the risk aspects of a primarily contractual scenario.

The apparent lack of a consensus suggests that the Drafting Committee might have some flexibility on this issue, and that the lack of a direct action means the draft must go against the payor/drawer, which can then proceed against the depositary bank, which then may depend on the situation and under general sections 3-404 or 3-420. The drawer may not have the financial resources, and the payee is more likely to recover a near-immediate remedy by the payor/drawer as opposed to waiting out a lengthy lawsuit against the depositary bank. A recast against the depositary bank based on evidence of an improper endorsement is a much easier claim than one against another remote depositary bank based on negligence. So a direct negligence claim against the depositary bank may not be meaningful unless the depositary bank were to provide an alternative for a drawer whose does not sue to its own bank.

After discussion of these issues, the Drafting Committee approved in principle a direct action for negligence on behalf of the drawer, but against the depositary bank, by expansion of section 3-406.
an impersonation of agency is a defense but a misrepresentation of agency is not. It was urged that these distinctions are inappropriate.

Still, the consensus seemed to be that these issues are all covered by the general negligence and preclusion rule at section 3-406, of the Uniform Commercial Code. This is little more than a particularized example.

Whatever problems there are with coots that fail to understand this probably is not a sufficient reason to change the statute, absent a mandate for a comprehensive and detailed statutory rewrite.

XVI. Electronic Negotiable Instruments

The enactment of the federal ESIGN law,16 and state enactments of the UETA27 and UCTA,28 as well as the e-commerce provisions in revised UCC Article 9 and the expansion of electronic banking and e-commerce generally, suggest a need to consider how Articles 3 and 4 of this law link to this commercial world.

As one might expect, as of the December 2000 Chicago meeting drafting the Drafting Committee had received several suggestions suggesting issues appropriate for consideration.29

One question is whether ESIGN exempts Articles 3 and 4, either (or both) in current UCC form or as amended. The consensus was that both current and future versions of Articles 3 and 4 are exempted, so that the disclosure rules and other ESIGN requirements generally are not implicated under Articles 3 and 4. Moreover, the ESIGN section 10(c)(1) consumer disclosure triggers are only triggered in an underlying requirement for a writing; therefore, if the Articles 3 requirement for a "writing" are changed to require a "record," there will be no writing requirement to trigger the ESIGN rules.

Some may argue as a policy matter that Articles 3 and 4 should adopt the ESIGN consumer disclosure rules, even if ESIGN specifically excludes Articles 3 and 4 and clearly the disclosures are not directed at Articles 3 and 4. But these disclosures have been widely criti-

ized as being overly cumbersome.

There seemed to be little support for adopting the ESIGN rules in Articles 3 and 4, and without specific inclusion in Articles 3 and 4 it would seem that ESIGN is non-

event in this context. Of course, ESIGN may be brought into a transaction by other law, as where a promissory note is executed in a consumer credit transaction otherwise requiring written in-

Lending disclosures. But this is largely a non-UCC issue, although it was noted by Reporter Ronald Mann that it could be mentioned in a comment.

Article 4A is different in this regard, because it was drafted with electronic wire transfers in mind; therefore, when Article 4A speaks of a writing it means exactly that. It is not a matter of over-

sight or obsolescent language, but reflects an intent that a writing be required despite the existence of electronic alter-

atives. Thus Article 4A does not need revision to bring it up to date with the electronic world.

There was support for updating Articles 3 and 4, to generally change "writing" to "record" throughout (as in the Article 9 revisions), with careful at-

ention to possible needs for exceptions. This was tentatively approved, with the expectation that any needed exceptions will be discussed at future meetings.

There was again discussion of the recog-

nition that related consumer disclosures may be required under other law and therefore impacted under ESIGN.

It should be noted in this respect that the Uniform Electronic Transactions Act (UESTA), which is rapidly being enacted by the states,22 includes a section 16 ("Transferrable Records") that essentially allows creation of an electronic negotiable promissory note or document of title (called a "transferrable record") using the concept of "control" as in a substitute for the Article 3 concept of negotiation. If the party with control

reets the tests for a holder in due course under section 3-302 (or similar require-

ments at sections 7-101 or 9-306), he or

she will have the rights a HDC, or due

negotiation under Article 7, or under old

section 9-308 respectively.

This effectively authorizes electronic

negotiable notes and the like, but not che-

ches (or other drafts) or bank payments and collections. The federal ESIGN law30 contains a companion rule,31 though it is limited to transferrable records that would qualify as a note under Article 3 and are secured by real property (i.e., real estate mortgage loans).32 Thus, in the Article 3 and 4 context, UETA and ESIGN transferrable records provisions may affect (and effectively) electronic promissory notes but not check imaging, truncation or other checking and bank collection systems, perhaps suggesting a need to address such issues in Articles 3 and 4.

XVII. Stop Payment Orders

Section 4-403 provides for lapse of written stop payment orders after six months, thereby requiring stop orders to be renewed every six months if the customer wishes to avoid the risk the item will be paid. It is heightened by step payment orders. For example, the possibility that the holder of the item will delay presentation for six months in the hope the stop order will lapse. These continual six month stop order re-

news are a burden for banks and their customers.

A memorandum by Paul Turner was presented (at its author's request) at the Chicago meeting, arguing that stop orders should not lapse after six months. There is no direct analogy to the state check rule,33 which serves an entirely unrelated pur-

pose, despite some inference to the contrary in the comments.34 The apparent intent is to allow bank traders and financial institutions to order every six months to allow banks to periodically purge their records of obsolete stop orders and to avoid a massive pile-up of failed stop orders that might interfere with enforcement of cur-

rent or orders of payment of subsequent checks. This purpose may have less force in the electronic age, when almost unlimited amounts of data can be efficiently stored, although the risk to payment systems is not trivial. At least in the same amount of time. The cost of renewing

stop orders probably exceeds the cost of continuing to store the data concern-

ing old ones.

Even today, however, banks logically don't want to be responsible for storing and monitoring such data forever. Professor Greenfield argued that banks should have this responsibility, in order to prevent unfair surcharge to bank custo-

mers who may not realize (or may forget) that their stop orders have expired. Such customers are susceptible to unscrupu-

lus holders who may defer presentation for six months or longer in the hope that a stop order will lapse.

There are other situations—such as "reverse positive pay," where the bank presents all items to the customer and the customer decides which ones to pay, al-

lowing the customer to maintain its own risk of payment records. But this is essen-

tially limited to large customers and likely will never be an option for many con-

sumers. Thus the CPR memo and presentation argued for the six month lapse rule to be deleted, effectively cre-

ating a permanent stop payment order that would never lapse.

The bank representatives at the Chicago meeting opposed this change, but some agreed that six months seems an oddly short effective life. Why not five years, at four years, or one year? Doesn't renew every six months create more of a burden than would renewing it for a longer period? It should be easier to retain the records until a nor-

mal information purge period, than to renew or renew them every six months.

But the banks noted that stop orders cause other items of the same amount to be kicked out and discarded, and that an extended order life would exacerbate this.

The concern to the original Article 4 emphasizes this point. A corollary of an extended life may be the requirement of more frequent payment, though this would not solve the problem.

If a customer's checks are lost, the bank must protect itself by stopping payment

without charge to customer; the risk of unauthorized payment is on the bank and it cannot charge the customer. The customer's stop payment order to cover this risk. The law is clear on this; perhaps consumer education is the issue, warranting an example in the comments. What about the customer's obligation to notify the bank of lost or stolen checks? Section 4-406 gives after-payment notice requirements for lost checks; the section 3-409 negligence rule generally but not specifically im-

poses duty at the time a loss or theft of checks is discovered before payment. The chore rights, liability on the instrument, payment and discharge are to be im-

plicated, additional revisions will be necessary.

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16. UCC 3-406. Bank Statements

Section 4-406(b) allows the payer bank to return check copies instead of the original. A proposed revision would specify that the bank must make available a copy of both sides, and that it must be legible (i.e., must reflect what is there in readable fashion). The current text in-

cludes a "legible" requirement, but this generally means an accurate reproduci-

tion, not necessarily a readable one (as the original) may not be readable. As

noted, the proposed change would also require the availability of copies of both sides of all cancelled checks. This was described as a clarification of current law. Consumer advocates seek this change. But such copies would be required only on request of the customer. Otherwise a statement alone would be okay. The

proposal requires a yet-to-be specified number of free copies per year. This pro-

posal would facilitate truncation and is generally considered uncontroversial.

B. Section 4-406(a), (b) and (c)

Under a proposed revision to section 4-406(a), a copy of the cancelled checks would be the same as the original for enforce-

ment and receipt purposes. There is a little controversy on this basic point, but there was a consensus it should be moved elsewhere in Article 4, as section 4-406 does not otherwise cover enforcement issues, and the primary issues with regard to enforcement involve dishonest, not cancelled (i.e., lost) checks. It may also require a legislative note to recommend conforming amendments to state ele-

mentary codes.35 If other Article 3 issues regarding negotiation, holder in due

course rights, liability on the instrument, payment and discharge are to be im-

plicated, additional revisions will be necessary.
How many free copies of cancelled checks should be provided under the proposed new final section of section 4-406(a)? The conclusion was that this should be a per account holder, rather than per year basis. How many should be free? One per statement period was suggested. This could not be the bank's policy contract. This was approved. As noted above, this is designed to encourage check truncation and save banks from paying to mail and return unused cancelled checks. This is viewed as a small price for banks to pay for the resulting economies. Professor Greenfield argued for three free copies per statement, not to exceed 12 per year.

Ed Rubah argued that the payee's name should be added to the requirements for a safe harbor under section 406(a), as necessary information to be provided to a customer on his or her statement as a substitute for a cancelled check. The response was that this would be very expensive, because current processing computers cannot read the customer's name and thus it requires manual input. The cost does not warrant adding this information requirement in every case; most of the other information is sufficient, and the customer can get a copy if more information is needed. The problem could be satisfied by offering carbonless checks, but these also cost more for the customer; this is already available where the customer wants, so a statutory requirement based on this seems pointless.

C. Other Truncation Issues

Currently it is not feasible to capture the payee name on the MICR line. Around 70 billion checks are processed every year. There is no room on the MICR line, and including the payee's name would require a manual encoding of roughly 70 billion technologies. Ed Rubah suggested mandating the technology even though it is not currently feasible, in order to force technology development. The issue is important, because if the bank doesn't provide the payee's name or a copy, there may not be a precision as regards the payee's endorsement. What about the last sentence of 4-406(a)? It was urged that the provision only operates as to information provided or otherwise available, and is only triggered when the information is received, r.e., an altered payee is usually discovered when the original (payor notifies the drawer of nonpayment). Only then would the drawer have a duty to report the alteration to the payor bank. Thus there may not be a precision as to a payee alteration if the statement does not give the payee name, despite section 4-406(a). The statute is not clear on this, and it was argued that section 4-406 should be revived to provide that a consumer drawer has no duty to report an altered payee until the drawer has knowledge of the alteration. This was later deemed a moderately controversial ("middle of the tree") proposal.

XIX. Suretyship

Should Article 3 be conformed to the Restatement of Suretyship? The Conference Committee expressed support for this, commenting favorably on proposed amendments to section 3-103(12) (the definition of secondary obligor) and section 4-111(32) (exoneration). These changes would recognize the rights of secondary obligor (including an accommodation party) to require the principal debtor to perform the contract. Also, section 3-605 would be significantly re-written to conform to the Restatement, e.g., endorsing a check would be completely discharged by an unauthorized modification, not merely "to the extent of the loss" as under current Article 3 law. The impracticality of collateral defense at section 3-605(5) would be eliminated because of section 3-60(5) changes. Section 3-605(b) would be revised to provide that release of the principal debtor without a reservation of rights also releases secondary obligor and releases the secondary obligor's recourse against the principal debtor. But this would not apply if there is a reservation of rights clause in the contract. This would essentially adopt the positions of the latest Restatement of Suretyship. These proposals were later deemed to be uncontroversial.

XX. Miscellaneous Issues

Of the following proposals, all except the section 3-609 change were later included in a list of "technical amendments" deemed to be "uncontroversial." The section 3-609 issue was left open for future discussion.

A. Cashiers Checks

Section 3-301 would be revised to include the remitter of a cashier's check as a party entitled to enforce the instrument, so as to allow the remitter to return the check for a refund if the underlying transaction is not consummated. This would allow the check to be returned to the issuing bank for a refund before transfer or negotiation or after rescission of such a transfer.

B. Promise as Value

Can an undertaking other than a promise (e.g., performance) constitute value for purposes of holder in due course status? The proposal would change section 3-303(a)(1) to substitute "undertaking" for "promise," to detour courts from reading "as defined in section 3-303(9)(c)(2)(A)."

XXI. Article 4A Issues

A memo from Paul Turner raised issues under sections 4A-201 through 4A-204, 4A-402, and 4A-505. Modifications of the statute of repose by contract is part of a larger modification-by-contract issue. This was deferred for consideration of those issues. But the Article 4A text on this issue was not on the agenda. Nonetheless, this and the error resolution issues under Article 4A were reserved for the next meeting, including sections 4A-303 and 4A-402.

Can a bank's on-security procedures not commercially reasonable if the consumer does not agree to a commercially reasonable one? Can this be provided in the basic agreement? Article 4A says yes.

Regarding section 4A-502 and the Sheerbonnet case: To what extent can Article 4A be supplemented (or changed) by other law (e.g., general commercial law)? There was agreement that Article 4A is a careful compromise, and should not be upset by a court using the common law to vary the Article 4A rules. Sheerbonnet (allowing tort and equity claims) is a minority view, but was contained in a separate section 1-303 in Article 1 may help, and may cite Sheerbonnet as an example of bad law.

XXII. Consumer Issues

There were arguments that Article 4A should relieve consumers of liability for fraud losses. There were arguments for detailed consumer provisions and a statutory liability cap for consumers as in Regulation E and the Truth in Lending Act, based on an economic efficiency argument. But this is contrary to the philosophy of the UCC, which is based on a social policy favoring voluntary agreements, with limited safeguards applicable only upon market failure. People buy insurance despite actual unfairness because they prefer a small certain loss to an uncertain large loss. It was argued that this should be extended to the payment system: individual losses would be absorbed by banks and paid over to all customers in the form of higher banking transaction costs, rather than being allocated to the party responsible for the loss. This would provide incentives for banks to reduce fraud losses; it was argued that customers are not in a position to use technology advances to reduce fraud (though certainly consumers have other ways to deter fraud). The Reporters queried: What about the ability of consumers to avoid fraud in these other ways, e.g., safeguarding their blank checks and account information, reporting thefts and losses, etc? Relating items of this would create a new moral hazard. Also this would discourage banks from offering low-cost checking to underserved customers. The market indicates that the public does not prefer the insurance model here, as customers prefer low cost checking that includes some risks of fraud, which they can largely guard against. Also it is not clear the bank is better able to avoid fraud than the customer. Banks already bear the loss in most circumstances under Price v. Neal, and have strict liability under section 4-302, unless the consumer's negligence facilitated the fraud. Thus banks already have considerable incentive to avoid fraud. Professor Robin would extend this bank liability to cases where the customer is guilty or negligent and the bank is not. This has been characterized as being among those issues that are at the edge in terms of being the most controversial.

XXIII. Conclusion

All of these issues and conclusions, indeed the future of the Drafting Committee, remain tentative at this writing, though clearly it is time for interested parties to come forward and express their views to the Drafting Committee. Future reports in this journal will discuss subsequent deliberations and decisions as the work of the Drafting Committee continues.