FACSIMILE TRANSACTION

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FROM: Connie Ring
RE: Article 2B
DATE: January 25, 1999
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Dear Jane, Paul and Paul:

Thank you for your letter of January 20 which will be included in the packet sent to all members of the Drafting Committee and observers who have requested materials.

We appreciate your thoughtful input and providing to us three draft alternative proposals on attribution procedures. Ray, Fred Miller and I have discussed in depth your concerns and it has stimulated some additional thought by us that may address your concerns. We hope to formulate those thoughts into a proposal that likewise will be included in the packet of material for the meeting.

Your suggestions prompted us to look again at the Article 4A procedure. I have talked to other members of that Drafting Committee and they concur in the analysis below. While the merits of your alternative are not based on what 4A does or doesn't do in order for you to understand our forthcoming proposal it is necessary to be clear about the 4A procedure. We believe, you said incorrectly in your letter "…the rule in 4A-202 … imposes the threshold risk of wire transfer fraud loss on the customer."

Article 4A-202(a) provides that the order must be authorized by the sender. Thus, if the sender claims that the order is unauthorized and the Bank states no defense, the Bank loses and the customer wins. This is true for all UCC allocation systems, although not necessarily for other systems such as credit cards.

The Bank may defend on the basis that the order is authorized providing proof (i) of actual, inplied apparent, authorization (see official comment 1 to 4A-203 as to the difficulties of such proof) or (ii) "…that it accepted the payment order in good faith and in compliance with the security procedure [which is "commercially reasonable"] and any written agreement or instruction of the customer restricting acceptance of the customer" (4A-202(b)). "Prove" (4A-105(a)(7)) is a defined term meaning "the burden of establishing the fact (section 1-201(8))."

Therefore, the Bank, if it is defending on the basis of (ii) above, must discharge the burden of persuasion that it had a security agreement with the customer, it complied in good faith with that security procedure, that procedure was "commercially reasonable" [or the customer rejected an offered commercially reasonable procedure], and the bank complied with any agreement with or instruction from the customer. If the bank does not "prove" each of the above elements, the Bank loses.

Even if the bank carries the burden of persuasion, it does not win if the customer proves that the order was not caused in essence by the customer's fault or negligence (4A-203(a)(2)). In short, if the loss is caused by a third party, the Bank loses.

In summary, in the first instance the Bank loses if the customer says the order was unauthorized. The bank only wins if it proves the order was authorized. A security procedure is on way the bank can attempt to prove the order was authorized in law but only if the security procedure is "commercially reasonable" – an added hurdle for the Bank.

Prior to Article 4A, the typical bank security procedure said that if the Bank followed it, the Bank won. The imposition of the "commercially reasonable" standard was pro-customer.

Your letter seems to imply that the security procedure provisions were to protect banks from sudden and catastrophic losses because of the placement of your sentence "Nevertheless, a goal of the Article 4A drafters was to protect the banks from sudden and catastrophic losses not caused through their fault." Sections 4A-201 to 203 were drafted independently, and without reference to, that concern (the focus of that concern was in drafting Part 5. The "feared chain reaction" which you state "led to the rule in Section 4A-202" is not true in my opinion as Chair of the Drafting Committee and confirmed by others on the Drafting Committee.

In your letter you also state that Section 2B-116(a)(2) is not listed as a non-variable rule. While it may be desirable to say it directly, Article 1 applies to Article 2B and provides in Section 1-102(3) that "…obligations of…reasonableness…prescribed by this Act may not be disclaimed by agreement…"

Again, I state that the merits of your proposals do not depend on the analysis of Article 4A but to the extent Article 4A may provide some enlightenment on possible provisions for other forms of electronic commerce, they should be understood correctly.

Your alternatives are creative and stimulate the possibility of even more creativity in addressing these real concerns.

Sincerely,

Carlyle C. Ring, Jr.

cc: Article 2B Drafting Committee