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## Virginia And Article 4 Of The Uniform Commercial Code

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reconsider its previous action and follow the recent trend<sup>60</sup> in placing the obligation of support on the parties responsible, rather than on the state.

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## VIRGINIA AND ARTICLE 4 OF THE UNIFORM COMMERCIAL CODE

The Uniform Commercial Code (UCC), first proposed by the American Law Institute and the National Conference of Commissioners on Uniform State Laws in 1951, has been adopted by six states.<sup>1</sup> Article 4, which deals with the subject of Bank Deposits and Collections, is the most controversial part of this proposed legislation.<sup>2</sup> There has been considerable disagreement among bankers and legal authorities as to the merits of this Article. The proponents generally point to the great volume of items handled today by the banking institutions and conclude that this is an area wherein uniformity is both practical and necessary.<sup>3</sup> The opponents object primarily to the latitude given the banks to alter the provisions of the Article by agree-

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<sup>60</sup>Forty-five jurisdictions presently have paternity statutes: Ala., Ariz., Ark., Cal., Colo., Conn., Del., D.C., Fla., Ga., Hawaii, Ill., Ind., Iowa, Ky., Me., Md., Mass., Mich., Minn., Miss., Mont., Neb., Nev., N.H., N.J., N.M., N.Y., N.C., N.D., Ohio, Okla., Ore., Pa., P.R., R.I., S.C., S.D., Tenn., Utah, Vt., Wash., W. Va., Wis., and Wyo. Idaho had a statute which was held unconstitutional by its supreme court in *State v. Wilmot*, 51 Idaho 233, 4 P.2d 363 (1931), because the action included the charging of a misdemeanor and the case was to be tried in an improper court. Missouri applies the desertion and non-support laws to illegitimate children. The Louisiana statute is similar to the present Virginia statute. La. Rev. Stat. § 9:391 (1950). Alaska and Texas have no provisions at all.

<sup>1</sup>Pennsylvania, Massachusetts, Kentucky, Connecticut, New Hampshire, Rhode Island. Report of the Committee on Uniform State Laws, Seventieth Annual Meeting of the Virginia State Bar Association 14 (1960). The Uniform Commercial Code will probably be introduced in the legislatures of about twenty-five states in 1961 and 1962. The Uniform Commercial Code in Pennsylvania 1954-1961, Appendix (1961).

Article 4 has gone through many revisions, and discussions of earlier drafts should be used with great caution. All references herein are to the 1957 Official Text with Comments which has not been revised as of the present time.

<sup>2</sup>Brome, *Bank Deposits and Collections*, 16 *Law & Contemp. Prob.* 308 (1951).

<sup>3</sup>Cosway, *Innovations in Articles Three and Four of the Uniform Commercial Code*, 16 *Law & Contemp. Prob.* 284 (1951); Leary, *Article 4: Bank Deposits and Collections Under the Uniform Commercial Code*, 15 *U. Pitt. L. Rev.* 565 (1954); Malcolm, *Article 4—A Battle With Complexity*, 1952 *Wis. L. Rev.* 265. It is estimated that some 25,000,000 items a day move through banking channels. Malcolm, *id.* at 270.

ment,<sup>4</sup> although some think that the provisions are unduly restrictive.<sup>5</sup>

Until recently there had been almost no legislation in the area of bank deposits and collections. The Negotiable Instruments Law (NIL) had some slight effect, but the first real attempt at uniform legislation in the field was the Bank Collection Code of the American Bankers Association, initially proposed in 1928,<sup>6</sup> which became law in 18 jurisdictions.<sup>7</sup> The purpose of that act was to legalize the modernization of banking practices and to protect banks in their collection processes.<sup>8</sup> At a somewhat earlier date, Congress had passed the Federal Reserve Act<sup>9</sup> to regulate national banks. About the same time that the Bank Collection Code was coming into use, the Commissioners on Uniform State Laws were working on their own codification of banking law, but upon presentation to the Conference of Commissioners, this proposed act was not adopted.

The draftsmen of the Banking title of the Commercial Code had a combination of statutes, regulations, case law, agreements and customs with which to work. Article 4 was not intended as a sweeping reform statute; it was to be for the most part a codification of existing law with a few innovations.<sup>10</sup> It is interesting to note that the Commissioners from Virginia voted for the adoption of the Commercial Code when it came up before the Conference of Commissioners in 1951.<sup>11</sup>

If the UCC were presented for adoption in Virginia, the legislature would have to ascertain the effect of this act on existing Virginia law. At present the statute books of the state contain few sections that relate to the field of bank deposits and collections. Moreover, there is a paucity of cases on the subject.

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<sup>4</sup>See generally Beutel, *The proposed Uniform [?] Commercial Code Should Not Be Adopted*, 61 *Yale L.J.* 334, 357 (1952); Gilmore, *The Uniform Commercial Code: A Reply to Professor Beutel*, 61 *Yale L.J.* 364, 374 (1952).

<sup>5</sup>See note 2 *supra*.

<sup>6</sup>See Townsend, *The Bank Collection Code of the American Bankers Association*, 8 *Tulane L. Rev.* 21, 236, 376 (1933-1934); Bogart, *Failed Banks, Collection Items, and Trust Preferences*, 29 *Mich. L. Rev.* 545 (1931). The Bank Collection Code was held unconstitutional as to national banks in *Jennings v. United States Fid. & Guar. Co.*, 294 U.S. 216 (1935), and at least two states have found it constitutionally objectionable. Gilmore, *supra* note 4 at 376 n.25.

<sup>7</sup>Annot., 99 *A.L.R.* 1255, 1256 (1935).

<sup>8</sup>Townsend, *supra* note 6 at 22.

<sup>9</sup>38 Stat. 251 (1913), 12 U.S.C. §§ 221-522 (1958).

<sup>10</sup>A Symposium of the Proposed Uniform Commercial Code, 17 *Albany L. Rev.* 1, 81 (1953).

<sup>11</sup>Handbook of the National Conference of Commissioners on Uniform State Laws 162 (1951).

STATUTORY CHANGES<sup>12</sup>

The principal sections of the statutory law of Virginia that would be affected by the Commercial Code are those pertaining to checks.

*Payment of Stale Checks.* According to the UCC a bank is not under obligation to its customer to pay a check presented more than six months after the date thereof, but it may charge the customer's account for a payment made thereafter in good faith.<sup>13</sup> The Virginia provision places the limitation at one year.<sup>14</sup>

*Stop Payment Orders.* The UCC provides that the customer may stop payment on any item, but the direction must be received in such time and manner as to give the bank time to act on it. An oral stop order is binding for fourteen days but may be extended by a written order which is effective for six months and is renewable.<sup>15</sup> Virginia Code section 6-73 provides that a stop payment order relating to a check or draft is not effective for more than one year. The initial order can be renewed in writing for an additional one year period and these renewals may be made from time to time.<sup>16</sup> In Virginia it is not clear whether or not the first order must be in writing.<sup>17</sup>

*Wrongful Dishonor.* The Virginia statute relating to liability of a bank for wrongful dishonor of a depositor's check provides that in the absence of malice on the part of the bank the depositor must allege and prove actual damage and his recovery cannot exceed the amount so proved.<sup>18</sup> The UCC provision on the subject is similar, but it is wider in scope in that it refers to the dishonor of an item rather than simply a check.<sup>19</sup>

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<sup>12</sup>The only authority available for the comparisons made here and in the section on case law is a report submitted to the Virginia Code Commission by Professor Wilfred J. Ritz of the School of Law of Washington and Lee University. Professor Ritz is presently serving as chairman of the Committee on Uniform State Laws of the Virginia State Bar Association. Ritz, *The Uniform Commercial Code and the Commercial Law of Virginia 124-49* (1956).

<sup>13</sup>Uniform Commercial Code § 4-404.

<sup>14</sup>Va. Code Ann. § 6-72 (1950).

<sup>15</sup>Uniform Commercial Code § 4-403.

<sup>16</sup>The practical difficulty here is that stop payment orders are difficult and expensive for banks to handle, but it is thought that the losses resulting from this should be borne by the banks as a business expense. Uniform Commercial Code § 4-403, Comment, Point 2.

<sup>17</sup>Ritz, *op. cit. supra.* note 12 at 146.

<sup>18</sup>Va. Code Ann. § 6-71 (1950). See *Wood v. American Nat'l Bank*, 100 Va. 306, 40 S.E. 931 (1902).

<sup>19</sup>Uniform Commercial Code § 4-402. The word "item" is defined in the Uniform Commercial Code § 4-104(1)(g) as "Any instrument for the payment of money even though it is not negotiable, but does not include money." The word "check" is defined in the Uniform Commercial Code § 3-104(2)(b) as "a draft drawn on a bank and payable on demand."

*Duty to Examine Statements.* Both the UCC and Virginia law place a duty on the customer to examine his bank statements and returned checks in order to determine if there are any forged or raised checks or any forged or unauthorized endorsements.<sup>20</sup> However, the approach of the two is not the same. The Virginia Code provides that a bank will not be liable to its customer for any amount paid because of a forged signature, a raised check, note or acceptance, or an unauthorized or forged endorsement unless the customer has examined his vouchers and notified the bank of the irregularity. The customer must notify the bank within 90 days in the case of a forged or raised check and within two years in the case of a forged or unauthorized endorsement.

The UCC provides that the customer must exercise reasonable care and promptness in examining his statement and items in order to hold the bank liable. Unless the customer notifies the bank of an irregularity within fourteen days after the statement has been made available to him, he cannot assert an unauthorized signature or alteration by the same wrongdoer as a defense on a subsequent item. He can, however, use these defenses if he is able to establish a lack of ordinary care on the bank in paying the items. The UCC further stipulates an absolute time limitation of one year regarding forged signatures and a three year limitation on endorsements without regard to care on the part of either party.<sup>21</sup>

*Check of Deceased Drawer.* Virginia Code § 6-540 regarding payment of a check of a deceased drawer would also be affected.<sup>22</sup> The statute provides that the authority of the bank to pay a check is not revoked until two weeks after death. It is not clear whether the two weeks runs from the time of death or the time that the bank has knowledge of death. The UCC provides that a bank may pay items drawn by a person who has since died or become incompetent prior

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<sup>20</sup>Va. Code Ann. §§ 6-74, 75 (1950); Uniform Commercial Code § 4-406. See *Bank of Occoquan, Inc. v. Bushey*, 156 Va. 25, 157 S.E. 764 (1931); *First Nat'l Bank v. Richmond Elec. Co.*, 106 Va. 347, 56 S.E. 152 (1907).

<sup>21</sup>The difference between the two statutes is that while the Virginia provision is probably like a statute of limitations, the Uniform Commercial Code sets up absolute time limits, but places a burden of due care on the customer to examine his statement and notify the bank of the irregularities even before the limitation has run. That is to say that the customer is under a duty of due care from the beginning, but even if he did exercise due care, he cannot raise the defenses after the absolute time limitations have elapsed. See generally *National Bank v. Nolting*, 94 Va. 263, 26 S.E. 826 (1897).

<sup>22</sup>See also Va. Code Ann., §§ 6-53-55 (1950).

to the bank gaining knowledge of the death or adjudication of incompetency. It also provides for payment even with knowledge for ten days after death.<sup>23</sup>

*Direct Forwarding.* Both the Virginia Code and the UCC approve the practice of direct forwarding to a payor bank.<sup>24</sup> The UCC provides that an item cannot be forwarded directly to a non-bank payor unless authorized by the transferor. The Virginia statute provides that the forwarding bank shall not be liable in the case of such direct forwarding when the payor bank fails to pay the instrument because of insolvency or other default if the forwarding bank used due diligence in other respects.

The UCC contains a provision relating to insolvency in general which covers a much wider area than does the Virginia statute.<sup>25</sup> It sets up final payment<sup>26</sup> as the point in time at which items are to be turned back in case of insolvency of a payor or collecting bank.<sup>27</sup> This is potentially one of the most important sections of the UCC because it determines who bears the loss in case of bank failure,<sup>28</sup> but the FDIC<sup>29</sup> actually eliminates this problem except where large amounts are involved.

*Deferred Posting.* The UCC contains a deferred posting provision as does the Virginia Code.<sup>30</sup> Deferred posting is the practice whereby a payor bank posts and proves items on the day of receipt but does not charge the item to the customer's account or return a "not good" item until the next day. Both require that the payor bank must give credit before midnight of the day of receipt to follow this procedure.

<sup>23</sup>Uniform Commercial Code § 4-405.

<sup>24</sup>Va. Code Ann. § 6-63 (1950); Uniform Commercial Code § 4-204(2)(a). Payor bank is defined by Uniform Commercial Code § 4-105(b) as a bank by which an item is payable as drawn or accepted. Direct forwarding is just one of the methods by which banks are speeding up the collection process. Experience has shown that 99.5% of all items are paid in the normal course; Malcolm, *supra* note 3 at 269.

<sup>25</sup>Uniform Commercial Code § 4-214.

<sup>26</sup>Uniform Commercial Code § 4-213, Ritz, *op. cit. supra* note 12 at 138-41.

<sup>27</sup>A collecting bank is defined in the Uniform Commercial Code § 4-105 (d) as any bank handling the item for collection except the payor bank.

<sup>28</sup>Uniform Commercial Code § 4-214, Comment, Point 3 admits that the provision is unconstitutional as to national banks because it is similar to the one contained in the Bankers Collection Code. See note 6 *supra*. There is no reason, however, why the provision should not apply to other banks. An amendment to the National Bank Act would make it applicable to national banks. For discussions of the Bankers Collection Code as to preferences see Annot., 104 A.L.R. 1095 (1936); Annot., 94 A.L.R. 1395 (1935).

<sup>29</sup>64 Stat. 873 (1950), 12 U.S.C. §§ 1811-31 (1958).

<sup>30</sup>Va. Code Ann. §§ 6-543.1-3 (Supp. 1960); Uniform Commercial Code § 4-301.

The UCC is broader in this area in that this is not required where the payor bank is also the depository bank.<sup>31</sup>

#### CASE LAW<sup>32</sup>

The most litigated question of law in the Virginia cases concerning banking is the problem of whether a bank takes an item as a purchaser or a collection agent. While the resolution of the question is somewhat confused, the general import of the Virginia decisions is that the agreement between the parties is the determining factor.<sup>33</sup> The UCC seeks to settle this controversy by providing, "Unless a contrary intent clearly appears . . . the bank is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional."<sup>34</sup> It further provides that the relevant provisions of Article 4 apply even though the bank is found to be a purchaser. Most of the Virginia decisions on the subject are old because the problem has been done away with for the most part by FDIC.<sup>35</sup>

One Virginia authority is of the opinion that this section of the UCC does not settle the problem since a bank under UCC § 4-208 acquires a security interest in an item and any accompanying documents or the proceeds thereof.<sup>36</sup> Thus the question of whether the depository bank is a purchaser or an agent becomes, under the UCC, whether the depository bank has a security interest in the draft.

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<sup>31</sup>A depository bank is defined by Uniform Commercial Code § 4-105 (a) as the first bank to which an item is transferred for collection even if it is also the payor bank.

<sup>32</sup>See note 12 *supra*.

<sup>33</sup>For cases dealing with the purchaser-agent problem see: *McAuley v. Morris Plan Bank*, 155 Va. 777, 156 S.E. 418 (1931); *Webb v. O'Geary*, 145 Va. 356, 133 S.E. 568 (1926); *First Wis. Nat'l Bank v. People's Nat'l Bank*, 136 Va. 276, 118 S.E. 82 (1923); *Fourth Nat'l Bank v. Bragg*, 172 Va. 47, 102 S.E. 452 (1920); *Miller v. Norton*, 114 Va. 609, 77 S.E. 452 (1913); *Buckeye Nat'l Bank v. Huff & Cook*, 114 Va. 1, 75 S.E. 769 (1912); *Greensburg Nat'l Bank v. C. Syer & Co.*, 113 Va. 53, 73 S.E. 438 (1912); *Fayette Nat'l Bank v. Summers*, 105 Va. 689, 54 S.E. 862 (1906).

<sup>34</sup>Uniform Commercial Code § 4-201 (1). The comments under this section are very helpful in understanding the problem.

<sup>35</sup>See note 29 *supra*. The old rule that bank credit constitutes value only if drawn upon, thus making the bank a purchaser, seems to be changed by the provision of § 4-208 of the Uniform Commercial Code to the effect that a bank has a security interest when it has given credit available for withdrawal as of right, even though the credit is not drawn and there is a right of charge back. *Ritz*, *op. cit. supra* note 12 at 131.

<sup>36</sup>*Ritz*, *op. cit. supra* note 12 at 129-32.

CUSTOM AND USAGE<sup>37</sup>

The residue of the "law" of banking in Virginia is established by agreements between banks, between banks and their customers, and by the Federal Reserve Board regulations and Federal Reserve Bank operating letters. Banks have written agreements with their customers that are incorporated into deposit slips, signature cards, note forms and pass books.<sup>38</sup>

The Federal Reserve regulations<sup>39</sup> and operating letters<sup>40</sup> govern national banks and state banks dealing with the federal reserve system, but these regulations do not control dealings between banks, state or national, that do not involve the federal reserve system. All banks in Virginia do at least some clearing through the Fifth Federal Reserve Bank. Regulation J<sup>41</sup> of the Federal Reserve Board requires that checks on member and non-member banks must be collectible at par<sup>42</sup> in funds acceptable to the Federal Reserve Bank in order to use its clearing service. The general rules set up in Regulation J are expanded by the operating letters of the various federal banks.<sup>43</sup> Most of these rules conform to the requirements of the UCC, but this is of little import because the UCC specifically provides that action taken in pursuance of these regulations and operating letters shall constitute ordinary care.<sup>44</sup> In the absence of these Federal Reserve regulations and operating letters, the banking procedure in Virginia concerning deposits and collections seems to be governed by custom and practice.

The section of the UCC that has been subject to the most criticism is 4-103. This is perhaps the most important section in Article 4 be-

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<sup>37</sup>The material in this section has been gathered primarily from personal interviews with Virginia bankers and bank attorneys.

<sup>38</sup>It has been held in some jurisdictions that these agreements do not always bind the customer if there is a factual finding that the customer has not assented to the terms. Malcolm, *supra* note 3 at 267 n. 16. See also McAuley v. Morris Plan Bank, 155 Va. 777, 156 S.E. 418 (1931).

<sup>39</sup>These regulations are promulgated by the Board of Governors of the Federal Reserve System as authorized by the Federal Reserve Act, 38 Stat. 251, 268 (1913), 12 U.S.C. § 248 (o) (1958).

<sup>40</sup>The various Federal Reserve Banks are authorized to send out operating letters to regulate the use of their clearing services. 12 C.F.R. § 210.6 (1959).

<sup>41</sup>This regulation refers to cash items. 12 C.F.R. § 210 (1959). See also 12 C.F.R. § 207 (1959) which is Regulation G of the Board of Governors of the Federal Reserve System and relates to non-cash items.

<sup>42</sup>12 C.F.R. § 210.3 (1959). Collectible at par means an item can be collected at face value. The reason for this regulation is that some banks (only one in Virginia) are non-par banks, that is, they charge collection fees on each item.

<sup>43</sup>See note 40 *supra*.

<sup>44</sup>Uniform Commercial Code § 4-103 (2) and (3).



cause it provides that any of the provisions of the Article can be changed by agreement as long as the bank does not disclaim responsibility for its lack of good faith, failure to exercise ordinary care or attempt to limit the measure of damages caused thereby. It further provides that the parties can determine by agreement the standards by which their responsibility shall be measured as long as these standards are not manifestly unreasonable. "Federal Reserve regulations and operating letters, clearing house rules, and the like" are deemed agreements even if not specifically assented to by all interested parties. It is also provided that action taken pursuant to Article 4, Federal Reserve regulations, or operating letters shall be deemed action taken in the exercise of ordinary care; and action taken under clearing house rules and the like shall likewise be prima facie evidence of ordinary care in the absence of special instructions to the contrary. The setting out of certain procedures in this Article does not mean that other procedures may not be reasonable under the circumstances. This section also deals with the measure of damages for failure to exercise ordinary care. It provides that unless there is bad faith, the measure of damages is limited to the amount of the item less any part that could not have been realized even if ordinary care had been exercised. In the case of bad faith any damages suffered as proximate consequence thereof may be recovered.

The drafters of the UCC assert that § 4-103 is necessary in order to permit banks to change their procedures, to speed up collections and to adapt to changing agreements.<sup>45</sup> This is the chief point on which some writers disagree. In commenting on this section the opponents argue that it gives too much power to one private interest group.<sup>46</sup> The proponents answered that the provision is necessary to the banking section because banks have to be prepared to meet changing conditions.<sup>47</sup>

#### CONCLUSION

In speaking generally of the Article on bank deposits and collections, one authority, although he recommended the codification and revision of commercial law,<sup>48</sup> feels that Article 4 would benefit only the bankers and lawyers and not the rest of the business community.<sup>49</sup> Another writer is of the opinion that only time and history

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<sup>45</sup>Uniform Commercial Code § 4-103, Comment, Point 1.

<sup>46</sup>Gilmore, *supra* note 4 at 375-76.

<sup>47</sup>Malcolm, *supra* note 3 at 276.

<sup>48</sup>Beutel, *The Proposed Uniform Bank Collections Act and Possibility of Recodification of the Law on Negotiable Instruments*, 9 *Tulane L. Rev.* 378 (1935).

<sup>49</sup>Beutel, *supra* note 4 at 336.