

## AUGUST-JUNE REDLINE

### ' 3B301. Person Entitled to Enforce Instrument.

"Person entitled to enforce" an instrument means (i) the holder of the instrument, (ii) a remitter in possession of the instrument, if the remitter has neither transferred nor negotiated the instrument, (iii) a nonholder in possession of the instrument who has the rights of a holder, or (iv) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d).

A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

#### **REPORTER'S NOTES:**

1. Clause (ii) is added to clarify that a remitter is a person entitled to enforce during the period before the remitter initially parts with the instrument. The same result arguably could have been reached under the old clause (ii) by treating a remitter as a nonholder in possession who has the rights of a holder, but the revision should resolve the question definitively.

**3B302. Holder in Due Course.**

(a) Subject to subsection (c) and Section 3-106(d), "holder in due course" means the holder of an instrument if:

(1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).

(b) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (a), but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(c) A person does not become a holder in due course in a transaction in which the obligor issues or transfers the instrument directly to that party without the participation of a remitter or analogous intermediary. Furthermore, except to the extent a transferor or other predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under Section 3-303(a)(1), the promiseundertaking of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the

~~promised~~undertaken performance.

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(g) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

**REPORTER'S NOTES:**

1. The sentence added to the beginning of subsection (c) is an effort to address the murky possibilities of a payee becoming a holder in due course, a topic addressed at length in the existing ' 3-302 cmt. 4. Because the ramifications of the provision could be significant, this draft is provided as a basis for further discussion by the Committee.

2. The revision of ' 3-302(d) is designed to conform to the change of language in ' 3-303.

' 3B303. Value and Consideration.

(a) An instrument is issued or transferred for value if:

(1) the instrument is issued or transferred for an undertaking of performance, to the extent the undertaking has been performed;

(2) the transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(3) the instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(4) the instrument is issued or transferred in exchange for a negotiable instrument; or

(5) the instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

**REPORTER'S NOTES:**

1. Subsection (a)(1) is revised to change the reference to "promise" to "undertaking." The reason for the change is to prevent a court from construing subsection (a)(1) as limited to the meaning given the term "promise" in Section 3-103(a)(9).

**' 3B305. Defenses and Claims in Recoupment.**

(a) Except as stated in subsection (b), the right to enforce the obligation of a party to pay an instrument is subject to the following:

(1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) a defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(3) a claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1). The right of a holder in due course to enforce the obligation of a party to pay the instrument also is subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3), to the extent that those defenses or claims arise out of a transaction between the obligor and the holder in which the obligor issued the instrument to the holder or transferred the instrument to the holder. The right of a holder in due course to enforce the obligation of a party to pay the instrument is not otherwise subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3).

(c) Except as stated in subsection (d), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (Section 3-306) of another person, but the other

person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (a) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity.

**REPORTER'S NOTES:**

1. The revision to Section 3-305(b) is intended to clarify the defenses and claims from which a holder in due course takes free. It attempts to clarify what was obscure in the 1990 revisions **C** that a holder in due course does not automatically take free of defenses described in Section 3-305(a)(2) **C** without returning to the "dealt with" language that the 1990 revision rejected. The basic concept is the one described in the closing sentences of existing 3-305 cmt. 2:

*If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.*

*It is intended that the revision produce results consistent with the two examples given in the existing Article 3 of circumstances in which a holder in due course that is the original payee would take free of defenses. Comment 2 to Section 3-106 discusses a traveler's check that is stolen and negotiated with a forged countersignature. The comment states that the payee should take free of the defense because it is a*

3-305(a)(2) defense, implying that holders in due course always take free of those defenses. This draft takes the view that the payee should take free because the defense (forged countersignature) did not arise out of a transaction between the payee and the bank; it arose out of a transaction between the payee and the thief. Comment 4 to Section 3-302 has a number of similar cases regarding cashier's checks; this draft is intended to reach similar results in those cases.

**3B307. Notice of Breach of Fiduciary Duty.**

(a) In this section:

(1) "Fiduciary" means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument.

(2) "Represented person" means the principal, beneficiary, partnership, corporation, or other person to whom the duty stated in paragraph (1) is owed.

(b) If (i) an instrument is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

(1) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(3) If an instrument is issued by the represented person or the fiduciary as such, and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty.

(4) If an instrument is issued by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.



(c) If the represented person failed to exercise ordinary care with respect to the issuance, deposit, or other disposition of an instrument taken by a party charged with notice of breach of fiduciary duty under subsection (b), and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss under subsection (b) may recover from the represented person to the extent the failure of the represented person to exercise ordinary care contributed to the loss.

**REPORTER'S NOTES:**

1. Subsection (c) extends the proportionate-fault rules of Sections 3-404, 3-405, 3-406, and 4-406 to this context. It is intended that a negligent represented person (whether drawer or payee) should not be entitled to pass the entire loss to the depositary or payor bank, notwithstanding the contrary rule in the more traditional treatments of fiduciary relationships such as the Uniform Fiduciaries~~=~~ Act. In accordance with the discussion at the Boston meeting, this draft includes no parallel revisions to Section 3-420. The Committee might wish to revisit that topic, at least to the extent necessary to prevent a negligent represented person from avoiding the adverse effect of the new Section 3-307(c) by casting its claim in conversion.

' 3B309. Enforcement of Lost, Destroyed, or Stolen Instrument.

(a) A person not in possession of an instrument is entitled to enforce the instrument if (i) the person seeking to enforce the instrument (or a person from whom the person seeking to enforce the instrument has directly or indirectly acquired ownership of the instrument) was entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(b) A person seeking enforcement of an instrument under subsection (a) must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, Section 3-308 applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

**REPORTER'S NOTES:**

1. Subsection (a) is revised to provide a definitive rejection of the reasoning of the *Dennis Joslin Co. v. Robinson Broadcasting Corp.*, 977 F. Supp. 491 (D.D.C. 1997). A transferee of a lost instrument need prove only that its transferor was entitled to enforce, not that the transferee was in possession at the time the instrument was lost. The decision to revise the statute does not reflect a determination that *Joslin* was a correct interpretation of the old statute; it reflects the importance of clarity as to the correct interpretation.

**' 3B310. Effect of Instrument on Obligation for Which Taken.**

(a) Unless otherwise agreed, if a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(b) Unless otherwise agreed and except as provided in subsection (a), if a note or a check that is n-uncertified or a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

(1) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(2) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(3) Except as provided in paragraph (4), if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(4) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation.

If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the

amount payable on the instrument, and to that extent the obligee's rights against the obligor are limited to enforcement of the instrument.

(c) If an instrument other than one described in subsection (a) or (b) is taken for an obligation, the effect is (i) that stated in subsection (a) if the instrument is one on which a bank is liable as maker or acceptor, or (ii) that stated in subsection (b) in any other case.

**REPORTER'S NOTES:**

1. Section 3-310(b)(4) is revised to clarify that an obligee that transfers an instrument can no longer enforce the underlying obligation, even if the instrument later is dishonored (so that suspension of the underlying obligation would end under Section 3-310(b)(1)). Because the revision produces the results that seem to be called for by the existing comments, this seems to be a nonsubstantive correction. See 3-310 cmt. 3 sent. 6 ("If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else.").

2. The revision to the chapeau of ' 3-310(b) is intended to prevent any suggestion that subsection 3-310(b) applies to cashiers checks or tellers checks.

**3B404. Impostors; Fictitious Payees.**

(a) If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) If (i) a person whose intent determines to whom an instrument is payable (Section 3-110(a) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(1) Any person in possession of the instrument is its holder.

(2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(c) Under subsection (a) or (b), an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depository bank to an account in a name substantially similar to that of the payee.

(d) With respect to an instrument to which subsection (a) or (b) applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss under this section may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

**REPORTER'S NOTES:**

1. Subsection (d) is revised to clarify that the reference to a person "bearing the loss" indicates a party that bears responsibility for the loss under this section.

**3B405. Employer's Responsibility for Fraudulent Indorsement by Employee.**

(a) In this section:

(1) "Employee" includes an independent contractor and employee of an independent contractor retained by the employer.

(2) "Fraudulent indorsement" means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(3) "Responsibility" with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(b) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss under this section may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(c) Under subsection (b), an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person or (ii) the instrument, whether or not indorsed, is deposited in a depository bank to an account in a name substantially similar to the name of that person.

**REPORTER'S NOTES:**

1. The last sentence of subsection (b) is revised to clarify that the reference to a person "bearing the loss" indicates a party that bears responsibility for the loss under this section.



**3B406. Negligence Contributing to Forged Signature or Alteration of Instrument.**

(a) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) If a person asserting the preclusion under subsection (a) fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person or persons precluded and the person or persons asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss. Furthermore, to the extent any person bearing a portion of the loss under the preceding sentence otherwise would bear a portion of the loss that exceeds the extent to which their failure to exercise ordinary care contributed to the loss, any such person may recover from any person failing to exercise ordinary care in paying or taking the instrument, if that failure substantially contributes to loss resulting from payment of the instrument, to the extent that the failure of that person to exercise ordinary care in paying or taking the instrument contributed to the loss.

(c) Under subsection (a), the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under subsection (b), the burden of proving failure to exercise ordinary care is on the person precluded.

**REPORTER'S NOTE:**

1. Subsection (b) is revised to specify that any person bearing a loss under this section is entitled to proceed directly against any person that paid or took the instrument that failed to exercise ordinary care in a way that would justify responsibility under subsection (a). The specific concern is to ensure that a drawer that is partially negligent and thus unable to recover from the payor bank can proceed directly against a depository bank that also bears responsibility for the loss under the standard of subsection (a). The provision is intended to be analogous to Section 3-404(d) and the second sentence of Section 3-405(b).

2. Because of the Committee's lack of consensus on the topic at the first meeting, this draft does not expressly provide for a general action directly by the drawer against the depositary bank; the drawer still must qualify as a person "bearing the loss." If the Committee does not decide to provide generally for such a direct action, it is contemplated that comments to this section will suggest that ordinary joinder procedures should permit drawers to proceed against all interested parties without undue delay by initiating contemporaneous litigation with both the payor bank and depositary bank.

**3B417. Presentment Warranties.**

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered; and

(3) the warrantor has no knowledge that the signature of the drawer of the draft is unauthorized.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. Except as provided in subsection (c), the right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3-404 or 3-405, that the drawer is precluded under Section 3-406 or 4-406 from asserting against the drawee the unauthorized indorsement or alteration, or that the drawer is responsible for the loss under Section 3-307. Notwithstanding the foregoing, if the warrantor failed to exercise ordinary care ~~in paying or taking~~ with regard to the instrument and that failure substantially contributed to loss, or if the warrantor is responsible for all or a portion of the loss under Section 3-307, the warrantor's defense shall be limited so that the loss shall be allocated among the warrantor, the drawee, and

any other party bearing a portion of the loss under Sections 3-307, 3-404, 3-405, 3-406, or 4-406 so that the loss is allocated among all such persons according to the extent to which each person's failure contributed to the loss.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(2) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) or (d) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A [cause of action] for breach of warranty under this section accrues when the claimant has reason to know of the breach.

**REPORTER'S NOTES:**

1. Subsections (b) and (c) are revised to provide for a more thoroughly proportionate allocation of fault in cases in which the errors of multiple parties contribute to a loss. In particular, it responds to the difficulty that, read literally, the existing language of Sections 3-417(c) and 4-208(c) provide a complete defense whenever there is a preclusion (or giving effect to an otherwise improper indorsement) under one of the proportionate-fault provisions, even if the warrantor also failed to exercise ordinary care.

*Conversely, the language of Sections 3-417(b) and 4-208(b) suggests that the warrantor has no defense at all based on those proportionate-fault provisions. Because the "correct" response seems to be that the warrantor should have a defense that leaves the drawee and the warrantor each responsible for their proportionate share of the fault, revision seems appropriate.*

*2. The references to Section 3-307 added to Sections 3-417(c) and 4-208(c) reflect the extension of concepts of proportionate fault to Section 3-307.*

**3B418. Payment or Acceptance by Mistake.**

(a) Except as provided in subsection (c), if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to Section 4-403 or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(b) Except as provided in subsection (c), if an instrument has been paid or accepted by mistake and the case is not covered by subsection (a), the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

(c) The remedies provided by subsection (a) or (b) may not be asserted against a person who took the instrument in good faith and for value or to the extent that a person in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided by Section 3-417 or 4-407.

(d) Notwithstanding Section 4-215, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (a) or (b), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

**REPORTER'S NOTES:**

*1. Section 3-418(c) is revised to clarify that a person whose protection from relief under Section 3-418(a) and (b) is based on good-faith reliance is entitled to protection only to the extent of that reliance.*

**' 3B419. Instruments Signed for Accommodation.**

(a) If an instrument is issued for value given for the benefit of a party to the instrument ("accommodated party") and another party to the instrument ("accommodation party") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "for accommodation."

(b) An accommodation party may sign the instrument as maker, drawer, acceptor, or indorser and, subject to subsection (d), is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in Section 3-605, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party. If the signature of a party to an instrument is accompanied by words indicating that the party is guaranteeing payment, or if the signer signs the instrument as an accommodation party in some other manner that does not unambiguously indicate an intention to guarantee collection rather than payment, the signer is obliged to pay the amount due on the instrument to a person entitled to

enforce the instrument if ~~in the instrument is not paid when due, without resort to any other~~ same circumstances as the accommodated party would be obliged, without prior resort to the accommodated party by the person entitled to enforce the instrument.

(e) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party, is entitled to enforce the instrument against the accommodated party, and is entitled to force the accommodated party to perform its obligations on the instrument. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

**REPORTER'S NOTES:**

1. The last sentence of Section 3-419(d) is based on old UCC ' 3-416(1). This reflects the Committee's determination at the last meeting that payment guaranties are sufficiently significant to warrant specific statutory attention.

2. The revisions to Section 3-419(e) are intended to codify the accommodated party's duty of exoneration, to preclude the negative implication that the codification of the duties of performance and reimbursement was intended to bar any duty of exoneration.



' **3-502. Dishonor.**

\* \* \* \* \*

(b) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules:

(1) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under Section 4-301 or 4-302, or becomes accountable for the amount of the check under Section 4-302.

\* \* \* \* \*

**Official Comment**

\* \* \* \* \*

4. Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. Those rules contemplate four separate situations that warrant discussion.

The first two situations arise in the normal course of affairs, in which the drawee bank makes settlement for the amount of the check to the presenting bank. In the first situation, the drawee bank under Section 4-301 [new Section 4-302(a)] recovers this settlement if it returns the check by its midnight deadline (Section 4-104). In that case the check is not paid and dishonor occurs under Section 3-502(b)(1). The second situation arises if the drawee bank has made such a settlement and does not return the check or give notice of dishonor or nonpayment within the midnight deadline. In that case, the settlement becomes final payment of the check under Section 4-215 [new Section 4-301(a)(2)]. Thus, no dishonor occurs regardless of whether the drawee bank retains the check indefinitely or for some reason returns the check after its midnight deadline.

The third and fourth situations arise less commonly, in cases in which the drawee bank does not settle for the check when it is received. Under Section 4-302 if the drawee bank is not also the depository bank and retains the check without settling for it beyond midnight of the day it is presented for

payment, the bank at that point becomes "accountable" for the amount of the check, i.e., it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank becomes accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor by its midnight deadline. Hence, if the drawee bank is also the depositary bank and does not either settle for the check when it is received (a settlement that would ripen into final payment if the drawee bank failed to take action to recover the settlement by its midnight deadline) or return the check or an appropriate notice by its midnight deadline, the drawee bank will become accountable for the amount of the check under Section 4-302. Thus, in all cases in which the drawee bank becomes accountable under Section 4-302, the check has not been paid (either by a settlement that became unrecoverable or otherwise) and thus, under Section 3-502(b)(1), the check is dishonored.

The fact that the bank is obliged to pay the check under Section 4-302 does not mean that the check has been paid. Indeed, because each of the paragraphs of Section 4-302(b) is limited by its terms to situations in which a bank has not paid the item, a drawee bank will be accountable under Section 4-302 only in situations in which it has not previously paid the check. Section 3-502(b)(1) reflects the view that a person presenting a check is entitled to payment, not just the ability to hold the drawee accountable under Section 4-302. If that payment is not made in a timely manner, the check is dishonored.

\* \* \* \* \*

' 3B602. Payment.

(a) Subject to subsection (b), an instrument is paid to the extent payment is made by or on behalf of a party obliged to pay the instrument, and to a person entitled to enforce the instrument. An instrument note also is paid if payment is made by or on behalf of a party obliged to pay the instrument note to a person that (i) formerly was entitled to enforce the instrument note and (ii) had not at the time the payment was made provided adequate notification to the party obliged to pay that the instrument note had been transferred. A notification is adequate only if it (A) is authenticated by the transferor; (B) reasonably identifies the transferred instrument note; and (C) identifies the name of the transferee and the address at which payments subsequently can be made. To the extent of thea payment under either of the preceding sentences, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section 3-306 by another person.

(b) The obligation of a party to pay the instrument is not discharged under subsection (a) if:

(1) a claim to the instrument under Section 3-306 is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier's check, teller's check, or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(2) the person making payment knows that the instrument is a lost or stolen instrument and pays a person it knows is in wrongful possession of the instrument.

**REPORTER-S NOTES:**

1. Subsection (a) is revised to bring Section 3-602 into conformity with Restatement of Mortgages ' 5.5 and Restatement of Contracts ' 338(1). Probably the most important question raised by this draft is the requirements for an adequate notification. Among other things, this draft does not permit notification from the transferee. The Committee will want to

*consider that topic after receiving comments from the affected industries.*

*2. Subsection (b)(2) is revised to add a reference to lost instruments. There is no obvious reason that the rule of that provision should not apply to lost instruments.*

**3B605. Discharge of Secondary Obligors.**

(a) A secondary obligor is discharged from any unperformed portion of its obligation on an instrument if a person entitled to enforce the instrument agrees to a modification of the duties of a party obligated to pay the instrument that either amounts to a substituted contract or imposes risks on the secondary obligor fundamentally different from those imposed on the secondary obligor before modification.

*ALTERNATIVE A*

(b) To the extent that a person entitled to enforce an instrument releases the obligation of a party to pay the instrument:

(i) unless the release preserves the right of recourse of the secondary obligor under subsection (j), the secondary obligor is discharged from any unperformed portion of its obligation on the instrument and the secondary obligor's right of recourse against the released party is discharged.

(ii) if the secondary obligor is not discharged under subsection (i), the secondary obligor is discharged to the extent (A) of the value of the consideration for the release; and (B) that the release would otherwise cause the secondary obligor a loss.

*ALTERNATIVE B*

(b) A discharge under Section 3-604 of the obligation of a party to pay an instrument does not discharge either the obligation of a secondary obligor to pay the instrument or the right of recourse of the secondary obligor against the discharged party.

(c) If a person entitled to enforce an instrument grants a party obligated to pay an instrument an extension of the time at which one or more payments are due on the instrument:

(i) unless the terms of the extension preserve the right of recourse of the secondary obligor under subsection (j), the extension also extends the time for performance of

any corresponding duties owed to the secondary obligor by the party whose obligation is extended.

(ii) the secondary obligor is discharged from any unperformed portion of its obligation on the instrument to the extent that the extension would otherwise cause the secondary obligor a loss.

(iii) to the extent that the secondary obligor is not discharged under subsection (ii), the secondary obligor may (A) perform its obligations to any person entitled to enforce the instrument as though the time for payment had not been extended or, (B) unless the extension preserves the right of recourse of the secondary obligor, treat the time for performance of its obligations as having been extended correspondingly.

(d) If a person entitled to enforce an instrument agrees, with or without consideration, to a modification of the obligation of a party other than an extension of the due date or a complete or partial release:

(i) the modification correspondingly modifies any corresponding duties owed to the secondary obligor by the party whose obligation is modified.

(ii) the secondary obligor is discharged from any unperformed portion of its obligation on the instrument to the extent that the extension would otherwise cause the secondary obligor a loss.

(iii) to the extent that the secondary obligor is not discharged under subsection (ii), the obligations of the secondary obligor are correspondingly modified.

(e) If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of the secondary obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (i) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (ii) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest.

(f) If the obligation of a party is secured by an interest in collateral not provided by an accommodation party and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under subsection (e), the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. Nothing in this subsection shall prevent any such party from interposing a defense unrelated to impairment of collateral that arises under general principles of law related to suretyship and contribution.

(g) Under subsection (e) or (f), impairing value of an interest in collateral includes (i) failure to obtain or maintain perfection or recordation of the interest in collateral, (ii) release of collateral without substitution of collateral of equal value or equivalent reduction of the underlying obligation, (iii) failure to perform a duty to preserve the value of collateral owed, under Article 9 or other law, to a debtor or other person secondarily liable, or (iv) failure to comply with applicable law in disposing of collateral.

(h) An accommodation party is not discharged under subsection (c), (d), or (e) unless the person entitled to enforce the instrument has notice of the accommodation or has notice under Section 3-419(c) that the instrument was signed for accommodation.

(i) A party is not discharged under this section if (i) the party asserting discharge consents to the event or conduct that is the basis of the discharge, or (ii) the instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral; provided, however, that no such waiver shall waive a defense that is not permitted to be waived by the law that creates the defense in question. Unless the circumstances indicate otherwise,

consent by the party obligated to pay the instrument to an act that would lead to a discharge under this section constitutes consent to that act by the secondary obligor whenever the secondary obligor either controls the party obligated to pay the instrument or deals with the person entitled to enforce the instrument on behalf of the party obligated to pay the instrument.

(j) A release or extension preserves the right of recourse of a secondary obligor if the express terms of the release or extension provide [in writing] that (i) the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor; and (ii) the right of recourse of the secondary obligor continues as though the release or extension had not been granted. If the release or extension preserves the right of recourse of a secondary obligor, the rights of the secondary obligor against that party continue as though the release or extension did not occur.

(k) A secondary obligor asserting discharge under this section has the burden of persuasion both with respect to the occurrence of the acts alleged to harm the secondary obligor and also as to loss or prejudiced caused by those acts. Notwithstanding the foregoing, if

(i) the secondary obligor demonstrates prejudice caused by an impairment of its right of recourse; and

(ii) the circumstances of the case indicate that the amount of loss is not reasonably susceptible of calculation or requires proof of facts that are not ascertainable;

then it is presumed that the act impairing recourse caused a loss or impairment equal to the liability of the secondary obligor on the instrument. In that event, the burden of persuasion as to any lesser amount of such loss is on the person entitled to enforce the instrument.



' 3B103. Definitions.

\* \* \* \* \*

(12) "Secondary obligor" with respect to an instrument means an indorser, a drawer, or an accommodation party that has a right of recourse against a party obligated to pay the instrument.

**REPORTER'S NOTES:**

1. The definition of secondary obligor is added to improve the cumbersome phrasing used for that concept in the existing version of Article 3 and to bring the terminology in line with the terminology of the Restatement of Suretyship. {Because inclusion of the definition permits deletion of the old Section 3-605(a), it also permits addition of the new Section 3-605(a) without renumbering all of the subsections of Section 3-605.}

2. Section 3-605(a) is based on Restatement of Suretyship ' 37(2)(b) & 41(b)(i). The comments should include illustrations designed to limit the risk that the section will be interpreted broadly, starting with something like Illustration 4 from Restatement ' 41. The new section does not include a provision parallel to Restatement ' 37(2)(a) and 39(c)(iii) (calling for a complete discharge of the secondary obligor for a release of a nonmonetary obligation) because instruments subject to Article 3 should not include significant nonmonetary obligations.

3. Alternative A for Section 3-605(b) is based on Restatement of Suretyship ' 39. Alternative B reflects the substance of the existing version of that provision.

4. Section 3-605(c) is based on Restatement of Suretyship ' 40.

5. Section 3-605(d) is based on Restatement of Suretyship ' 41.

6. Subsections (e), (f) & (g) track Restatement of Suretyship ' 42. Because they are much closer to the Restatement in their existing form than subsections (b), (c) &

(d), they have not undergone significant substantive changes. Also, in this draft, those provisions do not track the Restatement precisely; the most important distinction is that they retain the existing UCC formulation for the extent of the impairment in Section 3-605(e) rather than the somewhat different Restatement formulation. The last sentence of subsection (f) is added to preclude the negative inference that the specific delineation of the defense of impairment of collateral is intended to preclude the assertion of other defenses.

7. Section 3-605(h) is revised to change the requirement of "knowledge" of the accommodation to a requirement of "notice" of the accommodation. This returns the law to its status under old Article 3 and more closely parallels the provisions of Section 3-419(c) (which uses notice rather than knowledge to regulate relations between an accommodation party and a person entitled to enforce).

8. The proviso at the end of the first sentence of Section 3-605(h) clarifies the ineffectiveness of such a waiver to waive unwaivable defenses such as improper disposition of collateral. See PEB Commentary No. 11 (Issue 11) & 3-605 cmt. 8. The notice requirement is designed to be consistent with Restatement of Suretyship ' 32(2). The last sentence of Section 3-605(i) is based on Restatement of Suretyship ' 48(2).

9. Section 3-605(j) is based on Restatement of Suretyship ' 38.

10. Section 3-605(k) is based on Restatement of Suretyship ' 49.

## ARTICLE 4

### BANK DEPOSITS AND COLLECTIONS

#### PART 1. GENERAL PROVISIONS AND DEFINITIONS

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#### PART 1

##### GENERAL PROVISIONS AND DEFINITIONS

##### ' 4B104. Definitions and Index of Definitions.

(a) In this Article, unless the context otherwise requires:

\* \* \* \* \*

(3) "Banking day" means that part of any business day on which a bank is open to the public for carrying on substantially all of its banking functions.

(3A) "Business day" means a calendar day other than a Saturday or Sunday or a holiday recognized by the United States government.

(3B) The return of a check satisfies the "business-day test" if the returned check is sent in a manner such that the check would normally be received by the depositary bank not later than 4:00 p.m. (local time of the depositary bank) of:

(A) the second business day following the banking day on which the check was presented to the payor bank, if the payor bank is located in the same check processing region as the depositary bank; or

(B) the fourth business day following the banking day on which the check was presented to the payor bank, if the payor bank is not located in the same check processing region as the depositary bank.

If the business day by which a check must be received by the depositary bank under the foregoing provisions is not a banking

day for the depository bank, the payor bank meets the business-day test if the returned check is received by the depository bank on or before the depository bank's next banking day.

(3C) "Cash item" means a check, a draft that is payable through or at an office of a bank; a negotiable demand draft drawn on the Treasury of the United States, a demand draft drawn on a state government or unit of general local government that is not payable through or at a bank, a United States Postal Service money order; or a traveler's check payable through or at a bank, but does not include a noncash item or an item payable in a medium other than United States money.

(3D) "Check processing region" means the geographical area served by an office of a Federal Reserve Bank for purposes of its check processing activities.

\* \* \* \* \*

(8A) A bank makes an "expeditious return" of a check if it returns the check in a manner that satisfies either the business-day test or the forward-collection test;

(8B) "Forward collection" means the process by which a bank sends a check on a cash basis to the payor bank for payment;

(8C) The return of a check satisfies the "forward-collection test" if the returned check is sent in a manner that a similarly situated bank would normally handle a check:

(A) of similar amount as the returned check;

(B) drawn on the depository bank; and

(C) received for forward collection by the similarly situated bank at the time the bank returning the check received the returned check.

Notwithstanding the foregoing, a bank does not fail to satisfy the forward-collection test solely because of its application of a cutoff hour for the receipt of returned checks that is earlier than the similarly situated bank's cut-off hour for checks received for forward collection, so long as the cut-off hour for the receipt of returned checks is not earlier than 2:00 p.m.

\* \* \* \* \*

(10) "Midnight deadline" with respect to a bank is midnight after the conclusion of its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later. Notwithstanding the foregoing, the midnight deadline with respect to a payor bank is extended until the time of dispatch of such item or notice if the bank uses a means of delivery that would ordinarily result in receipt by the bank to which the item or notice is sent on or before the receiving bank's next banking day following the otherwise applicable midnight deadline. The extension provided in the preceding sentence is extended further if the payor bank uses a highly expeditious means of transportation, even if this means of transportation would ordinarily result in delivery after the receiving bank's next banking day. Notwithstanding the foregoing, if the midnight deadline provided by the first sentence of this subsection is a Saturday ~~that is a banking day for the payor bank~~ on which the bank is open to the public for carrying on substantially all of its banking functions, the midnight deadline is extended only if the bank uses a means of delivery that would ordinarily result in receipt by the bank to which the item or notice is sent before the cut-off hour for the next processing cycle (if sent to a returning bank) or the next banking day (if sent to the depositary bank).

(10A) "Routing number" means (a) the number printed on the face of a check in fractional form or in nine-digit form; or (b) the number in a bank's indorsement in fractional or nine-digit form.

(11) "Settle" means to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed.

(11A) "Similarly situated bank" means a bank of similar size, located in the same community, and with similar check handling activities.

**REPORTER'S NOTES**

10 The definition of banking day is based on Regulation CC, ' 229.2(f). As the commentary to that provision explains, the distinction between banking day and business day is designed to permit a differentiation between rules that apply based on

normal days of operation (business days) and those that apply based on actual days of operation (banking days). The distinction has particular significance in the definition of expeditious return and in the obligation of same-day settlement in new UCC Section 4-213(f).

2. The definition of business day is based on Regulation CC, ' 229.2(g). The proposed definition avoids the precise delineation of holidays that appears in Regulation CC to preserve flexibility in the likely event that those holidays change in the future. It is not clear, however, that the proposed language is adequately specific or accurately describes the relevant holidays.

3. The definitions of business-day test, expeditious return, and forward-collection test are based on Regulation CC, ' 229.30(a) & 229.31(a). The slight changes in wording are not intended to alter the meaning that they have in that context. Among other things, the Committee might wish to consider (a) whether it remains important to retain both the forward-collection test and the business-day test; and (b) whether it is important to retain the distinction between the general use of "would normally be received" language and language of actual receipt (which applies in the last sentence when the depository bank is closed on the applicable (second or fourth) day.

4. The definition of check processing region is based on Regulation CC, ' 229.2(m).

5. The definition of forward collection is based on Regulation CC, ' 229.2(q).

6. The modification of the definition of midnight deadline is based on Regulation CC, ' 229.30(c). It recognizes the preemptive effect that provision has had on the simpler preexisting definition. The Committee might wish to explore whether the complexity caused by the last sentence is warranted.

7. The definition of routing number is based on Regulation CC, ' 229.2(dd).

8. The definition of settle is revised to reflect the removal of the concept of provisional settlement.

9. The definition of similarly situated bank is based on Regulation CC, ' 229.2(ee). It is important in delineating the meaning of the forward-collection test.

10. The definition of cash item is based on the definition of check in Regulation CC, ' 229.2(k). The Committee will want to consider carefully the places that this definition is used (all in Part 4 of Article 3) as well as the places that it is not (including the references to demand items in '' 4-301 and 4-302 of this draft).

' 4B105. "Bank"; "Depository Bank"; "Payor Bank"; "Intermediary Bank"; "Collecting Bank"; "Presenting Bank"; Returning Bank.

(3) "Payor bank" means a bank that is the drawee of a draft, including a bank that is identified as the drawee of on a check solely by inclusion of its routing number on the check.

\* \* \* \* \*

(7) "Returning bank" means a bank (other than the payor bank or depository bank) handling a returned check or a notice in lieu of return.

\* \* \* \* \*

**REPORTER'S NOTES:**

1. The definition of returning bank is based on Regulation CC, ' 229.2(cc).

2. The reference to routing numbers in the definition of payor bank is intended to ensure that banks identified only by routing number (a common occurrence in the so-called MICR fraud cases) have the customary obligations to process such checks or be held accountable for them by depository and collecting banks. That concept formerly was implemented indirectly in Regulation CC, ' 229.36(b)(2).



**4B106. Payable Through or Payable at Bank; Collecting Bank.**

(a) (1) If an item states that it is "payable through" a bank identified in the item, (A) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (B) the item may be presented for payment only by or through the designated bank.

(2) A bank that arranges for checks payable by it to be payable through another bank shall require that the following information be printed conspicuously on the face of each check:

(A) The name, location, and first four digits of the nine-digit routing number of the bank by which the check is payable; and

(B) The words "payable through" followed by the name of the payable through bank.

(3) The bank by which the check is payable is responsible for damages under [new Section 4-312] to the extent that (A) checks payable by it and not payable through another bank are labeled as provided in this section; (B) checks payable by it and payable through another bank are not labeled as provided in this section; and (C) checks payable by it are otherwise issued (by it or its customer) in a condition that adversely affects the ability of a bank to indorse the check legibly in accordance with [new Section 4-206].

*ALTERNATIVE A*

(b) If an item states that it is "payable at" a bank identified in the item, the item is equivalent to a draft drawn on the bank.

*ALTERNATIVE B*

(b) If an item states that it is "payable at" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the designated bank.

(c) If a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a co-drawee or a collecting bank, the bank is a collecting bank.

(d) ~~A check payable at or through a bank is considered to be drawn on that bank f~~For purposes of the expeditious return requirement of [new Section 4-303] and the notice of nonpayment requirement of [new Section 4-305], (I) a check payable at or through a bank is considered to be drawn on that bank, and (II) the bank at or through which a cash item is payable is considered to be a payor bank with respect to such an item.

**REPORTER'S NOTES:**

1. Subsection (a) is expanded to consolidate material regarding payable-through items from Regulation CC, '' 229.36(e) and 229.38(d)(1). Subsection (d) is based on Regulation CC, ' 229.36(a).

2. The point of paragraph (a)(3) is that a payor bank should be responsible for the inappropriately styled checks of its customers, which includes both checks that incorrectly seem to be payable through checks and checks that incorrectly seem not to be payable through checks. This is drawn from Regulation CC, but some commenters have questioned its propriety. The Commission should consider the question specifically.

3. The payable-through provisions require further attention from the Committee. Among other things, the current provisions do not contemplate payment over the counter of a payable-through item. It is not clear that result conforms to industry understanding of the current rules.

4. The revisions to subsection (d) are intended to ensure that the expeditious return and accountability requirements apply to payable at or through items not drawn on banks.

' 4B110. Electronic Presentment. [Deleted. Content now appears in Section 4-204.]

## ARTICLE 4

### BANK DEPOSITS AND COLLECTIONS

\* \* \* \* \*

#### PART 2

##### FORWARD COLLECTION AND PRESENTMENT

#### ' 4B201. Status of Collecting Bank as Agent; Applicability of Article; Item Indorsed By a Bank or "Pay Any Bank".

(a) Unless a contrary intent clearly appears and before final payment is made for an item, ~~the~~a collecting bank, with respect to an item, is an agent or sub-agent of the owner of the item. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank, such as those resulting from outstanding advances on the item and rights of recoupment or setoff. If an item is handled by banks for purposes of presentment, payment, collection, or return, the relevant provisions of this Article apply even though action of the parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(b) After an item has been indorsed by a bank or with the words "pay any bank" or the like, only a bank may acquire the rights of a holder until the item has been:

(1) returned to the customer initiating collection; or

(2) specially indorsed by a bank to a person who is not a bank.

#### **REPORTER'S NOTES**

1. 4-201(a) is revised to remove references to provisional settlement.

2. 4-201(b) is revised to add the rules for indorsement by banks from Regulation CC, ' 229.35(c).

**4B202. Responsibility for Collection or Return; When Action Timely.**

(a) A collecting bank or returning bank must exercise ordinary care in:

(1) presenting an item or sending it for presentment;

(2) sending notice of dishonor or nonpayment or returning an item other than a documentary draft after learning that the item has not been paid or accepted, as the case may be; and

(3) notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(b) A bank exercises ordinary care under subsection (a) by taking proper action before its midnight deadline following receipt of an item, notice, or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(c) Subject to subsection (a)(1), a bank is not liable for the insolvency, neglect, misconduct, mistake, or default of another bank or person or for loss or destruction of an item in the possession of others or in transit.

**REPORTER'S NOTES:**

1. Subsections (a) and (b) are revised to clarify that they apply both to collecting banks and returning banks. It also reflects a view that the duty should apply to all banks that take the specified actions, whether they are themselves collecting or returning banks, or instead simply agents for those banks.

2. Subsection (a)(2) is revised to accommodate the concept of direct return by a payor bank.

3. Former subsection (a)(3) is removed because it seems confusing and unnecessary with the removal of provisions related to provisional settlement.

**4B204. Methods of Sending and Presenting; Sending Directly to Payor Bank.**

(a) A collecting bank shall send items by a reasonably prompt method, taking into consideration relevant instructions, the nature of the item, the number of those items on hand, the cost of collection involved, and the method generally used by it or others to present those items.

(b) A collecting bank may send:

(1) an item directly to the payor bank;

(2) an item to a nonbank payor if authorized by its transferor; ~~and~~

(3) an item other than documentary drafts to a nonbank payor, if authorized by Federal Reserve regulation or operating circular, clearing-house rule, or the like.

(c) An item is considered received by the payor bank or other ~~payor~~drawee when it is received:

(1) at a location to which delivery is requested by the ~~payor~~drawee;

(2) in the case of a check, at (A) a location designated by the payor bank; or (B) if the payor bank has not designated a location that is in the check processing region consistent with the routing number on the check, at (I) any branch or head office, if the payor bank is identified on the check by name without address; or (II) at a branch, head office, or other location consistent with the name and address of the bank on the check, if the bank is identified on the check by name and address.

(d) A bank may present a check to a payor bank by transmission of information describing the check in accordance with an agreement with the payor bank. Presentment of an item pursuant to an agreement for presentment is made when the payor bank receives the presentment notice. If presentment is made by presentment notice, a reference to "item" or "check" in this Article means the presentment notice unless the context otherwise indicates.

**REPORTER'S NOTES:**

1. Subsection (c) is revised to incorporate the substance of Regulation CC, ' 229.36(b). Subsection (d) incorporates the substance of ~~Regulation CC, ' 229.36(c) and~~ old UCC ' 4-110.

2. As explained in the Reporter's Notes to new UCC ' 4-213, the presentation locations described in subsection (c)(2) are drawn from Regulation CC, ' 229.36(f)(1) rather than 229.36(b).

The general concept is that a condition of same-day settlement should be compliance with the ~~payers~~drawee's wishes regarding the location of presentation. That concept is included in this draft largely in the interest of simplicity. Because it is a significant change, industry views should be solicited.

~~3. The last sentence of Regulation CC, ' 229.36(c) is removed from this draft, based on the tentative view that (a) the sentence was included because of doubts about the regulatory capacity to act more broadly; and (b) the apparent inconsistency of that sentence with the existing UCC ' 4-110(b) [the second sentence of new UCC 'Section 4-204(d)].~~

**4B206. Indorsement Standards.**

(a) Except as provided in subsections (b) and (c), any agreed method that identifies the transferor bank is sufficient for the transfer of an item by a collecting bank during forward collection.

(b) A depositary bank that handles a check during forward collection shall indorse the check in dark purple or black ink with an indorsement that includes (1) the bank's nine-digit routing number, set off by arrows at each end of the number and pointing toward the number; (2) the bank's name and location; and (3) the date of the indorsement. The depositary bank may include additional information that does not interfere with the legibility of the required information. The depositary bank's indorsement shall be placed on the back of the check so that the routing number is wholly contained in the area 3.0 inches from the leading edge of the check (that is, the right side of the check as viewed from the front) to 1.5 inches from the trailing edge of the check (that is, the left side of the check as viewed from the front).

(c) Any subsequent collecting bank that indorses the check shall indorse the check, using an ink color other than purple, with an indorsement that includes only its nine-digit routing number (without arrows), the indorsement date, and an optional trace or sequence number. Any such indorsement shall be placed on the back of the check so that the indorsement is wholly contained in the area no more than 3.0 inches from the leading edge of the check.

(d) A depositary bank may arrange with another bank to apply the other bank's indorsement as the depositary bank indorsement, provided that any indorsement of the depositary bank on the check avoids the area reserved for the depositary bank indorsement in subsection (b). In that case, the other bank, indorsing as the depositary bank, is considered the depositary bank for purposes of this Article.

**REPORTER'S NOTES:**

*1. Subsections (b), (c), and (d) are based on Regulation CC, ' 229.35(a), (d), and paragraphs 1 and 2 in Appendix D. The revision of the last sentence of 229.35(d) is intended to provide some minor clarification as to which bank is treated as the depositary bank.*



**4B208. Presentment Warranties.**

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered;

(3) the warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized; and

(4) with respect to any item drawn on a consumer account, which does not bear a handwritten signature purporting to be the signature of the drawer, that the purported drawer of the draft has authorized the issuance of the item in the amount for which the item is drawn.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. Except as provided in subsection (c), the right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3-404 or 3-405, that the drawer is precluded under Section 3-406 or 4-406 from asserting against the drawee the unauthorized indorsement

or alteration, or that the drawer is responsible for the loss under Section 3-307. Notwithstanding the foregoing, if the warrantor failed to exercise ordinary care ~~in paying or taking~~with regard to the instrument and that failure substantially contributed to loss, or if the warrantor is responsible for all or a portion of the loss under Section 3-307, the warrantor's defense shall be limited so that the loss shall be allocated among the warrantor, the drawee, and any other party bearing a portion of the loss under Sections 3-307, 3-404, 3-405, 3-406, or 4-406 so that the loss is allocated among all such persons according to the extent to which each person's failure contributed to the loss.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

**REPORTER'S NOTES:**

1. New subsection (a)(4) is added to respond to difficulties with telephonically originated checks. It is modeled on, though somewhat different from, nonuniform amendments to Article 3 enacted in several states. One point that the committee did not discuss is whether the warranty should extend to problems in the amount of the item or simply to the basic authorization question. Because the existing

nonuniform provisions do extend to the amount, this draft has taken that approach. The draft assumes that a new subsection would be added to UCC ' 4-104 defining "Consumer account" to mean an account established by a natural person primarily for personal, family, or household purposes. The Committee has not yet determined whether the relief would be limited to consumer accounts, but this version is drafted as a basis for discussion.

The draft does not include a separate revision to the transfer warranties, based on the reasoning that any breach of the warranty set forth in this provision would constitute a breach of Section 4-207(a)(2). Hence, Section 4-207 (and the analogous provision in Section 3-416) would allow an intermediary from whom the payor bank recovered to recover from the ultimate malfeasant. Specifically, the draft rests on the premise that the signature a merchant places on a draft issued for a larger amount than the customer authorized is not an "authentic and authorized signature." If the Committee determines that it is appropriate to extend the warranty to the amount of the item, the the Committee might wish to add a more specific transfer warranty.

2. Subsections (b) and (c) are revised to provide for a more thoroughly proportionate allocation of fault in cases in which the errors of multiple parties contribute to a loss. In particular, it responds to the difficulty that, read literally, the existing language of Sections 3-417(c) and 4-208(c) provide a complete defense whenever there is a preclusion (or giving effect to an otherwise improper indorsement) under one of the proportionate-fault provisions, even if the warrantor also failed to exercise ordinary care. Conversely, the language of Sections 3-417(b) and 4-208(b) suggests that the warrantor has no defense at all based on those proportionate-fault provisions.

Because the "correct" response seems to be that the warrantor should have a defense that leaves the drawee and the warrantor each responsible for their proportionate share of the fault, revision seems appropriate.

3. The references to Section 3-307 added to Sections 3-417(c) and 4-208(c) reflect the extension of concepts of proportionate fault to Section 3-307.

' 4B209. Encoding and Retention Warranties.

(a) A person ~~that~~who presents or transfers a check warrants to any person that subsequently handles it that, at the time of presentment or transfer, the information encoded after issue in magnetic ink on the check is correct.

(b) A person who undertakes to retain an item pursuant to an agreement for electronic presentment warrants to any subsequent collecting bank and to the payor bank or other payor that retention and presentment of the item comply with the agreement. If a customer of a depository bank undertakes to retain an item, that bank also makes this warranty.

(c) A person to whom warranties are made under this section and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.

**REPORTER'S NOTES:**

1. Subsection (a) is based on Regulation CC, ' 229.34(c)(3). The Drafting Committee in Boston voted to adopt a more UCC-typical standard of liability not limited to the amount of the item. The New York Clearing House has objected to that standard. The Committee might wish to consider its views.

**4B210. Security Interest of Collecting Bank in Items, Accompanying Documents and Proceeds.**

(a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(1) in case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(2) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or

(3) if it makes an advance on or against the item.

(b) If credit given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(c) Receipt by a collecting bank of final payment ~~for~~of an item is a realization on its security interest in the item, accompanying documents, and proceeds. So long as the bank does not receive final payment ~~for~~of the item or give up possession of the item or accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to Article 9, but:

(1) no security agreement is necessary to make the security interest enforceable (Section 9-203(1)(a));

(2) no filing is required to perfect the security interest; and

(3) the security interest has priority over conflicting perfected security interests in the item, accompanying documents, or proceeds.

**REPORTER'S NOTES:**

*1. Subsection (c) is revised to change references to final settlement to references to final payment.*

' **4B213. Medium and Time of Settlement by Bank; Same-day Settlement.**

(a) With respect to settlement by a bank, the medium and time of settlement may be prescribed by Federal Reserve regulations or circulars, clearing-house rules, and the like, or agreement. In the absence of such prescription:

(1) the medium of settlement is cash or credit to an account in a Federal Reserve bank of or specified by the person to receive settlement; and

(2) the time of settlement, is:

(i) with respect to tender of settlement by cash, a cashier's check, or teller's check, when the cash or check is sent or delivered;

(ii) with respect to tender of settlement by credit in an account in a Federal Reserve Bank, when the credit is made;

(iii) with respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered; or

(iv) with respect to tender of settlement by a funds transfer, when payment is made pursuant to Section 4A-406(a) to the person receiving settlement.

(b) If the tender of settlement is not by a medium authorized by subsection (a) or the time of settlement is not fixed by subsection (a), no settlement occurs until the tender of settlement is accepted by the person receiving settlement.

(c) If settlement for an item is made by cashier's check or teller's check and the person receiving settlement, before its midnight deadline:

(1) presents or forwards the check for collection, settlement ~~is final~~occurs when the cashier's check or teller's check is finally paid; or

(2) fails to present or forward the check for collection, settlement ~~is final~~occurs at the midnight deadline of the person receiving settlement.

(d) If settlement for an item is made by giving authority to charge the account of the bank giving settlement in the bank receiving settlement, settlement ~~is final~~occurs when the charge is made by the bank receiving settlement if there are funds available in the account for the amount of the item.

(e) Settlements between banks for the forward collection of a check are final at the time prescribed in subsections (a) through (d).

(f) (1) A payor bank may require that checks presented for forward collection be separated from returned checks.

(2) If a presenting bank delivers the check to a location described in Section 4-204 by 8 a.m. on a business day (local time of the location to which the check is delivered), the payor bank is accountable to the presenting bank for the amount of the check, unless, by the close of Fedwire on the business day that it receives the check, the payor bank either returns the check or settles with the presenting bank for the amount of the check by credit to an account at a Federal Reserve Bank designated by the presenting bank. If the payor bank is accountable for the check under the preceding sentence, but does not make final payment of the check, it shall not be accountable for the amount of the check, but it shall be accountable to the presenting bank for interest compensation for each day after the business day on which the check was presented (including the day of settlement or return) until the paying bank settles for the check or returns the check or a notice in lieu of the check, as provided in [new Sections 4-303 and 4-307].

(3) Notwithstanding paragraph (2) of this subsection, if a payor bank closes on a business day and receives presentment of a check on that day in accordance with paragraph (1) of this subsection, the payor bank is accountable to the presenting bank for the amount of the check, unless, by the close of Fedwire on the business day it receives the check, it either returns the check or settles with the presenting bank for the amount of the check by credit to an account at a Federal Reserve Bank designated by the presenting bank. If the closing is voluntary, the paying bank shall pay interest compensation to the presenting bank for each day after the business day on which

the check was presented (including the day of settlement or return) until the paying bank either returns the check or settles for the check.

(g) (1) Each bank that transfers one or more checks to a collecting bank and in return receives a settlement or other consideration warrants to the transferee bank that the accompanying information, if any, accurately indicates the total amount of the checks transferred.

(2) Each bank that presents one or more checks to a paying bank and in return receives a settlement or other consideration warrants to the paying bank that the total amount of the checks presented is equal to the total amount of the settlement demanded by the presenting bank from the paying bank.

(3) If the payor bank settles with the presenting bank in an amount exceeding the total amount of the checks, the payor bank may set off the excess settlement amount against subsequent settlements for checks presented, or for returned checks for which it is the depository bank, that it receives from the other bank.

**REPORTER'S NOTES:**

1. Subsections (e) and (f) reflect the substance of Regulation CC, ' 229.36(d) & (f), respectively. Subsection (g) is based on Regulation CC, ' 229.34(c)(1), (2) & (4).

2. Subsection (c)(1) is revised to clarify that the final payment in question is the final payment of the item given as settlement, not the final payment of the item for which settlement is being made.

3. The last sentence of Regulation CC, ' 229.36(d) is omitted as superfluous now that the provision has been moved into the Uniform Commercial Code. The regulatory commentary suggests that the purpose of the sentence was to preserve rights that other parties might have against the collecting bank for negligence in forward collection and the like. New UCC ' 4-202 seems to set those rights out adequately.

4. This draft suggests consolidation of the same-day settlement rules of Regulation CC 229.36(f) and the underlying UCC settlement rules into a single set of settlement rules that



require settlement on the first business day on which the payor bank has the item by 8 a.m. As written in this draft, the provisions are somewhat more onerous for collecting banks than the existing Regulation CC rules because they eliminate any opportunity to require same-day settlement on items delivered during the business day after 8 a.m. That seemed at least plausible because of the likelihood that in many arrangements the timing is settled by contract and also because of the impression held by representatives of the Federal Reserve that payor banks generally have been able to evade the existing UCC requirement. Industry comments on this provision will be important.

5. The Committee might wish to consider, after consultation with representatives of the Federal Reserve and the affected industries, whether it is important to retain the distinction in new UCC ' 4-213(f)(3) between voluntary and involuntary closings.

6. One obscurity of the existing framework is treatment of cases in which a bank (that is not the depositary bank) fails to settle on the first day but returns the item on the second day (before the midnight deadline). Under existing UCC ' 4-302(a)(1), the bank is accountable for the item, even though it has not made final payment for the item under Section 4-215(a).

The New York Court of Appeals has construed the similar predecessor provisions to mean that the payor bank is obligated for the entire amount of the item even if it has not made final payment. *A.K.S. Jewelry Mfg. Corp. v. Doras Distributor, Inc.* 661 NE2d 683, 28 UCC Rep Serv 2d 417 (1995). The court acknowledges the oddity of the result, but feels compelled to the result by the language of the statute. 28 UCC Rep Serv 2d at 424-25. I am less sure about the language of the statute (which obviously is somewhat different in most states on the point of accountability, for reasons discussed above).

If the Committee is unsatisfied with the result of that decision, several alternate courses are available. For one thing, it has been suggested that the revisions might dispense entirely with the separate midnight rule. That sort of revision seems beyond the scope of the discussions from the first meeting. Moreover, it seems to me that the rule serves an important function in punishing banks for failure to settle promptly. Thus, I am inclined to think that the most logical

arrangement is to say that the payor bank is obligated to compensate the depository bank for the delay in settlement, but that the payor bank is entitled to return the item and avoid responsibility for its face amount. That ~~seems to be the rule implemented by Regulation CC, which imposes~~B a straightforward interest obligation for failure to provide same-day settlement B appears in Regulation CC for voluntary closings, which are in some ways analogous to a voluntary failure to settle. ' 229.36(f)(2). Because this draft incorporates the Regulation CC provisions into Article 4 (specifically, into new Section 4-213), that topic should be less obscure under this draft. A sentence at the end of new subsection (f) states that result explicitly for ordinary failures to settle. This draft does not, however, add anything on that topic to new subsection 4-213(f)(3); it consciously leaves unsettled the rules for a failure to settle caused by an involuntary closure.

Because the resolution suggested by this draft is incomplete and in any event contrary to the decision of the New York court, the topic warrants further discussion by the Committee.

7. As one commenter noted, it is not helpful for ' 4-213(a)(2) to refer to the time that cash is sent or delivered. The Committee might wish to consider an alteration of those provisions that provides more specific guidance.

**4B214. Right of ChargeBack or Refund; Liability of Collecting Bank; Return of Item.**

(a) If a collecting bank has settled with its customer for an item and by reason of dishonor, suspension of payments by a bank, or otherwise the payor bank does not make final payment ~~for~~of the item, the collecting bank may charge back the amount of any credit given for the item to its customer's account or obtain a refund from its customer of that amount.

(b) If a collecting bank receives a returned item or notice of nonpayment, it shall return the item or send notice (~~including~~such as an image of the item) to its customer of the facts by its midnight deadline or within a longer reasonable time. If the collecting bank does not return the item or send notice as required by the preceding sentence, the bank is liable to the customer for any loss resulting from the delay, and the customer to the extent of the amount of the item may offset against the bank's right of charge-back or refund any such loss.

If the bank sends notice (including an image of the item) instead of returning the item, it warrants that the item will not thereafter be presented for payment without the consent of the customer.

(c) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to the instructions of the customer or transferor.

(d) A depository bank that is also the ~~payor~~drawee may charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books ([new Section 4-302]).

(e) The right to charge back is not affected by:

(1) previous use of a credit given for the item; or

(2) failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(f) A failure to charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(g) If credit is given in dollars as the equivalent of the value of an item payable in foreign money, the dollar amount of

any charge-back or refund must be calculated on the basis of the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

**REPORTER'S NOTES:**

1. The new subsection (b) includes the substance of Regulation CC, ' 229.33(d) as well as the notice requirements formerly contained in subsection (a).

2. The section is revised to remove the concept of provisional settlement.

3. Subsection (b) describes the customer's right as an offset against the collecting bank. That is not intended as a substantive change, but rather a clarification of the mechanics of the charge-back.

4. The last sentence of subsection (b) (and the revision of the first sentence to refer to an image of the item) are designed to provide protection for customers that receive images rather than the actual items.

**4B215. Obligation of Collecting Bank to its Customer; When Certain Credits Become Available for Withdrawal.**

(a) If a collecting bank that has not yet settled with its customer for an item receives a settlement for an item for which a payor bank makes final payment, the collecting bank is accountable to its customer for the amount of the item.

(b) Subject to (i) applicable law stating a time for availability of funds and (ii) any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in a customer's account becomes available for withdrawal as of right:

(1) if the bank has received a settlement for the item during forward collection, when the item is finally paid and the bank has had a reasonable time to receive return of the item and the item has not been received within that time;

(2) if the bank is both the depository bank and the payor bank, and the item is finally paid, at the opening of the bank's second banking day following receipt of the item.

(c) Subject to applicable law stating a time for availability of funds and any right of a bank to apply a deposit to an obligation of the depositor, a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit.

**REPORTER'S NOTES:**

1. Former subsection (a) is moved to Part 3 on final payment.

2. Former subsections (b) and (c) are omitted with the removal of the concept of provisional settlement.

3. Subsection (a) is revised to make its use of accountability consistent with the use of that term in new Section 4-301. As the Reporter's Notes to that section explain, accountability is not used to describe the obligation of a bank that already has provided funds, except perhaps in the context of provisional settlement. Because these revisions remove all references to provisional settlement, accountability seems out of place here, except in the odd case in which the collecting bank did not provide a settlement during forward collection.

*The important right of the customer is the right to have the funds available for withdrawal as of right, which remains unchanged in new Section 4-215(b), subject to the Expedited Funds Availability Act as implemented in subpart B of Regulation CC.*

**' 4B216. Obligation of Collecting Bank to Subsequent Collecting Bank.**

(a) Whether or not it indorses the check, a bank that handles a check for forward collection is liable to any bank that subsequently handles the check to the extent that the subsequent bank does not receive payment for the check because of suspension of payments by another bank or otherwise.

(b) The liability of a bank under subsection (a) is not affected by the failure of any bank to exercise ordinary care, but any bank that fails to do so remains liable under subsection (a). A bank seeking recovery against a prior bank shall send notice to that prior bank reasonably promptly after it learns the facts entitling it to recover. A bank may recover from the bank with which it settled for the check by ~~revoking the settlement,~~ charging back any credit given to an account, or obtaining a refund.

**REPORTER'S NOTES:**

1. This section is based on Regulation CC, ' 229.35(b). This draft omits the last sentence of the provision from the Regulation CC provision as superfluous. It generally is designed to dovetail with the depository bank's right of charge-back in Section 4-214(a). Indeed, the Committee might wish to consider deleting the provision as duplicative of ' 4-214.

## ARTICLE 4

### BANK DEPOSITS AND COLLECTIONS

\* \* \* \* \*

#### PART 3

#### FINAL PAYMENT AND RETURN OF ITEMS

##### ' 4B301. Final Payment; Accountability of Payor Bank.

(a) An item is finally paid by a payor bank when the bank has first done any of the following:

(1) paid the item in cash;

(2) settled for the item and failed to satisfy the midnight deadline for dishonoring the item under [new Section 4-302].

(b) If an item is presented to and received by a payor bank, the bank is accountable for the amount of:

(1) a demand item, other than a documentary draft, whether properly payable or not, if the bank does not pay the item (whether finally or otherwise) or return the item or send [written] notice of dishonor until after its midnight deadline; or

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

(c) The liability of a payor bank to pay an item pursuant to subsection (b) is subject to defenses based on breach of a presentment warranty (Section 4-208) or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank. A bank's accountability for the amount of an item under subsection (b) is not affected by, and does not affect, a bank's liability under [new Section 4-312] for failure to make an expeditious return under [new Section 4-303].

**REPORTER'S NOTES:**



1. Former subsection 4-215(a) is moved to this Part to facilitate integration with provisions imported from Regulation CC. The definition of final payment is much simpler with the elimination of the concept of provisional settlement.

2. Former subsection 4-302(a)(1) is simplified by the omission of the concept of provisional settlement and accompanying simplification of the concept of final payment. Also, provisions regarding accountability for failure to make same-day settlement have been deleted in light of the similar provisions from Regulation CC, ' 229.36(f) that now appear in new UCC ' 4-213.

One obvious difficulty with the existing UCC ' 4-302 is the treatment of a case in which a bank settles for an item, retains the item beyond its midnight deadline without returning it, and then successfully returns the item at some later date. Under the original version of Article 3, the payor bank was accountable for the item under the last sentence of UCC ' 4-213(1) ("Upon a final payment \* \* \* the payor bank shall be accountable for the amount of the item."). Thus, even if the bank succeeded in returning the item and obtaining compensation for it, the depository bank upon a complaint by its customer readily could recover the funds for the item from the payor bank.

The 1990 version of Article 3 apparently took a different view of accountability. Under the 1990 version of Article 3, the payor bank was "accountable" only for items for which it had not "paid." Because a payor bank that settled for an item on the date that it received the item and then retained the item past its midnight deadline finally paid the item at the passage of the midnight deadline, it apparently is not "accountable" for the item under the current version of Article 3. See UCC ' 4-215 cmt. 6:

The last sentence of former Section 4-213(1) is deleted as an unnecessary source of confusion. Initially the view that payor bank may be accountable for, that is, liable for the amount of, an item that it has already paid seems incongruous. This is particularly true in the light of the language formerly found in Section 4-302 stating that the payor

bank can defend against liability for accountability by showing that it has already settled for the item.

See also UCC ' 3-~~6~~502 cmt. ~~14~~1:

If the drawee bank [that has settled for the item on the date of presentment] does not return the check or give notice of dishonor or nonpayment within the midnight deadline, the settlement becomes final payment of the check. Section 4-215. Thus, no dishonor occurs regardless of whether the check is retained or is returned after the midnight deadline.  
\* \* \* In all cases in which the drawee bank becomes accountable, the check has not been paid.

Candor requires me to point out that the reading identified above is difficult to reconcile with the comments to existing UCC ' 4-302, which state that a payor bank "may avoid accountability either by settling for the item on the day of receipt **and returning the item before its midnight deadline under Section 4-301** or by returning the item on the day of receipt." UCC ' 4-302 cmt. ~~2~~1 (emphasis added). The highlighted language seems confusingly superfluous under the analysis articulated above. See also UCC ' 4-215(d) & cmt. 10 (discussing accountability of a collecting bank to its customer).

In the end, because the payor bank is not accountable for the item for which it has made final payment, the 1990 versions of Articles 3 and 4 apparently contain no explicit mechanism by which the depositary bank can recover funds that the payor bank obtained by an improper return. The situation is complicated **B** or mitigated, depending on your perspective **B** by the relevant provisions in Regulation CC. As discussed in the Reporters' Notes to new UCC ' 4-303, Regulation CC provides a plain avenue of recovery because the payor bank warrants that it has returned the item in a timely manner. Perhaps the drafters of Article 4 saw no need for an explicit avenue of recovery because Article 4 (unlike Regulation CC, see ' 229.31(c), 229.32(b)) does not provide a mechanism for the payor bank to obtain funds from collecting banks when it makes such an improper return.

In any event, the current draft attempts to leave in place the framework found in existing law, with some changes designed to make it more likely that readers of the statute will have a

*fair chance to understand that framework. Specifically, new UCC ' 4-301(b)(2) now includes a specific reference to final payment designed to make it clear that "pay" in that provision normally refers to final payment. This draft also includes a revised version of the relevant passages of UCC ' 3-602 cmt. 1. This topic warrants further discussion by the Committee.*

**' 4B302. Recovery of Payment by Return of Items; Time of Dishonor.**

(a) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter as required by [new Section 4-213(f)], the payor bank may recover the amount of the settlement if, before it has made final payment and before its midnight deadline, it

(1) returns the item; or

(2) if the item is unavailable for return, sends [written] notice of dishonor or nonpayment.

(b) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (a).

(c) Unless previous notice of dishonor has been sent, an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(d) For purposes of subsection (a), an item is returned:

(1) as to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(2) in all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to instructions.

***REPORTER'S NOTES:***

*1. The introductory clause is added to subsection (d) to avoid confusion with the duty of expeditious return that appears in new UCC ' 4-303.*

*2. The Committee should consider whether the destination for a return adequate to satisfy the midnight deadline (proposed ' 4-302(d)(2)) should be different from the destination adequate*

to satisfy the expeditious return requirement (proposed ' 4-303(a)).

' 4B303. Payor Bank's Duties in Returning Items.

(a) If a payor bank determines not to pay a check cash item, it shall make an expeditious return of the check item; provided, however, that a payor bank has no obligation to make an expeditious return to a party that has breached a presentment warranty under Section 4-208. Subject to the requirement for expeditious return, a payor bank may send a returned check cash item to the depository bank or to any other bank agreeing to handle the returned check cash item expeditiously under [new Section 4-304].

(b) A payor bank returning a check cash item shall clearly indicate on the face of the check cash item that it is a returned check cash item and the reason for return. A payor bank may convert a check to a qualified returned check.

(c) A payor bank that transfers a returned check cash item and receives a settlement or other consideration for it warrants to the transferee returning bank, to any subsequent returning bank, to the depository bank, and to the owner of the check cash item, that:

(1) it has returned the check within the deadline under cash item as required by this section and under [new Section 4-302(a)];

(2) it is authorized to return the check cash item; and

(3) the check cash item has not been materially altered.

**REPORTER'S NOTES:**

1. This section reproduces the substance of Regulation CC, ' 229.30(a) & (d) and 229.34(a)(1)-(3).

2. The revision to the phrasing of what now appears as 4-303(c)(1) is intended (in combination with new UCC ' 4-106(d)) to convey the rule in Regulation CC, ' 229.34(a)(1) that the payable through bank warrants that the midnight deadline and expeditious return requirements are satisfied, running from the time that the item was received by the payable through bank. The Committee should consider specifically whether that framework is appropriate. In particular, although this seemed to be the intent of the first meeting of the Committee, it might

be better to leave liability for failure to make expeditious return to the more general liability rules in [new section 4-312].

3. As discussed in the Reporter's Notes to new UCC ' 4-301, the warranty obligations created by this section would be quite important to the structure of the statute because they would provide the remedy for a depository bank that receives an improperly returned check. Because warranty actions might seem more debatable than actions based on accountability under the old UCC ' 4-302, it might be appropriate to include a comment indicating that ordinarily the recovery for a breach of UCC ' 4-302(c)(1) should be at least the amount of the item. If the topic seems particularly troublesome, the Committee might consider including some specific allocations of burdens of persuasion and production. Conversely, the Committee should note that a warranty of expeditious return is in considerable tension with the comparative negligence standard in 4-312. The draft attempts to implement the views of the Committee in Boston, but more focused consideration of the point would be useful.

4. The Committee should consider whether the provisions on qualified returned checks are sufficiently important to warrant inclusion in the Code.

**4B304. Returning Bank's Duties in Returning Items.**

(a) A returning bank shall make an expeditious return of any returned checkcash item that it agrees to handle under [new Section 4-303] ~~unless it is unable to identify the depository bank~~. Subject to the requirement for expeditious return, a returning bank may send a returned checkcash item to the depository bank or to any other bank agreeing to handle the returned checkcash item expeditiously under this section.

(b) A returning bank that indorses a cash item shall indorse the checkcash item, using an ink color other than purple, with an indorsement placed on the back of the checkcash item so that no portion of the indorsement is less than 3.0 inches from the leading edge of the checkcash item.

(c) A returning bank may convert a returned check to a qualified returned check. If the returning bank converts a returned check to a qualified returned check, and returns the check in a manner permitted by this section other than returning the check directly to the depository bank, the time for expeditious return under the forward-collection test and the midnight deadline for taking action under Section 4-202 are extended by one business day.

(d) A returning bank shall settle with a bank sending a returned checkcash item to it for return by the same means that it settles or would settle with the sending bank for a checkcash item received for forward collection drawn on the depository bank. This settlement is final when made.

(e) A returning bank may impose a charge for handling a returned checkcash item on a bank sending the returned checkcash item.

(f) A returning bank that transfers a returned checkcash item and receives a settlement or other consideration for it warrants ~~to any transferee returning bank,~~ to any subsequent returning bank, to the depository bank, and to the owner of the checkcash item, that:

(1) the payor bank returned the checkcash item within the deadlines under [new Section 4-303] and under [new Section 4-302(a)];

(2) it is authorized to return the checkcash item; and



(3) the ~~check~~cash item has not been materially altered.

(g) Each bank that transfers a returned ~~check~~cash item to a returning or depository bank and in return receives a settlement or other consideration warrants to the transferee bank that the accompanying information, if any, accurately indicates the total amount of the ~~checks~~cash items transferred. If a bank to which one or more returned cash items are transferred settles with the bank that transferred the item or items in an amount exceeding the total amount of the item or items, the bank to which the item or items were transferred may set off the excess settlement amount against subsequent settlements for checks presented, or for returned checks for which it is the depository bank, that it receives from the other bank.

**REPORTER-S NOTES:**

1. This section reproduces the substance of Regulation CC, ' 229.31(a), (c) & (d), 229.34(a)(1)-(3) & 229.35(a). Subsection (b) is based on paragraph 3 of Appendix D. Subsection (g) is based on Regulation CC, ' 229.34(c)(2).

2. As with the current Regulation CC, the deadline extensions for returning banks that convert returned checks to qualified returned checks apply only to the midnight deadline and the forward-collection test, not to the business-day test.

The Committee might wish to explore with representatives of the Federal Reserve and affected industries whether it is necessary to retain the special deadlines in new UCC ' 4-304(c) for qualified return checks.

**4B305. Notice of Nonpayment.**

(a) If a payor bank determines not to pay a check cash item in the amount of \$2,500 or more, it shall provide notice of nonpayment such that the notice is received by the depository bank by 4:00 p.m. (local time) on the second business day following the banking day on which the check cash item was presented to the payor bank. If the day the paying payor bank is required to provide notice under the previous sentence is not a banking day for the depository bank, it is sufficient for the payor bank to provide notice that is received on the depository bank's next banking day.

(b) The notice may be provided by any reasonable means, including the returned check cash item, a writing (including a legible copy of both sides of the check cash item), telephone, Fedwire, telex, electronic mail, telecopy, or other form of telegraph. The notice must include the reason for nonpayment as well as such additional information that reasonably identifies the check cash item as is reasonably available to the payor bank from the returned check cash item itself.

(c) Each payor bank that gives a notice of nonpayment warrants to the transferee bank, to any subsequent transferee bank, to the depository bank, and to the owner of the check cash item, that:

(1) the payor bank returned or will return the check cash item within the deadlines under [new Section 4-303] and under [new Section 4-302(a)];

(2) it is authorized to send the notice; and

(3) the check cash item has not been materially altered.

**REPORTER'S NOTES:**

1. This section includes the substance of Regulation CC, 229.33(a), (b) & (c).

2. References to electronic mail and telegraph are intended to update the types of notices that might be reasonable in particular circumstances.

3. The information required in the notice is made less specific than Regulation CC, reflecting the difficulties payor banks have in obtaining the information described in the existing regulation.

**4B306. Rights and Obligations of Depositary Banks Regarding Returned ~~Checks~~Cash items and Notices of Nonpayment.**

(a) A depositary bank shall accept returned ~~checks~~cash items and written notices of nonpayment:

(1) at any location at which presentment of checks for forward collection is requested by the depositary bank; and

(2) (A) at a branch, head office, or other location consistent with the name and address of the bank in its indorsement on the ~~check~~cash item;

(B) if no address appears in the indorsement, at a branch or head office associated with the routing number of the bank in its indorsement on the ~~check~~cash item;

(C) if the address in the indorsement is not in the same check processing region as the address associated with the routing number of the bank in its indorsement on the ~~check~~cash item, at a location consistent with the address in the indorsement and at a branch or head office associated with the routing number in the bank's indorsement; or

(D) if no routing number or address appears in its indorsement on the ~~check~~cash item, at any branch or head office of the bank.

(b) ~~During its banking day,~~ the depositary bank shall accept notices of nonpayment that are not written ~~during its banking day~~:

(1) either at the telephone or telegraph number of its return check unit indicated in the indorsement, or, if no such number appears in the indorsement or if the number is illegible, at the general purpose telephone or telegraph number of its head office or the branch indicated in the indorsement; and

(2) at any other number or electronic-mail address held out by the bank for receipt of notices of nonpayment.

(c) A depositary bank may require that returned ~~checks~~cash items be separated from forward collection ~~checks~~cash items.

(d) A depositary bank shall ~~pay~~settle with the returning or payor bank returning the ~~check~~cash item to it for the amount of

the check cash item before the close of business on the banking day on which it received the check cash item by:

(1) debit to an account of the depositary bank on the books of the returning or payor bank;

(2) cash;

(3) wire transfer; or

(4) any other form of payment acceptable to the returning or payor bank;

provided, however, that the proceeds of the payment are available to the returning or payor bank in cash or by credit to an account of the returning or paying bank on or as of that day.

If the banking day on which the depositary bank receives the check cash item is not a banking day for the returning or payor bank or if the depositary bank is otherwise unable to make the payment on the day on which it receives the check cash item, payment shall be made by the next day that is a banking day for the returning or paying bank. The liability of a depositary bank to pay an item under this subsection is subject to a defense based on proof that the person returning the item has returned it for the purpose of defrauding the depositary bank.

All payments under this subsection are final when made.

(e) If a depositary bank settles with another bank for returned checks cash items for which it is the depositary bank in an amount exceeding the total amount of the checks cash items, the depositary bank may set off the excess settlement amount against subsequent settlements for checks cash items presented, or for returned checks cash items for which it is the depositary bank, that it receives from the other bank.

(f) If a bank receives a returned check cash item or written notice of nonpayment on the basis that it is the depositary bank, and the bank determines that it is not the depositary bank with respect to the check cash item or notice, it shall either:

(1) promptly send the returned check cash item or notice to the depositary bank directly or by means of a returning bank agreeing to handle the returned check cash item expeditiously under [new Section 4-304]; or

(2) promptly send the check cash item or notice back to the bank from which the check cash item or notice was received.

(g) A depository bank may not impose a charge on a paying bank or a returning bank for accepting ~~and paying checks~~ or settling for cash items being returned to the depository bank.

**REPORTER'S NOTES:**

1. This section consolidates the substance of Regulation CC, ' 229.32 & 229.33(c). Subsection (e) is based on Regulation CC, ' 229.34(c)(4).

2. Subsection (d) imposes an absolute obligation on the depository bank to settle when it receives returned checks. The penultimate sentence (based on existing UCC ' 4-302(b)) is designed to protect depository banks against payor banks involved in check-kiting or analogous schemes to obtain funds by returning checks as to which the payor bank obviously has no proper basis for return.

3. This draft tracks Regulation CC in that the obligation under subsection (f) of the returning bank that agrees to make an expeditious return of a misrouted check is tied to the date that the payor bank originally received the check. Presumably that will not pose a problem in most cases because the returning bank can protect itself if it satisfies the forward-collection test. If that is thought unduly burdensome on returning banks, the section should add a special rule for application of the business-day test in that situation.

4. For reasons of symmetry, this draft adds a requirement, apparently not in the existing Regulation CC, that the incorrect depository bank act promptly if it chooses to return the check to the bank from which it was received.

**' 4B307. Notice in Lieu of Return.**

(a) If a check is unavailable for return, the payor bank or the returning bank may send in its place a legible copy of the front and back of the returned check, or, if no such copy is available, a written notice of nonpayment containing the information specified in [new Section 4-305(a)]. The copy or notice shall clearly state that it constitutes a notice in lieu of return. A notice in lieu of return is considered a returned check subject to the expeditious return requirements of [new Sections 4-303 and 4-304] and the other applicable provisions of this Article.

(b) Each paying bank or returning bank that sends a notice in lieu of return to transfer a returned check and receives a settlement or other consideration for it warrants to any transferee returning bank, to any subsequent returning bank, to the depository bank, and to the owner of the check, that the original check has not and will not be returned.

***REPORTER'S NOTES:***

*1. This section consolidates the substance of Regulation CC, '' 229.30(f) and 229.31(f), as well as the warranty provision of ' 229.34(a)(4).*

**4B308. Unidentifiable Depository Banks.**

(a) If a payor bank or a returning bank that was not a collecting bank with respect to a returned check cash item is unable to identify the depository bank with respect to the check cash item, that bank may send the returned check cash item to any bank that handled the check cash item for forward collection, even if the bank to which the check cash item is sent does not agree to handle the check cash item expeditiously under [new Section 4-304]. If a returning bank that was a collecting bank with respect to a returned check cash item is unable to identify the depository bank with respect to the check cash item, it may send the check cash item to a prior collecting bank, even if the bank to which the check cash item is sent does not agree to handle the check cash item expeditiously under [new Section 4-304].

(b) A bank sending a returned check cash item under this section must advise the bank to which the check cash item is sent that the bank sending the check cash item is unable to identify the depository bank.

(c) The expeditious return requirements of [new Sections 4-303 and 4-304] do not apply to the return of check cash items under this section. A bank that returns a check cash item under this section need not send a notice of nonpayment under [new Section 4-305].

(d) A returning bank that receives a returned check cash item under subsection (a), but that is able to identify the depository bank, must thereafter make an expeditious return of the check cash item to the depository bank.

**REPORTER'S NOTES:**

1. This section is based on Regulation CC, " 229.30(b) & 229.31(b).

2. This draft makes two substantive changes to the existing provisions of Regulation CC: it adds a new rule waiving the requirement of a notice of nonpayment and it extends the requirement that the bank receiving such a check need not agree to return the check expeditiously.



3. This draft tracks Regulation CC in that the obligation of a returning bank to make an expeditious return when it can identify the depositary bank is tied to the date that the payor bank originally received the check. Like the similar problem in Section 4-306 (regarding checks routed to the wrong depositary bank), that presumably will not pose a problem in most cases because the returning bank can protect itself if it satisfies the forward-collection test. If that is thought unduly burdensome on returning banks, the section should add a special rule for application of the business-day test in that situation. More generally, some commenters have suggested that the Committee consider an extended test for all unidentifiable cases.

' **4B309. Depositary Banks Without Accounts.**

Neither the expeditious return requirements of [new Sections 4-303 and 4-304] nor the notice of nonpayment requirement of [new Section 4-305] apply to checkscash items deposited in a depositary bank that does not maintain accounts.

**REPORTER'S NOTES:**

1. This section consolidates the substance of Regulation CC, '' 229.30(e), 229.31(e) & 229.33(e).

' 4B310. Reliance on Routing Number.

A payor bank or a returning bank may return a ~~check~~cash item based on any routing number designating the depository bank appearing on the returned ~~check~~cash item in the depository bank's indorsement or in magnetic ink on a qualified returned check.

**REPORTER'S NOTES:**

1. This section consolidates the substance of Regulation CC, '' 229.30(g), 229.31(g).

**' 4B311. Warranty Procedures.**

(a) A person to whom a warranty is made under [new Sections 4-303, 4-304, 4-305, or 4-307] and who took the ~~check~~cash item in good faith may recover as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.

(b) If a bank is sued for breach of a warranty under [new Sections 4-303, 4-304, 4-305, or 4-307], the bank may give a prior bank in the return chain written notice of the litigation, and the bank notified may then give similar notice to any other prior bank. If any such notice sent seasonably states that the bank notified may come in and defend and that failure to do so will bind the notified bank in an action later brought by the bank giving the notice as to any determination of fact common to the two litigations, the notified bank is so bound unless the notified bank does come in and defend.

(c) Unless a claimant gives notice of a claim for breach of warranty under [new Sections 4-303, 4-304, 4-305, or 4-307] to the bank that made the warranty within 30 days after the claimant has reason to know of the breach and the identity of the warranting bank, the warranting bank is discharged to the extent of any loss caused by the delay in giving notice of the claim.

**REPORTER'S NOTES:**

1. This section is based on Regulation CC, ' 229.34(d)-(f).

2. The amount to be recovered for breach of warranty is altered to match the more common UCC formulation, modeled in this case on UCC ' 4-209(e).

**4B312. Liability.**

(a) A bank shall exercise ordinary care and act in good faith in complying with the requirements of this Part. A bank that fails to exercise ordinary care or fails to act in good faith under this Part shall be liable for such failure to the depositary bank, the depositary bank's customer, the owner of a checkcash item, or another party to the checkcash item.

(b) A person harmed by a failure to exercise ordinary care under subsection (a) may recover as damages the amount of the loss incurred, up to the amount of the checkcash item, reduced by the amount of the loss that person is entitled to recover from the payor bank under [new Section 4-301(b)] and by the amount of the loss that person would have incurred even if the bank had exercised ordinary care. A person harmed by a failure to act in good faith may recover the same damages and also other damages, if any, proximately caused by the failure of the bank to exercise ordinary care or to act in good faith.

(c) If a person fails to exercise ordinary care or act in good faith under this Article in indorsing a checkcash item, accepting a returned checkcash item or notice of nonpayment, or otherwise, then the damages to which that person is entitled under this section shall be diminished according to the extent to which the negligence or bad faith attributable to that person contributed to the loss. For purposes of this subsection:

(1) a payor bank fails to exercise ordinary care to the extent that the condition of the check when issued affects the ability of a bank to indorse the check legibly in accordance with [new Section 4-206 or new Section 4-304]; and

(2) a depositary bank fails to exercise ordinary care to the extent that the condition of the back of a check arising after the issuance of the check and before the depositary bank accepted the check for collection adversely affects the ability of a bank to indorse the check legibly in accordance with [new Section 4-206 or new Section 4-304].

(3) In the case of a checkcash item that is payable through a bank that is located in a different check processing region than the bank by which the checkcash item is payable, the bank by which the checkcash item is payable fails to exercise ordinary care to the extent that the checkcash item is not returned to the depositary bank through the payable through bank

as quickly as the checkcash item would have been required to be returned under [new Section 4-303] had the bank by which the checkcash item is payable received the checkcash item as payor bank on the day that the payable through bank received the checkcash item and returned the checkcash item as payor bank in accordance with the business-day test.

(d) Unless a bank violates subsection (a) in choosing the means of return or notice of nonpayment, it is not liable under that provision for the insolvency, neglect, misconduct, mistake, or default of another bank or person, or for loss or destruction of a checkcash item or notice of nonpayment in transit or in the possession of others.

(e) Whether or not it indorses the checkcash item, a bank that handles a checkcash item for return is liable to any bank that subsequently handles the checkcash item to the extent that the subsequent bank does not receive payment for the checkcash item because of suspension of payments by another bank or otherwise. The ability of a bank to recover under this subsection is not affected by its failure to exercise ordinary care, but any bank that fails to do so remains liable under this subsection and other applicable law. A bank seeking recovery against a prior bank shall send notice to that prior bank reasonably promptly after it learns the facts entitling it to recover. A bank may recover from the bank with which it settled for the checkcash item by ~~revoking the settlement,~~ charging back any credit given to an account, or obtaining a refund.

(f) If a bank is delayed in acting beyond the time limits set forth in this Part because of interruption of communication or computer facilities, suspension of payments by a bank, war, emergency conditions, failure of equipment, or other circumstances beyond its control, its time for acting is extended for the time necessary to complete the action, if it exercises diligence that is reasonable in the circumstances.

**REPORTER'S NOTES:**

1. This section is based on Regulation CC, ' ' 229.38(a)-(e). Subsections 229.38(f) and (h) are omitted because they seem inappropriate for state-law enactment. Subsection 229.38(g) is omitted because it would be invalid as a provision of state law. New subsection (e) is based on Regulation CC, ' 229.35(b).

2. The revisions to Regulation CC, ' 229.38(d)(1) [the second sentence of new UCC ' 4-312(c)] are intended to clarify the intent of that provision, not to alter the substance of existing law.

3. The revisions to the third sentence of ' 229.35(b) [the second sentence of new UCC ' 4-312(e)] are intended to clarify the intent of that provision, not to alter the substance of existing law.

4. As at least one commenter noted, there is considerable analytic tension between ' 4-312(d) and ' 4-202(c). The Committee might wish to consider the propriety of the distinction.

' 4B313. When Items Subject to Notice, Stop-Payment Order, Legal Process, or Setoff; Order in Which Items May Be Charged or Certified.

(a) Any knowledge, notice, or stop-payment order received by, legal process served upon, or setoff exercised by a payor bank comes too late to terminate, suspend, or modify the bank's right or duty to pay an item or to charge its customer's account for the item if the knowledge, notice, stop-payment order, or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the earliest of the following:

(1) the bank accepts or certifies the item;

(2) the bank pays the item in cash;

(3) [omitted]

(4) the bank becomes accountable for the amount of the item under [new Section 4-302] dealing with the payor bank's responsibility for late return of items; or

(5) with respect to checkscash items, a cutoff hour no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the checkscash item and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the checkscash item.

(b) Subject to subsection (a), items may be accepted, paid, certified, or charged to the indicated account of its customer in any order.

**REPORTER'S NOTES:**

1. Subsection (a)(3) is omitted with the removal of the concept of a provisional settlement.



**' 4B314. Insolvency and Preference.**

(a) If an item is in or comes into the possession of a payor or collecting bank that suspends payment and the item has not been finally paid, the item must be returned by the receiver, trustee, or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(b) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank, the owner of the item has a preferred claim against the payor bank.

(c) If a collecting bank receives from subsequent parties settlement for an item, and the bank suspends payments without making a settlement for the item with its customer, the owner of the item has a preferred claim against the collecting bank.

***REPORTER'S NOTES:***

*1. This provision (old UCC ' 4-216) is moved to Part 3 to reflect the revised division of subject matter between Parts 2 and 3 of Article 4.*

*2. The revisions to the text reflect the removal of the concept of provisional settlement.*

**' 4B402A. Bank=s Obligation to Recredit Pending Investigation of Certain Warranty Claims.**

(a) If a customer that is the drawer on a consumer account provides a payor bank notice that reasonably identifies an item drawn on the customer=s account that does not bear a handwritten signature purporting to be the signature of the drawer, and if the customer alleges with reasonable specificity that the customer did not authorize the issuance of the item in the amount for which the item was drawn, then the payor bank within 10 business days must either (i) provisionally credit the customer=s account in the amount of the alleged error (including interest if applicable); or (ii) complete a reasonably thorough investigation that concludes that the customer=s allegation is unfounded.

(b) The payor bank must accord the customer full use of any funds credited to a customer=s account under subsection (a) until and unless the bank completes a reasonably thorough investigation that concludes that the customer=s allegation is unfounded.

(c) The payor bank shall report the results of any such investigation to the customer within three business days after completing the investigation (including, if applicable, notice of any credit given as a result of the payor bank=s assessment of the merits of the customer=s allegation). Upon request by the customer, the payor bank shall provide the customer at no charge a copy of any documents on which the payor bank relied in making its determination of the merits of the customer=s allegation.

(d) The payor bank and the customer may determine by agreement the requirements for a notice that reasonably identifies an item and an allegation that is reasonably specific, so long as those requirements are not manifestly unreasonable. Except as described in the preceding sentence, the rights and obligations arising under this section may not be varied by agreement.

**REPORTER=S NOTES:**

*1. This provision is modeled on Regulation E, ' 205.11. It responds to the Committee=s request that we investigate various methods of ensuring that consumers have effective recourse with respect to fraudulently issued telephonically generated checks. It is considerably simplified from Regulation*

*E*, and would have to be much more detailed before it could be included in the UCC. It should, however, be adequate to serve as a basis for discussion of the basic concept.

2. One particular simplification that warrants comment is the absence of any provision permitting the payor bank to recover funds from the depositary bank during the pendency of the investigation. Such a provision raises some complicated policy questions. For one thing, the absence of the provision does not obviously harm the payor bank in a serious way, because the payor bank should be able to recover any applicable interest losses under Section 4-208(b). On the other hand, a device (like the credit-card charge-back system) for retrieving the funds more promptly from the depositary bank might actually be beneficial for the depositary bank if it caused the depositary bank to move more promptly to recover from its miscreant depositors (thus limiting the number of cases in which the depositary bank cannot recover because the miscreant depositor has absconded or otherwise become financially irresponsible).

Of course, depositary banks could protect against absconding customers even without such a provision if they simply required reserves from customers that deposit such checks. The topic warrants further discussion by the Committee.

3. We anticipate that the comment to this provision would offer some guidance as to the types of situations in which Regulation *E* does and does not apply (because the provision is superfluous or preempted in the cases in which Regulation *E* applies).

**4B406. Customer's Duty to Discover and Report Unauthorized Signature or Alteration.**

(a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment.

(b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of both sides of the item. Notwithstanding any agreement to the contrary, the bank upon request shall provide without charge at least \_\_\_ items (or legible copies of both sides of those items) during each calendar year.

(c) If a bank acting pursuant to subsection (b) provides the customer a copy of the item rather than the item, the copy of the item shall be deemed to be the item for purposes of enforcement of the item, so that the customer's right to enforce the item shall not be diminished solely because the customer does not possess the item. Furthermore, any such copy of the item, together with a statement of account showing payment of the item, shall constitute prima facie evidence that the customer has made payment in the amount of the item.

(d) If a bank sends or makes available a statement of account or items pursuant to subsection (a), the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized.

If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(e) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection (d), the customer is precluded from asserting against the bank:

(1) the customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and

(2) the customer's unauthorized signature or alteration 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 or alteration and after the customer had been afforded a reasonable period of time, not exceeding 30 days, in which to examine the item or statement of account and notify the bank.

(f) If subsection (e) applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (d) and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (e) does not apply.

(g) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer under subsection (a) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the customer may not recover under Sections 3-404(d), 3-405(b), or 3-406(b) from any other person whose failure to exercise ordinary care contributed to a loss with respect to the item as to which the customer is precluded under this subsection, and the payor bank may not recover for breach of warranty under Section 4-208 with respect to the unauthorized signature or alteration to which the preclusion applies.

**REPORTER'S NOTES:**

1. The revisions of Section 4-406(b) are intended to ensure adequate accommodation of the interests of customers

adversely affected by a bank's decision not to return items with monthly statements.

2. The new subsection (c) is intended to ensure that customers are not prejudiced in enforcement or proof of payment by the bank's decision not to return items to its customers.

3. The additional language in Section 4-406(g) is intended to enhance the completeness of the interface between Section 4-406 and the other proportionate fault provisions.—

4. The Committee should consider whether to alter the result in *Monreal v. Fleet Bank*, 2000 WL 539456 (N.Y. 2000) (holding that the preclusion under ' 4-406(g) (now (f)) applies on a statement-by-statement rather than scheme-by-scheme basis).

**4B407. Payor Bank's Right to Subrogation on Improper Payment.**

If a payor bank has paid an item over the order of the drawer or maker to stop payment, or after an account has been closed, or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank is subrogated to the rights

(1) of any holder in due course on the item against the drawer or maker;

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

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

For purposes of the payor bank's rights under this section, the item is deemed not to have been paid and is treated as dishonored.

**REPORTER'S NOTES:**

1. The last sentence is added to make it clear that the rights to which the payor bank is subrogated on the instrument and in the underlying transaction should not be treated as discharged under Sections 3-602 and 3-310 because of the bank's payment of the item. The sentence is modeled on Section 3-418(d).