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Bank Deposits and Collections and Letters of Credit

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BANK DEPOSITS AND COLLECTIONS AND LETTERS OF CREDIT.

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ARTICLE IV—BANK DEPOSITS AND COLLECTIONS

BANKING PRACTICES AND THE CODE

In drafting the Uniform Commercial Code the most controversial article was the relating to bank deposits and collections.

In its various stages of development it has been described by some as "a deliberate sell-out . . . to the bank lobby" and "[a] one-sided piece of class legislation".[1]

Others have criticised the article as working a hardship on the banks.[2] It has been suggested that Article IV should be omitted from the code but that even with Article IV the code will improve the law over the next fifty years.[3]

Still others have seen great virtue in Article IV; it has been characterized as "extremely well drafted", "for the first time you can find the entire complex bank law and custom in one place"—"it strikes an over-all fair balance between the practical needs and requirements of the banking community and the necessity of assuring bank customers most efficient service."[4]

In analyzing Article IV, the conclusion reached is likely to be determined by the door in which you enter. If you start with the belief that the law controlling the various relationships involved in bank deposits and collections should be determined by the ordinary rules of contract, agency, trust, torts and guaranty, you will join the ranks of critics of this article. You may even conclude, as one writer has, that banks should be virtual insurers in collecting checks.[5] On the other hand if you are familiar with the practical problems in handling and collecting the great mass of checks which

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[1] Beutel, *The Proposed Uniform* [?] *Commercial Code Should Not Be Adopted,* 61 YALE L.J. 334, 362-63 (1952).

[2] Brome, *Bank Deposits and Collections,* 16 LAW & CONTEMP. PROB. 308 (1951).

[3] Gillmore, *The Uniform Commercial Code: A Reply to Professor Beutel,* 61 YALE L.J. 364 (1952).

[4] Rapson, *Article 4-Bank Deposits and Collections,* 17 RUTGERS L. REV. 79 (1962).

[5] Beutel, *The Proposed Uniform* [?] *Commercial Code Should Not Be Adopted,* 61 YALE L.J. 334 (1952).

are involved each day in ordinary banking operations you are likely to conclude that Article IV has merit.

Because of the importance of expeditiously handling the substantial quantities of checks involved in day-to-day business transactions in meeting and promoting the demands of modern business, and because this cannot be accomplished other than by a bulk production line method which precludes separate inspection of each item, most writers have concluded that the rules of law applicable to ordinary contracts cannot be fairly applied to the various transactions and relationships involved in bank collection and bank deposit situations.[6]

In developing Article IV the initial draft was based on the usual rules of contract, tort, agency and guaranty law.[7] This was vigorously opposed by banks and attorneys for banks. Because of the opposition to this draft there was a period of time when a view prevailed that no provision should be incorporated in the code with reference to bank deposits and collections; finally, provisions informally drafted by a group of bank attorneys were presented and after modification by American Law Institute draftsmen reached its "final" form in 1952. This draft was adopted in Pennsylvania but met with criticism particularly in New York and was further modified by a joint subcommittee to reach its present form in 1957.[8]

The difference in attitude toward Article IV is best explained by the importance placed on (1) the need for speedy handling of checks, (2) consideration of the practical problems and operations in handling the tremendous volume of items[9] which move through

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[6] In twenty-five years the number of checks clearing banks each year has risen from 2 billion to over 16 billion. At the present time there are about 25,000 banking offices in the United States. These banks handle in excess of 50 million items a day. A single bank in a metropolitan area often handles over 3 million items in a single day. The First National Bank & Trust Company of Lincoln averages 100,000 items a day.

[7] According to Beutel a draft by Professor Leary which "properly distribute[d] liability and risk of loss" met unanimous opposition of the American Bankers Association. 61 YALE L.J. 334, 359 (1952). Clarke, Bailey and Young, in their work on bank deposits and collections published by the American Law Institute, comment that the first draft was cast in rigid form and met much opposition among many banks and bank attorneys. CLARKE, BAILEY AND YOUNG, BANK DEPOSITS AND COLLECTIONS, 12 (1959).

[8] CLARKE, BAILEY AND YOUNG, BANK DEPOSITS AND COLLECTIONS, 12-13 (1959).

[9] The term "item" is one of common usage in the banking industry and is defined by the Code as "any instrument for the payment of money even though it is not negotiable but does not include money." UNIFORM COMMERCIAL CODE (hereinafter abbreviated U.C.C.) § 4-104(g).

the ordinary commercial banks each day, and (3) the tremendous increase in the volume of these items each year.

In the distant past the presentation of items for collection contemplated physical presentment over the counter to a responsible official of the bank and his careful consideration of the instrument and determination of the bank's action. With three million items moving through a single bank each day or even with one or two thousand items which often move through a small bank in a single day this type of procedure is completely impractical.

To meet the demand for prompt handling of checks a bank must handle checks by machine and on a production line basis. Except for items earmarked for special handling,[10] the thousands or millions of checks moving through the bank each day are generally handled as "cash items". When making deposits the depositor is given a receipt for the total he reports on his deposit slip. No effort is made to verify the items at the time the deposit is made. Credit is given to the depositor with the understanding that errors or deficiencies will be corrected and adjusted after proofing and after completion of the collection process.

A single deposit may contain checks on the bank where the deposit is made[11] as well as checks on banks in the same area[12] and checks on banks outside of that area.[13] Each requires a different method of handling. Many items will be handled by five or six different banks before they are finally paid. Each one of the thousands or millions of checks must be handled at least five times by each bank.

The simplest procedure involves the "on us" item. In this situation the depositary bank is also the payor bank. After proofing and sorting, the items are sent to the bookkeeping department and ultimately reach the bookkeeper handling the drawer's account. This bookkeeper must then ascertain that the signature is valid, that the check is complete and consistent, that there have been no material alterations, that it is properly endorsed, that there are no stop orders pertaining to this check, that there are no attachment orders relating to this account, and that there are sufficient funds

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[10] These items with specific instructions are referred to in the industry as "collection items" and receive special handling and individual attention. Only a very small percentage of checks are so handled.

[11] These are referred to in the industry as "on us" items.

[12] These are often categorized as "city items" or items to be handled through the local clearing house.

[13] These are frequently identified as "country items."

in the drawer's account to cover the check. If everything is in order the amount of the check is finally charged to the drawer's account and the check is cancelled and "has been paid".

It is true that handling by the bookkeeper of the drawer's account must involve the exercise of some judgment and individual consideration of each check. However, the process has been streamlined and mechanized to such an extent[14] that a reasonably sharp bookkeeper for the drawer's account can handle as many as 1800 items during an ordinary eight hour day.

Production line handling pays its greatest dividends in time saving in the handling procedures of the bank of deposit and of intermediary banks who can move the item on its way with a minimum of special consideration.

City items are handled generally through a clearing house, which is an organization formed by a group of banks in the same area to handle the daily exchange of checks and balancing of accounts between said banks.

Clearing house items as well as country bank items are handled by "cash letters"[15] listing the total amount of all checks submitted with the cash letter. Attached to each cash letter is a machine tape listing only the amount of each check and the total. Cash letters are handled by the receiving bank as any other deposit. Immediate credit is given subject to adjustment after proofing and in event any item is not collected. The items are sorted into "on us", "city" and "country items" and moved on their way as any other deposit.

Generally, country items are not sent directly to the payor bank. In the early days such action constituted negligence.[16] Under existing law and practice, they may be sent directly to the payor bank, but more often they are sent to a correspondent bank nearer or with more direct connections with payor bank than the sender. The Federal Reserve Banks often act in this capacity. An item deposited in a Nebraska bank and drawn on a California bank may pass through three or four banks before it reaches the payor bank.

Once an item has been paid, settlement must be made with

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[14] Modern machines are so constructed that information may be set in the machine to alert the operator by warning lights and similar devices in event of stop orders, attachments, overdrafts and similar matters.

[15] A "cash letter" serves the same purpose for deposit by a bank as a deposit slip does in cases of individual deposits.

[16] Western Wheeled Scraper Co. v. Sadilek, 50 Neb. 105, 69 N.W. 765 (1897).

the forwarding bank. If it is not paid, notice must be given the forwarding bank.

In each instance, both in sending an item for collection and in making settlement or advising of non-payment, the army "chain of command" process is generally followed.

The entire operation must be conducted with the maximum of speed and diligence. The practical problems encountered in this process form the basis for a good share of the Code provisions.

Some underlying principles involved in the adoption of Article IV include:

(1) Checks must be handled on a machine basis to keep up with the volume. They cannot be handled individually.

(2) Over 99½% of all items handled in the process of bank deposits and bank collections proceed routinely and are paid in due course without incident.

(3) The basic responsibility of any bank involved in the process of bank deposits and bank collections should be to act seasonably, to act in good faith, and to act with ordinary care under the circumstances. If each bank so acts the risk of loss from machine handling of items should rest with the depositor. A collecting bank should not be required to do the impossible or to insure collection of items properly handled.

(4) In view of anticipated growth and ordinary progress, the rules should be as flexible as possible.

The predecessor to Article IV is the American Bankers Association Collection Code. Nebraska adopted the American Bankers Association Collection Code in 1929.[17] To a large extent Article IV includes the rules set forth in the ABA Collection Code so the Uniform Commercial Code will not radically change Nebraska law in the area of bank deposits and collections.

THE PROBLEM AREAS

As stated, 99½% of all checks clear in due course without incident. With regard to the other one-half per cent, the problem involved usually consists of notifying the proper parties, reversing any credit given, and seasonably returning the item. Rarely is litigation involved. A great majority of the checks which fail to clear involve insufficient funds in the drawer's account. Usually these checks are returned promptly, the credits given by the various banks are reversed and the original depositor, having received back the insufficient fund check, initiates further action against the drawer to get his money.

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[17] NEB. REV. STAT. §§ 62-201 to 62-219 (Reissue 1958).

The problems which reach the courts usually involve such matters as (1) insolvency of a bank in the collection chain, (2) attachment of the drawer's account or similar matters, or (3) unusual delay in handling items which do not clear.

The Code attempts to set out definite rules to control the various situations which may arise and to develop uniform rules to govern them.

THE PROVISIONS OF PART 1 OF ARTICLE IV

Part 1 contains matters of general application such as the title, definitions, rules of interpretation in event of conflict with other sections of the Code and the rule to be followed in event of conflict of laws.

Probably the most important section of Part 1 and certainly the most controversial is section 4-103 which permits the rules set forth in the code to be varied by agreement.

The basic consideration for incorporating such a provision in a Code which was designed to promote uniformity was to avoid rigidity which would freeze present methods of handling. It was expected that improved methods of handling checks would be developed and new rules based on modern developments should be encouraged. The wisdom of this policy is illustrated by the current methods of handling these items, i.e., the use of punch card checks and checks with magnetic ink, procedures which were little known or used ten years ago.

It has been said also that the flexibility provided by this section would prove very useful in the event some "bug" or unworkable rule was incorporated in the code inadvertently. While no such "bugs" have yet developed in states which have adopted the code, section 4-103 creates some peace of mind against the unhappy prospect of enacting amendatory legislation in the various states which have adopted the Code.

The chief argument against the section would seem to be its effect on certainty and uniformity. Adequate safeguards are provided against any overreaching by banks since no agreement can relieve a bank of its obligation to act in good faith and with due care. Neither can a bank by agreement change the measure of damages resulting from its failure to use due care or to act in good faith. One further protective clause requires that the agreements cannot be "manifestly unreasonable." This provides ample means for courts to refuse to recognize agreements which result in any overreaching.

The most effective types of agreements which may change the rules are Federal Reserve Regulations,[18] operating letters,[19] and clearing house rules. Agreements of this type are likely to be followed uniformly, thus removing another objection to the section. Another type of agreement which is recognized and which may or may not be effective is so-called "fine print" statements on deposit slips or signature cards. The term "agreement" is defined in section 1-201(3) of the Code and is intended to include recognition of usages of the trade, established course of dealing, surrounding circumstances and the like.

No doubt this section provides a source of some future litigation but it is not expected to be a major problem since the rules generally incorporated in "fine print" agreements are now incorporated in the Code. Many banks in states which have adopted the Code have welcomed the opportunity to eliminate the fine print from their deposit slips and signature cards.[20]

Furthermore, it is most likely that changes in procedure which become necessary by reason of advancements in techniques or because of a "bug" in the Code will be handled by Federal Reserve Regulations, operating letters or clearing house rules rather than by "fine print" agreements.

The Nebraska court has considered fine print statements on deposit slips and has taken a stand which would be consistent with the provisions of section 1-103.[21] It does not seem that this section will materially change the situation in Nebraska, as it now exists.

Other sections in Part 1 which are designed to promote convenience and certainty include section 4-107, allowing a bank to

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[18] These are regulations adopted by the Federal Reserve Board.

[19] Operating letters are letters of instructions issued by Federal Reserve Banks covering their procedures and rules in handling collection items handled for members of the Federal Reserve System and non-members who clear checks through that bank.

[20] Vergari, How the Uniform Commercial Code Has Affected Bank Operation in Pennsylvania, BUS. LAW., Nov. 1955, pp. 57, 60-71.

[21] NEB. REV. STAT. § 62-202 (Reissue 1958) permits variation of the rules where stated by agreement. In Western Smelting & Refining Co. v. First Nat'l Bank, 150 Neb. 477, 35 N.W.2d 116 (1948), the court recognized the right of the parties to modify the statutory relationship by agreement. Cases dealing with fine print legends on deposit slips and signature cards acceptance, ratification and estoppel include First Nat'l Bank v. Federal Reserve Bank, 6 F.2d 339 (8th Cir. 1925); Jefferson County Bldg. & Loan Ass'n v. Southern Bank & Trust Co., 225 Ala. 25, 142 So. 66 (1932); Semingson v. Stockyards Nat'l Bank, 162 Minn. 424, 203 N.W.412 (1925); and Farmers State Bank v. Union Nat'l Bank, 42 N.D. 449, 173 N.W. 789 (1919).

fix a cut-off hour for receipt of items. Under this provision, the bank may remain open for limited operations such as receiving deposits or cashing checks without adversely affecting its bookkeeping department by requiring it to handle collection items coming in after regular banking hours. This probably represents existing Nebraska law,[22] but the existing statute does not spell this out.

Finally, section 4-108 permits a collecting bank, in a good faith effort to collect an item, to grant an additional day to permit the check to be paid. This is new and no such express provision exists in Nebraska at this time. This section also spells out excuses for delay in handling or transmitting an item or notice relating thereto by a collecting or payor bank.[23]

PART 2 OF ARTICLE IV

This part of Article IV relates principally to the rules affecting depositary and collection banks.

Section 4-201 expressly incorporates provisions which are usually set out in fine print deposit slip agreements describing the agency status of the depositary and collecting banks and the provisional nature of any credit for the item.

The present Nebraska law[24] is substantially similar but its application depends on the nature of the endorsement.[25] Section 4-201 of the Code makes the rules applicable without regard for the form of endorsement, lack of endorsement, withdrawal of the funds by the depositor or even action clearly establishing that the collecting bank is owner.

Historically much litigation has involved determining whether

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[22] Such action is usually by agreement that deposits received after regular banking hours are received for safekeeping only and are not accepted as a deposit until the next banking day. This is a matter of some concern to banks under existing law. The Code provision should be helpful in establishing a definite rule to protect the bank and permit it to offer additional service without increasing its liability or overburdening the bookkeeping and transit departments.

[23] Compare with NEB. REV. STAT. § 62-208 (Reissue 1958), which provides accepted methods of forwarding and presenting items and the time permitted.

[24] NEB. REV. STAT. § 62-202 (Reissue 1958) makes each bank in the collection process the agent or sub-agent of the owner of the item. It makes any credit given revocable until proceeds are received in actual money or unconditional credit. See also State *ex rel.* Sorenson v. South Omaha Bank, 129 Neb. 43, 260 N.W. 815 (1935).

[25] See NEB. REV. STAT. § 62-204 (Reissue 1958).

the bank had become the owner of the item.[26] The Code purports to set down the rules without regard to the question of ownership.

Section 4-202 of the Code and existing Nebraska law[27] clearly establish that a bank is not liable for negligence, insolvency or default of sub-agents. Section 4-202 spells out in detail the areas in which the collecting bank must exercise due care. Finally, it states affirmatively that action taken before the "midnight deadline" is seasonable and places the burden on the bank to show that any longer time was seasonable. Again existing Nebraska law is in accord.[28]

A slight change in Nebraska law is effected by Section 4-204 which permits a bank to send items by any reasonably prompt method. Existing law is keyed to transmission by mail.[29]

A further change permits a depositary bank to supply missing endorsements.[30] This is designed to speed up collections. Each collecting bank is concerned only with instructions of its immediate predecessor. It was considered that this time-saving method would not prejudice the rights of the depositor or drawee since one bank in the chain still remains bound to act in accordance with proper endorsement.[31]

Section 4-207 of Article IV relates to the warranties incident to the various relationships involved in the bank deposit and bank collection transactions. These warranties are substantially similar to warranties provided in Article III. They are automatic as a part of the collection process and run with the item, so that a collecting bank may sue a remote prior collecting bank and avoid a multiplicity of suits.

Section 4-208, relating to the security interest of any collecting bank in the items, accompanying documents and the proceeds, and section 4-209, making the bank a holder in due course for value to the extent of its security interest, are in accord with existing law.

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[26] See Annot., 99 A.L.R. 486 (1935); Annot., 68 A.L.R. 725 (1930); Annot., 42 A.L.R. 492 (1926); Annot., 16 A.L.R. 1084 (1922); and Annot., 11 A.L.R. 1043 (1921).

[27] NEB. REV. STAT. § 62-207 (Reissue 1958). And see Henefin v. Livestock Nat'l Bank, 116 Neb. 331, 217 N.W. 91 (1927).

[28] See Urwiller v. Platte Valley State Bank, 164 Neb. 630, 83 N.W.2d 88 (1957).

[29] See NEB. REV. STAT. §62-208 (Reissue 1958).

[30] U.C.C. § 4-205.

[31] See comment, U.C.C. § 4-205.

Section 4-210 relates to the manner of presentment where non-bank payors are involved and codifies a practice extensively followed, whereby the collecting bank may notify the payor that it holds the item for collection and places the burden upon the payor to get to the bank and respond to the notice.

Section 4-211 relates to the media of remittance. At one time in Nebraska it was essential that remittance be made in money.[32] In 1929, the provision which became section 62-211 of the Nebraska Revised Statutes was enacted. This authorizes remittance in other media including checks on other banks and " such other method of settlement as may be customary." The provisions in section 4-211 of the Code are more detailed than those contained in section 62-211 of the Nebraska Revised Statutes but result in no substantial change.

Under modern conditions it is impracticable to require payment in money, and the drafters of the Code, as did the drafters of the ABA Collection Code, considered that a bank in the collection process should not be penalized for taking a practical approach.

The provisions of section 4-211 are not all-inclusive and do not purport to deal with settlements by bank credits or through clearing houses or by cash. This section deals specifically with remittance instruments and authorizes the presenting bank to accept a bank check drawn on any bank (except the remitting bank) or a cashier's check or similar primary obligation of the remitting bank if the remitting bank is a member or clears through a member of the same clearing house as the collecting bank. It may also accept appropriate authority to charge an account of the remitting bank or of another bank with the collecting bank. In cases where the item is drawn on a non-bank payor, remittance by cashier's check, certified check, or other bank check or obligation of a bank is authorized.

If a check, instrument, or authorization is ultimately dishonored, the collecting bank is not held responsible under section 211, subsection (2), if it has forwarded the remittance item for collection before its midnight deadline or, in event the item is drawn against the collecting bank, has properly dishonored the remittance check or authorization to charge before its midnight deadline.

Subsection (3) of section 211 provides for the time at which the remittance instrument or authorization to charge becomes a final settlement. Any settlement becomes final when it is finally paid by the payor. It may also become final if the person receiving

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[32] State v. Nebraska State Bank, 120 Neb. 539, 234 N.W. 82 (1931).

a settlement has authorized remittance by a non-bank check or obligation or by a cashier's check or similar primary obligation of a payor or remitting bank which is not of a kind approved by section 211. Similarly, it may become a final settlement if the person receiving the settlement fails to seasonably present, forward for collection, or pay or return a remittance instrument before its midnight deadline.

Under existing bank practice and existing law in the State of Nebraska, a bank receiving a check for deposit to the account of its customer, or receiving a check from a collecting bank for collection, treats the item as a cash item and gives immediate credit to the account of the customer or forwarding bank. This credit is a conditional credit and if the item is not ultimately collected, the amount of the credit is charged back to the account. The right to charge back, under the existing law, is stated in Section 62-202 of the Nebraska Revised Statutes and is usually incorporated in the small print appearing on the signature cards or deposit slips. Section 4-212 codifies the existing practice if the bank acts before its settlement has become final by reason of the lapse of time or other provisions of the Code.

It should be noted at this point that, in enacting section 4-212, the Nebraska Legislature chose to omit one of the optional provisions of the article that permitted a bank to return an item directly to the bank which had initiated the collection process without going through the intermediary banks in the chain of collection. Thus, under the Nebraska law, each bank must return the item to the bank from whom it was received and it cannot short-cut the procedure by dealing directly with the initiating bank in the chain.

Section 4-213 provides that a payor bank has made final payment when it has made payment in cash; has made a settlement without a right to revoke, either express or otherwise; has completed the process of posting to the account of the maker or drawer; or has made provisional settlement and has failed to revoke in the time and manner provided by law, clearing house rules, or agreement. Once an item has been finally paid by the payor bank all of the provisional settlements in the bank collection chain become final. When a bank receives final settlement, it then becomes primarily liable to the account of its customer for the amount of the item. This accords with existing law.

Section 4-213 does contain provisions which recognize problems of banks in sorting, proving, and posting items. Thus, the right of a customer to withdraw credit resulting from final settlement is limited by a reasonable time for the bank to ascertain that

the settlement has become final or, if it is the payor bank, until the opening of the second banking day following receipt of the item. Even in case of deposit of money the depositor does not have the right to withdraw the deposit until the opening of the next banking day following receipt.

A question is also involved as to just when the payor bank has irrevocably made payment. Often this point becomes important when the bank receives notice of garnishment, in bankruptcy proceedings and similar matters. Section 213 recognizes that the key point in final settlement is when the bookkeeper for the drawer's account determines that the check is good and completes the process of posting to the drawer's account. Under current machine posting, this requires something more than just making the entry on the ledger.[33]

Section 4-214 presents some interesting problems and reaches a result consistent with existing practice in Nebraska, although by a different route. The problem involved in this section involves such situations as bankruptcy of one of the collecting banks and the treatment of various items in the process of being collected by that bank.

Section 62-215 of the Nebraska Statutes sets forth the existing law and follows the rule of the ABA Collection Code. It is this section which has caused some courts to hold the ABA Collection Code unconstitutional and the inclusion of the principle in the Uniform Commercial Code has been criticized by some writers on the same ground.[34]

The problem involves, first of all, the National Banking Act and the priorities provided by it in cases of insolvency of national banks. To be specific, consider the situation where the X national bank receives a check for deposit to the account of Y and forwards the check to the payor bank for payment. In the ordinary course of the collection process, the payor bank credits the account of the X bank with the amount of the check and charges the account of the drawer of the check. In the meantime, the X national bank has become insolvent and the question for determination is whether Y has any special claim to the proceeds of the check or to the credit given by the payor bank to the X national bank.

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[33] Compare with rules quoted in Placek v. Edstrom, 148 Neb. 79, 26 N.W.2d 489 (1947).

[34] Beutel, *The Proposed Uniform* [?] *Commercial Code Should Not be Adopted* 61 YALE L.J. 334 (1952).

The Supreme Court of the United States considered the problem in *Jennings v. United States Fidelity & Guaranty Company.*[35] That action involved an Indiana bank and the ABA Collection Code which had been adopted at that time by the State of Indiana. That code provided that a trust was impressed upon the proceeds of the collection for the depositor. The court held that such a trust, was, in effect, a preference and as applied to a national bank was inconsistent with the system of equal distribution established by Federal law. In effect it held that the Indiana provision was unconstitutional insofar as national banks are concerned.

Following this decision the Illinois court held the provisions of the Illinois law which incorporated the ABA Collection Code to be unconstitutional insofar as state banks are concerned, since it could not apply to national banks.

This same provision has been incorporated in the Uniform Commercial Code and it has been commented by some writers that amendment of the National Banking Act is necessary before this provision can be applied to national banks.

Generally, section 4-214 provides that items which were not finally paid when the bank closed its doors should be returned to the forwarding bank. Items which were finally paid but not settled for should be treated as preferred claims. Provisional settlements made by the bank before becoming insolvent are not affected by the insolvency when the settlements subsequently become final by reason of the lapse of time or the happening of an event.

PART 3 OF ARTICLE IV

Part 3 of Article IV relates primarily to payor banks and includes in its provisions the terms of deferred posting laws which have been adopted by almost every State in the Union. The Nebraska Deferred Posting Act is found in Sections 62-308 to 62-310 of the Nebraska Statutes.

Deferred posting laws came into existence because of the problem, particularly during the war years, of coordinating credits and charges against customers' accounts and meeting the personnel requirements involved in the absence of a deferred posting law. Under a deferred posting act, the bank sorts and proves the items on the date of receipt, but does not post the items to the customer's account or return the items to the forwarding bank, if necessary, until the next succeeding banking day.

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[35] 294 U.S. 216 (1935).

Section 4-301(1) is in substantial accord with section 62-308 of the Nebraska Statutes and simply provides that where the bank has made an authorized settlement of a demand item on the day of receipt of the item, it may revoke the settlement and recover any payment before final payment and before midnight of the following day by returning the item or sending notice of dishonor to its forwarding bank. The time of dishonor is the date of return or the date of the notice of dishonor.

Return of an item is spelled out as re-delivery to the presenting or last collecting bank or to the clearing house or in accordance with clearing house rules. Section 4-302 spells out the responsibility of a payor bank for late return of an item. In the absence of a valid defense, based on a presentment warranty or some similar situation, the payor becomes obligated to pay the item if it retains it beyond its midnight deadline without paying the item or returning the item or sending notice of dishonor.

Section 4-303 deals specifically with the problems involved in notice, stop orders, and legal process. It again considers the practical situation and before the bank is legally obligated by any such notice or order, the notice must have been received by the bank and a reasonable time for the bank to take action must have expired without certain events fixing the bank's responsibility having occurred.[36]

PART 4 OF ARTICLE IV

Part 4 relates to the relationship between the payor bank and its customer. It creates some changes in the existing law and practice. One of these is the rule on stopping payment of checks.

This is one area which has caused difficulty in the past. Banks have been prone to create strict requirements, including indemnity agreements, for this service. It is a general rule that the giving of a check does not constitute assignment of funds and the drawer can stop payment of the check at any time. At the present time, banks generally require the notice to be in writing and often the writing includes an indemnity agreement from the drawer to the bank which sometimes purports to operate even in cases where the bank is negligent.[37]

The Code does authorize oral notices of stop payment. This is a practice which has been characterized as "objectionable from

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[36] Events fixing the bank's responsibility include such things as return of the item, charging the account of the drawer, etc.

[37] U.C.C. § 4-103 expressly prohibits such agreements.

the standpoint of good banking and should be discouraged."[38] In New York, this section drew serious objection from the New York Clearing House. The Code places limits on the effective time of oral and written notices of fourteen days and six months respectively.

While the Code rule may not accord with "good banking," it probably represents the general practice and it is in accord with the statutory rule in twenty-six states. Nebraska has no statute or decisions in this area.

Agreements relieving a bank of liability in the event it inadvertently pays a check on which payment has been stopped have been held to be without consideration or against public policy and, therefore, unenforceable. In any event such agreements are not favored by the courts.[39]

Section 4-404 provides the bank is not obligated to pay checks more than six months old. It may pay the check in good faith and charge the customer's account. It is not obligated to do so. It is a general rule that a check over a year old need not be paid and a requirement of the bank that the check must be presented within six months has been held not to be unreasonable.[40] Existing Nebraska law relating to negotiable instruments requires presentment within a "reasonable time."[41]

Section 4-405 is a worthwhile provision which permits banks to honor checks of a deceased or incompetent person until the bank knows of the death or of an adjudication of incompetency and has reasonable opportunity to act upon it. Even with knowledge the bank can continue to honor checks of the deceased for a period of ten days unless ordered to stop payment by a person claiming an interest in the account. Many banks have followed this practice although it has been without authority in most cases.

The Code provision relates only to the right of the bank to pay the check. What are the obligations of the creditor to file a claim against the estate to protect the payment? Will such payment qualify as a proper deduction for estate tax purposes? Probably the better practice will involve filing a protective claim against

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[38] 3 PATON, DIGEST OF LEGAL OPINIONS 3455 (1944).

[39] Grisinger v. Solden State Bank, 92 Cal. App. 443, 268 Pac. 425 (1928). *Contra,* Tremont Trust Co. v. Burack, 235 Mass. 398, 126 N.E. 782 (1920); Gaita v. Windsor Bank, 251 N.Y. 152, 167 N.E. 203 (1929).

[40] 1 PATON, DIGEST OF LEGAL OPINIONS 1109 (1940).

[41] NEB. REV. STAT. § 62-171 (Reissue 1958).

the estate to justify the payment. It may be that the creditor who is paid is protected by principles of estoppel and that the government will not take the technical view in auditing the estate tax return. Still one should realize that the Code operates only on the commercial relation between the bank and its customer and does not purport to change the probate or tax laws.

PART 5 OF ARTICLE IV

Part 5 was originally included in Article III of the Code. In the revisions which resulted after further study following the 1952 draft of the Code, this part was shifted to Article IV.

This part of the Code deals with rules controlling banks and their customers in relation to collection of documentary drafts. Documentary drafts are defined in section 4-104 and include such drafts as are accompanied by any documents whether negotiable or non-negotiable.

There has been little problem with such drafts in Nebraska[42] and the Code sections will give a source of rules to be followed but will not have a great deal of effect on the existing practice.

ARTICLE V—LETTERS OF CREDIT

Letters of credit are creatures which are not extensively found in Nebraska. They are used primarily in foreign commerce but do afford some usefulness in domestic commerce.

It is believed that little can be accomplished at this time by any extensive consideration of the provisions of Article V and that the matter can be treated more appropriately by describing letters of credit and their use.

The law relating to letters of credit is a specialized field affecting only a very few banks. Of the 25,000 banks in the United States about 100 of them make a practice of issuing letters of credit and of these about twenty-five banks issue 75% of all such letters.

The major situations in which letters of credit are utilized involve importers of merchandise dealing with foreign sellers who are not familiar with the importers credit position. In such situations the seller is reluctant to ship the merchandise without assurance of payment and the buyer does not desire to pay for the merchandise until receiving and checking it.

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[42] However, see Farmers State Bank v. Aksamit, 112 Neb. 465, 199 N.W. 733 (1924).

In such situations the buyer can "buy credit" in the form of a letter of credit from a bank known to the seller or his bank. The bank issues a formal letter of credit which refers to the contract of sale and authorizes the seller to draw a draft for a specified amount to be presented on sight or at a certain time, with specified documents, at which time it will be honored by the bank. This bank is known as the issuer[43] or issuing bank.

The bank will then send the letter of credit to its correspondent bank in the area where the seller is located. If this bank merely advises the seller that the letter of credit has been issued it is an "advising bank."[44] Often the bank will notify the seller that it will honor a draft drawn and presented in accordance with the letter of credit in which event it is described as "the confirming bank."[45] The seller of the merchandise is referred to as the "beneficiary" of the letter of credit[46] and the buyer is called the "buyer" of the letter of credit or "customer."[47] Letters of credit may take other forms but this is the general type of transaction handled by such letters.

There has been very little litigation involving letters of credit and the Code provisions have met with general acceptance. There have been no Nebraska cases involving such transactions.

In the past, and for that matter at the present time, letters of credit on an international basis have been controlled by a document adopted by the Thirteenth Congress of the International Chamber of Commerce in 1951 and described as "Uniform Customs and Practices for Commercial Documentary Credits." Although some changes have been made,[48] for the most part the Code provisions are patterned after and based upon the uniform provisions adopted by the International Chamber of Commerce.

One of the most difficult areas involving letters of credit is whether the seller has complied with the terms of the credit. It may be that this is an area in which legislation can be of little ser-

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[43] U.C.C. § 5-103(c).

[44] U.C.C. § 5-103(e).

[45] U.C.C. § 5-103(f).

[46] U.C.C. § 5-103(d).

[47] U.C.C. § 5-103(g).

[48] For example, the Code provides that the issuer has three days to decide if it will pay the draft issued pursuant to the letter of credit. This is a change, an extension of the time otherwise allowed.

vice but in any event it is not covered by the provisions of the Code.[49]

CONCLUSION

No attempt has been made to cover completely all areas and problems involved in Article IV and Article V. In the event any question arises as to the meaning of any provision of the Code the best source for interpreting these provisions is the Comment of the drafters which can be found with the published Code.[50]

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[49] For a more complete discussion of Article V and letters of credit, see Mentschikoff, *Letters of Credit* 19 BUS. LAW. 107 (1963); see also WHITNEY, THE LAW OF MODERN COMMERCIAL PRACTICES § 711, at 1001 (1958).

[50] For an able discussion and plea for a uniform interpretation of the Code, attention is directed to Merrill, *Uniformly Correct Construction of Uniform Laws,* 49 A.B.A.J. 545 (1963).

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