

**INTERIM REPORT OF THE
JOINT SUBCOMMITTEE STUDYING**

**Modifications
to the
Uniform Commercial Code**

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



HOUSE DOCUMENT NO. 48

**COMMONWEALTH OF VIRGINIA
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Interim Report of the
Joint Subcommittee Studying
Modifications to the Uniform Commercial Code
To
The Governor and the General Assembly of Virginia
Richmond, Virginia
January, 1990

TO: Honorable L. Douglas Wilder, Governor of Virginia,
and
The General Assembly of Virginia

I. INTRODUCTION

Since January 1, 1966, when the Uniform Commercial Code (Titles 8.1 through 8.10 of the Code of Virginia) became effective, some of its concepts and language have become outdated and some in need of modernization. Also, since that time, there has arisen a need for comprehensive laws to recognize new developments in commercial law. The National Conference of Commissioners on Uniform State Laws have offered their revisions to existing Titles 8.3 (Commercial Paper), 8.4 (Banking Deposits and Collections) and 8.6 (Bulk Sales), and have offered their additions of Titles of 8.2A (Leases) and 8.4A (Funds Transfers). These modifications to the Uniform Commercial Code are being offered in an attempt to recognize the need to modernize the Uniform Commercial Code and to codify comprehensive laws to recognize new developments.

A Joint Subcommittee was established pursuant to House Joint Resolution No. 59 of the 1988 General Assembly to study and review these modifications of the Uniform Commercial Code (U.C.C.). The study and Subcommittee were continued by the 1989 General Assembly with its adoption of House Joint Resolution No. 248. Delegates George H. Heilig, Jr. of Norfolk, Clifton A. Woodrum of Roanoke, Willard R. Finney, of Franklin, and William S. Moore, Jr. of Portsmouth were the members of the House of Delegates appointed to serve on the Subcommittee; and Senator William E. Fears of Accomac and Senator Moody E. Stallings of Virginia Beach were the members of the Senate of Virginia appointed to serve on the Subcommittee. See Appendix 1 of this report.

II. EXECUTIVE SUMMARY

During the 1988 and 1989 Interim, Joint Subcommittee received testimony on proposed revisions to five areas of the Uniform Commercial Code, which were offered by the National Conference of Commissioners on Uniform State Laws. Revisions have been proposed in three existing Articles of the U.C.C.; Commercial Paper (Article 3 or Title 8.3 of the Code of Virginia), Banking

Deposits and Collections (Article 4 or Title 8.4 of the Code of Virginia) and Bulk Sales (Article 6 or Title 8.6 of the Code of Virginia). The Conference has also proposed that two new Articles be added to the ten existing Articles of the U.C.C. to cover commercial law in the areas of Leases (Article 2A or Title 8.2A of the Code of Virginia) and Funds Transfers (Article 4A or Title 8.4A of the Code of Virginia).

During the course of this study in 1988 and 1989, the Joint Subcommittee heard from; Mr. Carlyle C. Ring, Jr., one of Virginia's Commissioners to the National Conference of Commissioners on Uniform State Laws, and John W. Edmonds, III, Esquire, representing the Virginia Bankers Association. The Joint Subcommittee also received correspondence from the business law sections of the Virginia State Bar and the Virginia Bar Association.

In 1988, the Joint Subcommittee found that the issues addressed by the proposed revisions to the U.C.C. were very complex, and that several interest groups were developing their positions regarding these proposed revisions. The Joint Subcommittee found that the various suggested revisions to the U.C.C. had merit and appeared to be conceptionally sound, but there was a need to more thoroughly address some of the changes in detail since they require imposing additions and changes to the Uniform Commercial Code. The Joint Subcommittee also found that the National Conference of Commissioners on Uniform State Laws was still refining many of these proposed revisions. The Joint Subcommittee recommended to the 1989 General Assembly that the study be continued in order to afford the various interest groups time to perform a detailed and thorough analysis of these changes and to report their positions on these proposed revisions to the Subcommittee, and to afford more time to the Conference to refine these proposed revisions.

Again, in 1989, the Joint Subcommittee received testimony on the suggested revisions to the U.C.C. concerning Leases, Wire Transfers and Bulk Sales. Again, the Joint Subcommittee found that it was unable to complete its work the areas of the study concerning Leases and Bulk Sales due to new developments nationwide and to the fact that many issues concerning these proposed revisions remain unresolved. However, the Joint Subcommittee found that the final version of Article 4A (Wire Transfers) represents a compromise which attempts to strike a balance between the interest of the public, those of the providers of funds transfer services and those of the users. It found that Article 4A, when enacted into law by the various states, will provide a comprehensive legal structure for a class of payments known as wholesale funds transfers, and a comprehensive body of law that defines the rights and obligations that arise from "funds transfers." It found that presently, while the greatest dollar value is moved by funds transfers, existing law, regulation and private agreement covering funds transfers are considered inadequate and generally incapable of efficiently resolving the rights and obligations of the parties connected with "funds transfers." Because the interested parties were in agreement with the draft of Article 4A, the Joint Subcommittee recommended that a bill be drafted to introduce legislation in the 1990 Session of the General Assembly to enact Article 4A. It also recommended that a resolution be drafted to continue the study for another year.

III. WORK AND DELIBERATIONS OF THE SUBCOMMITTEE

Although the Joint Subcommittee received information and testimony on Articles 2, 2A, 3, 4, 4A, 6 and 9, this interim document shall limit its report to that information and testimony received on Articles 2A, 4A and 6. It will be the purpose of future documents to report on the Joint Subcommittee's work and deliberations concerning proposed revisions to those other Articles. Secondly, this interim document will be limited by only including that written information and materials which the Joint Subcommittee received while reviewing the proposed addition of Article 4A since the Subcommittee made the proposed addition of Article 4A, its only substantive recommendation. The Subcommittee is mindful that should it include written information and materials received on the other Articles, confusion may be created at a later date if the current proposed modifications relating to those Articles were amended or modified during the 1990 interim.

Article 2A

The leasing of items of personal property ranging from hand-held equipment, automobiles to commercial aircraft is big business in this country, with a estimated dollar volume reaching \$150 billion. Yet the laws governing leasing have not kept pace with the intricacies of today's leasing arrangements, resulting in considerable uncertainty for lessors and lessees alike. To fill this gap, the National Conference of Commissioners on Uniform State Laws has approved a new article to the Uniform Commercial Code. Article 2A provides for the fundamentals of the leasing contract, including the formation of the contract, provisions for express and implied warranties, and damages for breach of a leasing contract. The changes in leasing transactions in recent years make it clear that modernization is long overdue. States now depend on the common law to resolve disputes over lease contracts. This creates great uncertainty, particularly for companies that conduct business in more than one state, since case law conflicts from state to state.

Under present law, transactions of this type of governed partly by common law principles relating to personal property, partly by principles relating to real estate leases, and partly by reference to Articles 2 and 9 of the Uniform Commercial Code, dealing with Sales and Secured Transaction, respectively. The legal rules and concepts derived from these sources imperfectly fit a transaction that involves personal property rather than realty, and a lease rather than either a sale or a security interest as such. A statute directly addressing the personal property lease is, therefore, appropriate.

The Commissioners on Uniform State Laws are of the opinion that since leases are an important part of business and commercial law, they should be governed by the Uniform Commercial Code. Further, the leasing business is interstate in character, and uniformity is as important to the conduct of leasing transactions as it is to sales transactions. Article 2A gives leasing transactions an important underpinning in the law. Because of the broad similarities between lease and sales transactions, that underpinning is largely derived from the sales article of the U.C.C. (Article 2). Article 2 has been adopted in every state except Louisiana.

Article 2A is a uniform state law on leasing, with standardized provisions on warranties and remedies that are variable by agreement between the lessor and lessee. With regard to remedies, the proposed Article allows room for the development of a state's consumer protection and products liability law. The proposed revision is drafted so that it does not conflict with state certificate of title statutes.

The Joint Subcommittee learned that six states have adopted this Article and essentially in its uniform form. California, however, enacted Article 2A with significant amendments. Those amendments are under consideration in Massachusetts and some other states. In New York, there is currently a Commission studying Article 2A and some believe that Commission may recommend adoption without most or all of the California amendments.

The Joint Subcommittee determined that because there have been several amendments offered to Article 2A by several of the states and because these amendments are currently under review by the Conference, it would be best at this time not to recommend the adoption of Article 2A. They decided that it would be better to wait and afford all of those involved an opportunity to work with the various interest groups on the suggested amendments and to see how other states are proceeding.

Article 4A

There is no comprehensive body of law governing wholesale wire transfers, as currently exists for checks and other types of payments. The average transfer, typically between banks and their corporate customers, is \$5 million, and total daily transfers now average more than \$1 trillion.

There are a number of mechanisms for making payments through the banking system. Most of these mechanisms are covered in whole or in part by state or federal statutes. In terms of number of transactions, payments made by check or credit card are the most common payment methods. Payment by check is covered by Article 3 and 4 of the U.C.C. and some aspects of payment by credit card are covered by federal law. In recent years, electronic funds transfers have been increasingly common in consumer transactions. Some consumer payments that are effected electronically are covered by federal statute, Electronic Fund Transfer Act (EFTA). If any part of a funds transfer is covered by EFTA, the entire funds transfers is excluded for Article 4A.

Another type of payment, commonly referred to as a wholesale wire transfer, is the primary focus of Article 4A. Payments that are covered by Article 4A are overwhelmingly between business and financial institutions. The dollar volume of payments made by wire transfers far exceeds the dollar volume of payments by other means. The greatest volume of payments by wire transfer occurs over the two principle wire payment systems: the Federal Reserve Wire Transfer Network (Fed Wire); and the New York Clearing House Interbank Payment System (CHIPS). Most payments carried out by use of Automated Clearing Houses are consumer payments covered by EFTA and therefore, not covered by Article 4A. There is, however, a significant volume of non-consumer ACH payments that closely resemble wholesale wire transfers. These payments are also covered by Article 4A.

There is some resemblance between payments made by wire transfer and payments made by other means such as checks and credit cards or electronically-based consumer payments, but there are also many differences. Article 4A excludes from its coverage these other payments mechanisms.

Funds transfers are divided into two categories determined by whether the instruction to pay is given by the person making payment or the person receiving payment. If the instruction is given by the person making the payment, the transfer is commonly referred to as a "credit transfer." If the instruction is given by the person receiving payment, the transfer is commonly referred to as a "debit transfer." Article 4A governs credit transfers and excludes debit transfer.

While utilization of "funds transfers" continues to grow, there is no comprehensive law governing commercial "funds transfer." The Federal Reserve Regulation J covers the interbank part of any commercial "funds transfers" by Fed Wire. Bank participants making transfers over CHIPS are governed by the CHIPS rules. The Electronic Funds Transfers Act of 1978 covers consumer transactions. The various funds transfer system rules apply to only limited aspects of wire transfer transactions. The resolution of the many issues that are not covered by funds transfer system rules depends on contracts of the parties, to the extent they exist, or principles of law applicable to other payment mechanisms that might be applied by analogy. The result is a great deal of uncertainty.

There is overwhelming concern that the rule for checks in Article 3 and 4, which utilize the signatures and endorsements on the check as the basis for determining liability, do not apply to electronic funds transfers. Also, the rules governing the liability of banks to customers under Article 4 are not satisfactory. Although the electronic transfer networks or systems (Fed Wire and CHIPS) have rules to govern transactions between participating banks, they do not affect bank customers. Outside Fed Wire and CHIPS, common-law contract rules are the basis for determining liability. However, negotiated contracts are rare. Bank customers usually need funds transfers immediately and do not take the time to negotiate a contract. When a commercial customer initiates a "funds transfer" through a bank for payment to a designated beneficiary, no comprehensive rules and no readily ascertainable law pertains. As a result, most commercial "funds transfers" are made with no provision for the significant liabilities that will accrue if something goes wrong.

After having received testimony describing the transactions covered by proposed Article 4A and the reasons why proposed Article 4A is needed, the Joint Subcommittee learned how Article 4A intends to fill the void. The Joint Subcommittee was told that the proposed revision comprehensively provides coverage of commercial "funds transfers" from the order of the originator to the originator's bank, through intermediary banks, to the beneficiary's bank. Proposed Article 4A sets forth safety net rules absent agreement of the parties, covering liabilities and obligations arising from: unauthorized payment orders, proper and improper (wrongful and erroneous) execution of payment orders, fraud, and insolvency of participating banks. What constitutes payment for the discharge of an underlying obligation is, also, governed by proposed Article 4A.

The Joint Subcommittee was told further that the major objectives of Article 4A are to preserve a fast, efficient, reliable system for the transfer of large volumes of funds rapidly at a low cost; to provide certainty as to the obligations and liabilities; to safeguard the integrity of the "funds transfer" systems; and to establish the basic rights and responsibilities of the participants, except as varied by agreement of the parties. See Appendices 2 and 3 of this report.

The Joint Subcommittee recommended that legislation be drafted for the 1990 Session of the General Assembly to propose Article 4A of the Uniform Commercial Code. The Subcommittee recommended that the draft include a January 1, 1991 effective date.

Article 6

Bulk sale legislation originally was enacted in response to a fraud perceived to be common around the turn of the century; a merchant would acquire his stock on credit, then sale his entire inventory ("in bulk") and abscond with the proceeds, leaving creditors unpaid. The creditors had a right to sue the merchant on the unpaid debts, but that right often was of little practical value. Even if the merchant-debtor was found; in personam jurisdiction over him might not have been readily available. Those creditors who succeeded in obtaining a judgment often were unable to satisfy it because the defrauding seller had spent or hidden the sale proceeds. Nor did the creditors ordinarily have recourse to the merchandise sold. The transfer of the inventory to an innocent buyer effectively immunized the goods from the reach of the seller's creditors. The creditors of the bulk seller thus might be left without a means to satisfy their claims. Article 6 of the Uniform Commercial Code was enacted in response to the perceived risk.

Article 6 is remarkable in that it obligates buyers in bulk to incur costs to protect the interest of the seller's creditors, with whom they usually have no relationship. Even more striking is that Article 6 affords creditors a remedy against a good-faith purchaser for full value without notice of any wrong doing on the part of the seller. The Article thereby impedes normal business transactions, many of which can be expected to benefit the seller's creditors. For this reason, Article 6 has been subjected to serious criticism.

A very strong case can be made that, in light of business, technology and legal development since the 1890's when the bulk sale laws first came into force, there is no longer a need for such laws, and that they serve as a trap for the unwary, at a cost to all, interfering with good faith transactions, and are based on the assumption that some transfers are dishonest, and result in consequences unrelated to the injury caused. In addition, today, credit is extended on a far more professional basis, is supported by vastly improved information-gathering capabilities and credit reporting services, and is not infrequently of a national or regional, rather than local, character. Creditor avoidance by debtor's simply moving with sale proceeds to a different state is far less likely to succeed in light of improved communication and transportation, modern long-arms statutes, enhanced sister-state enforcement of judgments under the Uniform Enforcement of Foreign Judgments Act, and the Uniform Fraudulent Transfer Act. The adoption of the Uniform Commercial Code

has greatly facilitated the extension of credit on a secured basis, thereby both permitting creditors the option of obtaining a security interest and by facilitating the creation of blanket liens, making it less likely that unsecured creditors will truly rely on the ultimate existence of unencumbered assets. Statewide filing under the Code and increased computerization also have facilitated the discovery of security interests. Finally, a modern bankruptcy statute, more freely utilized by debtors and repleted with transaction-avoidance devices which are implemented with sophistication and vigor, together with the recently modernized Uniform Fraudulent Transfer Act have provided a different legal environment that greatly lessens the need for bulk transfer laws.

The National Conference of Commissioners on Uniform State Laws and the American Law Institute believe that changes in the business and legal contexts in which sales are conducted that made regulation of bulk sales unnecessary. The Conference and the Institute have, therefore, withdrawn their support for Article 6 of the Uniform Commercial Code and encouraged states to repeal it.

The Conference and the Institute recognize that bulk sales may present a particular problem in some states and that some legislatures may wish to continue to regulate bulk sales. They believe that existing Article 6 has become inadequate for that purpose. For those states that are disinclined to repeal Article 6, they have promulgated a revised version of Article 6. The revised Article is designed to afford better protection to creditors while minimizing the impediments to good-faith transactions.

The Joint Subcommittee found that those groups interested in the bulk sales laws of Virginia had not had sufficient time to review the two options offered by the Conference. With that in mind, the Joint Subcommittee decided that the study should be continued for another year to afford time for a more detailed analysis of the repeal or the revision of the bulk sales law.

IV. RECOMMENDATIONS OF THE SUBCOMMITTEE

THE JOINT SUBCOMMITTEE RECOMMENDS THAT LEGISLATION BE DRAFTED FOR INTRODUCTION IN THE 1990 SESSION OF THE GENERAL ASSEMBLY WHICH WILL ADD ARTICLE 4A TO THE UNIFORM COMMERCIAL CODE TO PROVIDE A COMPREHENSIVE LEGAL STRUCTURE FOR A CLASS OF PAYMENTS KNOWN AS WHOLESALE FUNDS TRANSFERS.

The Joint Subcommittee recognizes that the major interest groups participated in the drafting of Article 4A, and that the final version of this proposed revision to the Uniform Commercial Code reflects the compromises which are necessary to achieve the support of those groups. The Joint Subcommittee notes that one of the key public benefits of Article 4A is that it creates a uniform body of law governing the rights and obligations of participants in a funds transfer. The members of the Subcommittee found that the interconnected nature of the funds transfer system requires that the basic rules underlying the system be the same for all participants. Of course, the new article permits a degree of flexibility by allowing provisions to be varied by agreement in order to accommodate the needs of different users and providers of funds transfer services.

By making this recommendation, the Joint Subcommittee also found that the public also gains from the certainty created by Article 4A. One by-product of such certainty is the ability to identify which party to a fund transfer is liable when a transfer is mishandled or when payments are not completed due to the insolvency of a participant in the transfer. This, in turn, permits parties to implement procedures to control risk.

Another advantage of Article 4A is that it has been drafted to accommodate such features as speed, low cost and reliability. It is these features which have made wholesale funds transfers such an attractive form of payment.

Perhaps the single greatest advantage of Article 4A over current law is that of the proposed revision's treatment of the consequential damages issue. Banks which fail to complete (or to complete in a timely fashion) a funds transfer are typically sued in lawsuits which allege that the banks' actions caused damages far in excess of the amount of the transfers. While no reported decision has ever awarded such damages, one of the leading cases in this area has been interpreted by some practitioners as permitting consequential damages. Article 4A resolves this issue by prohibiting recovery of consequential damages for late or improper execution of a funds transfer except where the bank has expressly agreed in writing to undertake such liability.

Finally, the Joint Subcommittee found that another troublesome situation for banks addressed by Article 4A was the problem of name and account number discrepancies in payment orders. The issue often arises in the context of a fraud committed on a bank which is misled into believing that it is sending funds on the behalf of its customer to the customer's account with another bank. Unfortunately, the account number is for the account of the malefactor, not the customer, but the bank receiving the funds does not recognize any discrepancy because it acts on the payment order solely on the basis of the account number. Article 4A resolves such disputes by providing, generally, that the bank receiving the payment order may pay the person identified by the account number and has no duty to determine whether the name and number refer to the same person.

For these reasons, the Joint Subcommittee recommends that legislation be drafted for the 1990 Session of the General Assembly to add Article 4A to the Uniform Commercial Code. See Appendix 4 of this report.

THE JOINT SUBCOMMITTEE RECOMMENDS THAT THIS STUDY BE CONTINUED FOR ANOTHER YEAR.

The Joint Subcommittee recognizes that the various interest groups have not had enough time to thoroughly address some of the proposed revisions to the U.C.C. The Joint Subcommittee believes that the various interest groups' testimony and input is crucial for a successful review of the modifications to the U.C.C. For this reason, the Joint Subcommittee makes its recommendation to continue the study. See Appendix 5 of this report.

V. CONCLUSION

The Joint Subcommittee believes that Article 4A of the Uniform Commercial Code is essential law. The members believe that the continuance and viability of funds transfers depends upon its enactment. It is obvious that electronic technology is now a fact of life and new methods for transferring bank credit for the purposes of payment are a result. The Subcommittee believes that Article 4A is a reflection of this fact. Such technology is widely used to make large transfers of funds that satisfy obligations arising from commercial transactions. The technology is simply too convenient and too fast not to be used for the transfer of large sums around the world. The Joint Subcommittee found that there was no significant or organized opposition expressed to the proposed Article 4A.

The Joint Subcommittee expresses its appreciation to those interest groups who have worked long and hard on those issues described in this report, and look forward to working with them in the future on the matters yet unresolved.

Respectfully submitted,

George H. Heilig, Jr., (Chairman)
William E. Fears, (Vice-Chairman)
Clifton A. Woodrum
Willard R. Finney
William S. Moore, Jr.
Moody E. Stallings, Jr.

VI. APPENDICES

1. House Joint Resolution No. 59 of 1988.
House Joint Resolution No. 248 of 1989.
2. Article 4A Information and Materials.
3. Proposed Legislation on Article 4A, with Comments.
4. Draft Legislation on Article 4A.
5. Draft Resolution to Continue the Study.

HOUSE JOINT RESOLUTION NO. 59

Requesting creation of a joint subcommittee to review modifications of the Uniform Commercial Code.

Agreed to by the House of Delegates, February 16, 1988
Agreed to by the Senate, March 2, 1988

WHEREAS, the Uniform Commercial Code (U.C.C.) has been adopted in forty-nine states, the District of Columbia and the Virgin Islands; and

WHEREAS, the National Conference of Commissioners on Uniform State Laws has adopted revisions to various articles of the U.C.C. and is considering additional revisions to update the U.C.C.; and

WHEREAS, the need for continued uniformity in the area of commercial laws is great; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That a six-member joint subcommittee be created to review the revisions to the U.C.C. considered and adopted by the National Conference of Commissioners on Uniform State Laws and make recommendations to the General Assembly regarding enactment of the revisions in Virginia. The membership of the joint subcommittee shall be appointed as follows: two members from the House Committee on Corporations, Insurance and Banking and two members from the House Committee for Courts of Justice to be appointed by the Speaker of the House of Delegates; two members of the Senate Committee on Commerce and Labor to be appointed by the Senate Committee on Privileges and Elections.

The indirect costs of this study are estimated to be \$10,650; the direct costs of this study shall not exceed \$4,320.

GENERAL ASSEMBLY OF VIRGINIA -- 1989 SESSION
HOUSE JOINT RESOLUTION NO. 248

Continuing the Joint Subcommittee Studying Modifications of the Uniform Commercial Code.

Agreed to by the House of Delegates, February 6, 1989
Agreed to by the Senate, February 23, 1989

WHEREAS, the 1988 Session of the General Assembly established, pursuant to House Joint Resolution No. 59, a joint subcommittee to review modifications of the Uniform Commercial Code (U.C.C.); and

WHEREAS, the joint subcommittee then met and asked various interested groups to meet with their members and inform the joint subcommittee as to their position regarding revisions to various articles of the U.C.C. proposed by the National Conference of Commissioners on Uniform State Laws; and

WHEREAS, these interests groups were unable to make the detailed and thorough analyses which the proposed revisions warrant; and

WHEREAS, although the joint subcommittee feels that the various suggested revisions to the U.C.C. have merit and appear to be conceptually sound, there is a need to more thoroughly address some of the changes in detail since they require imposing additions and changes to the Code; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the joint subcommittee established in 1988 to review modifications to the Uniform Commercial Code be continued. The membership of the joint subcommittee shall remain the same and any vacancies that occur shall be filled in the same manner as provided in House Joint Resolution No. 59 of 1988. The joint subcommittee shall complete its work in time to submit its recommendations to the 1990 Session of the General Assembly.

The indirect costs of this study are estimated to be \$10,860; the direct costs of this study shall not exceed \$4,320.

Important Information on Article 4A of the UCC

In 1989, as Article 4A of the UCC is proposed for enactment by the states, over \$1 trillion is transferred daily by "funds transfers." Five years ago the daily average was \$300 million and two years ago it rose to \$500 million. Some peak days now exceed \$2 trillion, while utilization continues to grow. "Funds transfers" exceed the total amounts transferred in all other payment systems — credit and debit cards and checks combined. The average "fund transfer" exceeds \$5 million.

Yet there is no comprehensive law governing commercial "funds transfers." Regulation J covers the interbank part of any commercial "funds transfer" by the Federal Reserve network (Fedwire). The Clearing House Interbank Payment System (CHIPS) rules cover the bank participants in that system. The Electronic Funds Transfer Act of 1978 covers consumer transactions. In spite of all of that, when a commercial customer initiates a "funds transfer" through a bank for payment to a designated beneficiary, no comprehensive rules and no readily ascertainable law pertains. As a result, most commercial "funds transfers" are made with no provision for the significant liabilities that will accrue if something goes wrong.

Article 4A fills the void. It comprehensively provides coverage of commercial "funds transfers" from the order of the originator to the originator's bank, through intermediary banks, to the beneficiary's bank. No other country has such a comprehensive law, proposed or in being.

Article 4A sets forth safety net rules absent agreement of the parties, covering liabilities and obligations arising from: unauthorized payment orders; proper and improper (wrongful and erroneous) execution of payment orders; fraud; and, insolvency of participating banks. What constitutes payment for the discharge of an underlying obligation is, also, governed by Article 4A.

The major objectives of Article 4A are to preserve a fast, efficient, reliable system for the transfer of large volumes of funds rapidly at a low cost; to provide certainty as to the obligations and liabilities; to safeguard the integrity of the "funds transfer" system; and to establish the basic rights and responsibilities of the participants, except as varied by agreement of the parties.

Benefits to Corporate Users

Most senders of payment orders in a "funds transfer" are banks and corporations. Senders under Article 4A enjoy the following benefits:

1. *Finality of payment* — Funds transferred are essentially equivalent to cash with a more certain degree of finality than is currently the case.
2. *Moneyback guarantee* — If the "funds transfer" is not completed, the originator's bank must return the originator's money.
3. *Discharge of underlying obligation* — A statutory discharge of the underlying obligation generally occurs upon acceptance by the beneficiary's bank.
4. *Commercially reasonable security procedures* — Substantial incentives for banks to provide reasonable security procedures are fostered or the bank may absorb the loss for an unauthorized order.
5. *Error reporting* — While users have a duty to report errors, failure to do so within a reasonable time results only in possible interest losses. No other damages are imposed.

6. *Loss apportionment* – If a loss results from an unauthorized order, when there is an agreed security procedure, the receiving bank suffers the loss unless the bank can prove:

- the security procedure was commercially reasonable;
- the bank followed the procedure;
- the bank acted in good faith; and
- the bank complied with the customer's written agreement or instructions restricting acceptance of payment orders.

Even if the bank proves the above, should the customer prove that it's without fault, pure interloper losses fall on the bank.

7. *Damages for dishonor* – If the beneficiary's bank has accepted the order and the beneficiary demands payment, the bank, for failure to pay, may be liable for damages, including consequential damages, if the beneficiary gave notice of the particular circumstances that would give rise to such damages and indication of the magnitude of them.

Benefits to Banks

The banking community will benefit as follows from Article 4A:

1. *Certainty* – There is no statutory or case law that adequately governs these transactions. Frequently, contracts between customers and banks are absent or inadequate. Perhaps no contract could be adequate to govern the risks, given the paucity of applicable law. Therefore, all parties to "funds transfers" operate in an uncertain legal environment. Article 4A removes the uncertainty. Certainty as to liability and responsibility promotes sound credit policy and financial management. Since Article 4A largely embraces current operating practices, the efficiency of the present system is preserved.
2. *Banks as users* – As the principal users of the "funds transfer" system, banks will enjoy all of the benefits of Article 4A listed above for users.
3. *Limitation of liability* – Article 4A limits liability to loss of interest and principal, or in certain cases other incidental costs and reasonable attorney's fees. Only in the event of intentional dishonor and with specific notice of the particular circumstances and contemplated magnitude, are consequential damages recoverable.
4. *Statute of limitations* – Article 4A precludes objection to payment of an order executed by a bank unless made within one year from the time the customer receives notice the order was sent.
5. *Creditor processes* – Under Section 4A-502, banks are protected from creditor processes during the fast electronic batch processing of payment orders.
6. *Choice of law* – Section 4A-507 contains rules as to choice of applicable law that will promote certainty.
7. *Netting of obligations* – If banks owe other banks and are owed by those same banks on payment orders sent and received, Section 4A-403

gives statutory authorization for bilateral and unilateral netting of payment obligations among banks to reduce insolvency risk.

8. *Number and name of account* – If a bank discloses to its customer that it may rely upon numbers to identify a beneficiary in a payment order, Section 4A–305(3) authorizes it to rely upon the number used by the customer to identify the beneficiary. Because processing is electronic and rapid, reliance on numbers facilitates "funds transfers."

9. *Rely on tested message* – Banks can rely upon the message that tests against the security procedure, unless the customer proves that the payment order is unauthorized and the breach of the confidential security information did not result from a source controlled by the customer. The bank, however, must have offered a commercially reasonable security procedure to the customer and have followed that procedure and any customer written agreement or instruction, all in good faith.

Why states should adopt Article 4A of the UCC

New Article 4A of the Uniform Commercial Code concerns a type of payment made through the banking system called a "funds transfer." (A popular term for the bulk of these kinds of transfers is "wholesale wire transfer." This term is not used in Article 4A because all "funds transfers" are not "wholesale" and not "wire" transfers.) A "funds transfer" is, generally, a large, rapid money transfer between commercial entities. In the average "funds transfer" \$5,000,000.00 changes hands. In most instances, such transfers will occur between banks using computers and electronic communications. (Consumer transfers through credit cards and ATM machines are not governed by Article 4A, but are governed by federal law.) Article 4A provides a body of law on the rights and obligations connected with "funds transfers."

There is currently no comprehensive body of law that defines the rights and obligations that arise from "funds transfers." Some aspects of "funds transfers" are governed by rules of the principal transfer systems. Transfers made by the Federal Reserve network (Fedwire) are governed by Federal Reserve Regulation J and transfers over the Clearing House Interbank Payment System (CHIPS) are governed by CHIPS rules. But these rules apply to only limited aspects of "funds transfer" transactions.

Article 4A will provide:

CERTAINTY

Currently, no participant in a "funds transfer" can know with certainty what the rights and obligations of parties are. Enactment of Article 4A solves the problem.

BALANCE

Article 4A carefully addresses the interests of banks, commercial users of this payment method and the public. It seeks a fair balance between interests involved in "funds transfers."

REMEDIES

What law exists does not provide clear remedies for "funds transfers" when something goes wrong. UCC-4A establishes who takes the risk of loss, who will be liable and what will be the damages.

EFFICIENCY

Article 4A is designed to facilitate a speedy and inexpensive system to transmit huge sums that are substantially cash equivalent, benefiting both the national and international economies.

FREEDOM OF CONTRACT

Users and banks are free to vary many provisions of UCC-4A by individual contract. They are not locked into invariable rules that might impede transactions between them.

UNIFORMITY

"Funds transfers" are an important part of business and are interstate in character. Uniformity is as important to the conduct of "funds transfers" as it is to other current payment methods.

CONCLUSION

The growing role that "funds transfers" have in the business world today makes it clear that modern law on this subject is needed. Users of "funds transfers" now depend mainly on court cases, or their own rules, to resolve disputes. This creates great uncertainty. UCC-4A answers these immediate needs.

UNIFORM COMMERCIAL CODE

ARTICLE 4A – FUNDS TRANSFERS

– A Summary –

The payment of obligations is of vital importance to almost all commercial transactions. Occasionally problems arise when payment is not made, or is made improperly. It is neither convenient nor prudent to pay large or even modest obligations in actual cash. So, individuals and corporations, big account holders and small, have turned to bank accounts and bank credit, and have paid obligations by written instruments that accomplish a transfer of bank credit - check, money order, bank draft, etc. For the past twenty years, in every state, the rights and obligations of parties to payment by check have been governed by Articles 3 and 4 of the Uniform Commercial Code (UCC). Checks will remain the method by which many obligations are paid for the foreseeable future. However, electronic technology is now a fact of life and new methods for transferring bank credit for the purposes of payment are a result. Article 4A is a reflection of this fact.

How has technology affected systems of payment? Most people are aware of automated teller machines for their personal use. Indeed, these machines have become very popular. But such technology is widely used to make large transfers of funds that satisfy obligations arising from commercial transactions as well. The technology is simply too convenient and too fast not to be used for the transfer of large sums around the world.

The amounts which move through the large value automated systems are truly staggering. In 1989 as Article 4A is promulgated, one trillion dollars are transferred on an average day. In 1989, a record day of three trillion dollars was recorded. This is roughly the 1989 gross national product of the United States. Undoubtedly, this record will be surpassed in due course

and probably frequently in the future. Such figures indicate the impact of the technology. They also indicate the need for some governing law.

In 1989, as the new Article 4A is proposed to the states for adoption, there is no backstop statutory law to govern funds transfers. The rules for checks in Articles 3 and 4, which utilize the signatures and endorsements on the check as the basis for determining liability, do not apply to electronic funds transfers. Nor are the rules governing the liability of banks to customers under Article 4 helpful. Many transfers in the United States are effected through electronic transfer networks; one is owned and operated by the Federal Reserve and is known as FedWire and the other is owned and operated by the New York Clearing House and is known as CHIPS (Clearing House Interbank Payments Systems). Each of these systems has rules to govern transactions between participating banks, but they do not affect bank customers. Outside FedWire and CHIPS, common-law contract rules are the basis for determining liability. However, serviceable, negotiated contracts are rare. Bank customers usually need a funds transfer immediately and do not take the time to negotiate a contract. Transfers are frequently made in a legal void.

Article 4A is the remedy for this void. Because the total volume of funds transfers is very great and because many individual transactions are very large, the cost of uncertainty in the law could be very high. Article 4A is necessary to the continued usage of existing funds transfers and for the anticipated future expansion in this usage.

Some terminology is necessary to follow a funds transfer under Article 4A. A "sender" is any person or entity who sends a "payment order." The first sender

is the originator, and subsequent senders are banks participating in the transfer. A sender communicates a "payment order" to a "receiving bank." Receiving banks become senders if they forward "payment orders" to other banks. The last bank in the communications chain is the beneficiary's bank, and it can never be a sender with respect to the specific funds transfer. The "beneficiary" is the entity that the sender intends to pay. A "payment order" is simply the form of communication that the parties to a funds transfer agree to use. The payment order's salient characteristics are that it calls for an unconditional payment of money from the sender to the beneficiary and that it is transmitted to a receiving bank.

Unless the persons or entities involved in a payment of money use the same bank, a funds transfer involves at least four parties: the originator of the payment; the bank to which the originator communicates the first payment order; the beneficiary's bank that receives the final payment order; and last, the beneficiary. Intermediary receiving and sending banks also may be involved. These are banks that act as conduits of payment when there is no capacity to communicate directly between the originator's bank and the beneficiary's bank.

An example illustrates the process of a funds transfer. Suppose Alpha Corporation wants to pay money to Beta Corporation to satisfy a large contractual obligation. Alpha is in New York, and Beta is in California. Alpha has a bank account with a balance sufficient to pay Beta at First Bank in New York. Beta maintains an account at Second Bank in California. The process of payment is simple. Alpha orders First Bank to pay the owed money to Beta through a transfer to Second Bank. Alpha's order is pursuant to an agreement that Alpha has with First Bank. When First Bank receives the payment order from Alpha, it communicates with Second Bank. The communication indicates that a specific amount at First Bank held for Alpha will be transferred to Second Bank with the understanding that it will be passed on to Beta. Second Bank accepts this second payment order and notifies Beta that the money is available to Beta. Value passes

between the two banks through accounting entries in a process known as settlement.

With simple transactions, why do we need a whole new article in the Uniform Commercial Code? New law - or any law - isn't necessary if everything works. But what if something goes wrong? What if First Bank makes a mistake as to the amount to be paid? What happens if Second Bank doesn't notify Beta? What happens if the payment order is fraudulent, and not actually issued by Alpha? What happens if there is a bank failure? These are a few examples of possible errors.

A funds transfer is like a string of Christmas lights: everything is fine until a light burns out. There must be a remedy for the burned out light, and to the extent there are losses they must be paid. What are the remedies if someone takes a loss? Who bears the risk of loss at a given time in the transactional process? No adequate answers to these questions exist without a backstop statutory law that allocates the loss at the appropriate places in the funds transfer. Article 4A provides clear and reliable answers, and thereby keeps the string of lights burning.

To resolve the problem of who is responsible when something in a funds transfer goes wrong, Article 4A divides the actions of the parties to a funds transfer into three essential parts. First, a funds transfer is initiated by the originator and accepted by the originator's bank. Part 2 of Article 4A, entitled "Issue and Acceptance of Payment Order," governs the relationship between the sender of a payment order and the receiving bank that will execute the payment order. What constitutes acceptance and rejection (both rightful and wrongful) of a payment order, and what must be done to amend a payment order, are determined by the rules of Part 2, as these involve the relationship between the sender and receiving bank in a funds transfer.

As between sender and receiving bank, who suffers a loss if there is a mistake? Part 2 of Article 4A resolves this critical issue. Two kinds of mistakes can occur between sender and receiving bank, an un-

authorized payment order and an erroneous payment order. The key to the rules on an unauthorized payment order is the "security procedure" that exists between sender and receiving bank. This is the agreed procedure that verifies the authenticity of a payment order or other relevant communication. In electronic funds transfer systems, the security procedure is an important element, and may involve codes, encryption, callback procedures, and the like. Any procedure that can be devised to protect the transaction is eligible. To be legally effective, it must only be commercially reasonable.

The security procedure determines who takes the risk of loss when there is an unauthorized payment order. If there is a commercially reasonable security procedure that is followed by the receiving bank, the sender must absorb the loss. If the sender proves that the security procedure was not followed or was breached by someone outside the control of the sender, the receiving bank takes the loss. The assumption is that the security procedure, if followed and not breached, will verify the authenticity of payment orders.

The risk of loss for an erroneous payment order also hinges upon compliance with a security procedure for detecting error. If the sender proves that it complied with the security procedure, the receiving bank takes the loss. Otherwise, the sender is responsible for erroneous orders.

The second part of a funds transfer is the passage of funds from receiving bank to receiving bank, until the beneficiary's bank is contacted. This is covered by Part 3 of Article 4A, which is entitled "Execution of Sender's Payment Order by Receiving Bank."

Rules governing the relationship between receiving banks are contained in this part. A principal obligation of a receiving bank (other than the beneficiary's bank) is to "execute" a payment order once it has accepted the order - that is, pass it on to the next bank in the string. It executes by issuing a payment order to the next bank. (The beneficiary's bank has a different obligation. It must pay the obligation

to the beneficiary, and that is covered in Part 4 of Article 4A.) Unless agreed otherwise, a bank may use any commercially reasonable method to issue a payment order. A receiving bank is, generally, responsible for any error it commits in issuing a payment order. If a receiving bank overpays the beneficiary of a payment order, the excess is recovered from the beneficiary, not from prior senders. If a receiving bank pays a person or entity that is not the intended beneficiary, recovery is from the person receiving the money, and not from any prior sender. Only if a receiving bank underpays in a payment order, may the bank recover from prior senders, and then only an amount to cover the error and only if it issues a curative order.

Part 3 of Article 4A covers other issues pertaining to receiving banks. For instance, rules on reporting an erroneous payment order and late execution of a payment order are furnished.

The last part of a funds transfer involves actual payment to the beneficiary. It is the subject of Part 4 of Article 4A, "Payment." Each sender, going back to the originator, is obligated to pay. At a given time, the beneficiary is considered to have been paid. There is a two step approach to actual payment, although the steps are accomplished simultaneously if the transfer is made by Fedwire. First, credit is extended by each receiving bank to each sender when the sender's payment order is accepted - basically, a communications function. The second stage involves settling up between participants - the actual passage of value.

Perhaps the most important section in Part 4 is Section 4A-402. It provides that a sender of a payment order is obliged to pay the amount of the order to the receiving bank if the funds transfer is properly completed. It is essential to distinguish, in this regard, a payment order from a check.

A check is a kind of payment order. When a person writes a check on an account, it orders the institution in which the account resides to pay money to a named person (whose technical name is the payee). Although a check suspends the liability of the person

who writes it for an underlying obligation until the instrument is rightfully presented for payment and paid at the institution in which the account resides, it can be passed from person to person as payment for other obligations and accrues and extinguishes liabilities for those persons as it passes between them. If the institution refuses to pay when the check is presented, then the person who initially wrote the check is liable for the underlying obligation as well as for the check. In contrast, acceptance of a payment order for a funds transfer by a receiving bank obligates the sender to pay that bank, and that bank alone. There is no instrument that may be passed from hand to hand as payment between other people. There are no lingering liabilities that result from the negotiability of an instrument. A payment order for a funds transfer is simple and direct.

How does settlement take place? If the sender is a bank, and the funds transfer is through one of the funds transfer systems, payment takes place according to the rules of the system that govern settlement between banks. Typically, payment is a matter of debiting an account of the sender with the receiving bank, and crediting the receiving bank's account. These methods hold whether the sender is an individual or a bank.

The beneficiary's bank, the last bank in the string, is responsible for paying the beneficiary. Payment generally takes place by crediting an account of the beneficiary, although satisfaction of a beneficiary's debt also constitutes payment, and payment in general occurs when the funds are available to the beneficiary for withdrawal. The originator of a payment order, that first light in the string of lights, generally is deemed to have paid the beneficiary on the underlying commercial obligation when the beneficiary's bank accepts the payment order. If it seems premature to discharge the originator, it is because at the time of acceptance by the beneficiary's bank, the originator has done all

in its power to see that the beneficiary has obtained a credit balance at the beneficiary's bank in the agreed-upon amount. It is analogous to a situation where the originator has deposited cash to the beneficiary's account at beneficiary's bank. At that point, the originator's obligation to the beneficiary should be considered satisfied.

Finally, there are some other features of Article 4A to be considered. First, any transaction that is subject to the Electronic Funds Transfer Act of 1978 is not subject to Article 4A. This express exclusion places consumer transactions outside Article 4A, and leaves them to federal law. Second, the regulations and operating circulars of the Federal Reserve Board supersede any inconsistent provision of Article 4A. Third, transfer system rules will prevail if inconsistent with any part of Article 4A. Fourth, it is possible to vary the effect of most of the provisions of Article 4A, honoring the general Uniform Commercial Code policy of freedom of contract.

The fifth matter of special interest needs extra emphasis. Funds transfers occur and are useful so long as it is fast, efficient and inexpensive to use current and future electronic methods. A great deal of money can be passed through the current system for very little comparative cost. Therefore, Article 4A limits consequential damages for improper payment orders. Consequential damages might raise costs, reduce transaction speed by requiring the exercise of discretion by management, and increase uncertainty.

Article 4A of the Uniform Commercial Code is essential law. The continuance and viability of funds transfers depends upon its advancement in the states. And uniformity is an absolute requirement in every state, unconditionally and without deviation. Otherwise, there will be impairment of the functioning of funds transfers for the long term.

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REPORT OF THE
AD HOC PAYMENT SYSTEMS LAWS
TASK FORCE
TO THE
BOARD OF DIRECTORS
OF THE
AMERICAN BANKERS ASSOCIATION

ON

UNIFORM COMMERCIAL CODE
ARTICLE 4A
FUNDS TRANSFERS

NOVEMBER 21, 1989

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EXECUTIVE SUMMARY

On August 3, 1989 the National Conference of Commissioners on Uniform State Laws approved Article 4A as an addition to the existing Uniform Commercial Code. Article 4A, when enacted into law by the various states, will govern a class of payment transactions known as wholesale funds transfers. Present law, regulation and private agreements covering funds transfers are considered inadequate and generally incapable of efficiently resolving such issues as liability for mistakes, fraud and insolvency.

The provisions of Article 4A were drafted through the joint efforts of Uniform Law Commissioners, academics, bankers, corporate users of funds transfers and regulators. The final version of 4A represents a compromise which attempts to strike a balance between the interests of the public, those of the providers of funds transfer services and those of the users. While the banking representatives would have resolved several issues differently, it is the general consensus of the bankers that participated in the drafting process, as well as the Ad Hoc Payment Systems Laws Task Force, that Article 4A's benefits to the banking system significantly outweigh its disadvantages.

The task force urges the American Bankers Association Board of Directors to adopt a resolution indicating the Association's support for Article 4A and encouraging State Legislatures to enact 4A into law.

Project Background

On August 3, 1989 the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the addition of Article 4A to the Uniform Commercial Code (UCC). This is the first time in over thirty years that the Commission has made any significant changes to the UCC's provisions on payment. Article 4A, when enacted into law by the various states, will provide a comprehensive legal structure for a class of payments known as wholesale funds transfers. (Throughout this report the term "funds transfer" will be used to denote a discrete method of payment by which a bank customer instructs its bank to credit another bank account. The term "wire transfer", which refers to the method used to transmit the instruction, is a specific sub-class of funds transfer.) Presently, while the greatest dollar value is moved by funds transfers, the existing law governing such transactions is a make shift framework of private agreement, system rules, federal regulation and case law. This patch-work quilt of rules creates uncertainty, litigation and unnecessary expense when problems occur in the course of such transfers.

NCCUSL was organized in 1892 to promote uniformity of law by the voluntary action of state governments. The UCC, which was drafted during the late 1940's and early 1950's, is a fundamental source of statutory commercial law and covers such topics as sales of goods, negotiable instruments, letters of credit, secured lending and securities. Since 1961 a group known as the Permanent Editorial

Board for the UCC (which is composed of NCCUSL members and members of the American Law Institute) has supervised changes to the UCC when, for example, new commercial practices have made additional UCC provisions desirable.

The adoption of Article 4A is the culmination of a project begun in 1977 to revise the payment provisions of the present UCC (i.e., Articles 3 and 4). The initial drafting effort produced a document known as the Uniform New Payments Code which was designed to cover all types of payments (check, credit card, wholesale wire transfer, etc.) under one uniform set of rules. This work was criticized by the banking industry and due to the efforts of the American Bankers Association, among others, the New Payments Code approach was eventually dropped.

In late 1985 a new committee was organized to draft less sweeping changes to present Articles 3 and 4 of the UCC and to develop a new Article to govern wholesale funds transfers. The drafting committee was composed of Uniform Law Commissioners, academics, and advisors from the banking, legal, regulatory and corporate communities. During the past three years numerous meetings on Article 4A were held by the drafting committee as well as other groups such as the American Bankers and American Bar Associations.

Project Review

The American Bankers Association's response to the 4A effort has been coordinated through the work of the Ad Hoc Payment Systems Laws Task Force. This task force is composed of bank operations experts and bank counsel appointed by former Association President Mark Olson in 1987. In addition, W. Robert Moore, Senior Vice President (retired) Chemical Bank of New York and Thomas J. Greco, Associate General Counsel in the ABA's Office of the General Counsel, served as the Association's advisors to the NCCUSL drafting committee and participated in most of that group's meetings.

Bankers and bank counsel had numerous opportunities to review and comment on the various drafts of Article 4A. For example, two meetings were held specifically to generate comments to earlier versions of 4A. On December 3, 1987 the American Bankers Association, along with the Association of Reserve City Bankers, the Bank Administration Institute and the New York Clearing House Association jointly sponsored a one-day forum on 4A. Over two hundred bankers and bank counsel attended the forum, and the comments received were incorporated into the task force's January 29, 1988 report to the NCCUSL drafting committee. On October 18, 1988 the task force met with bankers and counsel who were directly involved in the drafting process in order to achieve an industry consensus on several open issues. In addition to these meetings numerous drafts have been distributed to various ABA committees and to individual bankers throughout the drafting process.

Provisions of Article 4A

Two major interest groups participated in the drafting of Article 4A, the banking industry and the corporate users of funds transfers. The final version of 4A reflects the compromises which were necessary to achieve the support of both groups and, consequently, neither side is entirely satisfied with each and every provision of the proposed law. The remainder of this section highlights the public benefits of 4A and notes the advantages and disadvantages of 4A from the banking industry's perspective.

Public Benefits

One of the key public benefits of Article 4A is that it creates a uniform body of law governing the rights and obligations of participants in a funds transfer. The interconnected nature of the funds transfer system requires that the basic rules underlying the system be the same for all participants. Of course, 4A permits a degree of flexibility by allowing many provisions to be varied by agreement in order to accommodate the needs of different users and providers of funds transfer services.

The public also gains from the certainty created by 4A. One by-product of such certainty is the ability to identify which party to a funds transfer is liable when a transfer is mishandled or when payments are not completed due to the insolvency of a participant in the transfer. This, in turn, permits parties to implement procedures to

control risk. This factor is particularly significant given the Federal Reserve Board's concern for reducing risk (i.e., insolvency risk) in the payments system.

Another advantage of Article 4A is that it has been drafted to accommodate such features as speed, low cost and reliability. It is these features which have made wholesale funds transfers such an attractive form of payment. For example, 4A's rules on discrepancies in a payment order between identifying numbers and name promotes the use of automation, which both increases processing speed and keeps costs low. The Article's rules governing liability for erroneous execution encourage operational practices which ensure reliability by penalizing the party responsible for the error.

Benefits to the Banking Industry

In addition to the benefits from uniformity and certainty described above, perhaps the single greatest advantage of Article 4A over current law is 4A's treatment of the consequential damages issue. Banks which fail to complete (or to complete in a timely fashion) a funds transfer are typically sued in lawsuits which allege that the banks' actions caused damages far in excess of the amount of the transfers. While no reported decision has ever awarded such damages, one of the leading cases in this area (Evra Corporation v. Swiss Bank Corporation) has been interpreted by some practitioners as permitting consequential damages. Article 4A resolves this issue by prohibiting recovery of consequential damages

for late or improper execution of a funds transfer except where the bank has expressly agreed in writing to undertake such liability.

Another troublesome situation for banks addressed by 4A is the problem of name and account number discrepancies in payment orders. The issue often arises in the context of a fraud committed on a bank which is misled into believing that it is sending funds on the behalf of its customer to the customer's account with another bank. Unfortunately, the account number is for the account of the malefactor, not the customer, but the bank receiving the funds does not recognize any discrepancy because it acts on the payment order solely on the basis of the account number. Article 4A resolves such disputes by providing, generally, that the bank receiving the payment order may pay the person identified by the account number and has no duty to determine whether the name and number refer to the same person.

Finally, 4A establishes a relatively short one-year period in which a customer must notify its bank of unauthorized transfers from its account. Failure to raise objection to a transfer within one-year after the customer receives notice of the transfer bars subsequent assertions that the transfer was not proper.

Disadvantages to Banks

While "disadvantages" may be too strong a term, there is no question that Article 4A establishes rules that may be less

favorable than present common law or the agreements that banks have been able to obtain from some of their customers. One of the more controversial issues during the drafting process was the treatment of the "interloper fraud" issue.

This issue arises in the context of Article 4A's provisions on authorized and unauthorized payment orders. As a general rule, a bank's customer is only bound by its authorized payment orders. 4A also states, however, that payment orders verified by a "commercially reasonable security procedure" will be binding on the customer. (4A's provisions on commercially reasonable security measures and verified payment orders are, on the whole, very beneficial to both users and providers of funds transfers.) The "interloper" situation occurs when the security procedure is somehow breached (through no fault of the customer or the bank) and the order is verified. If the customer is able to prove that the unauthorized (but verified) order was not caused by a person the customer entrusted to send its payment order or by a person who obtained, from the customer, the information needed to breach the security procedure, then the bank will ultimately be liable for the loss.

Another aspect of 4A which favors users over providers of funds transfer services is the Article's so called "money-back guarantee" rule. Article 4A provides that the sender of a payment order is not required to pay the order if the order is not accepted by the beneficiary's bank. This could expose a bank to insolvency risk if,

for example, an intermediary bank in a funds transfer fails and the customer must be refunded (because the transfer was not completed) but the customer's bank is unable to get its own funds from the failed institution.

A somewhat related rule applies to payment to the beneficiary and gives rise to similar concerns regarding insolvency risk. As a general rule Article 4A prohibits the beneficiary's bank from recovering funds once they are paid to the beneficiary. Therefore, a bank which permits its customer to use funds from a funds transfer before the bank itself receives payment assumes the risk in the event that the order is not paid. There are two exceptions to this rule. The first, intended to address transfers conducted through the Automated Clearing House system, would permit a funds transfer system rule to provide that funds transfers through the system are provisional until the beneficiary's bank receives payment. The second addresses transfers through a system (such as the one envisioned for CHIPS) which multilaterally nets participants' obligations and has a loss sharing agreement in place to complete settlement if one or more participants fail to settle. If, despite such loss sharing rules, the system is unable to settle, then the beneficiary's bank would be able to recover payments from the beneficiary.

Conclusion

The task force believes that the present lack of comprehensive rules governing funds transfers must be remedied if this method of

payment is to remain a fast, reliable and low cost system of transmitting large sums. Article 4A represents a concerted effort by the Uniform Law Commissioners, the providers of funds transfer services and the corporate users of the system to draft uniform rules which equitably balance the interests of the affected parties. The banking community was afforded the opportunity to participate in the drafting of 4A and, while not all of the issues were resolved in the manner that banking might have wished, the proposed Article represents a considerable improvement over the present state of the law.

The task force urges the Board of Directors to consider the points raised in the task force report and vote in favor of the attached resolution.

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Big-Buck Transfers A Big Risk

The law tries to catch
up with technology.

BY MARCIA COYLE

National Law Journal Staff Reporter

TAKE A COOL half-billion dollars. Through the miracle of electronic wizardry, zip it from your bank account in Dallas to another account in Zurich — and pray that nothing goes wrong.

If prayers fail, prepare to enter the twilight zone of rights and liabilities, where technology has outpaced law, and law is scrambling to catch up.

The denizens of this uncomfortable twilight zone are big banks, big corpo-

rations, big bucks and big risks.

For nearly four years, a committee of the Uniform Law Commissioners, in conjunction with the American Law Institute, has been working feverishly to end the legal ambiguities surrounding so-called wholesale wire transfers, a particular way of making a dollar payment. That effort — expected to produce a new article to the Uniform Commercial Code — has often involved an intense battle between banking and corporate interests.

There is no comprehensive body of law governing wholesale wire transfers, as currently exists for checks and other types of payments, and the financial fallout can be enormous when errors occur. The average transfer — typically between banks and their corporate customers — is \$5 million, and total daily transfers now average more than \$1 trillion.

“When you look at the amount of money moving, it’s striking that there are no backstop rules,” says one bank lawyer. “People are transferring the net worth of their companies routinely and relying on private agreements with their banks, or no agreements at all.”

Risky Business

The wholesale wire transfer is basically a very simple transaction, says Prof. Robert L. Jordan of the University of California at Los Angeles School of Law, reporter for the ULC drafting committee. If, for example, someone in Los Angeles wants to make a payment to someone in New York, he simply tells his Los Angeles bank to send the money to the other person’s bank account in New York, explains the professor. By electronic transfer, the Los Angeles bank sends the payment order to the New York bank, which then credits the amount to the account of the so-called beneficiary — often before the money arrives from L.A.

Small-business users pick up the phone, call their bank and use a code word for authentication to order payment. Large corporate users, such as oil companies that engage in “Star Wars”-like transfers, may be so sophisticated that their computers talk to their banks, adds Thomas Baxter, associate general counsel of the Federal Reserve Bank of New York.

“You really have a spectrum of use,” says Mr. Baxter, who, along with the American Bar Association and others, has been advising and monitoring the ULC effort. “In the middle of all this, you have banks debiting accounts of senders and crediting the banks of receivers. We accomplish this by the wonders of technology.”

Wholesale wire transfers generally travel over two payment systems — the Fed Wire, operated by the Federal Reserve System, and CHIPS, the Clearing House Interbank Payments System in New York, the largest and only competitor to the Fed Wire. Another system — SWIFT — ties the U.S. systems with other international funds-transfer systems.

Although CHIPS and the Fed Wire have rules and regulations governing certain aspects of interbank transfers among their members, there are no rules governing the entire transaction — beginning with the so-called originator, who initiates a payment order, and ending with the so-called beneficiary, who gets paid.

Some banks and corporate users rely on private agreements to apportion risks if something goes wrong. "But there has been difficulty getting these agreements," says Mr. Baxter. "It also became clear over time that the rights of third parties could be affected by those agreements."

For example, he adds, what if there is a third-party intermediary bank in the transaction and it fails to settle, i.e., pay the balance? "Neither the originator nor the beneficiary may have se-

lected that bank," he explains. "Who bears the loss?"

There never has been a failure on the CHIPS system, says general counsel Norman Nelson, but that does not mean the clearinghouse is ignoring the potential for one. Although working with the ULC to draft a uniform law, CHIPS also has been working independently to ensure so-called settlement finality, he says.

"If a bank is unable to pay the balance, we're looking at having all other participants to the agreement pay pro rata to make sure the system will settle," Mr. Nelson explains.

CHIPS has 140 participants, international banks with offices in New York through which funds are transferred. "Our record day was the day after Memorial Day when we moved \$1.25 trillion," says Mr. Nelson. "On a normal day, we move \$600 billion to \$700 billion."



DIFFICULT: Washington attorney Carlyle C. Ring Jr. says it's difficult to work out uniform wire transfer laws.

Established in 1970, CHIPS, he says, has "grown and grown and grown," as has the entire wholesale wire transfer system. "The main thing now is to get a comprehensive body of law."

Commercial lawyers and others close to the wire-transfer field estimate that 90 percent of these transfers are now done without agreements covering rights and obligations.

Computer-Age Growth

Wire transfers have existed for many years, says ULC reporter Professor Jordan, but the volume of money moved has grown dramatically in the past two decades. One major reason for the increase in the number of wholesale wire transfers and their amounts is the arrival of computers, he explains.

Before the computer age, transfers were made on a more primitive basis, such as by paper-fed telex machines, recalls Professor Jordan.

"Along with the computer, there has grown up a whole new profession of cash managers who make sure that business is always using its money so it is earning money," he adds. "The ability to move instantly large sums of money from one part of the world to another has increased the volume of transfers.

"And the potential liability of banks has grown also, to the point where they have become very uncomfortable with the lack of any body of law governing what happens when something goes wrong."

The wholesale wire transfer, says Professor Jordan, is a system based on speed and low cost. The liability question for banks is very important, he explains, adding, "If you load up the liabilities, the costs will be greater."

Some of the financial land mines in the wholesale wire transfer are also a product of the new technology.

"There is now great danger that a computer hacker could get on the line, intercept a payment message and

change the beneficiary," says Professor Jordan. "Unauthorized messages also present great potential for fraud."

There also are potential bank insolvency problems, he adds. In many cases, the beneficiary bank pays the beneficiary before it gets the money from the originator bank, he explains. It is customary then for the beneficiary to immediately withdraw the money.

"If the originator bank becomes insolvent, the beneficiary bank has a problem and it's not clear whether the beneficiary bank can get its money back from the beneficiary," he says.

And then there are transfers involving multiple transactions, says Professor Jordan. "What happens if there is a large bank failure? It could set off a chain reaction of other banks failing because of the enormous sums of money they are dealing with."

When errors occur and banks and their corporate users find themselves in litigation, he says, the courts "have to make up the law as they go along."

Court decisions have been unsatisfactory, according to the professor, because courts must fall back on ordinary negligence rules or analogize the situation to problems involving the more traditional check.

"The rules governing payment by check don't always apply," he explains.

Mr. Baxter agrees, noting that in a check transfer, the authentication device is the signature of the drawer. "In the wire transfer world, we don't have any signature. We're getting into an area where the law is not that sophisticated. Payment law is built around the signature. Now we have to think about new alternatives."

Growing Pains

For the past four decades, the Uniform Commercial Code has been the "premiere product" of the ULC, a confederation of state commissioners on uniform laws, says Carlyle C. Ring Jr., of counsel to Washington, D.C.'s Ober, Kaler, Grimes & Shriver. But it was getting rapidly out of date, he adds.

Ten years ago, he recalls, the permanent editorial board of the UCC appointed a committee to look at whether the commercial code needed to be revised because of electronic developments. The committee launched an ambitious effort to draft a comprehensive payment code covering checks, wholesale wire transfers and other

payment instruments.

"The committee got into trouble because it was trying to do too much," explains Mr. Ring, a UCC board member. "Consumer groups and banks were not happy at all."

In 1986, the project was scaled down to focus only on wholesale wire transfers. "Uniform laws have been successful where we've been able to get the various interest groups together," says Mr. Ring. "When we step into an area of strong policy disagreement, it's very difficult to achieve uniformity."

If the uniform law effort fails to address the changing technology, he adds, the federal government will preempt the field. Pressures driving the modernization move, he says, include the Federal Reserve System's concern about major bank failures given the uncertainty over rights and liabilities, banks' anxiety over how they fare in the courts when problems occur and corporate users' demands for fair rules.

When the wholesale wire transfer project began three years ago, Mr. Ring, who is co-chairman of the ULC drafting committee, was in private practice. "My role was to be a neutral facilitator, to keep it on track." Today, still co-chairman, he is also general counsel and vice president of Atlantic Research Corp., a corporate user.

After roughly 12 drafts, proposed Article 4A, governing wholesale wire transfers, has the support of the banking and corporate communities and the Federal Reserve System, according to Mr. Ring, who calls the article "basically a safety net." It will not apply to consumer transactions, which continue to be governed by the federal Electronic Fund Transfer Act.

A 'Hard Fight'

But bringing those three groups together was neither easy nor pleasant, says Arthur L. Herold of Washington, D.C.'s Webster, Chamberlain & Bean.

Mr. Herold is not a member of the drafting committee, but he does represent the National Corporate Cash Management Association, an organization of corporate treasury officers. The cor-

porate community, he recalls, was not aware of the 4A movement until about a year after the drafting committee began work.

During that year, he and colleagues from Exxon, Shell Oil Co., Kidder Peabody and Sears, Roebuck and Co., attended drafting meetings where, he says, "We were treated as outsiders, shouted down and outvoted."

Throughout 1988, he recalls, his association built a coalition of the oil companies, insurance and railroad industries, and retailers to increase its "voice" at the drafting sessions.

"We felt 4A was being bank-driven," Mr. Herold says. "We don't object to a 4A that equitably distributes risks, but if the rules aren't fair, we'd rather take our chances in the courts."

"We told the committee if they wanted corporate support, they would have



ACTIVE: Thomas Baxter is associate general counsel of the Federal Reserve Bank of New York.

to begin to accommodate our concerns, and if they didn't care, we would have to vigorously oppose enactment of 4A in the states. That tended to get their attention."

Mr. Herold called the effort a "hard fight" that became unnecessarily hostile and personal at times. His association has taken a neutral position on Article 4A even though an internal vote showed more members would support it than oppose it. "We felt the members should feel free to express their own feelings," he says.

But whether Article 4A ultimately will be equitable or will impose significant risks on the corporate community, Mr. Herold says, is still unknown.

"The banks are free from a lot of risk," he adds. "Banks don't like having no law and don't like the current common law. If anyone has a worse reputation with juries than big corporations, it's banks. The banks felt it was better to play with rules than without, and they basically wrote the rules."

But Mr. Herold and others involved in the drafting process credit Professor Jordan for pulling the disparate interests together. "He's a special per-

son," says Mr. Herold. "We had great confidence in his fairness. Without him, I don't think this would ever have been done."

Article 4A, says Professor Jordan, tries to provide more certain rules for these transfers and to reduce the possibility of litigation. "It represents compromises and trade-offs," he explains. "We think we've come up with a fairly well-balanced statute for allocating risks and liabilities."

Into the States

The proposed Article 4A already has been approved by the American Law Institute. Following ULC approval, the next step will be to win enactment in state legislatures, says Mr. Ring.

"Our goal is to pick up four or five big banking states — New York, California, Texas, Illinois, Georgia and Massachusetts — and then the remaining states, we think, will move quickly," he says. "The rest will want to act rapidly to preserve banking business for themselves and because the courts probably will adopt the rules of 4A even before the legislatures act."

Taking the uniform law route is often time-consuming, notes Mr. Ring, adding there was considerable debate about whether new rules should be enacted instead at the federal level.

"But the federal government and the other parties are willing to give us a chance to use the prestige of the UCC to get these rules adopted," he says.

There has been historical deference to state development of commercial law, he explains. The Federal Reserve, he adds, is reluctant to take on new and substantial regulation. And Congress, he says, has become "such a grab bag" that the banking and corporate communities feared legislation could become enmeshed in extraneous issues.

Most uniform laws, Mr. Ring says, draw on experiments in states or other nations. But Article 4A, he adds, did not fit the pattern. England, Japan and the United Nations are looking to the ULC for guidance on similar projects.

"We're not looking at any models because there are none," he says. "As a matter of fact, we're ahead of the rest of the world."



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ABA ENDORSES ADDITION TO THE UNIFORM COMMERCIAL CODE AFFECTING WIRE TRANSFERS

WASHINGTON, December 8 -- The Board of Directors of the American Bankers Association has endorsed the addition of Article 4A to the Uniform Commercial Code (UCC) -- the model law which governs commercial transactions -- and urged state legislatures to adopt it.

"The Board of Directors has reviewed the report of the American Bankers Association's Ad Hoc Payment Systems Laws Task Force and recognizes the need for comprehensive and uniform law to govern wholesale funds transfers," according to a resolution approved by the ABA Board.

The UCC is a complex set of legal rules which have been approved by all 50 state legislatures, in part or in its entirety. The code structures the relationship of parties to a variety of commercial transactions, including sales contracts, letters of credit and check collection.

Article 4A clarifies for banks and their customers the terms and limitations of damages from wire transfers which may be late or improperly executed. Some of the issues addressed in Article 4A include:

- * rules governing the time and manner of execution of payment orders;
- * the measure of damages for late execution or failure to execute;
- * resolution procedures for erroneous transfers, allocation of risk of loss from unauthorized payment orders;
- * the customer's duty to discover and report erroneous or unauthorized payments; and,
- * the duties of a beneficiary's bank to the beneficiary.

In a report to the ABA Board, the Ad Hoc Task Force said, "...the present lack of comprehensive rules governing funds transfers must be remedied if this method of payment is to remain a fast, reliable and low cost system of

ARTICLE 4A/P2

transmitting large sums."

"Article 4A represents a concerted effort by the Uniform Law Commissioners, the providers of funds transfer services and the corporate users of the system to draft uniform rules which equitably balance the interests of the affected parties," the Task Force said.

Article 4A has already been approved by both of its sponsoring bodies, The American Law Institute and the National Conference of Commissioners on Uniform State Laws. This model law will next be considered by individual states for adoption. The resolution passed by the ABA Board encouraged state legislatures to enact 4A into law "in an expeditious manner."

ABA has been active in the development of Article 4A since 1985. Task Force Chairman W. Robert Moore and other bankers had numerous opportunities to review and comment on the various drafts of Article 4A. Moore, who is retired, had been senior vice president of Chemical Bank, New York.

In addition, ABA held a one-day symposium on Article 4A last November to help educate bankers on the proposed changes and the affects the article will have on the banking industry and bank customers.

The American Bankers Association is the national trade and professional association for America's commercial banks of all sizes. Assets of ABA member banks are about 95 percent of the industry total.

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APPENDIX 3

UNIFORM COMMERCIAL CODE

ARTICLE 4A - FUNDS TRANSFERS

ARTICLE 4A - FUNDS TRANSFERS

PREFATORY NOTE

The National Conference of Commissioners on Uniform State laws and The American Law Institute have approved a new Article 4A to the Uniform Commercial Code. Comments that follow each of the sections of the statute are intended as official comments. They explain in detail the purpose and meaning of the various sections and the policy considerations on which they are based.

Description of transaction covered by Article 4A.

There are a number of mechanisms for making payments through the banking system. Most of these mechanisms are covered in whole or part by state or federal statutes. In terms of number of transactions, payments made by check or credit card are the most common payment methods. Payment by check is covered by Articles 3 and 4 of the UCC and some aspects of payment by credit card are covered by federal law. In recent years electronic funds transfers have been increasingly common in consumer transactions. For example, in some cases a retail customer can pay for purchases by use of an access or debit card inserted in a terminal at the retail store that allows the bank account of the customer to be instantly debited. Some aspects of these point-of-sale transactions and other consumer payments that are effected electronically are covered by a federal statute, the Electronic Fund Transfer Act (EFTA). If any part of a funds transfer is covered by EFTA, the entire funds transfer is excluded from Article 4A.

Another type of payment, commonly referred to as a wholesale wire transfer, is the primary focus of Article 4A. Payments that are covered by Article 4A are overwhelmingly between business or financial institutions. The dollar volume of payments made by wire transfer far exceeds the dollar volume of payments made by other means. The volume of payments by wire transfer over the two principal wire payment systems -- the Federal Reserve wire transfer network (Fedwire) and the New York Clearing House Interbank Payments Systems (CHIPS) -- exceeds one trillion dollars per day. Most payments carried out by use of automated clearing houses are consumer payments covered by EFTA and therefore not covered by Article 4A. There is, however, a significant volume of non-consumer ACH payments that closely resemble wholesale wire transfers. These payments are also covered by Article 4A.

There is some resemblance between payments made by wire transfer and payments made by other means such as paper-based checks and credit cards or electronically-based consumer payments, but there are also many differences. Article 4A excludes from its coverage these other payment mechanisms. Article 4A follows a policy of treating the transaction that it covers -- a "funds transfer" -- as a unique method of

payment that is governed by unique principles of law that address the operational and policy issues presented by this kind of payment.

The funds transfer that is covered by Article 4A is not a complex transaction and can be illustrated by the following example which is used throughout the Prefatory Note as a basis for discussion. X, a debtor, wants to pay an obligation owed to Y. Instead of delivering to Y a negotiable instrument such as a check or some other writing such as a credit card slip that enables Y to obtain payment from a bank, X transmits an instruction to X's bank to credit a sum of money to the bank account of Y. In most cases X's bank and Y's bank are different banks. X's bank may carry out X's instruction by instructing Y's bank to credit Y's account in the amount that X requested. The instruction that X issues to its bank is a "payment order." X is the "sender" of the payment order and X's bank is the "receiving bank" with respect to X's order. Y is the "beneficiary" of X's order. When X's bank issues an instruction to Y's bank to carry out X's payment order, X's bank "executes" X's order. The instruction of X's bank to Y's bank is also a payment order. With respect to that order, X's bank is the sender, Y's bank is the receiving bank, and Y is the beneficiary. The entire series of transactions by which X pays Y is known as the "funds transfer." With respect to the funds transfer, X is the "originator," X's bank is the "originator's bank," Y is the "beneficiary" and Y's bank is the "beneficiary's bank." In more complex transactions there are one or more additional banks known as "intermediary banks" between X's bank and Y's bank. In the funds transfer the instruction contained in the payment order of X to its bank is carried out by a series of payment orders by each bank in the transmission chain to the next bank in the chain until Y's bank receives a payment order to make the credit to Y's account. In most cases, the payment order of each bank to the next bank in the chain is transmitted electronically, and often the payment order of X to its bank is also transmitted electronically, but the means of transmission does not have any legal significance. A payment order may be transmitted by any means, and in some cases the payment order is transmitted by a slow means such as first class mail. To reflect this fact, the broader term "funds transfer" rather than the narrower term "wire transfer" is used in Article 4A to describe the overall payment transaction.

Funds transfers are divided into two categories determined by whether the instruction to pay is given by the person making payment or the person receiving payment. If the instruction is given by the person making the payment, the transfer is commonly referred to as a "credit transfer." If the instruction is given by the person receiving payment, the transfer is commonly referred to as a "debit transfer." Article 4A governs credit transfers and excludes debit transfers.

Why is Article 4A needed?

There is no comprehensive body of law that defines the rights and obligations that arise from wire transfers. Some aspects of wire transfers are governed by rules of the principal transfer systems. Transfers made by Fedwire are governed by Federal Reserve Regulation J and transfers over CHIPS are governed by the CHIPS rules. Transfers made by means of automated clearing houses are governed by uniform rules adopted by various associations of banks in various parts of the nation or by Federal Reserve rules or operating circulars. But the various funds transfer system rules apply to only limited aspects of wire transfer transactions. The resolution of the many issues that are not covered by funds transfer system rules depends on contracts of the parties, to the extent that they exist, or principles of law applicable to other payment mechanisms that might be applied by analogy. The result is a great deal of uncertainty. There is no consensus about the juridical nature of a wire transfer and consequently of the rights and obligations that are created. Article 4A is intended to provide the comprehensive body of law that we do not have today.

Characteristics of a funds transfer.

There are a number of characteristics of funds transfers covered by Article 4A that have influenced the drafting of the statute. The typical funds transfer involves a large amount of money. Multimillion dollar transactions are commonplace. The originator of the transfer and the beneficiary are typically sophisticated business or financial organizations. High speed is another predominant characteristic. Most funds transfers are completed on the same day, even in complex transactions in which there are several intermediary banks in the transmission chain. A funds transfer is a highly efficient substitute for payments made by the delivery of paper instruments. Another characteristic is extremely low cost. A transfer that involves many millions of dollars can be made for a price of a few dollars. Price does not normally vary very much or at all with the amount of the transfer. This system of pricing may not be feasible if the bank is exposed to very large liabilities in connection with the transaction. The pricing system assumes that the price reflects primarily the cost of the mechanical operation performed by the bank, but in fact, a bank may have more or less potential liability with respect to a funds transfer depending upon the amount of the transfer. Risk of loss to banks carrying out a funds transfer may arise from a variety of causes. In some funds transfers, there may be extensions of very large amounts of credit for short periods of time by the banks that carry out a funds transfer. If a payment order is issued to the beneficiary's bank, it is normal for the bank to release funds to the beneficiary immediately. Sometimes, payment to the beneficiary's bank by the bank that issued the order to the beneficiary's bank is delayed until the end of the day. If that payment is not received because of the insolvency of the bank that is obliged to pay, the beneficiary's bank may suffer a loss. There is also risk of loss if a bank fails to execute the payment order of a customer, or if the order is executed late.

There also may be an error in the payment order issued by a bank that is executing the payment order of its customer. For example, the error might relate to the amount to be paid or to the identity of the person to be paid. Because the dollar amounts involved in funds transfers are so large, the risk of loss if something goes wrong in a transaction may also be very large. A major policy issue in the drafting of Article 4A is that of determining how risk of loss is to be allocated given the price structure in the industry.

Concept of acceptance and effect of acceptance
by the beneficiary's bank.

Rights and obligations under Article 4A arise as the result of "acceptance" of a payment order by the bank to which the order is addressed. Section 4A-209. The effect of acceptance varies depending upon whether the payment order is issued to the beneficiary's bank or to a bank other than the beneficiary's bank. Acceptance by the beneficiary's bank is particularly important because it defines when the beneficiary's bank becomes obligated to the beneficiary to pay the amount of the payment order. Although Article 4A follows convention in using the term "funds transfer" to identify the payment from X to Y that is described above, no money or property right of X is actually transferred to Y. X pays Y by causing Y's bank to become indebted to Y in the amount of the payment. This debt arises when Y's bank accepts the payment order that X's bank issued to Y's bank to execute X's order. If the funds transfer was carried out by use of one or more intermediary banks between X's bank and Y's bank, Y's bank becomes indebted to Y when Y's bank accepts the payment order issued to it by an intermediary bank. The funds transfer is completed when this debt is incurred. Acceptance, the event that determines when the debt of Y's bank to Y arises, occurs (i) when Y's bank pays Y or notifies Y of receipt of the payment order, or (ii) when Y's bank receives payment from the bank that issued a payment order to Y's bank.

The only obligation of the beneficiary's bank that results from acceptance of a payment order is to pay the amount of the order to the beneficiary. No obligation is owed to either the sender of the payment order accepted by the beneficiary's bank or to the originator of the funds transfer. The obligation created by acceptance by the beneficiary's bank is for the benefit of the beneficiary. The purpose of the sender's payment order is to effect payment by the originator to the beneficiary and that purpose is achieved when the beneficiary's bank accepts the payment order. Section 4A-405 states rules for determining when the obligation of the beneficiary's bank to the beneficiary has been paid.

Acceptance by a bank other than the beneficiary's bank.

In the funds transfer described above, what is the obligation of X's bank when it receives X's payment order? Funds transfers by a bank

on behalf of its customer are made pursuant to an agreement or arrangement that may or may not be reduced to a formal document signed by the parties. It is probably true that in most cases there is either no express agreement or the agreement addresses only some aspects of the transaction. Substantial risk is involved in funds transfers and a bank may not be willing to give this service to all customers, and may not be willing to offer it to any customer unless certain safeguards against loss such as security procedures are in effect. Funds transfers often involve the giving of credit by the receiving bank to the customer, and that also may involve an agreement. These considerations are reflected in Article 4A by the principle that, in the absence of a contrary agreement, a receiving bank does not incur liability with respect to a payment order until it accepts it. If X and X's bank in the hypothetical case had an agreement that obliged the bank to act on X's payment orders and the bank failed to comply with the agreement, the bank can be held liable for breach of the agreement. But apart from any obligation arising by agreement, the bank does not incur any liability with respect to X's payment order until the bank accepts the order. X's payment order is treated by Article 4A as a request by X to the bank to take action that will cause X's payment order to be carried out. That request can be accepted by X's bank by "executing" X's payment order. Execution occurs when X's bank sends a payment order to Y's bank intended by X's bank to carry out the payment order of X. X's bank could also execute X's payment order by issuing a payment order to an intermediary bank instructing the intermediary bank to instruct Y's bank to make the credit to Y's account. In that case execution and acceptance of X's order occur when the payment order of X's bank is sent to the intermediary bank. When X's bank executes X's payment order the bank is entitled to receive payment from X and may debit an authorized account of X. If X's bank does not execute X's order and the amount of the order is covered by a withdrawable credit balance in X's authorized account, the bank must pay X interest on the money represented by X's order unless X is given prompt notice of rejection of the order. Section 4A-210(b).

Bank error in funds transfers.

If a bank, other than the beneficiary's bank, accepts a payment order, the obligations and liabilities are owed to the originator of the funds transfer. Assume in the example stated above, that X's bank executes X's payment order by issuing a payment order to an intermediary bank that executes the order of X's bank by issuing a payment order to Y's bank. The obligations of X's bank with respect to execution are owed to X. The obligations of the intermediary bank with respect to execution are also owed to X. Section 4A-302 states standards with respect to the time and manner of execution of payment orders. Section 4A-305 states the measure of damages for improper execution. It also states that a receiving bank is liable for damages if it fails to execute a payment order that it was obliged by express agreement to execute. In each case consequential damages are not recoverable unless an express agreement of the receiving bank provides for them. The

policy basis for this limitation is discussed in Comment 2 to Section 4A-305.

Error in the consummation of a funds transfer is not uncommon. There may be a discrepancy in the amount that the originator orders to be paid to the beneficiary and the amount that the beneficiary's bank is ordered to pay. For example, if the originator's payment order instructs payment of \$100,000 and the payment order of the originator's bank instructs payment of \$1,000,000, the originator's bank is entitled to receive only \$100,000 from the originator and has the burden of recovering the additional \$900,000 paid to the beneficiary by mistake. In some cases the originator's bank or an intermediary bank instructs payment to a beneficiary other than the beneficiary stated in the originator's payment order. If the wrong beneficiary is paid the bank that issued the erroneous payment order is not entitled to receive payment of the payment order that it executed and has the burden of recovering the mistaken payment. The originator is not obliged to pay its payment order. Section 4A-303 and Section 4A-207 state rules for determining the rights and obligations of the various parties to the funds transfer in these cases and in other typical cases in which error is made.

Pursuant to Section 4A-402(c) the originator is excused from the obligation to pay the originator's bank if the funds transfer is not completed, i.e. payment by the originator to the beneficiary is not made. Payment by the originator to the beneficiary occurs when the beneficiary's bank accepts a payment order for the benefit of the beneficiary of the originator's payment order. Section 4A-406. If for any reason that acceptance does not occur, the originator is not required to pay the payment order that it issued or, if it already paid, is entitled to refund of the payment with interest. This "money-back guarantee" is an important protection of the originator of a funds transfer. The same rule applies to any other sender in the funds transfer. Each sender's obligation to pay is excused if the beneficiary's bank does not accept a payment order for the benefit of the beneficiary of that sender's order. There is an important exception to this rule. It is common practice for the originator of a funds transfer to designate the intermediary bank or banks through which the funds transfer is to be routed. The originator's bank is required by Section 4A-302 to follow the instruction of the originator with respect to intermediary banks. If the originator's bank sends a payment order to the intermediary bank designated in the originator's order and the intermediary bank causes the funds transfer to miscarry by failing to execute the payment order or by instructing payment to the wrong beneficiary, the originator's bank is not required to pay its payment order and if it has already paid it is entitled to recover payment from the intermediary bank. This remedy is normally adequate, but if the originator's bank already paid its order and the intermediary bank has suspended payments or is not permitted by law to refund payment, the originator's bank will suffer a loss. Since the originator required the originator's bank to use the failed intermediary bank, Section 4A-402(e) provides that in this case the originator is obliged to pay its payment order and has a claim against the intermediary bank for the amount of

the order. The same principle applies to any other sender that designates a subsequent intermediary bank.

Unauthorized payment orders.

An important issue addressed in Section 4A-202 and Section 4A-203 is how the risk of loss from unauthorized payment orders is to be allocated. In a large percentage of cases, the payment order of the originator of the funds transfer is transmitted electronically to the originator's bank. In these cases it may not be possible for the bank to know whether the electronic message has been authorized by its customer. To ensure that no unauthorized person is transmitting messages to the bank, the normal practice is to establish security procedures that usually involve the use of codes or identifying numbers or words. If the bank accepts a payment order that purports to be that of its customer after verifying its authenticity by complying with a security procedure agreed to by the customer and the bank, the customer is bound to pay the order even if it was not authorized. But there is an important limitation on this rule. The bank is entitled to payment in the case of an unauthorized order only if the court finds that the security procedure was a commercially reasonable method of providing security against unauthorized payment orders. The customer can also avoid liability if it can prove that the unauthorized order was not initiated by an employee or other agent of the customer having access to confidential security information or by a person who obtained that information from a source controlled by the customer. The policy issues are discussed in the comments following Section 4A-203. If the bank accepts an unauthorized payment order without verifying it in compliance with a security procedure, the loss falls on the bank.

Security procedures are also important in cases of error in the transmission of payment orders. There may be an error by the sender in the amount of the order, or a sender may transmit a payment order and then erroneously transmit a duplicate of the order. Normally, the sender is bound by the payment order even if it is issued by mistake. But in some cases an error of this kind can be detected by a security procedure. Although the receiving bank is not obliged to provide a security procedure for the detection of error, if such a procedure is agreed to by the bank Section 4A-205 provides that if the error is not detected because the receiving bank does not comply with the procedure, any resulting loss is borne by the bank failing to comply with the security procedure.

Insolvency losses.

Some payment orders do not involve the granting of credit to the sender by the receiving bank. In those cases, the receiving bank accepts the sender's order at the same time the bank receives payment of the order. This is true of a transfer of funds by Fedwire or of cases in which the receiving bank can debit a funded account of the sender.

But in some cases the granting of credit is the norm. This is true of a payment order over CHIPS. In a CHIPS transaction the receiving bank usually will accept the order before receiving payment from the sending bank. Payment is delayed until the end of the day when settlement is made through the Federal Reserve System. If the receiving bank is an intermediary bank, it will accept by issuing a payment order to another bank and the intermediary bank is obliged to pay that payment order. If the receiving bank is the beneficiary's bank, the bank usually will accept by releasing funds to the beneficiary before the bank has received payment. If a sending bank suspends payments before settling its liabilities at the end of the day, the financial stability of banks that are net creditors of the insolvent bank may also be put into jeopardy, because the dollar volume of funds transfers between the banks may be extremely large. With respect to two banks that are dealing with each other in a series of transactions in which each bank is sometimes a receiving bank and sometimes a sender, the risk of insolvency can be managed if amounts payable as a sender and amounts receivable as a receiving bank are roughly equal. But if these amounts are significantly out of balance, a net creditor bank may have a very significant credit risk during the day before settlement occurs. The Federal Reserve System and the banking community are greatly concerned with this risk, and various measures have been instituted to reduce this credit exposure. Article 4A also addresses this problem. A receiving bank can always avoid this risk by delaying acceptance of a payment order until after the bank has received payment. For example, if the beneficiary's bank credits the beneficiary's account it can avoid acceptance by not notifying the beneficiary of the receipt of the order or by notifying the beneficiary that the credit may not be withdrawn until the beneficiary's bank receives payment. But if the beneficiary's bank releases funds to the beneficiary before receiving settlement, the result in a funds transfer other than a transfer by means of an automated clearing house or similar provisional settlement system is that the beneficiary's bank may not recover the funds if it fails to receive settlement. This rule encourages the banking system to impose credit limitations on banks that issue payment orders. These limitations are already in effect. CHIPS has also proposed a loss-sharing plan to be adopted for implementation in the second half of 1990 under which CHIPS participants will be required to provide funds necessary to complete settlement of the obligations of one or more participants that are unable to meet settlement obligations. Under this plan, it will be a virtual certainty that there will be settlement on CHIPS in the event of failure by a single bank. Section 4A-403(b) and (c) are also addressed to reducing risks of insolvency. Under these provisions the amount owed by a failed bank with respect to payment orders it issued is the net amount owing after setting off amounts owed to the failed bank with respect to payment orders it received. This rule allows credit exposure to be managed by limitations on the net debit position of a bank.

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MISCELLANEOUS PROVISIONS

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1 ARTICLE 4A

2 FUNDS TRANSFERS

3 PART 1

4 SUBJECT MATTER AND DEFINITIONS

5 § 4A-101. SHORT TITLE

6 This Article may be cited as Uniform Commercial Code--Funds
7 Transfers.

8 § 4A-102. SUBJECT MATTER

9 Except as otherwise provided in Section 4A-108, this Article
10 applies to funds transfers defined in Section 4A-104.

11 COMMENT

12 Article 4A governs a specialized method of payment referred to in
13 the Article as a funds transfer but also commonly referred to in the
14 commercial community as a wholesale wire transfer. A funds transfer is
15 made by means of one or more payment orders. The scope of Article 4A is
16 determined by the definitions of "payment order" and "funds transfer"
17 found in Section 4A-103 and Section 4A-104.

18 The funds transfer governed by Article 4A is in large part a prod-
19 uct of recent and developing technological changes. Before this Article
20 was drafted there was no comprehensive body of law -- statutory or judi-
21 cial -- that defined the juridical nature of a funds transfer or the
22 rights and obligations flowing from payment orders. Judicial authority
23 with respect to funds transfers is sparse, undeveloped and not uniform.
24 Judges have had to resolve disputes by referring to general principles
25 of common law or equity, or they have sought guidance in statutes such
26 as Article 4 which are applicable to other payment methods. But at-
27 tempts to define rights and obligations in funds transfers by general
28 principles or by analogy to rights and obligations in negotiable instru-
29 ment law or the law of check collection have not been satisfactory.

30 In the drafting of Article 4A, a deliberate decision was made to
31 write on a clean slate and to treat a funds transfer as a unique method
32 of payment to be governed by unique rules that address the particular
33 issues raised by this method of payment. A deliberate decision was also

1 made to use precise and detailed rules to assign responsibility, define
2 behavioral norms, allocate risks and establish limits on liability,
3 rather than to rely on broadly stated, flexible principles. In the
4 drafting of these rules, a critical consideration was that the various
5 parties to funds transfers need to be able to predict risk with cer-
6 tainty, to insure against risk, to adjust operational and security
7 procedures, and to price funds transfer services appropriately. This
8 consideration is particularly important given the very large amounts of
9 money that are involved in funds transfers.

10 Funds transfers involve competing interests -- those of the banks
11 that provide funds transfer services and the commercial and financial
12 organizations that use the services, as well as the public interest.
13 These competing interests were represented in the drafting process and
14 they were thoroughly considered. The rules that emerged represent a
15 careful and delicate balancing of those interests and are intended to be
16 the exclusive means of determining the rights, duties and liabilities of
17 the affected parties in any situation covered by particular provisions
18 of the Article. Consequently, resort to principles of law or equity
19 outside of Article 4A is not appropriate to create rights, duties and
20 liabilities inconsistent with those stated in this Article.

21 § 4A-103. PAYMENT ORDER - DEFINITIONS

22 (a) In this Article:

23 (1) "Payment order" means an instruction of a sender to
24 a receiving bank, transmitted orally, electronically, or in
25 writing, to pay, or to cause another bank to pay, a fixed or
26 determinable amount of money to a beneficiary if:

27 (i) the instruction does not state a condition to
28 payment to the beneficiary other than time of payment,

29 (ii) the receiving bank is to be reimbursed by
30 debiting an account of, or otherwise receiving payment from, the
31 sender, and

32 (iii) the instruction is transmitted by the sender
33 directly to the receiving bank or to an agent, funds-transfer

1 system, or communication system for transmittal to the receiving
2 bank.

3 (2) "Beneficiary" means the person to be paid by the
4 beneficiary's bank.

5 (3) "Beneficiary's bank" means the bank identified in a
6 payment order in which an account of the beneficiary is to be
7 credited pursuant to the order or which otherwise is to make
8 payment to the beneficiary if the order does not provide for
9 payment to an account.

10 (4) "Receiving bank" means the bank to which the
11 sender's instruction is addressed.

12 (5) "Sender" means the person giving the instruction to
13 the receiving bank.

14 (b) If an instruction complying with subsection (a)(1) is to
15 make more than one payment to a beneficiary, the instruction is a
16 separate payment order with respect to each payment.

17 (c) A payment order is issued when it is sent to the
18 receiving bank.

19 COMMENT

20 This section is discussed in the Comment following Section 4A-104.

21 § 4A-104. FUNDS TRANSFER - DEFINITIONS

22 In this Article:

23 (a) "Funds transfer" means the series of transactions, begin-
24 ning with the originator's payment order, made for the purpose of
25 making payment to the beneficiary of the order. The term includes

1 any payment order issued by the originator's bank or an intermedi-
2 ary bank intended to carry out the originator's payment order. A
3 funds transfer is completed by acceptance by the beneficiary's bank
4 of a payment order for the benefit of the beneficiary of the orig-
5 inator's payment order.

6 (b) "Intermediary bank" means a receiving bank other than the
7 originator's bank or the beneficiary's bank.

8 (c) "Originator" means the sender of the first payment order
9 in a funds transfer.

10 (d) "Originator's bank" means (i) the receiving bank to which
11 the payment order of the originator is issued if the originator is
12 not a bank, or (ii) the originator if the originator is a bank.

13 COMMENT

14 1. Article 4A governs a method of payment in which the person
15 making payment (the "originator") directly transmits an instruction to a
16 bank either to make payment to the person receiving payment (the "bene-
17 ficiary") or to instruct some other bank to make payment to the bene-
18 ficiary. The payment from the originator to the beneficiary occurs when
19 the bank that is to pay the beneficiary becomes obligated to pay the
20 beneficiary. There are two basic definitions: "Payment order" stated
21 in Section 4A-103 and "Funds transfer" stated in Section 4A-104. These
22 definitions, other related definitions, and the scope of Article 4A can
23 best be understood in the context of specific fact situations. Consider
24 the following cases:

25 Case #1. X, which has an account in Bank A, instructs that bank to
26 pay \$1,000,000 to Y's account in Bank A. Bank A carries out X's in-
27 struction by making a credit of \$1,000,000 to Y's account and notifying
28 Y that the credit is available for immediate withdrawal. The instruc-
29 tion by X to Bank A is a "payment order" which was issued when it was
30 sent to Bank A. Section 4A-103(a)(1) and (c). X is the "sender" of the
31 payment order and Bank A is the "receiving bank." Section 4A-103(a)(5)
32 and (a)(4). Y is the "beneficiary" of the payment order and Bank A is
33 the "beneficiary's bank." Section 4A-103(a)(2) and (a)(3). When Bank
34 A notified Y of receipt of the payment order, Bank A "accepted" the
35 payment order. Section 4A-209(b)(1). When Bank A accepted the order it
36 incurred an obligation to Y to pay the amount of the order. Section
37 4A-404(a). When Bank A accepted X's order, X incurred an obligation to
38 pay Bank A the amount of the order. Section 4A-402(b). Payment from X

1 to Bank A would normally be made by a debit to X's account in Bank A.
2 Section 4A-403(a)(3). At the time Bank A incurred the obligation to pay
3 Y, payment of \$1,000,000 by X to Y was also made. Section 4A-406(a).
4 Bank A paid Y when it gave notice to Y of a withdrawable credit of
5 \$1,000,000 to Y's account. Section 4A-405(a). The overall transaction,
6 which comprises the acts of X and Bank A, in which the payment by X to Y
7 is accomplished is referred to as the "funds transfer." Section 4A-
8 104(a). In this case only one payment order was involved in the funds
9 transfer. A one-payment-order funds transfer is usually referred to as
10 a "book transfer" because the payment is accomplished by the receiving
11 bank's debiting the account of the sender and crediting the account of
12 the beneficiary in the same bank. X, in addition to being the sender of
13 the payment order to Bank A, is the "originator" of the funds transfer.
14 Section 4A-104(c). Bank A is the "originator's bank" in the funds
15 transfer as well as the beneficiary's bank. Section 4A-104(d).

16 Case #2. Assume the same facts as in Case #1 except that X in-
17 structs Bank A to pay \$1,000,000 to Y's account in Bank B. With respect
18 to this payment order, X is the sender, Y is the beneficiary, and Bank A
19 is the receiving bank. Bank A carries out X's order by instructing Bank
20 B to pay \$1,000,000 to Y's account. This instruction is a payment order
21 in which Bank A is the sender, Bank B is the receiving bank, and Y is
22 the beneficiary. When Bank A issued its payment order to Bank B, Bank A
23 "executed" X's order. Section 4A-301(a). In the funds transfer, X is
24 the originator, Bank A is the originator's bank, and Bank B is the
25 beneficiary's bank. When Bank A executed X's order, X incurred an
26 obligation to pay Bank A the amount of the order. Section 4A-402(c).
27 When Bank B accepts the payment order issued to it by Bank A, Bank B
28 incurs an obligation to Y to pay the amount of the order (Section 4A-404
29 (a)) and Bank A incurs an obligation to pay Bank B. Section 4A-402(b).
30 Acceptance by Bank B also results in payment of \$1,000,000 by X to Y.
31 Section 4A-406(a). In this case two payment orders are involved in the
32 funds transfer.

33 Case #3. Assume the same facts as in Case #2 except that Bank A
34 does not execute X's payment order by issuing a payment order to Bank B.
35 One bank will not normally act to carry out a funds transfer for another
36 bank unless there is a preexisting arrangement between the banks for
37 transmittal of payment orders and settlement of accounts. For example,
38 if Bank B is a foreign bank with which Bank A has no relationship, Bank
39 A can utilize a bank that is a correspondent of both Bank A and Bank B.
40 Assume Bank A issues a payment order to Bank C to pay \$1,000,000 to Y's
41 account in Bank B. With respect to this order, Bank A is the sender,
42 Bank C is the receiving bank, and Y is the beneficiary. Bank C will ex-
43 ecute the payment order of Bank A by issuing a payment order to Bank B
44 to pay \$1,000,000 to Y's account in Bank B. With respect to Bank C's
45 payment order, Bank C is the sender, Bank B is the receiving bank, and Y
46 is the beneficiary. Payment of \$1,000,000 by X to Y occurs when Bank B
47 accepts the payment order issued to it by Bank C. In this case the
48 funds transfer involves three payment orders. In the funds transfer, X
49 is the originator, Bank A is the originator's bank, Bank B is the ben-
50 efiary's bank, and Bank C is an "intermediary bank." Section 4A-104

1 (b). In some cases there may be more than one intermediary bank, and in
2 those cases each intermediary bank is treated like Bank C in Case #3.

3 As the three cases demonstrate, a payment under Article 4A involves
4 an overall transaction, the funds transfer, in which the originator, X,
5 is making payment to the beneficiary, Y, but the funds transfer may en-
6 compass a series of payment orders that are issued in order to effect
7 the payment initiated by the originator's payment order.

8 In some cases the originator and the beneficiary may be the same
9 person. This will occur, for example, when a corporation orders a bank
10 to transfer funds from an account of the corporation in that bank to
11 another account of the corporation in that bank or in some other bank.
12 In some funds transfers the first bank to issue a payment order is a
13 bank that is executing a payment order of a customer that is not a bank.
14 In this case the customer is the originator. In other cases, the first
15 bank to issue a payment order is not acting for a customer, but is
16 making a payment for its own account. In that event the first bank to
17 issue a payment order is the originator as well as the originator's
18 bank.

19 2. "Payment order" is defined in Section 4A-103(a)(1) as an in-
20 struction to a bank to pay, or to cause another bank to pay, a fixed or
21 determinable amount of money. The bank to which the instruction is ad-
22 dressed is known as the "receiving bank." Section 4A-103(a)(4). "Bank"
23 is defined in Section 4A-105(a)(2). The effect of this definition is to
24 limit Article 4A to payments made through the banking system. A trans-
25 fer of funds made by an entity outside the banking system is excluded.
26 A transfer of funds through an entity other than a bank is usually a
27 consumer transaction involving relatively small amounts of money and a
28 single contract carried out by transfers of cash or a cash equivalent
29 such as a check. Typically, the transferor delivers cash or a check to
30 the company making the transfer, which agrees to pay a like amount to a
31 person designated by the transferor. Transactions covered by Article 4A
32 typically involve very large amounts of money in which several transac-
33 tions involving several banks may be necessary to carry out the payment.
34 Payments are normally made by debits or credits to bank accounts. Orig-
35 inators and beneficiaries are almost always business organizations and
36 the transfers are usually made to pay obligations. Moreover, these
37 transactions are frequently done on the basis of very short-term credit
38 granted by the receiving bank to the sender of the payment order.
39 Wholesale wire transfers involve policy questions that are distinct from
40 those involved in consumer-based transactions by nonbanks.

41 3. Further limitations on the scope of Article 4A are found in
42 the three requirements found in subparagraphs (i), (ii), and (iii) of
43 Section 4A-103(a)(1). Subparagraph (i) states that the instruction to
44 pay is a payment order only if it "does not state a condition to payment
45 to the beneficiary other than time of payment." An instruction to pay a
46 beneficiary sometimes is subject to a requirement that the beneficiary
47 perform some act such as delivery of documents. For example, a New York
48 bank may have issued a letter of credit in favor of X, a California

1 seller of goods to be shipped to the New York bank's customer in New
2 York. The terms of the letter of credit provide for payment to X if
3 documents are presented to prove shipment of the goods. Instead of
4 providing for presentment of the documents to the New York bank, the
5 letter of credit states that they may be presented to a California bank
6 that acts as an agent for payment. The New York bank sends an instruc-
7 tion to the California bank to pay X upon presentation of the required
8 documents. The instruction is not covered by Article 4A because payment
9 to the beneficiary is conditional upon receipt of shipping documents.
10 The function of banks in a funds transfer under Article 4A is comparable
11 to the role of banks in the collection and payment of checks in that it
12 is essentially mechanical in nature. The low price and high speed that
13 characterize funds transfers reflect this fact. Conditions to payment
14 by the California bank other than time of payment impose responsibil-
15 ities on that bank that go beyond those in Article 4A funds transfers.
16 Although the payment by the New York bank to X under the letter of
17 credit is not covered by Article 4A, if X is paid by the California
18 bank, payment of the obligation of the New York bank to reimburse the
19 California bank could be made by an Article 4A funds transfer. In such
20 a case there is a distinction between the payment by the New York bank
21 to X under the letter of credit and the payment by the New York bank to
22 the California bank. For example, if the New York bank pays its
23 reimbursement obligation to the California bank by a Fedwire naming the
24 California bank as beneficiary (see Comment 1 to Section 4A-107),
25 payment is made to the California bank rather than to X. That payment
26 is governed by Article 4A and it could be made either before or after
27 payment by the California bank to X. The payment by the New York bank
28 to X under the letter of credit is not governed by Article 4A and it
29 occurs when the California bank, as agent of the New York bank, pays X.
30 No payment order was involved in that transaction. In this example, if
31 the New York bank had erroneously sent an instruction to the California
32 bank unconditionally instructing payment to X, the instruction would
33 have been an Article 4A payment order. If the payment order was accept-
34 ed (Section 4A-209(b)) by the California bank, a payment by the New York
35 bank to X would have resulted (Section 4A-406(a)). But Article 4A would
36 not prevent recovery of funds from X on the basis that X was not enti-
37 tled to retain the funds under the law of mistake and restitution,
38 letter of credit law or other applicable law.

39 4. Transfers of funds made through the banking system are common-
40 ly referred to as either "credit" transfers or "debit" transfers. In a
41 credit transfer the instruction to pay is given by the person making
42 payment. In a debit transfer the instruction to pay is given by the
43 person receiving payment. The purpose of subparagraph (ii) of subsec-
44 tion (a)(1) of Section 4A-103 is to include credit transfers in Article
45 4A and to exclude debit transfers. All of the instructions to pay in
46 the three cases described in Comment 1 fall within subparagraph (ii).
47 Take Case #2 as an example. With respect to X's instruction given to
48 Bank A, Bank A will be reimbursed by debiting X's account or otherwise
49 receiving payment from X. With respect to Bank A's instruction to Bank
50 B, Bank B will be reimbursed by receiving payment from Bank A. In a
51 debit transfer, a creditor, pursuant to authority from the debtor, is

1 enabled to draw on the debtor's bank account by issuing an instruction
2 to pay to the debtor's bank. If the debtor's bank pays, it will be
3 reimbursed by the debtor rather than by the person giving the instruc-
4 tion. For example, the holder of an insurance policy may pay premiums
5 by authorizing the insurance company to order the policyholder's bank to
6 pay the insurance company. The order to pay may be in the form of a
7 draft covered by Article 3, or it might be an instruction to pay that is
8 not an instrument under that Article. The bank receives reimbursement
9 by debiting the policyholder's account. Or, a subsidiary corporation
10 may make payments to its parent by authorizing the parent to order the
11 subsidiary's bank to pay the parent from the subsidiary's account.
12 These transactions are not covered by Article 4A because subparagraph
13 (2) is not satisfied. Article 4A is limited to transactions in which
14 the account to be debited by the receiving bank is that of the person in
15 whose name the instruction is given.

16 If the beneficiary of a funds transfer is the originator of the
17 transfer, the transfer is governed by Article 4A if it is a credit
18 transfer in form. If it is in the form of a debit transfer it is not
19 governed by Article 4A. For example, Corporation has accounts in Bank A
20 and Bank B. Corporation instructs Bank A to pay to Corporation's ac-
21 count in Bank B. The funds transfer is governed by Article 4A. Some-
22 times, Corporation will authorize Bank B to draw on Corporation's ac-
23 count in Bank A for the purpose of transferring funds into Corporation's
24 account in Bank B. If Corporation also makes an agreement with Bank A
25 under which Bank A is authorized to follow instructions of Bank B, as
26 agent of Corporation, to transfer funds from Customer's account in Bank
27 A, the instruction of Bank B is a payment order of Customer and is
28 governed by Article 4A. This kind of transaction is known in the wire-
29 transfer business as a "drawdown transfer." If Corporation does not
30 make such an agreement with Bank A and Bank B instructs Bank A to make
31 the transfer, the order is in form a debit transfer and is not governed
32 by Article 4A. These debit transfers are normally ACH transactions in
33 which Bank A relies on Bank B's warranties pursuant to ACH rules, in-
34 cluding the warranty that the transfer is authorized.

35 5. The principal effect of subparagraph (iii) of subsection (a)
36 of Section 4A-103 is to exclude from Article 4A payments made by check
37 or credit card. In those cases the instruction of the debtor to the
38 bank on which the check is drawn or to which the credit card slip is to
39 be presented is contained in the check or credit card slip signed by the
40 debtor. The instruction is not transmitted by the debtor directly to
41 the debtor's bank. Rather, the instruction is delivered or otherwise
42 transmitted by the debtor to the creditor who then presents it to the
43 bank either directly or through bank collection channels. These pay-
44 ments are governed by Articles 3 and 4 and federal law. There are, how-
45 ever, limited instances in which the paper on which a check is printed
46 can be used as the means of transmitting a payment order that is covered
47 by Article 4A. Assume that Originator instructs Originator's Bank to
48 pay \$10,000 to the account of Beneficiary in Beneficiary's Bank. Since
49 the amount of Originator's payment order is small, if Originator's Bank
50 and Beneficiary's Bank do not have an account relationship, Originator's

1 Bank may execute Originator's order by issuing a teller's check payable
2 to Beneficiary's Bank for \$10,000 along with instructions to credit
3 Beneficiary's account in that amount. The instruction to Beneficiary's
4 Bank to credit Beneficiary's account is a payment order. The check is
5 the means by which Originator's Bank pays its obligation as sender of
6 the payment order. The instruction of Originator's Bank to Benefici-
7 ary's Bank might be given in a letter accompanying the check or it may
8 be written on the check itself. In either case the instruction to
9 Beneficiary's Bank is a payment order but the check itself (which is an
10 order to pay addressed to the drawee rather than to Beneficiary's Bank)
11 is an instrument under Article 3 and is not a payment order. The check
12 can be both the means by which Originator's Bank pays its obligation
13 under § 4A-402(b) to Beneficiary's Bank and the means by which the
14 instruction to Beneficiary's Bank is transmitted.

15 6. Most payments covered by Article 4A are commonly referred to
16 as wire transfers and usually involve some kind of electronic trans-
17 mission, but the applicability of Article 4A does not depend upon the
18 means used to transmit the instruction of the sender. Transmission may
19 be by letter or other written communication, oral communication or
20 electronic communication. An oral communication is normally given by
21 telephone. Frequently the message is recorded by the receiving bank to
22 provide evidence of the transaction, but apart from problems of proof
23 there is no need to record the oral instruction. Transmission of an
24 instruction may be a direct communication between the sender and the
25 receiving bank or through an intermediary such as an agent of the
26 sender, a communication system such as international cable, or a funds
27 transfer system such as CHIPS, SWIFT or an automated clearing house.

28 § 4A-105. OTHER DEFINITIONS

29 (a) In this Article:

30 (1) "Authorized account" means a deposit account of a
31 customer in a bank designated by the customer as a source of pay-
32 ment of payment orders issued by the customer to the bank. If a
33 customer does not so designate an account, any account of the
34 customer is an authorized account if payment of a payment order
35 from that account is not inconsistent with a restriction on the use
36 of that account.

1 (2) "Bank" means a person engaged in the business of
2 banking and includes a savings bank, savings and loan association,
3 credit union, and trust company. A branch or separate office of a
4 bank is a separate bank for purposes of this Article.

5 (3) "Customer" means a person, including a bank,
6 having an account with a bank or from whom a bank has agreed
7 to receive payment orders.

8 (4) "Funds-transfer business day" of a receiving bank
9 means the part of a day during which the receiving bank is open for
10 the receipt, processing, and transmittal of payment orders and can-
11 cellations and amendments of payment orders.

12 (5) "Funds-transfer system" means a wire transfer net-
13 work, automated clearing house, or other communication system of a
14 clearing house or other association of banks through which a pay-
15 ment order by a bank may be transmitted to the bank to which the
16 order is addressed.

17 (6) "Good faith" means honesty in fact and the observ-
18 ance of reasonable commercial standards of fair dealing.

19 (7) "Prove" with respect to a fact means to meet the
20 burden of establishing the fact (Section 1-201(8)).

21 (b) Other definitions applying to this Article and the sec-
22 tions in which they appear are:

23 "Acceptance"	Section 4A-209
24 "Beneficiary"	Section 4A-103
25 "Beneficiary's bank"	Section 4A-103
26 "Executed"	Section 4A-301

1	"Execution date"	Section 4A-301
2	"Funds transfer"	Section 4A-104
3	"Funds-transfer system rule"	Section 4A-501
4	"Intermediary bank"	Section 4A-104
5	"Originator"	Section 4A-104
6	"Originator's bank"	Section 4A-104
7	"Payment by beneficiary's bank	
8	to beneficiary"	Section 4A-405
9	"Payment by originator to	
10	beneficiary"	Section 4A-406
11	"Payment by sender	
12	to receiving bank"	Section 4A-403
13	"Payment date"	Section 4A-401
14	"Payment order"	Section 4A-103
15	"Receiving bank"	Section 4A-103
16	"Security procedure"	Section 4A-201
17	"Sender"	Section 4A-103

18 (c) The following definitions in Article 4 apply to this
19 Article:

20	"Clearing house"	Section 4-104
21	"Item"	Section 4-104
22	"Suspends payments"	Section 4-104

23 (d) In addition Article 1 contains general definitions and
24 principles of construction and interpretation applicable throughout
25 this Article.

COMMENT

1
2 1. The definition of "bank" in subsection (a)(2) includes some
3 institutions that are not commercial banks. The definition reflects the
4 fact that many financial institutions now perform functions previously
5 restricted to commercial banks, including acting on behalf of customers
6 in funds transfers. Since many funds transfers involve payment orders
7 to or from foreign countries the definition also covers foreign banks.
8 The definition also includes Federal Reserve Banks. Funds transfers
9 carried out by Federal Reserve Banks are described in Comments 1 and 2
10 to Section 4A-107.

11 2. Funds transfer business is frequently transacted by banks out-
12 side of general banking hours. Thus, the definition of banking day in
13 Section 4-104(1)(c) cannot be used to describe when a bank is open for
14 funds transfer business. Subsection (a)(4) defines a new term, "funds
15 transfer business day," which is applicable to Article 4A. The defini-
16 tion states, "is open for the receipt, processing, and transmittal of
17 payment orders and cancellations and amendments of payment orders." In
18 some cases it is possible to electronically transmit payment orders and
19 other communications to a receiving bank at any time. If the receiving
20 bank is not open for the processing of an order when it is received, the
21 communication is stored in the receiving bank's computer for retrieval
22 when the receiving bank is open for processing. The use of the conjunc-
23 tive makes clear that the defined term is limited to the period during
24 which all functions of the receiving bank can be performed, i.e., re-
25 ceipt, processing, and transmittal of payment orders, cancellations and
26 amendments.

27 3. Subsection (a)(5) defines "funds transfer system." The term
28 includes a system such as CHIPS which provides for transmission of a
29 payment order as well as settlement of the obligation of the sender to
30 pay the order. It also includes automated clearing houses, operated by
31 a clearing house or other association of banks, which process and trans-
32 mit payment orders of banks to other banks. In addition the term in-
33 cludes organizations that provide only transmission services such as
34 SWIFT. The definition also includes the wire transfer network and auto-
35 mated clearing houses of Federal Reserve Banks. Systems of the Federal
36 Reserve Banks, however, are treated differently from systems of other
37 associations of banks. Funds transfer systems other than systems of the
38 Federal Reserve Banks are treated in Article 4A as a means of communica-
39 tion of payment orders between participating banks. Section 4A-206.
40 The Comment to that section and the Comment to Section 4A-107 explain
41 how Federal Reserve Banks function under Article 4A. Funds transfer
42 systems are also able to promulgate rules binding on participating banks
43 that, under Section 4A-501, may supplement or in some cases may even
44 override provisions of Article 4A.

45 4. Subsection (d) incorporates definitions stated in Article 1 as
46 well as principles of construction and interpretation stated in that
47 Article. Included is Section 1-103. The last paragraph of the Comment
48 to Section 4A-102 is addressed to the issue of the extent to which

1 general principles of law and equity should apply to situations covered
2 by provisions of Article 4A.

3 § 4A-106. TIME PAYMENT ORDER IS RECEIVED

4 (a) The time of receipt of a payment order or communication
5 cancelling or amending a payment order is determined by the rules
6 applicable to receipt of a notice stated in Section 1-201(27).

7 A receiving bank may fix a cut-off time or times on a funds-trans-
8 fer business day for the receipt and processing of payment orders
9 and communications cancelling or amending payment orders. Differ-
10 ent cut-off times may apply to payment orders, cancellations, or
11 amendments, or to different categories of payment orders, cancel-
12 lations, or amendments. A cut-off time may apply to senders gener-
13 ally or different cut-off times may apply to different senders or
14 categories of payment orders. If a payment order or communication
15 cancelling or amending a payment order is received after the close
16 of a funds-transfer business day or after the appropriate cut-off
17 time on a funds-transfer business day, the receiving bank may treat
18 the payment order or communication as received at the opening of
19 the next funds-transfer business day.

20 (b) If this Article refers to an execution date or payment
21 date or states a day on which a receiving bank is required to take
22 action, and the date or day does not fall on a funds-transfer
23 business day, the next day that is a funds-transfer business day is
24 treated as the date or day stated, unless the contrary is stated in
25 this Article.

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COMMENT

The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A-401 and Section 4A-301. The time of receipt of a payment order, or communication cancelling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section 1-201(27). Thus, time of receipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut-off time.

§ 4A-107. FEDERAL RESERVE REGULATIONS AND OPERATING CIRCULARS

Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency.

COMMENT

1. Funds transfers under Article 4A may be made, in whole or in part, by payment orders through a Federal Reserve Bank in what is usually referred to as a transfer by Fedwire. If Bank A, which has an account in Federal Reserve Bank X, wants to pay \$1,000,000 to Bank B, which has an account in Federal Reserve Bank Y, Bank A can issue an instruction to Reserve Bank X requesting a debit of \$1,000,000 to Bank A's Reserve account and an equal credit to Bank B's Reserve account. Reserve Bank X will debit Bank A's account and will credit the account of Reserve Bank Y. Reserve Bank X will issue an instruction to Reserve Bank Y requesting a debit of \$1,000,000 to the account of Reserve Bank X and an equal credit to Bank B's account in Reserve Bank Y. Reserve Bank Y will make the requested debit and credit and will give Bank B an advice of credit. The definition of "bank" in Section 4A-105(a)(2) includes both Reserve Bank X and Reserve Bank Y. Bank A's instruction to Reserve Bank X to pay money to Bank B is a payment order under Section 4A-103(a)(1). Bank A is the sender and Reserve Bank X is the receiving bank. Bank B is the beneficiary of Bank A's order and of the funds transfer. Bank A is the originator of the funds transfer and is also the originator's bank. Section 4A-104(c) and (d). Reserve Bank X, an intermediary bank under Section 4A-104(b), executes Bank A's order by sending a payment order to Reserve Bank Y instructing that bank to credit the Federal Reserve account of Bank B. Reserve Bank Y is the beneficiary's bank.

Suppose the transfer of funds from Bank A to Bank B is part of a larger transaction in which Originator, a customer of Bank A, wants to pay Beneficiary, a customer of Bank B. Originator issues a payment

1 order to Bank A to pay \$1,000,000 to the account of Beneficiary in Bank
2 B. Bank A may execute Originator's order by means of Fedwire which
3 simultaneously transfers \$1,000,000 from Bank A to Bank B and carries a
4 message instructing Bank B to pay \$1,000,000 to the account of Y. The
5 Fedwire transfer is carried out as described in the previous paragraph,
6 except that the beneficiary of the funds transfer is Beneficiary rather
7 than Bank B. Reserve Bank X and Reserve Bank Y are intermediary banks.
8 When Reserve Bank Y advises Bank B of the credit to its Federal Reserve
9 account it will also instruct Bank B to pay to the account of Benefici-
10 ary. The instruction is a payment order to Bank B which is the benefi-
11 ciary's bank. When Reserve Bank Y advises Bank B of the credit to its
12 Federal Reserve account Bank B receives payment of the payment order
13 issued to it by Reserve Bank Y. Section 4A-403(a)(1). The payment
14 order is automatically accepted by Bank B at the time it receives the
15 payment order of Reserve Bank Y. Section 4A-209(b)(2). At the time of
16 acceptance by Bank B payment by Originator to Beneficiary also occurs.
17 Thus, in a Fedwire transfer, payment to the beneficiary's bank, accept-
18 ance by the beneficiary's bank and payment by the originator to the ben-
19 eficiary all occur simultaneously by operation of law at the time the
20 payment order to the beneficiary's bank is received.

21 If Originator orders payment to the account of Beneficiary in Bank
22 C rather than Bank B, the analysis is somewhat modified. Bank A may not
23 have any relationship with Bank C and may not be able to make payment
24 directly to Bank C. In that case, Bank A could send a Fedwire instruct-
25 ing Bank B to instruct Bank C to pay Beneficiary. The analysis is the
26 same as the previous case except that Bank B is an intermediary bank and
27 Bank C is the beneficiary's bank.

28 2. A funds transfer can also be made through a Federal Reserve
29 Bank in an automated clearing house transaction. In a typical case,
30 Originator instructs Originator's Bank to pay to the account of Benefi-
31 ciary in Beneficiary's Bank. Originator's instruction to pay a partic-
32 ular beneficiary is transmitted to Originator's Bank along with many
33 other instructions for payment to other beneficiaries by many different
34 beneficiary's banks. All of these instructions are contained in a mag-
35 netic tape or other electronic device. Transmission of instructions to
36 the various beneficiary's banks requires that Originator's instructions
37 be processed and repackaged with instructions of other originators so
38 that all instructions to a particular beneficiary's bank are transmitted
39 together to that bank. The repackaging is done in processing centers
40 usually referred to as automated clearing houses. Automated clearing
41 houses are operated either by Federal Reserve Banks or by other associa-
42 tions of banks. If Originator's Bank chooses to execute Originator's
43 instructions by transmitting them to a Federal Reserve Bank for process-
44 ing by the Federal Reserve Bank, the transmission to the Federal Reserve
45 Bank results in the issuance of payment orders by Originator's Bank to
46 the Federal Reserve Bank, which is an intermediary bank. Processing by
47 the Federal Reserve Bank will result in the issuance of payment orders
48 by the Federal Reserve Bank to Beneficiary's Bank as well as payment
49 orders to other beneficiary's banks making payments to carry out Origi-
50 nator's instructions.

1 3. Although the terms of Article 4A apply to funds transfers in-
2 volving Federal Reserve Banks, federal preemption would make ineffective
3 any Article 4A provision that conflicts with federal law. The payments
4 activities of the Federal Reserve Banks are governed by regulations of
5 the Federal Reserve Board and by operating circulars issued by the Re-
6 serve Banks themselves. In some instances, the operating circulars are
7 issued pursuant to a Federal Reserve Board regulation. In other cases,
8 the Reserve Bank issues the operating circular under its own authority
9 under the Federal Reserve Act, subject to review by the Federal Reserve
10 Board. Section 4A-107 states that Federal Reserve Board regulations and
11 operating circulars of the Federal Reserve Banks supersede any inconsis-
12 tent provision of Article 4A to the extent of the inconsistency. Feder-
13 al Reserve Board regulations, being valid exercises of regulatory auth-
14 ority pursuant to a federal statute, take precedence over state law if
15 there is an inconsistency. Childs v. Federal Reserve Bank of Dallas,
16 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984).
17 Section 4A-107 treats operating circulars as having the same effect
18 whether issued under the Reserve Bank's own authority or under a Federal
19 Reserve Board regulation.

20 § 4A-108. EXCLUSION OF CONSUMER TRANSACTIONS GOVERNED BY FEDERAL
21 LAW

22 This Article does not apply to a funds transfer any part of
23 which is governed by the Electronic Fund Transfer Act of 1978
24 (Title XX, Public Law 95-630, 92 Stat. 3728, 15 U.S.C. § 1693 et
25 seq.) as amended from time to time.

26 COMMENT

27 The Electronic Fund Transfer Act of 1978 is a federal statute that
28 covers a wide variety of electronic funds transfers involving consumers.
29 The types of transfers covered by the federal statute are essentially
30 different from the wholesale wire transfers that are the primary focus
31 of Article 4A. Section 4A-108 excludes a funds transfer from Article 4A
32 if any part of the transfer is covered by the federal law. Existing
33 procedures designed to comply with federal law will not be affected by
34 Article 4A. The effect of Section 4A-108 is to make Article 4A and EFTA
35 mutually exclusive. For example, if a funds transfer is to a consumer
36 account in the beneficiary's bank and the funds transfer is made in part
37 by use of Fedwire and in part by means of an automated clearing house,
38 EFTA applies to the ACH part of the transfer but not to the Fedwire
39 part. Under Section 4A-108, Article 4A does not apply to any part of
40 the transfer. However, in the absence of any law to govern the part of
41 the funds transfer that is not subject to EFTA, a court might apply
42 appropriate principles from Article 4A by analogy.

1 PART 2

2 ISSUE AND ACCEPTANCE OF PAYMENT ORDER

3 § 4A-201. SECURITY PROCEDURE

4 "Security procedure" means a procedure established by agree-
5 ment of a customer and a receiving bank for the purpose of (i) ver-
6 ifying that a payment order or communication amending or cancelling
7 a payment order is that of the customer, or (ii) detecting error in
8 the transmission or the content of the payment order or communica-
9 tion. A security procedure may require the use of algorithms or
10 other codes, identifying words or numbers, encryption, callback
11 procedures, or similar security devices. Comparison of a signature
12 on a payment order or communication with an authorized specimen
13 signature of the customer is not by itself a security procedure.

14 COMMENT

15 A large percentage of payment orders and communications amending or
16 cancelling payment orders are transmitted electronically and it is
17 standard practice to use security procedures that are designed to assure
18 the authenticity of the message. Security procedures can also be used
19 to detect error in the content of messages or to detect payment orders
20 that are transmitted by mistake as in the case of multiple transmission
21 of the same payment order. Security procedures might also apply to
22 communications that are transmitted by telephone or in writing. Section
23 4A-201 defines these security procedures. The definition of security
24 procedure limits the term to a procedure "established by agreement of a
25 customer and a receiving bank." The term does not apply to procedures
26 that the receiving bank may follow unilaterally in processing payment
27 orders. The question of whether loss that may result from the transmis-
28 sion of a spurious or erroneous payment order will be borne by the re-
29 ceiving bank or the sender or purported sender is affected by whether a
30 security procedure was or was not in effect and whether there was or was
31 not compliance with the procedure. Security procedures are referred to
32 in Sections 4A-202 and 4A-203, which deal with authorized and verified
33 payment orders, and Section 4A-205, which deals with erroneous payment
34 orders.

1 § 4A-202. AUTHORIZED AND VERIFIED PAYMENT ORDERS

2 (a) A payment order received by the receiving bank is the
3 authorized order of the person identified as sender if that person
4 authorized the order or is otherwise bound by it under the law of
5 agency.

6 (b) If a bank and its customer have agreed that the authen-
7 ticity of payment orders issued to the bank in the name of the
8 customer as sender will be verified pursuant to a security proce-
9 dure, a payment order received by the receiving bank is effective
10 as the order of the customer, whether or not authorized, if (i) the
11 security procedure is a commercially reasonable method of providing
12 security against unauthorized payment orders, and (ii) the bank
13 proves that it accepted the payment order in good faith and in
14 compliance with the security procedure and any written agreement or
15 instruction of the customer restricting acceptance of payment
16 orders issued in the name of the customer. The bank is not re-
17 quired to follow an instruction that violates a written agreement
18 with the customer or notice of which is not received at a time and
19 in a manner affording the bank a reasonable opportunity to act on
20 it before the payment order is accepted.

21 (c) Commercial reasonableness of a security procedure is a
22 question of law to be determined by considering the wishes of the
23 customer expressed to the bank, the circumstances of the customer
24 known to the bank, including the size, type, and frequency of pay-
25 ment orders normally issued by the customer to the bank, alterna-
26 tive security procedures offered to the customer, and security

1 procedures in general use by customers and receiving banks simil-
2 arly situated. A security procedure is deemed to be commercially
3 reasonable if (i) the security procedure was chosen by the customer
4 after the bank offered, and the customer refused, a security
5 procedure that was commercially reasonable for that customer, and
6 (ii) the customer expressly agreed in writing to be bound by any
7 payment order, whether or not authorized, issued in its name and
8 accepted by the bank in compliance with the security procedure
9 chosen by the customer.

10 (d) The term "sender" in this Article includes the customer
11 in whose name a payment order is issued if the order is the autho-
12 rized order of the customer under subsection (a), or it is effec-
13 tive as the order of the customer under subsection (b).

14 (e) This section applies to amendments and cancellations of
15 payment orders to the same extent it applies to payment orders.

16 (f) Except as provided in this section and in Section 4A-
17 203(a)(1), rights and obligations arising under this section or
18 Section 4A-203 may not be varied by agreement.

19 COMMENT

20 This section is discussed in the Comment following Section 4A-203.

21 § 4A-203. UNENFORCEABILITY OF CERTAIN VERIFIED PAYMENT ORDERS

22 (a) If an accepted payment order is not, under Section 4A-
23 202(a), an authorized order of a customer identified as sender, but
24 is effective as an order of the customer pursuant to Section 4A-
25 202(b), the following rules apply:

1 (1) By express written agreement, the receiving bank may
2 limit the extent to which it is entitled to enforce or retain
3 payment of the payment order.

4 (2) The receiving bank is not entitled to enforce or
5 retain payment of the payment order if the customer proves that the
6 order was not caused, directly or indirectly, by a person (i) en-
7 trusted at any time with duties to act for the customer with re-
8 spect to payment orders or the security procedure, or (ii) who
9 obtained access to transmitting facilities of the customer or who
10 obtained, from a source controlled by the customer and without
11 authority of the receiving bank, information facilitating breach of
12 the security procedure, regardless of how the information was ob-
13 tained or whether the customer was at fault. Information includes
14 any access device, computer software, or the like.

15 (b) This section applies to amendments of payment orders to
16 the same extent it applies to payment orders.

17 COMMENT

18 1. Some person will always be identified as the sender of a pay-
19 ment order. Acceptance of the order by the receiving bank is based on a
20 belief by the bank that the order was authorized by the person identi-
21 fied as the sender. If the receiving bank is the beneficiary's bank
22 acceptance means that the receiving bank is obliged to pay the benefici-
23 ary. If the receiving bank is not the beneficiary's bank, acceptance
24 means that the receiving bank has executed the sender's order and is
25 obliged to pay the bank that accepted the order issued in execution of
26 the sender's order. In either case the receiving bank may suffer a loss
27 unless it is entitled to enforce payment of the payment order that it
28 accepted. If the person identified as the sender of the order refuses
29 to pay on the ground that the order was not authorized by that person,
30 what are the rights of the receiving bank? In the absence of a statute
31 or agreement that specifically addresses the issue, the question usually
32 will be resolved by the law of agency. In some cases, the law of agency
33 works well. For example, suppose the receiving bank executes a payment
34 order given by means of a letter apparently written by a corporation
35 that is a customer of the bank and apparently signed by an officer of

1 the corporation. If the receiving bank acts solely on the basis of the
2 letter, the corporation is not bound as the sender of the payment order
3 unless the signature was that of the officer and the officer was
4 authorized to act for the corporation in the issuance of payment orders,
5 or some other agency doctrine such as apparent authority or estoppel
6 causes the corporation to be bound. Estoppel can be illustrated by the
7 following example. Suppose P is aware that A, who is unauthorized to
8 act for P, has fraudulently misrepresented to T that A is authorized to
9 act for P. T believes A and is about to rely on the misrepresentation.
10 If P does not notify T of the true facts although P could easily do so,
11 P may be estopped from denying A's lack of authority. A similar result
12 could follow if the failure to notify T is the result of negligence
13 rather than a deliberate decision. Restatement, Second, Agency § 8B.
14 Other equitable principles such as subrogation or restitution might also
15 allow a receiving bank to recover with respect to an unauthorized pay-
16 ment order that it accepted. In *Gatoil (U.S.A.), Inc. v. Forest Hill*
17 *State Bank*, 1 U.C.C. Rep. Serv. 2d 171 (D.Md. 1986), a joint venturer
18 not authorized to order payments from the account of the joint venture,
19 ordered a funds transfer from the account. The transfer paid a bona
20 fide debt of the joint venture. Although the transfer was unauthorized
21 the court refused to require recredit of the account because the joint
22 venture suffered no loss. The result can be rationalized on the basis
23 of subrogation of the receiving bank to the right of the beneficiary of
24 the funds transfer to receive the payment from the joint venture.

25 But in most cases these legal principles give the receiving bank
26 very little protection in the case of an authorized payment order.
27 Cases like those just discussed are not typical of the way that most
28 payment orders are transmitted and accepted, and such cases are likely
29 to become even less common. Given the large amount of the typical
30 payment order, a prudent receiving bank will be unwilling to accept a
31 payment order unless it has assurance that the order is what it purports
32 to be. This assurance is normally provided by security procedures des-
33 cribed in Section 4A-201.

34 In a very large percentage of cases covered by Article 4A, trans-
35 mission of the payment order is made electronically. The receiving bank
36 may be required to act on the basis of a message that appears on a com-
37 puter screen. Common law concepts of authority of agent to bind princ-
38 ipal are not helpful. There is no way of determining the identity or
39 the authority of the person who caused the message to be sent. The
40 receiving bank is not relying on the authority of any particular person
41 to act for the purported sender. The case is not comparable to payment
42 of a check by the drawee bank on the basis of a signature that is forg-
43 ed. Rather, the receiving bank relies on a security procedure pursuant
44 to which the authenticity of the message can be "tested" by various
45 devices which are designed to provide certainty that the message is that
46 of the sender identified in the payment order. In the wire transfer
47 business the concept of "authorized" is different from that found in
48 agency law. In that business a payment order is treated as the order of
49 the person in whose name it is issued if it is properly tested pursuant
50 to a security procedure and the order passes the test.

1 Section 4A-202 reflects the reality of the wire transfer business.
2 A person in whose name a payment order is issued is considered to be the
3 sender of the order if the order is "authorized" as stated in subsection
4 (a) or if the order is "verified" pursuant to a security procedure in
5 compliance with subsection (b). If subsection (b) does not apply, the
6 question of whether the customer is responsible for the order is deter-
7 mined by the law of agency. The issue is one of actual or apparent
8 authority of the person who caused the order to be issued in the name of
9 the customer. In some cases the law of agency might allow the customer
10 to be bound by an unauthorized order if conduct of the customer can be
11 used to find an estoppel against the customer to deny that the order was
12 unauthorized. If the customer is bound by the order under any of these
13 agency doctrines, subsection (a) treats the order as authorized and thus
14 the customer is deemed to be the sender of the order. In most cases,
15 however, subsection (b) will apply. In that event there is no need to
16 make an agency law analysis to determine authority. Under Section 4A-
17 202, the issue of liability of the purported sender of the payment order
18 will be determined by agency law only if the receiving bank did not com-
19 ply with subsection (b).

20 2. The scope of Section 4A-202 can be illustrated by the follow-
21 ing cases. Case #1. A payment order purporting to be that of Customer
22 is received by Receiving Bank but the order was fraudulently transmitted
23 by a person who had no authority to act for Customer. Case #2. An
24 authentic payment order was sent by Customer, but before the order was
25 received by Receiving Bank the order was fraudulently altered by an
26 unauthorized person to change the beneficiary. Case #3. An authentic
27 payment order was received by Receiving Bank, but before the order was
28 executed by Receiving Bank a person who had no authority to act for
29 Customer fraudulently sent a communication purporting to amend the order
30 by changing the beneficiary. In each case Receiving Bank acted on the
31 fraudulent communication by accepting the payment order. These cases
32 are all essentially similar and they are treated identically by Section
33 4A-202. In each case Receiving Bank acted on a communication that it
34 thought was authorized by Customer when in fact the communication was
35 fraudulent. No distinction is made between Case #1 in which Customer
36 took no part at all in the transaction and Case #2 and Case #3 in which
37 an authentic order was fraudulently altered or amended by an unauthor-
38 ized person. If subsection (b) does not apply, each case is governed by
39 subsection (a). If there are no additional facts on which an estoppel
40 might be found, Customer is not responsible in Case #1 for the fraudu-
41 lently issued payment order, in Case #2 for the fraudulent alteration or
42 in Case #3 for the fraudulent amendment. Thus, in each case Customer is
43 not liable to pay the order and Receiving Bank takes the loss. The only
44 remedy of Receiving Bank is to seek recovery from the person who re-
45 ceived payment as beneficiary of the fraudulent order. If there was
46 verification in compliance with subsection (b), Customer will take the
47 loss unless Section 4A-203 applies.

48 3. Subsection (b) of Section 4A-202 is based on the assumption
49 that losses due to fraudulent payment orders can best be avoided by the
50 use of commercially reasonable security procedures, and that the use of

1 such procedures should be encouraged. The subsection is designed to
2 protect both the customer and the receiving bank. A receiving bank
3 needs to be able to rely on objective criteria to determine whether it
4 can safely act on a payment order. Employees of the bank can be trained
5 to "test" a payment order according to the various steps specified in
6 the security procedure. The bank is responsible for the acts of these
7 employees. Subsection (b)(ii) requires the bank to prove that it ac-
8 cepted the payment order in good faith and "in compliance with the
9 security procedure." If the fraud was not detected because the bank's
10 employee did not perform the acts required by the security procedure,
11 the bank has not complied. Subsection (b)(ii) also requires the bank to
12 prove that it complied with any agreement or instruction that restricts
13 acceptance of payment orders issued in the name of the customer. A
14 customer may want to protect itself by imposing limitations on accept-
15 ance of payment orders by the bank. For example, the customer may
16 prohibit the bank from accepting a payment order that is not payable
17 from an authorized account, that exceeds the credit balance in specified
18 accounts of the customer, or that exceeds some other amount. Another
19 limitation may relate to the beneficiary. The customer may provide the
20 bank with a list of authorized beneficiaries and prohibit acceptance of
21 any payment order to a beneficiary not appearing on the list. Such
22 limitations may be incorporated into the security procedure itself or
23 they may be covered by a separate agreement or instruction. In either
24 case, the bank must comply with the limitations if the conditions stated
25 in subsection (b) are met. Normally limitations on acceptance would be
26 incorporated into an agreement between the customer and the receiving
27 bank, but in some cases the instruction might be unilaterally given by
28 the customer. If standing instructions or an agreement state limita-
29 tions on the ability of the receiving bank to act, provision must be
30 made for later modification of the limitations. Normally this would be
31 done by an agreement that specifies particular procedures to be follow-
32 ed. Thus, subsection (b) states that the receiving bank is not required
33 to follow an instruction that violates a written agreement. The
34 receiving bank is not bound by an instruction unless it has adequate
35 notice of it. Subsections (25), (26) and (27) of Section 1-201 apply.

36 Subsection (b)(i) assures that the interests of the customer will
37 be protected by providing an incentive to a bank to make available to
38 the customer a security procedure that is commercially reasonable. If a
39 commercially reasonable security procedure is not made available to the
40 customer, subsection (b) does not apply. The result is that subsection
41 (a) applies and the bank acts at its peril in accepting a payment order
42 that may be unauthorized. Prudent banking practice may require that
43 security procedures be utilized in virtually all cases except for those
44 in which personal contact between the customer and the bank eliminates
45 the possibility of an unauthorized order. The burden of making avail-
46 able commercially reasonable security procedures is imposed on receiving
47 banks because they generally determine what security procedures can be
48 used and are in the best position to evaluate the efficacy of procedures
49 offered to customers to combat fraud. The burden on the customer is to
50 supervise its employees to assure compliance with the security procedure

1 and to safeguard confidential security information and access to trans-
2 mitting facilities so that the security procedure cannot be breached.

3 4. The principal issue that is likely to arise in litigation
4 involving subsection (b) is whether the security procedure in effect
5 when a fraudulent payment order was accepted was commercially reason-
6 able. The concept of what is commercially reasonable in a given case is
7 flexible. Verification entails labor and equipment costs that can vary
8 greatly depending upon the degree of security that is sought. A custo-
9 mer that transmits very large numbers of payment orders in very large
10 amounts may desire and may reasonably expect to be provided with state-
11 of-the-art procedures that provide maximum security. But the expense
12 involved may make use of a state-of-the-art procedure infeasible for a
13 customer that normally transmits payments orders infrequently or in
14 relatively low amounts. Another variable is the type of receiving bank.
15 It is reasonable to require large money center banks to make available
16 state-of-the-art security procedures. On the other hand, the same
17 requirement may not be reasonable for a small country bank. A receiving
18 bank might have several security procedures that are designed to meet
19 the varying needs of different customers. The type of payment order is
20 another variable. For example, in a wholesale wire transfer, each pay-
21 ment order is normally transmitted electronically and individually. A
22 testing procedure will be individually applied to each payment order.
23 In funds transfers to be made by means of an automated clearing house
24 many payment orders are incorporated into an electronic device such as a
25 magnetic tape that is physically delivered. Testing of the individual
26 payment orders is not feasible. Thus, a different kind of security
27 procedure must be adopted to take into account the different mode of
28 transmission.

29 The issue of whether a particular security procedure is commercial-
30 ly reasonable is a question of law. Whether the receiving bank complied
31 with the procedure is a question of fact. It is appropriate to make the
32 finding concerning commercial reasonability a matter of law because sec-
33 urity procedures are likely to be standardized in the banking industry
34 and a question of law standard leads to more predictability concerning
35 the level of security that a bank must offer to its customers. The
36 purpose of subsection (b) is to encourage banks to institute reasonable
37 safeguards against fraud but not to make them insurers against fraud.
38 A security procedure is not commercially unreasonable simply because
39 another procedure might have been better or because the judge deciding
40 the question would have opted for a more stringent procedure. The
41 standard is not whether the security procedure is the best available.
42 Rather it is whether the procedure is reasonable for the particular
43 customer and the particular bank, which is a lower standard. On the
44 other hand, a security procedure that fails to meet prevailing standards
45 of good banking practice applicable to the particular bank should not be
46 held to be commercially reasonable. Subsection (c) states factors to be
47 considered by the judge in making the determination of commercial reas-
48 onableness. Sometimes an informed customer refuses a security procedure
49 that is commercially reasonable and suitable for that customer and in-
50 sists on using a higher-risk procedure because it is more convenient or

1 cheaper. In that case, under the last sentence of subsection (c), the
2 customer has voluntarily assumed the risk of failure of the procedure
3 and cannot shift the loss to the bank. But this result follows only if
4 the customer expressly agrees in writing to assume that risk. It is
5 implicit in the last sentence of subsection (c) that a bank that accedes
6 to the wishes of its customer in this regard is not acting in bad faith
7 by so doing so long as the customer is made aware of the risk. In all
8 cases, however, a receiving bank cannot get the benefit of subsection
9 (b) unless it has made available to the customer a security procedure
10 that is commercially reasonable and suitable for use by that customer.
11 In most cases, the mutual interest of bank and customer to protect
12 against fraud should lead to agreement to a security procedure which is
13 commercially reasonable.

14 5. The effect of Section 4A-202(b) is to place the risk of loss
15 on the customer if an unauthorized payment order is accepted by the re-
16 ceiving bank after verification by the bank in compliance with a commer-
17 cially reasonable security procedure. An exception to this result is
18 provided by Section 4A-203(a)(2). The customer may avoid the loss re-
19 sulting from such a payment order if the customer can prove that the
20 fraud was not committed by a person described in that subsection.
21 Breach of a commercially reasonable security procedure requires that the
22 person committing the fraud have knowledge of how the procedure works
23 and knowledge of codes, identifying devices, and the like. That person
24 may also need access to transmitting facilities through an access devic
25 or other software in order to breach the security procedure. This con-
26 fidential information must be obtained either from a source controlled
27 by the customer or from a source controlled by the receiving bank. If
28 the customer can prove that the person committing the fraud did not
29 obtain the confidential information from an agent or former agent of the
30 customer or from a source controlled by the customer, the loss is shift-
31 ed to the bank. "Prove" is defined in Section 4A-105(a)(7). Because of
32 bank regulation requirements, in this kind of case there will always be
33 a criminal investigation as well as an internal investigation of the
34 bank to determine the probable explanation for the breach of security.
35 Because a funds transfer fraud usually will involve a very large amount
36 of money, both the criminal investigation and the internal investigation
37 are likely to be thorough. In some cases there may be an investigation
38 by bank examiners as well. Frequently, these investigations will de-
39 velop evidence of who is at fault and the cause of the loss. The custo-
40 mer will have access to evidence developed in these investigations and
41 that evidence can be used by the customer in meeting its burden of
42 proof.

43 6. The effect of Section 4A-202(b) may also be changed by an
44 agreement meeting the requirements of Section 4A-203(a)(1). Some custo-
45 mers may be unwilling to take all or part of the risk of loss with re-
46 spect to unauthorized payment orders even if all of the requirements of
47 Section 4A-202(b) are met. By virtue of Section 4A-203(a)(1), a receiv-
48 ing bank may assume all of the risk of loss with respect to unauthorized
49 payment orders or the customer and bank may agree that losses from

1 unauthorized payment orders are to be divided as provided in the
2 agreement.

3 7. In a large majority of cases the sender of a payment order is
4 a bank. In many cases in which there is a bank sender, both the sender
5 and the receiving bank will be members of a funds transfer system over
6 which the payment order is transmitted. Since Section 4A-202(f) does
7 not prohibit a funds transfer system rule from varying rights and ob-
8 ligations under Section 4A-202, a rule of the funds transfer system can
9 determine how loss due to an unauthorized payment order from a particip-
10 ating bank to another participating bank is to be allocated. A funds
11 transfer system rule, however, cannot change the rights of a customer
12 that is not a participating bank. § 4A-501(b). Section 4A-202(f) also
13 prevents variation by agreement except to the extent stated.

14 § 4A-204. REFUND OF PAYMENT AND DUTY OF CUSTOMER TO REPORT WITH
15 RESPECT TO UNAUTHORIZED PAYMENT ORDER

16 (a) If a receiving bank accepts a payment order issued in the
17 name of its customer as sender which is (i) not authorized and not
18 effective as the order of the customer under Section 4A-202, or
19 (ii) not enforceable, in whole or in part, against the customer
20 under Section 4A-203, the bank shall refund any payment of the pay-
21 ment order received from the customer to the extent the bank is not
22 entitled to enforce payment and shall pay interest on the refund-
23 able amount calculated from the date the bank received payment to
24 the date of the refund. However, the customer is not entitled to
25 interest from the bank on the amount to be refunded if the customer
26 fails to exercise ordinary care to determine that the order was not
27 authorized by the customer and to notify the bank of the relevant
28 facts within a reasonable time not exceeding 90 days after the date
29 the customer received notification from the bank that the order was
30 accepted or that the customer's account was debited with respect

1 to the order. The bank is not entitled to any recovery from the
2 customer on account of a failure by the customer to give
3 notification as stated in this section.

4 (b) Reasonable time under subsection (a) may be fixed by
5 agreement as stated in Section 1-204(1), but the obligation of a
6 receiving bank to refund payment as stated in subsection (a) may
7 not otherwise be varied by agreement.

8 COMMENT

9 1. With respect to unauthorized payment orders, in a very large
10 percentage of cases a commercially reasonable security procedure will be
11 in effect. Section 4A-204 applies only to cases in which (i) no commer-
12 cially reasonable security procedure is in effect, (ii) the bank did not
13 comply with a commercially reasonable security procedure that was in
14 effect, (iii) the sender can prove, pursuant to Section 4A-203(a)(2),
15 that the culprit did not obtain confidential security information con-
16 trolled by the customer, or (iv) the bank, pursuant to Section 4A-
17 203(a)(1) agreed to take all or part of the loss resulting from an
18 unauthorized payment order. In each of these cases the bank takes the
19 risk of loss with respect to an unauthorized payment order because the
20 bank is not entitled to payment from the customer with respect to the
21 order. The bank normally debits the customer's account or otherwise
22 receives payment from the customer shortly after acceptance of the
23 payment order. Subsection (a) of Section 4A-204 states that the bank
24 must recredit the account or refund payment to the extent the bank is
25 not entitled to enforce payment.

26 2. Section 4A-204 is designed to encourage a customer to promptly
27 notify the receiving bank that it has accepted an unauthorized payment
28 order. Since cases of unauthorized payment orders will almost always
29 involve fraud, the bank's remedy is normally to recover from the benefi-
30 ciary of the unauthorized order if the beneficiary was party to the
31 fraud. This remedy may not be worth very much and it may not make any
32 difference whether or not the bank promptly learns about the fraud. But
33 in some cases prompt notification may make it easier for the bank to
34 recover some part of its loss from the culprit. The customer will rou-
35 tinely be notified of the debit to its account with respect to an un-
36 authorized order or will otherwise be notified of acceptance of the
37 order. The customer has a duty to exercise ordinary care to determine
38 that the order was unauthorized after it has received notification from
39 the bank, and to advise the bank of the relevant facts within a reason-
40 able time not exceeding 90 days after receipt of notification. Reason-
41 able time is not defined and it may depend on the facts of the particu-
42 lar case. If a payment order for \$1,000,000 is wholly unauthorized, the
43 customer should normally discover it in far less than 90 days. If a

1 \$1,000,000 payment order was authorized but the name of the beneficiary
2 was fraudulently changed, a much longer period may be necessary to dis-
3 cover the fraud. But in any event, if the customer delays more than 90
4 days the customer's duty has not been met. The only consequence of a
5 failure of the customer to perform this duty is a loss of interest on
6 the refund payable by the bank. A customer that acts promptly is en-
7 titled to interest from the time the customer's account was debited or
8 the customer otherwise made payment. The rate of interest is stated in
9 Section 4A-506. If the customer fails to perform the duty, no interest
10 is recoverable for any part of the period before the bank learns that it
11 accepted an unauthorized order. But the bank is not entitled to any
12 recovery from the customer based on negligence for failure to inform the
13 bank. Loss of interest is in the nature of a penalty on the customer
14 designed to provide an incentive for the customer to police its account.
15 There is no intention to impose a duty on the customer that might result
16 in shifting loss from the unauthorized order to the customer.

17 § 4A-205. ERRONEOUS PAYMENT ORDERS

18 (a) If an accepted payment order was transmitted pursuant to
19 a security procedure for the detection of error and the payment
20 order (i) erroneously instructed payment to a beneficiary not
21 intended by the sender, (ii) erroneously instructed payment in an
22 amount greater than the amount intended by the sender, or (iii) was
23 an erroneously transmitted duplicate of a payment order previously
24 sent by the sender, the following rules apply:

25 (1) If the sender proves that the sender or a person
26 acting on behalf of the sender pursuant to Section 4A-206 complied
27 with the security procedure and that the error would have been
28 detected if the receiving bank had also complied, the sender is not
29 obliged to pay the order to the extent stated in paragraphs (2) and
30 (3).

31 (2) If the funds transfer is completed on the basis of
32 an erroneous payment order described in clause (i) or (iii) of

1 subsection (a), the sender is not obliged to pay the order and the
2 receiving bank is entitled to recover from the beneficiary any
3 amount paid to the beneficiary to the extent allowed by the law
4 governing mistake and restitution.

5 (3) If the funds transfer is completed on the basis of a
6 payment order described in clause (ii) of subsection (a), the
7 sender is not obliged to pay the order to the extent the amount
8 received by the beneficiary is greater than the amount intended by
9 the sender. In that case, the receiving bank is entitled to re-
10 cover from the beneficiary the excess amount received to the extent
11 allowed by the law governing mistake and restitution.

12 (b) If (i) the sender of an erroneous payment order described
13 in subsection (a) is not obliged to pay all or part of the order,
14 and (ii) the sender receives notification from the receiving bank
15 that the order was accepted by the bank or that the sender's ac-
16 count was debited with respect to the order, the sender has a duty
17 to exercise ordinary care, on the basis of information available to
18 the sender, to discover the error with respect to the order and to
19 advise the bank of the relevant facts within a reasonable time, not
20 exceeding 90 days, after the bank's notification was received by
21 the sender. If the bank proves that the sender failed to perform
22 that duty, the sender is liable to the bank for the loss the bank
23 proves it incurred as a result of the failure, but the liability of
24 the sender may not exceed the amount of the sender's order.

25 (c) This section applies to amendments to payment orders to
26 the same extent it applies to payment orders.

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COMMENT

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1. This section concerns error in the content or in the transmission of payment orders. It deals with three kinds of error. Case #1. The order identifies a beneficiary not intended by the sender. For example, Sender intends to wire funds to a beneficiary identified only by an account number. The wrong account number is stated in the order. Case #2. The error is in the amount of the order. For example, Sender intends to wire \$1,000 to Beneficiary. Through error, the payment order instructs payment of \$1,000,000. Case #3. A payment order is sent to the receiving bank and then, by mistake, the same payment order is sent to the receiving bank again. In Case #3, the receiving bank may have no way of knowing whether the second order is a duplicate of the first or is another order. Similarly, in Case #1 and Case #2, the receiving bank may have no way of knowing that the error exists. In each case, if this section does not apply and the funds transfer is completed, Sender is obliged to pay the order. Section 4A-402. Sender's remedy, based on payment by mistake, is to recover from the beneficiary that received payment.

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Sometimes, however, transmission of payment orders of the sender to the receiving bank is made pursuant to a security procedure designed to detect one or more of the errors described above. Since "security procedure" is defined by Section 4A-201 as "a procedure established by agreement of a customer and a receiving bank for the purpose of * * * detecting error * * *," Section 4A-205 does not apply if the receiving bank and the customer did not agree to the establishment of a procedure for detecting error. A security procedure may be designed to detect an account number that is not one to which Sender normally makes payment. In that case, the security procedure may require a special verification that payment to the stated account number was intended. In the case of dollar amounts, the security procedure may require different codes for different dollar amounts. If a \$1,000,000 payment order contains a code that is inappropriate for that amount, the error in amount should be detected. In the case of duplicate orders, the security procedure may require that each payment order be identified by a number or code that applies to no other order. If the number or code of each payment order received is registered in a computer base, the receiving bank can quickly identify a duplicate order. The three cases covered by this section are essentially similar. In each, if the error is not detected, some beneficiary will receive funds that the beneficiary was not intended to receive. If this section applies, the risk of loss with respect to the error of the sender is shifted to the bank which has the burden of recovering the funds from the beneficiary. The risk of loss is shifted to the bank only if the sender proves that the error would have been detected if there had been compliance with the procedure and that the sender (or an agent under Section 4A-206) complied. In the case of a duplicate order or a wrong beneficiary, the sender doesn't have to pay the order. In the case of an overpayment, the sender does not have to pay the order to the extent of the overpayment. If subsection (a)(1) applies, the position of the receiving bank is comparable to that of a receiving bank that erroneously executes a payment order as stated in

1 Section 4A-303. However, failure of the sender to timely report the
2 error is covered by Section 4A-205(b) rather than by Section 4A-304
3 which applies only to erroneous execution under Section 4A-303. A re-
4 ceiving bank to which the risk of loss is shifted by subsection (a)(1)
5 or (2) is entitled to recover the amount erroneously paid to the benefi-
6 ciary to the extent allowed by the law of mistake and restitution.
7 Rights of the receiving bank against the beneficiary are similar to
8 those of a receiving bank that erroneously executes a payment order as
9 stated in Section 4A-303. Those rights are discussed in Comment 2 to
10 Section 4A-303.

11 2. A security procedure established for the purpose of detecting
12 error is not effective unless both sender and receiving bank comply with
13 the procedure. Thus, the bank undertakes a duty of complying with the
14 procedure for the benefit of the sender. This duty is recognized in
15 subsection (a)(1). The loss with respect to the sender's error is
16 shifted to the bank if the bank fails to comply with the procedure and
17 the sender (or an agent under Section 4A-206) does comply. Although the
18 customer may have been negligent in transmitting the erroneous payment
19 order, the loss is put on the bank on a last-clear-chance theory.
20 A similar analysis applies to subsection (b). If the loss with respect
21 to an error is shifted to the receiving bank and the sender is notified
22 by the bank that the erroneous payment order was accepted, the sender
23 has a duty to exercise ordinary care to discover the error and notify
24 the bank of the relevant facts within a reasonable time not exceeding 90
25 days. If the bank can prove that the sender failed in this duty it is
26 entitled to compensation for the loss incurred as a result of the fail-
27 ure. Whether the bank is entitled to recover from the sender depends
28 upon whether the failure to give timely notice would have made any
29 difference. If the bank could not have recovered from the beneficiary
30 that received payment under the erroneous payment order even if timely
31 notice had been given, the sender's failure to notify did not cause any
32 loss of the bank.

33 3. Section 4A-205 is subject to variation by agreement under
34 Section 4A-501. Thus, if a receiving bank and its customer have agreed
35 to a security procedure for detection of error, the liability of the
36 receiving bank for failing to detect an error of the customer as pro-
37 vided in Section 4A-205 may be varied as provided in an agreement of the
38 bank and the customer.

39 § 4A-206. TRANSMISSION OF PAYMENT ORDER THROUGH FUNDS-TRANSFER OR
40 OTHER COMMUNICATION SYSTEM

41 (a) If a payment order addressed to a receiving bank is
42 transmitted to a funds-transfer system or other third-party commu-

1 may be included in another electronic device. Typically, this process-
2 ing is done by an automated clearing house acting for a group of banks
3 including Originator's Bank. The automated clearing house is a funds
4 transfer system. Section 4A-105(a)(5). Originator's Bank delivers
5 Originator's electronic device or transmits the information contained in
6 the device to the funds transfer system for processing into payment
7 orders of Originator's Bank to the appropriate beneficiary's banks. The
8 processing may result in an erroneous payment order. Originator's Bank,
9 by use of Originator's electronic device, may have given information to
10 the funds transfer system instructing payment of \$100,000 to an account
11 in Bank X, but because of human error or an equipment malfunction the
12 processing may have converted that instruction into an instruction to
13 Bank X to make a payment of \$1,000,000. Under Section 4A-206, Origi-
14 nator's Bank issued a payment order for \$1,000,000 to Bank X when the
15 erroneous information was sent to Bank X. Originator's Bank is respon-
16 sible for the error of the automated clearing house. The liability of
17 the funds transfer system that made the error is not governed by Art-
18 icle 4A. It is left to the law of contract, a funds transfer system
19 rule, or other applicable law.

20 In the hypothetical case just discussed, if the automated clearing
21 house is operated by a Federal Reserve Bank, the analysis is different.
22 Section 4A-206 does not apply. Originator's Bank will execute Origina-
23 tor's payment orders by delivery or transmission of the electronic in-
24 formation to the Federal Reserve Bank for processing. The result is
25 that Originator's Bank has issued payment orders to the Federal Reserve
26 Bank which, in this case, is acting as an intermediary bank. When the
27 Federal Reserve Bank has processed the information given to it by Orig-
28 inator's Bank it will issue payment orders to the various beneficiary's
29 banks. If the processing results in an erroneous payment order, the
30 Federal Reserve Bank has erroneously executed the payment order of
31 Originator's Bank and the case is governed by Section 4A-303.

32 § 4A-207. MISDESCRIPTION OF BENEFICIARY

33 (a) Subject to subsection (b), if, in a payment order re-
34 ceived by the beneficiary's bank, the name, bank account number, or
35 other identification of the beneficiary refers to a nonexistent or
36 unidentifiable person or account, no person has rights as a ben-
37 efiary of the order and acceptance of the order cannot occur.

38 (b) If a payment order received by the beneficiary's bank
39 identifies the beneficiary both by name and by an identifying or

1 bank account number and the name and number identify different
2 persons, the following rules apply:

3 (1) Except as otherwise provided in subsection (c), if
4 the beneficiary's bank does not know that the name and number refer
5 to different persons, it may rely on the number as the proper
6 identification of the beneficiary of the order. The beneficiary's
7 bank need not determine whether the name and number refer to the
8 same person.

9 (2) If the beneficiary's bank pays the person identified
10 by name or knows that the name and number identify different per-
11 sons, no person has rights as beneficiary except the person paid by
12 the beneficiary's bank if that person was entitled to receive
13 payment from the originator of the funds transfer. If no person
14 has rights as beneficiary, acceptance of the order cannot occur.

15 (c) If (i) a payment order described in subsection (b) is
16 accepted, (ii) the originator's payment order described the ben-
17 eficiary inconsistently by name and number, and (iii) the benefi-
18 ciary's bank pays the person identified by number as permitted by
19 subsection (b)(1), the following rules apply:

20 (1) If the originator is a bank, the originator is
21 obliged to pay its order.

22 (2) If the originator is not a bank and proves that the
23 person identified by number was not entitled to receive payment
24 from the originator, the originator is not obliged to pay its order
25 unless the originator's bank proves that the originator, before
26 acceptance of the originator's order, had notice that payment of a

1 payment order issued by the originator might be made by the benefi-
2 ciary's bank on the basis of an identifying or bank account number
3 even if it identifies a person different from the named benefi-
4 ary. Proof of notice may be made by any admissible evidence. The
5 originator's bank satisfies the burden of proof if it proves that
6 the originator, before the payment order was accepted, signed a
7 writing stating the information to which the notice relates.

8 (d) In a case governed by subsection (b)(1), if the benefi-
9 ciary's bank rightfully pays the person identified by number and
10 that person was not entitled to receive payment from the origina-
11 tor, the amount paid may be recovered from that person to the
12 extent allowed by the law governing mistake and restitution as
13 follows:

14 (1) If the originator is obliged to pay its payment
15 order as stated in subsection (c), the originator has the right to
16 recover.

17 (2) If the originator is not a bank and is not obliged
18 to pay its payment order, the originator's bank has the right to
19 recover.

20 COMMENT

21 1. Subsection (a) deals with the problem of payment orders issued
22 to the beneficiary's bank for payment to nonexistent or unidentifiable
23 persons or accounts. Since it is not possible in that case for the
24 funds transfer to be completed, subsection (a) states that the order
25 cannot be accepted. Under Section 4A-402(c), a sender of a payment
26 order is not obliged to pay its order unless the beneficiary's bank
27 accepts a payment order instructing payment to the beneficiary of that
28 sender's order. Thus, if the beneficiary of a funds transfer is non-
29 existent or unidentifiable, each sender in the funds transfer that has
30 paid its payment order is entitled to get its money back.

1 2. Subsection (b), which takes precedence over subsection (a),
2 deals with the problem of payment orders in which the description of the
3 beneficiary does not allow identification of the beneficiary because the
4 beneficiary is described by name and by an identifying number or an ac-
5 count number and the name and number refer to different persons. A very
6 large percentage of payment orders issued to the beneficiary's bank by
7 another bank are processed by automated means using machines capable of
8 reading orders on standard formats that identify the beneficiary by an
9 identifying number or the number of a bank account. The processing of
10 the order by the beneficiary's bank and the crediting of the benefici-
11 ary's account are done by use of the identifying or bank account number
12 without human reading of the payment order itself. The process is com-
13 parable to that used in automated payment of checks. The standard for-
14 mat, however, may also allow the inclusion of the name of the benefici-
15 ary and other information which can be useful to the beneficiary's bank
16 and the beneficiary but which plays no part in the process of payment.
17 If the beneficiary's bank has both the account number and name of the
18 beneficiary supplied by the originator of the funds transfer, it is
19 possible for the beneficiary's bank to determine whether the name and
20 number refer to the same person, but if a duty to make that determina-
21 tion is imposed on the beneficiary's bank the benefits of automated
22 payment are lost. Manual handling of payment orders is both expensive
23 and subject to human error. If payment orders can be handled on an
24 automated basis there are substantial economies of operation and the
25 possibility of clerical error is reduced. Subsection (b) allows banks
26 to utilize automated processing by allowing banks to act on the basis of
27 the number without regard to the name if the bank does not know that the
28 name and number refer to different persons. "Know" is defined in Sec-
29 tion 1-201(25) to mean actual knowledge, and Section 1-201(27) states
30 rules for determining when an organization has knowledge of information
31 received by the organization. The time of payment is the pertinent time
32 at which knowledge or lack of knowledge must be determined.

33 Although the clear trend is for beneficiary's banks to process pay-
34 ment orders by automated means, Section 4A-207 is not limited to cases
35 in which processing is done by automated means. A bank that processes
36 by semi-automated means or even manually may rely on number as stated in
37 Section 4A-207.

38 In cases covered by subsection (b) the erroneous identification
39 would in virtually all cases be the identifying or bank account number.
40 In the typical case the error is made by the originator of the funds
41 transfer. The originator should know the name of the person who is to
42 receive payment and can further identify that person by an address that
43 would normally be known to the originator. It is not unlikely, however,
44 that the originator may not be sure whether the identifying or account
45 number refers to the person the originator intends to pay. Subsection
46 (b)(1) deals with the typical case in which the beneficiary's bank pays
47 on the basis of the account number and is not aware at the time of pay-
48 ment that the named beneficiary is not the holder of the account which
49 was paid. In some cases the false number will be the result of error by
50 the originator. In other cases fraud is involved. For example, Doe is

1 the holder of shares in Mutual Fund. Thief, impersonating Doe, requests
2 redemption of the shares and directs Mutual Fund to wire the redemption
3 proceeds to Doe's account #12345 in Beneficiary's Bank. Mutual Fund
4 originates a funds transfer by issuing a payment order to Originator's
5 Bank to make the payment to Doe's account #12345 in Beneficiary's Bank.
6 Originator's Bank executes the order by issuing a conforming payment
7 order to Beneficiary's Bank which makes payment to account #12345. That
8 account is the account of Roe rather than Doe. Roe might be a person
9 acting in concert with Thief or Roe might be an innocent third party.
10 Assume that Roe is a gem merchant that agreed to sell gems to Thief who
11 agreed to wire the purchase price to Roe's account in Beneficiary's
12 Bank. Roe believed that the credit to Roe's account was a transfer of
13 funds from Thief and released the gems to Thief in good faith in reli-
14 ance on the payment. The case law is unclear on the responsibility of a
15 beneficiary's bank in carrying out a payment order in which the identif-
16 ication of the beneficiary by name and number is conflicting. See
17 Securities Fund Services, Inc. v. American National Bank, 542 F.Supp.
18 323 (N.D.Ill. 1982) and Bradford Trust Co. v. Texas American Bank, 790
19 F.2d 407 (5th Cir. 1986). Section 4A-207 resolves the issue.

20 If Beneficiary's Bank did not know about the conflict between the
21 name and number, subsection (b)(1) applies. Beneficiary's Bank has no
22 duty to determine whether there is a conflict and it may rely on the
23 number as the proper identification of the beneficiary of the order.
24 When it accepts the order, it is entitled to payment from Originator's
25 Bank. Section 4A-402(b). On the other hand, if Beneficiary's Bank knew
26 about the conflict between the name and number and nevertheless paid
27 Roe, subsection (b)(2) applies. Under that provision, acceptance of the
28 payment order of Originator's Bank did not occur because there is no
29 beneficiary of that order. Since acceptance did not occur Originator's
30 Bank is not obliged to pay Beneficiary's Bank. Section 4A-402(b). Sim-
31 ilarly, Mutual Fund is excused from its obligation to pay Originator's
32 Bank. Section 4A-402(c). Thus, Beneficiary's Bank takes the loss. Its
33 only cause of action is against Thief. Roe is not obliged to return the
34 payment to the beneficiary's bank because Roe received the payment in
35 good faith and for value. Article 4A makes irrelevant the issue of
36 whether Mutual Fund was or was not negligent in issuing its payment
37 order.

38 3. Normally, subsection (b)(1) will apply to the hypothetical
39 case discussed in Comment 2. Beneficiary's Bank will pay on the basis
40 of the number without knowledge of the conflict. In that case subsec-
41 tion (c) places the loss on either Mutual Fund or Originator's Bank. It
42 is not unfair to assign the loss to Mutual Fund because it is the person
43 who dealt with the impostor and it supplied the wrong account number.
44 It could have avoided the loss if it had not used an account number that
45 it was not sure was that of Doe. Mutual Fund, however, may not have
46 been aware of the risk involved in giving both name and number. Sub-
47 section (c) is designed to protect the originator, Mutual Fund, in this
48 case. Under that subsection, the originator is responsible for the
49 inconsistent description of the beneficiary if it had notice that the
50 order might be paid by the beneficiary's bank on the basis of the

1 number. If the originator is a bank, the originator always has that
2 responsibility. The rationale is that any bank should know how payment
3 orders are processed and paid. If the originator is not a bank, the
4 originator's bank must prove that its customer, the originator, had
5 notice. Notice can be proved by any admissible evidence, but the bank
6 can always prove notice by providing the customer with a written state-
7 ment of the required information and obtaining the customer's signature
8 to the statement. That statement will then apply to any payment order
9 accepted by the bank thereafter. The information need not be supplied
10 more than once.

11 In the hypothetical case if Originator's Bank made the disclosure
12 stated in the last sentence of subsection (c)(2), Mutual Fund must pay
13 Originator's Bank. Under subsection (d)(1), Mutual Fund has an action
14 to recover from Roe if recovery from Roe is permitted by the law govern-
15 ing mistake and restitution. Under the assumed facts Roe should be en-
16 titled to keep the money as a person who took it in good faith and for
17 value since it was taken as payment for the gems. In that case, Mutual
18 Fund's only remedy is against Thief. If Roe was not acting in good
19 faith, Roe has to return the money to Mutual Fund. If Originator's Bank
20 does not prove that Mutual Fund had notice as stated in subsection
21 (c)(2), Mutual Fund is not required to pay Originator's Bank. Thus, the
22 risk of loss falls on Originator's Bank whose remedy is against Roe or
23 Thief as stated above. Subsection (d)(2).

24 § 4A-208. MISDESCRIPTION OF INTERMEDIARY BANK OR BENEFICIARY'S BANK

25 (a) This subsection applies to a payment order identifying an
26 intermediary bank or the beneficiary's bank only by an identifying
27 number.

28 (1) The receiving bank may rely on the number as the
29 proper identification of the intermediary or beneficiary's bank and
30 need not determine whether the number identifies a bank.

31 (2) The sender is obliged to compensate the receiving
32 bank for any loss and expenses incurred by the receiving bank as a
33 result of its reliance on the number in executing or attempting to
34 execute the order.

1 (b) This subsection applies to a payment order identifying an
2 intermediary bank or the beneficiary's bank both by name and an
3 identifying number if the name and number identify different
4 persons.

5 (1) If the sender is a bank, the receiving bank may rely
6 on the number as the proper identification of the intermediary or
7 beneficiary's bank if the receiving bank, when it executes the
8 sender's order, does not know that the name and number identify
9 different persons. The receiving bank need not determine whether
10 the name and number refer to the same person or whether the number
11 refers to a bank. The sender is obliged to compensate the receiv-
12 ing bank for any loss and expenses incurred by the receiving bank
13 as a result of its reliance on the number in executing or attempt-
14 ing to execute the order.

15 (2) If the sender is not a bank and the receiving bank
16 proves that the sender, before the payment order was accepted, had
17 notice that the receiving bank might rely on the number as the
18 proper identification of the intermediary or beneficiary's bank
19 even if it identifies a person different from the bank identified
20 by name, the rights and obligations of the sender and the receiving
21 bank are governed by subsection (b)(1), as though the sender were a
22 bank. Proof of notice may be made by any admissible evidence. The
23 receiving bank satisfies the burden of proof if it proves that the
24 sender, before the payment order was accepted, signed a writing
25 stating the information to which the notice relates.

1 (3) Regardless of whether the sender is a bank, the re-
2 ceiving bank may rely on the name as the proper identification of
3 the intermediary or beneficiary's bank if the receiving bank, at
4 the time it executes the sender's order, does not know that the
5 name and number identify different persons. The receiving bank
6 need not determine whether the name and number refer to the same
7 person.

8 (4) If the receiving bank knows that the name and number
9 identify different persons, reliance on either the name or the
10 number in executing the sender's payment order is a breach of the
11 obligation stated in Section 4A-302(a)(1).

12 COMMENT

13 1. This section addresses an issue similar to that addressed by
14 Section 4A-207. Because of automation in the processing of payment
15 orders, a payment order may identify the beneficiary's bank or an inter-
16 mediary bank by an identifying number. The bank identified by number
17 might or might not also be identified by name. The following two cases
18 illustrate Section 4A-208(a) and (b):

19 Case #1. Originator's payment order to Originator's Bank identi-
20 fies the beneficiary's bank as Bank A and instructs payment to Account
21 #12345 in that bank. Originator's Bank executes Originator's order by
22 issuing a payment order to Intermediary Bank. In the payment order of
23 Originator's Bank the beneficiary's bank is identified as Bank A but is
24 also identified by number, #67890. The identifying number refers to
25 Bank B rather than Bank A. If processing by Intermediary Bank of the
26 payment order of Originator's Bank is done by automated means, Interme-
27 diary Bank, in executing the order, will rely on the identifying number
28 and will issue a payment order to Bank B rather than Bank A. If there
29 is an Account #12345 in Bank B, the payment order of Intermediary Bank
30 would normally be accepted and payment would be made to a person not
31 intended by Originator. In this case, Section 4A-208(b)(1) puts the
32 risk of loss on Originator's Bank. Intermediary Bank may rely on the
33 number #67890 as the proper identification of the beneficiary's bank.
34 Intermediary Bank has properly executed the payment order of Origina-
35 tor's Bank. By using the wrong number to describe the beneficiary's
36 bank, Originator's Bank has improperly executed Originator's payment
37 order because the payment order of Originator's Bank provides for pay-
38 ment to the wrong beneficiary, the holder of Account #12345 in Bank B
39 rather than the holder of Account #12345 in Bank A. Section 4A-302(a)

1 (1) and Section 4A-303(c). Originator's Bank is not entitled to payment
2 from Originator but is required to pay Intermediary Bank. Section 4A-
3 303(c) and Section 4A-402(c). Intermediary Bank is also entitled to
4 compensation for any loss and expenses resulting from the error by
5 Originator's Bank.

6 If there is no Account #12345 in Bank B, the result is that there
7 is no beneficiary of the payment order issued by Originator's Bank and
8 the funds transfer will not be completed. Originator's Bank is not en-
9 titled to payment from Originator and Intermediary Bank is not entitled
10 to payment from Originator's Bank. Section 4A-402(c). Since Origina-
11 tor's Bank improperly executed Originator's payment order it may be
12 liable for damages under Section 4A-305. As stated above, Intermediary
13 Bank is entitled to compensation for loss and expenses resulting from
14 the error by Originator's Bank.

15 Case #2. Suppose the same payment order by Originator to Origina-
16 tor's Bank as in Case #1. In executing the payment order Originator's
17 Bank issues a payment order to Intermediary Bank in which the benefici-
18 ary's bank is identified only by number, #67890. That number does not
19 refer to Bank A. Rather, it identifies a person that is not a bank. If
20 processing by Intermediary Bank of the payment order of Originator's
21 Bank is done by automated means, Intermediary Bank will rely on the num-
22 ber #67890 to identify the beneficiary's bank. Intermediary Bank has no
23 duty to determine whether the number identifies a bank. The funds
24 transfer cannot be completed in this case because no bank is identified
25 as the beneficiary's bank. Subsection (a) puts the risk of loss on
26 Originator's Bank. Originator's Bank is not entitled to payment from
27 Originator. Section 4A-402(c). Originator's Bank has improperly exe-
28 cuted Originator's payment order and may be liable for damages under
29 Section 4A-305. Originator's Bank is obliged to compensate Intermediary
30 Bank for loss and expenses resulting from the error by Originator's
31 Bank.

32 Subsection (a) also applies if #67890 identifies a bank, but the
33 bank is not Bank A. Intermediary Bank may rely on the number as the
34 proper identification of the beneficiary's bank. If the bank to which
35 Intermediary Bank sends its payment order accepts the order, Intermedi-
36 ary Bank is entitled to payment from Originator's Bank, but Originator's
37 Bank is not entitled to payment from Originator. The analysis is sim-
38 ilar to that in Case #1.

39 2. Subsection (b)(2) of Section 4A-208 addresses cases in which
40 an erroneous identification of a beneficiary's bank or intermediary bank
41 by name and number is made in a payment order of a sender that is not a
42 bank. Suppose Originator issues a payment order to Originator's Bank
43 that instructs that bank to use an intermediary bank identified as Bank
44 A and by an identifying number, #67890. The identifying number refers
45 to Bank B. Originator intended to identify Bank A as intermediary bank.
46 If Originator's Bank relied on the number and issued a payment order to
47 Bank B the rights of Originator's Bank depend upon whether the proof of
48 notice stated in subsection (b)(2) is made by Originator's Bank. If

1 proof is made, Originator's Bank's rights are governed by subsection
2 (b)(1) of Section 4A-208. Originator's Bank is not liable for breach of
3 Section 4A-302(a)(1) and is entitled to compensation from Originator for
4 any loss and expenses resulting from Originator's error. If notice is
5 not proved, Originator's Bank may not rely on the number in executing
6 Originator's payment order. Since Originator's Bank does not get the
7 benefit of subsection (b)(1) in that case, Originator's Bank improperly
8 executed Originator's payment order and is in breach of the obligation
9 stated in Section 4A-302(a)(1). If notice is not given, Originator's
10 Bank can rely on the name if it is not aware of the conflict in name and
11 number. Subsection (b)(3).

12 3. Although the principal purpose of Section 4A-208 is to
13 accommodate automated processing of payment orders, Section 4A-208
14 applies regardless of whether processing is done by automation, semi-
15 automated means or manually.

16 § 4A-209. ACCEPTANCE OF PAYMENT ORDER .

17 (a) Subject to subsection (d), a receiving bank other than
18 the beneficiary's bank accepts a payment order when it executes the
19 order.

20 (b) Subject to subsections (c) and (d), a beneficiary's bank
21 accepts a payment order at the earliest of the following times:

22 (1) when the bank (i) pays the beneficiary as stated in
23 Section 4A-405(a) or 4A-405(b), or (ii) notifies the beneficiary of
24 receipt of the order or that the account of the beneficiary has
25 been credited with respect to the order unless the notice indicates
26 that the bank is rejecting the order or that funds with respect to
27 the order may not be withdrawn or used until receipt of payment
28 from the sender of the order;

29 (2) when the bank receives payment of the entire amount
30 of the sender's order pursuant to Section 4A-403(a)(1) or 4A-
31 403(a)(2); or

1 (3) the opening of the next funds-transfer business day
2 of the bank following the payment date of the order if, at that
3 time, the amount of the sender's order is fully covered by a with-
4 drawable credit balance in an authorized account of the sender or
5 the bank has otherwise received full payment from the sender,
6 unless the order was rejected before that time or is rejected
7 within (i) one hour after that time, or (ii) one hour after the
8 opening of the next business day of the sender following the
9 payment date if that time is later. If notice of rejection is
10 received by the sender after the payment date and the authorized
11 account of the sender does not bear interest, the bank is obliged
12 to pay interest to the sender on the amount of the order for the
13 number of days elapsing after the payment date to the day the
14 sender receives notice or learns that the order was not accepted,
15 counting that day as an elapsed day. If the withdrawable credit
16 balance during that period falls below the amount of the order, the
17 amount of interest payable is reduced accordingly.

18 (c) Acceptance of a payment order cannot occur before the
19 order is received by the receiving bank. Acceptance does not occur
20 under subsection (b)(2) or (b)(3) if the beneficiary of the payment
21 order does not have an account with the receiving bank, the account
22 has been closed, or the receiving bank is not permitted by law to
23 receive credits for the beneficiary's account.

24 (d) A payment order issued to the originator's bank cannot be
25 accepted until the payment date if the bank is the beneficiary's
26 bank, or the execution date if the bank is not the beneficiary's

1 bank. If the originator's bank executes the originator's payment
2 order before the execution date or pays the beneficiary of the
3 originator's payment order before the payment date and the payment
4 order is subsequently canceled pursuant to Section 4A-211(b), the
5 bank may recover from the beneficiary any payment received to the
6 extent allowed by the law governing mistake and restitution.

7 COMMENT

8 1. This section treats the sender's payment order as a request by
9 the sender to the receiving bank to execute or pay the order and that
10 request can be accepted or rejected by the receiving bank. Section 4A-
11 209 defines when acceptance occurs. Section 4A-210 covers rejection.
12 Acceptance of the payment order imposes an obligation on the receiving
13 bank to the sender if the receiving bank is not the beneficiary's bank,
14 or to the beneficiary if the receiving bank is the beneficiary's bank.
15 These obligations are stated in Section 4A-302 and Section 4A-404.

16 2. Acceptance by a receiving bank other than the beneficiary's
17 bank is defined in Section 4A-209(a). That subsection states the only
18 way that a bank other than the beneficiary's bank can accept a payment
19 order. A payment order to a bank other than the beneficiary's bank is,
20 in effect, a request that the receiving bank execute the sender's order
21 by issuing a payment order to the beneficiary's bank or to an interme-
22 diary bank. Normally, acceptance occurs at the time of execution, but
23 there is an exception stated in subsection (d) and discussed in Comment
24 9. Execution occurs when the receiving bank "issues a payment order
25 intended to carry out" the sender's order. Section 4A-301(a). In some
26 cases the payment order issued by the receiving bank may not conform to
27 the sender's order. For example, the receiving bank might make a mis-
28 take in the amount of its order, or the order might be issued to the
29 wrong beneficiary's bank or for the benefit of the wrong beneficiary.
30 In all of these cases there is acceptance of the sender's order by the
31 bank when the receiving bank issues its order intended to carry out the
32 sender's order, even though the bank's payment order does not in fact
33 carry out the instruction of the sender. Improper execution of the
34 sender's order may lead to liability to the sender for damages or it may
35 mean that the sender is not obliged to pay its payment order. These
36 matters are covered in Section 4A-303, Section 4A-305, and Section
37 4A-402.

38 3. A receiving bank has no duty to accept a payment order unless
39 the bank makes an agreement, either before or after issuance of the pay-
40 ment order, to accept it, or acceptance is required by a funds transfer
41 system rule. If the bank makes such an agreement it incurs a contract-
42 ual obligation based on the agreement and may be held liable for breach
43 of contract if a failure to execute violates the agreement. In many

1 cases a bank will enter into an agreement with its customer to govern
2 the rights and obligations of the parties with respect to payment orders
3 issued to the bank by the customer or, in cases in which the sender is
4 also a bank, there may be a funds transfer system rule that governs the
5 obligations of a receiving bank with respect to payment orders transmit-
6 ted over the system. Such agreements or rules can specify the circum-
7 stances under which a receiving bank is obliged to execute a payment
8 order and can define the extent of liability of the receiving bank for
9 breach of the agreement or rule. Section 4A-305(d) states the liability
10 for breach of an agreement to execute a payment order.

11 4. In the case of a payment order issued to the beneficiary's
12 bank, acceptance is defined in Section 4A-209(b). The function of a
13 beneficiary's bank that receives a payment order is different from that
14 of a receiving bank that receives a payment order for execution. In the
15 typical case, the beneficiary's bank simply receives payment from the
16 sender of the order, credits the account of the beneficiary and notifies
17 the beneficiary of the credit. Acceptance by the beneficiary's bank
18 does not create any obligation to the sender. Acceptance by the benefi-
19 ciary's bank means that the bank is liable to the beneficiary for the
20 amount of the order. Section 4A-404(a). There are three ways in which
21 the beneficiary's bank can accept a payment order which are described in
22 the following comments.

23 5. Under Section 4A-209(b)(1), the beneficiary's bank can accept
24 a payment order by paying the beneficiary. In the normal case of cred-
25 iting an account of the beneficiary, payment occurs when the beneficiary
26 is given notice of the right to withdraw the credit, the credit is ap-
27 plied to a debt of the beneficiary, or "funds with respect to the order"
28 are otherwise made available to the beneficiary. Section 4A-405(a).
29 The quoted phrase covers cases in which funds are made available to the
30 beneficiary as a result of receipt of a payment order for the benefit of
31 the beneficiary but the release of funds is not expressed as payment of
32 the order. For example, the beneficiary's bank might express a release
33 of funds equal to the amount of the order as a "loan" that will be auto-
34 matically repaid when the beneficiary's bank receives payment by the
35 sender of the order. If the release of funds is designated as a loan
36 pursuant to a routine practice of the bank, the release is conditional
37 payment of the order rather than a loan, particularly if normal inci-
38 dents of a loan such as the signing of a loan agreement or note and the
39 payment of interest are not present. Such a release of funds is payment
40 to the beneficiary under Section 4A-405(a). Under Section 4A-405(c) the
41 bank cannot recover the money from the beneficiary if the bank does not
42 receive payment from the sender of the payment order that it accepted.
43 Exceptions to this rule are stated in § 4A-405(d) and (e). The benefi-
44 ciary's bank may also accept by notifying the beneficiary that the order
45 has been received. "Notifies" is defined in Section 1-201 (26). In
46 some cases a beneficiary's bank will receive a payment order during the
47 day but settlement of the sender's obligation to pay the order will not
48 occur until the end of the day. If the beneficiary's bank wants to de-
49 fer incurring liability to the beneficiary until the beneficiary's bank
50 receives payment, it can do so. The beneficiary's bank incurs no lia-

1 bility to the beneficiary with respect to a payment order that it re-
2 ceives until it accepts the order. If the bank does not accept pursuant
3 to subsection (b)(1), acceptance does not occur until the end of the day
4 when the beneficiary's bank receives settlement. If the sender settles,
5 the payment order will be accepted under subsection (b)(2) and the funds
6 will be released to the beneficiary the next morning. If the sender
7 doesn't settle, no acceptance occurs. In either case the beneficiary's
8 bank suffers no loss.

9 6. In most cases the beneficiary's bank will receive a payment
10 order from another bank. If the sender is a bank and the beneficiary's
11 bank receives payment from the sender by final settlement through the
12 Federal Reserve System or a funds transfer system (Section 4A-403(a)(1))
13 or, less commonly, through credit to an account of the beneficiary's
14 bank with the sender or another bank (Section 4A-403(a)(2)), acceptance
15 by the beneficiary's bank occurs at the time payment is made. Section
16 4A-209(b)(2). A minor exception to this rule is stated in Section 4A-
17 209(c). Section 4A-209(b)(2) results in automatic acceptance of payment
18 orders issued to a beneficiary's bank by means of Fedwire because the
19 Federal Reserve account of the beneficiary's bank is credited and final
20 payment is made to that bank when the payment order is received.

21 Subsection (b)(2) would also apply to cases in which the benefi-
22 ciary's bank mistakenly pays a person who is not the beneficiary of the
23 payment order issued to the beneficiary's bank. For example, suppose
24 the payment order provides for immediate payment to Account #12345. The
25 beneficiary's bank erroneously credits Account #12346 and notifies the
26 holder of that account of the credit. No acceptance occurs in this case
27 under subsection (b)(1) because the beneficiary of the order has not
28 been paid or notified. The holder of Account #12345 is the beneficiary
29 of the order issued to the beneficiary's bank. But acceptance will
30 normally occur if the beneficiary's bank takes no other action, because
31 the bank will normally receive settlement with respect to the payment
32 order. At that time the bank has accepted because the sender paid its
33 payment order. The bank is liable to pay the holder of Account #12345.
34 The bank has paid the holder of Account #12346 by mistake, and has a
35 right to recover the payment if the credit is withdrawn, to the extent
36 provided in the law governing mistake and restitution.

37 7. Subsection (b)(3) covers cases of inaction by the benefi-
38 ciary's bank. It applies whether or not the sender is a bank and covers
39 a case in which the sender and the beneficiary both have accounts with
40 the receiving bank and payment will be made by debiting the account of
41 the sender and crediting the account of the beneficiary. Subsection
42 (b)(3) is similar to subsection (b)(2) in that it bases acceptance by
43 the beneficiary's bank on payment by the sender. Payment by the sender
44 is effected by a debit to the sender's account if the account balance is
45 sufficient to cover the amount of the order. On the payment date (Sec-
46 tion 4A-401) of the order the beneficiary's bank will normally credit
47 the beneficiary's account and notify the beneficiary of receipt of the
48 order if it is satisfied that the sender's account balance covers the
49 order or is willing to give credit to the sender. In some cases, how-

1 ever, the bank may not be willing to give credit to the sender and it
2 may not be possible for the bank to determine until the end of the day
3 on the payment date whether there are sufficient good funds in the send-
4 er's account. There may be various transactions during the day involv-
5 ing funds going into and out of the account. Some of these transactions
6 may occur late in the day or after the close of the banking day. To
7 accommodate this situation, subsection (b)(3) provides that the status
8 of the account is determined at the opening of the next funds transfer
9 business day of the beneficiary's bank after the payment date of the or-
10 der. If the sender's account balance is sufficient to cover the order,
11 the beneficiary's bank has a source of payment and the result in almost
12 all cases is that the bank accepts the order at that time if it did not
13 previously accept under subsection (b)(1). In rare cases, a bank may
14 want to avoid acceptance under subsection (b)(3) by rejecting the order
15 as discussed in Comment 8.

16 8. Section 4A-209 is based on a general principle that a receiv-
17 ing bank is not obliged to accept a payment order unless it has agreed
18 or is bound by a funds transfer system rule to do so. Thus, provision
19 is made to allow the receiving bank to prevent acceptance of the order.
20 This principle is consistently followed if the receiving bank is not the
21 beneficiary's bank. If the receiving bank is not the beneficiary's
22 bank, acceptance is in the control of the receiving bank because it oc-
23 curs only if the order is executed. But in the case of the benefici-
24 ary's bank acceptance can occur by passive receipt of payment under
25 subsection (b)(2) or (3). In the case of a payment made by Fedwire
26 acceptance cannot be prevented. In other cases the beneficiary's bank
27 can prevent acceptance by giving notice of rejection to the sender be-
28 fore payment occurs under Section 4A-403(a)(1) or (2). A minor excep-
29 tion to the ability of the beneficiary's bank to reject is stated in
30 Section 4A-502(c)(3).

31 Under subsection (b)(3) acceptance occurs at the opening of the
32 next funds transfer business day of the beneficiary's bank following the
33 payment date unless the bank rejected the order before that time or it
34 rejects within one hour after that time. In some cases the sender and
35 the beneficiary's bank may not be in the same time zone or the beginning
36 of the business day of the sender and the funds transfer business day of
37 the beneficiary's bank may not coincide. For example, the sender may be
38 located in California and the beneficiary's bank in New York. Since in
39 most cases notice of rejection would be communicated electronically or
40 by telephone, it might not be feasible for the bank to give notice be-
41 fore one hour after the opening of the funds transfer business day in
42 New York because at that hour, the sender's business day may not have
43 started in California. For that reason, there are alternative deadlines
44 stated in subsection (b)(3). In the case stated, the bank acts in time
45 if it gives notice within one hour after the opening of the business day
46 of the sender. But if the notice of rejection is received by the sender
47 after the payment date, the bank is obliged to pay interest to the send-
48 er if the sender's account does not bear interest. In that case the
49 bank had the use of funds of the sender that the sender could reasonably
50 assume would be used to pay the beneficiary. The rate of interest is

1 stated in Section 4A-506. If the sender receives notice on the day
2 after the payment date the sender is entitled to one day's interest.
3 If receipt of notice is delayed for more than one day, the sender is
4 entitled to interest for each additional day of delay.

5 9. Subsection (d) applies only to a payment order by the origin-
6 ator of a funds transfer to the originator's bank and it refers to the
7 following situation. On April 1, Originator instructs Bank A to make a
8 payment on April 15 to the account of Beneficiary in Bank B. By mis-
9 take, on April 1, Bank A executes Originator's payment order by issuing
10 a payment order to Bank B instructing immediate payment to Beneficiary.
11 Bank B credited Beneficiary's account and immediately released the funds
12 to Beneficiary. Under subsection (d) no acceptance by Bank A occurred
13 on April 1 when Originator's payment order was executed because accep-
14 tance cannot occur before the execution date which in this case would be
15 April 15 or shortly before that date. Section 4A-301(b). Under Section
16 4A-402(c), Originator is not obliged to pay Bank A until the order is
17 accepted and that can't occur until the execution date. But Bank A is
18 required to pay Bank B when Bank B accepted Bank A's order on April 1.
19 Unless Originator and Beneficiary are the same person, in almost all
20 cases Originator is paying a debt owed to Beneficiary and early payment
21 does not injure Originator because Originator does not have to pay Bank
22 A until the execution date. Section 4A-402(c). Bank A takes the inter-
23 est loss. But suppose that on April 3, Originator concludes that no
24 debt was owed to Beneficiary or that the debt was less than the amount
25 of the payment order. Under Section 4A-211(b) Originator can cancel its
26 payment order if Bank A has not accepted. If early execution of Origi-
27 nator's payment order is acceptance, Originator can suffer a loss be-
28 cause cancellation after acceptance is not possible without the consent
29 of Bank A and Bank B. Section 4A-211(c). If Originator has to pay Bank
30 A, Originator would be required to seek recovery of the money from
31 Beneficiary. Subsection (d) prevents this result and puts the risk of
32 loss on Bank A by providing that the early execution does not result in
33 acceptance until the execution date. Since on April 3 Originator's
34 order was not yet accepted, Originator can cancel it under Section 4A-
35 211(b). The result is that Bank A is not entitled to payment from
36 Originator but is obliged to pay Bank B. Bank A has paid Beneficiary by
37 mistake. If Originator's payment order is cancelled, Bank A becomes the
38 originator of an erroneous funds transfer to Beneficiary. Bank A has
39 the burden of recovering payment from Beneficiary on the basis of a
40 payment by mistake. If Beneficiary received the money in good faith in
41 payment of a debt owed to Beneficiary by Originator, the law of mistake
42 and restitution may allow Beneficiary to keep all or part of the money
43 received. If Originator owed money to Beneficiary, Bank A has paid
44 Originator's debt and, under the law of restitution, which applies pur-
45 suant to Section 1-103, Bank A is subrogated to Beneficiary's rights
46 against Originator on the debt.

47 If Bank A is the Beneficiary's bank and Bank A credited Benefici-
48 ary's account and released the funds to Beneficiary on April 1, the
49 analysis is similar. If Originator's order is cancelled, Bank A has
50 paid Beneficiary by mistake. The right of Bank A to recover the payment

1 from Beneficiary is similar to Bank A's rights in the preceding para-
2 graph.

3 § 4A-210. REJECTION OF PAYMENT ORDER

4 (a) A payment order is rejected by the receiving bank by a
5 notice of rejection transmitted to the sender orally, electronic-
6 ally, or in writing. A notice of rejection need not use any parti-
7 cular words and is sufficient if it indicates that the receiving
8 bank is rejecting the order or will not execute or pay the order.
9 Rejection is effective when the notice is given if transmission is
10 by a means that is reasonable in the circumstances. If notice of
11 rejection is given by a means that is not reasonable, rejection is
12 effective when the notice is received. If an agreement of the
13 sender and receiving bank establishes the means to be used to re-
14 ject a payment order, (i) any means complying with the agreement is
15 reasonable and (ii) any means not complying is not reasonable
16 unless no significant delay in receipt of the notice resulted from
17 the use of the noncomplying means.

18 (b) This subsection applies if a receiving bank other than
19 the beneficiary's bank fails to execute a payment order despite the
20 existence on the execution date of a withdrawable credit balance in
21 an authorized account of the sender sufficient to cover the order.
22 If the sender does not receive notice of rejection of the order on
23 the execution date and the authorized account of the sender does
24 not bear interest, the bank is obliged to pay interest to the
25 sender on the amount of the order for the number of days elapsing

1 after the execution date to the earlier of the day the order is
2 canceled pursuant to Section 4A-211(d) or the day the sender
3 receives notice or learns that the order was not executed, counting
4 the final day of the period as an elapsed day. If the withdrawable
5 credit balance during that period falls below the amount of the
6 order, the amount of interest is reduced accordingly.

7 (c) If a receiving bank suspends payments, all unaccepted
8 payment orders issued to it are deemed rejected at the time the
9 bank suspends payments.

10 (d) Acceptance of a payment order precludes a later rejection
11 of the order. Rejection of a payment order precludes a later
12 acceptance of the order.

13 COMMENT

14 1. With respect to payment orders issued to a receiving bank
15 other than the beneficiary's bank, notice of rejection is not necessary
16 to prevent acceptance of the order. Acceptance can occur only if the
17 receiving bank executes the order. Section 4A-209(a). But notice of
18 rejection will routinely be given by such a bank in cases in which the
19 bank cannot or is not willing to execute the order for some reason.
20 There are many reasons why a bank doesn't execute an order. The payment
21 order may not clearly instruct the receiving bank because of some ambig-
22 uity in the order or an internal inconsistency. In some cases, the re-
23 ceiving bank may not be able to carry out the instruction because of
24 equipment failure, credit limitations on the receiving bank, or some
25 other factor which makes proper execution of the order infeasible. In
26 those cases notice of rejection is a means of informing the sender of
27 the facts so that a corrected payment order can be transmitted or the
28 sender can seek alternate means of completing the funds transfer. The
29 other major reason for not executing an order is that the sender's ac-
30 count is insufficient to cover the order and the receiving bank is not
31 willing to give credit to the sender. If the sender's account is suffi-
32 cient to cover the order and the receiving bank chooses not to execute
33 the order, notice of rejection is necessary to prevent liability to pay
34 interest to the sender if the case falls within Section 4A-210(b) which
35 is discussed in Comment 3.

36 2. A payment order to the beneficiary's bank can be accepted by
37 inaction of the bank. Section 4A-209(b)(2) and (3). To prevent accep-
38 tance under those provisions it is necessary for the receiving bank to

1 send notice of rejection before acceptance occurs. Subsection (a) of
2 Section 4A-210 states the rule that rejection is accomplished by giving
3 notice of rejection. This incorporates the definitions in Section 1-
4 201(26). Rejection is effective when notice is given if it is given by
5 a means that is reasonable in the circumstances. Otherwise it is effec-
6 tive when the notice is received. The question of when rejection is
7 effective is important only in the relatively few cases under subsection
8 (b)(2) and (3) in which a notice of rejection is necessary to prevent
9 acceptance. The question of whether a particular means is reasonable
10 depends on the facts in a particular case. In a very large percentage
11 of cases the sender and the receiving bank will be in direct electronic
12 contact with each other and in those cases a notice of rejection can be
13 transmitted instantaneously. Since time is of the essence in a large
14 proportion of funds transfers, some quick means of transmission would
15 usually be required, but this is not always the case. The parties may
16 specify by agreement the means by which communication between the
17 parties is to be made.

18 3. Subsection (b) deals with cases in which a sender does not
19 learn until after the execution date that the sender's order has not
20 been executed. It applies only to cases in which the receiving bank was
21 assured of payment because the sender's account was sufficient to cover
22 the order. Normally, the receiving bank will accept the sender's order
23 if it is assured of payment, but there may be some cases in which the
24 bank chooses to reject. Unless the receiving bank had obligated itself
25 by agreement to accept, the failure to accept is not wrongful. There
26 no duty of the receiving bank to accept the payment order unless it is
27 obliged to accept by express agreement. Section 4A-212. But even if
28 the bank has not acted wrongfully, the receiving bank had the use of the
29 sender's money that the sender could reasonably assume was to be the
30 source of payment of the funds transfer. Until the sender learns that
31 the order was not accepted the sender is denied the use of that money.
32 Subsection (b) obliges the receiving bank to pay interest to the sender
33 as restitution unless the sender receives notice of rejection on the
34 execution date. The time of receipt of notice is determined pursuant to
35 § 1-201(27). The rate of interest is stated in Section 4A-506. If the
36 sender receives notice on the day after the execution date, the sender
37 is entitled to one day's interest. If receipt of notice is delayed for
38 more than one day, the sender is entitled to interest for each addi-
39 tional day of delay.

40 4. Subsection (d) treats acceptance and rejection as mutually ex-
41 clusive. If a payment order has been accepted, rejection of that order
42 becomes impossible. If a payment order has been rejected it cannot be
43 accepted later by the receiving bank. Once notice of rejection has been
44 given, the sender may have acted on the notice by making the payment
45 through other channels. If the receiving bank wants to act on a payment
46 order that it has rejected it has to obtain the consent of the sender.
47 In that case the consent of the sender would amount to the giving of a
48 second payment order that substitutes for the rejected first order. If
49 the receiving bank suspends payments (Section 4-104(1)(k)), subsection
50 (c) provides that unaccepted payment orders are deemed rejected at the

1 time suspension of payments occurs. This prevents acceptance by passage
2 of time under Section 4A-209(b)(3).

3 § 4A-211. CANCELLATION AND AMENDMENT OF PAYMENT ORDER

4 (a) A communication of the sender of a payment order can-
5 celling or amending the order may be transmitted to the receiving
6 bank orally, electronically, or in writing. If a security proce-
7 dure is in effect between the sender and the receiving bank, the
8 communication is not effective to cancel or amend the order unless
9 the communication is verified pursuant to the security procedure or
10 the bank agrees to the cancellation or amendment.

11 (b) Subject to subsection (a), a communication by the sender
12 cancelling or amending a payment order is effective to cancel or
13 amend the order if notice of the communication is received at a
14 time and in a manner affording the receiving bank a reasonable
15 opportunity to act on the communication before the bank accepts the
16 payment order.

17 (c) After a payment order has been accepted, cancellation or
18 amendment of the order is not effective unless the receiving bank
19 agrees or a funds-transfer system rule allows cancellation or
20 amendment without agreement of the bank.

21 (1) With respect to a payment order accepted by a
22 receiving bank other than the beneficiary's bank, cancellation or
23 amendment is not effective unless a conforming cancellation or
24 amendment of the payment order issued by the receiving bank is also
25 made.

1 (2) With respect to a payment order accepted by the
2 beneficiary's bank, cancellation or amendment is not effective un-
3 less the order was issued in execution of an unauthorized payment
4 order, or because of a mistake by a sender in the funds transfer
5 which resulted in the issuance of a payment order (i) that is a
6 duplicate of a payment order previously issued by the sender, (ii)
7 that orders payment to a beneficiary not entitled to receive
8 payment from the originator, or (iii) that orders payment in an
9 amount greater than the amount the beneficiary was entitled to
10 receive from the originator. If the payment order is canceled or
11 amended, the beneficiary's bank is entitled to recover from the
12 beneficiary any amount paid to the beneficiary to the extent al-
13 lowed by the law governing mistake and restitution.

14 (d) An unaccepted payment order is canceled by operation of
15 law at the close of the fifth funds-transfer business day of the
16 receiving bank after the execution date or payment date of the
17 order.

18 (e) A canceled payment order cannot be accepted. If an
19 accepted payment order is canceled, the acceptance is nullified and
20 no person has any right or obligation based on the acceptance.
21 Amendment of a payment order is deemed to be cancellation of the
22 original order at the time of amendment and issue of a new payment
23 order in the amended form at the same time.

24 (f) Unless otherwise provided in an agreement of the parties
25 or in a funds-transfer system rule, if the receiving bank, after
26 accepting a payment order, agrees to cancellation or amendment

1 the order by the sender or is bound by a funds-transfer system rule
2 allowing cancellation or amendment without the bank's agreement,
3 the sender, whether or not cancellation or amendment is effective,
4 is liable to the bank for any loss and expenses, including reason-
5 able attorney's fees, incurred by the bank as a result of the
6 cancellation or amendment or attempted cancellation or amendment.

7 (g) A payment order is not revoked by the death or legal
8 incapacity of the sender unless the receiving bank knows of the
9 death or of an adjudication of incapacity by a court of competent
10 jurisdiction and has reasonable opportunity to act before accept-
11 ance of the order.

12 (h) A funds-transfer system rule is not effective to the
13 extent it conflicts with subsection (c)(2).

14 COMMENT

15 1. This section deals with cancellation and amendment of payment
16 orders. It states the conditions under which cancellation or amendment
17 is both effective and rightful. There is no concept of wrongful cancel-
18 lation or amendment of a payment order. If the conditions stated in
19 this section are not met the attempted cancellation or amendment is not
20 effective. If the stated conditions are met the cancellation or amend-
21 ment is effective and rightful. The sender of a payment order may want
22 to withdraw or change the order because the sender has had a change of
23 mind about the transaction or because the payment order was erroneously
24 issued or for any other reason. One common situation is that of mult-
25 iple transmission of the same order. The sender that mistakenly trans-
26 mits the same order twice wants to correct the mistake by cancelling the
27 duplicate order. Or, a sender may have intended to order a payment of
28 \$1,000,000 but mistakenly issued an order to pay \$10,000,000. In this
29 case the sender might try to correct the mistake by cancelling the order
30 and issuing another order in the proper amount. Or, the mistake could
31 be corrected by amending the order to change it to the proper amount.
32 Whether the error is corrected by amendment or cancellation and reissue
33 the net result is the same. This result is stated in the last sentence
34 of subsection (e).

35 2. Subsection (a) allows a cancellation or amendment of a payment
36 order to be communicated to the receiving bank "orally, electronically,
37 or in writing." The quoted phrase is consistent with the language of

1 Section 4A-103(a) applicable to payment orders. Cancellations and
2 amendments are normally subject to verification pursuant to security
3 procedures to the same extent as payment orders. Subsection (a) recog-
4 nizes this fact by providing that in cases in which there is a security
5 procedure in effect between the sender and the receiving bank the bank
6 is not bound by a communication cancelling or amending an order unless
7 verification has been made. This is necessary to protect the bank be-
8 cause under subsection (b) a cancellation or amendment can be effective
9 by unilateral action of the sender. Without verification the bank can-
10 not be sure whether the communication was or was not effective to cancel
11 or amend a previously verified payment order.

12 3. If the receiving bank has not yet accepted the order, there is
13 no reason why the sender should not be able to cancel or amend the order
14 unilaterally so long as the requirements of subsection (a) and (b) are
15 met. If the receiving bank has accepted the order, it is possible to
16 cancel or amend but only if the requirements of subsection (c) are met.

17 First consider the case of a receiving bank other than the benefi-
18 ciary's bank. If the bank has not yet accepted the order, the sender
19 can unilaterally cancel or amend. The communication amending or can-
20 celling the payment order must be received in time to allow the bank to
21 act on it before the bank issues its payment order in execution of the
22 sender's order. The time that the sender's communication is received is
23 governed by Section 4A-106. If a payment order does not specify a de-
24 layed payment date or execution date, the order will normally be execu-
25 ted shortly after receipt. Thus, as a practical matter, the sender will
26 have very little time in which to instruct cancellation or amendment
27 before acceptance. In addition, a receiving bank will normally have
28 cut-off times for receipt of such communications, and the receiving bank
29 is not obliged to act on communications received after the cut-off hour.
30 Cancellation by the sender after execution of the order by the receiving
31 bank requires the agreement of the bank unless a funds transfer rule
32 otherwise provides. Subsection (c). Although execution of the sender's
33 order by the receiving bank does not itself impose liability on the
34 receiving bank (under Section 4A-402 no liability is incurred by the
35 receiving bank to pay its order until it is accepted), it would commonly
36 be the case that acceptance follows shortly after issuance. Thus, as a
37 practical matter, a receiving bank that has executed a payment order
38 will incur a liability to the next bank in the chain before it would be
39 able to act on the cancellation request of its customer. It is unrea-
40 sonable to impose on the receiving bank a risk of loss with respect to a
41 cancellation request without the consent of the receiving bank.

42 The statute does not state how or when the agreement of the receiv-
43 ing bank must be obtained for cancellation after execution. The receiv-
44 ing bank's consent could be obtained at the time cancellation occurs or
45 it could be based on a preexisting agreement. Or, a funds transfer sys-
46 tem rule could provide that cancellation can be made unilaterally by the
47 sender. By virtue of that rule any receiving bank covered by the rule
48 is bound. Section 4A-501. If the receiving bank has already execut-
49 ed the sender's order, the bank would not consent to cancellation unless

1 the bank to which the receiving bank has issued its payment order con-
2 sents to cancellation of that order. It makes no sense to allow cancel-
3 lation of a payment order unless all subsequent payment orders in the
4 funds transfer that were issued because of the cancelled payment order
5 are also cancelled. Under subsection (c)(1), if a receiving bank con-
6 sents to cancellation of the payment order after it is executed, the
7 cancellation is not effective unless the receiving bank also cancels the
8 payment order issued by the bank.

9 4. With respect to a payment order issued to the beneficiary's
10 bank, acceptance is particularly important because it creates liability
11 to pay the beneficiary, it defines when the originator pays its oblig-
12 ation to the beneficiary, and it defines when any obligation for which
13 the payment is made is discharged. Since acceptance affects the rights
14 of the originator and the beneficiary it is not appropriate to allow the
15 beneficiary's bank to agree to cancellation or amendment except in un-
16 usual cases. Except as provided in subsection (c)(2), cancellation or
17 amendment after acceptance by the beneficiary's bank is not possible un-
18 less all parties affected by the order agree. Under subsection (c)(2),
19 cancellation or amendment is possible only in the four cases stated.
20 The following examples illustrate subsection (c)(2):

21 Case #1. Originator's Bank executed a payment order issued in the
22 name of its customer as sender. The order was not authorized by the
23 customer and was fraudulently issued. Beneficiary's Bank accepted the
24 payment order issued by Originator's Bank. Under subsection (c)(2)
25 Originator's Bank can cancel the order if Beneficiary's Bank consents.
26 It doesn't make any difference whether the payment order that Origina-
27 tor's Bank accepted was or was not enforceable against the customer
28 under Section 4A-202(b). Verification under that provision is important
29 in determining whether Originator's Bank or the customer has the risk of
30 loss, but it has no relevance under Section 4A-211(c)(2). Whether or
31 not verified, the payment order was not authorized by the customer.
32 Cancellation of the payment order to Beneficiary's Bank causes the ac-
33 ceptance of Beneficiary's Bank to be nullified. Subsection (e). Bene-
34 ficiary's Bank is entitled to recover payment from the beneficiary to
35 the extent allowed by the law of mistake and restitution. In this kind
36 of case the beneficiary is usually a party to the fraud who has no right
37 to receive or retain payment of the order.

38 Case #2. Originator owed Beneficiary \$1,000,000 and ordered Bank A
39 to pay that amount to the account of Beneficiary in Bank B. Bank A
40 issued a complying order to Bank B, but by mistake issued a duplicate
41 order as well. Bank B accepted both orders. Under subsection (c)(2)(i)
42 cancellation of the duplicate order could be made by Bank A with the
43 consent of Bank B. Beneficiary has no right to receive or retain pay-
44 ment of the duplicate payment order if only \$1,000,000 was owed by Orig-
45 inator to Beneficiary. If Originator owed \$2,000,000 to Beneficiary,
46 the law of restitution might allow Beneficiary to retain the \$1,000,000
47 paid by Bank B on the duplicate order. In that case Bank B is entitled
48 to reimbursement from Bank A under subsection (f).

1 Case #3. Originator owed \$1,000,000 to X. Intending to pay X,
2 Originator ordered Bank A to pay \$1,000,000 to Y's account in Bank B.
3 Bank A issued a complying payment order to Bank B which Bank B accepted
4 by releasing the \$1,000,000 to Y. Under subsection (c)(2)(ii) Bank A
5 can cancel its payment order to Bank B with the consent of Bank B if Y
6 was not entitled to receive payment from Originator. Originator can
7 also cancel its order to Bank A with Bank A's consent. Subsection (c)
8 (1). Bank B may recover the \$1,000,000 from Y unless the law of mistake
9 and restitution allows Y to retain some or all of the amount paid. If
10 no debt was owed to Y, Bank B should have a right of recovery.

11 Case #4. Originator owed Beneficiary \$10,000. By mistake Origina-
12 tor ordered Bank A to pay \$1,000,000 to the account of Beneficiary in
13 Bank B. Bank A issued a complying order to Bank B which accepted by no-
14 tifying Beneficiary of its right to withdraw \$1,000,000. Cancellation
15 is permitted in this case under subsection (c)(2)(iii). If Bank B paid
16 Beneficiary it is entitled to recover the payment except to the extent
17 the law of mistake and restitution allows Beneficiary to retain payment.
18 In this case Beneficiary might be entitled to retain \$10,000, the amount
19 of the debt owed to Beneficiary. If Beneficiary may retain \$10,000,
20 Bank B would be entitled to \$10,000 from Bank A pursuant to subsection
21 (f). In this case Originator also cancelled its order. Thus Bank A
22 would be entitled to \$10,000 from Originator pursuant to subsection (f).

23 5. Unless constrained by a funds transfer system rule, a receivi-
24 bank may agree to cancellation or amendment of the payment order under
25 subsection (c) but is not required to do so regardless of the circum-
26 stances. If the receiving bank has incurred liability as a result of
27 its acceptance of the sender's order, there are substantial risks in
28 agreeing to cancellation or amendment. This is particularly true for a
29 beneficiary's bank. Cancellation or amendment after acceptance by the
30 beneficiary's bank can be made only in the four cases stated and the
31 beneficiary's bank may not have any way of knowing whether the require-
32 ments of subsection (c) have been met or whether it will be able to
33 recover payment from the beneficiary that received payment. Even with
34 indemnity the beneficiary's bank may be reluctant to alienate its custo-
35 mer, the beneficiary, by denying the customer the funds. Subsection (c)
36 leaves the decision to the beneficiary's bank unless the consent of the
37 beneficiary's bank is not required under a funds transfer system rule or
38 other interbank agreement. If a receiving bank agrees to cancellation
39 or amendment under subsection (c)(1) or (2), it is automatically entitl-
40 ed to indemnification from the sender under subsection (f). The indem-
41 nification provision recognizes that a sender has no right to cancel a
42 payment order after it is accepted by the receiving bank. If the re-
43 ceiving bank agrees to cancellation, it is doing so as an accommodation
44 to the sender and it should not incur a risk of loss in doing so.

45 6. Acceptance by the receiving bank of a payment order issued by
46 the sender is comparable to acceptance of an offer under the law of
47 contracts. Under that law the death or legal incapacity of an offeror
48 terminates the offer even though the offeree has no notice of the death
49 or incapacity. Restatement Second, Contracts § 48. Comment a. to that

1 section states that the "rule seems to be a relic of the obsolete view
2 that a contract requires a 'meeting of minds,' and it is out of harmony
3 with the modern doctrine that a manifestation of assent is effective
4 without regard to actual mental assent." Subsection (g), which reverses
5 the Restatement rule in the case of a payment order, is similar to Sec-
6 tion 4-405(1) which applies to checks. Subsection (g) does not address
7 the effect of the bankruptcy of the sender of a payment order before the
8 order is accepted, but the principle of subsection (g) has been recog-
9 nized in *Bank of Marin v. England*, 385 U.S. 99 (1966). Although Bank-
10 ruptcy Code Section 542(c) may not have been drafted with wire transfers
11 in mind, its language can be read to allow the receiving bank to charge
12 the sender's account for the amount of the payment order if the receiv-
13 ing bank executed it in ignorance of the bankruptcy.

14 7. Subsection (d) deals with stale payment orders. Payment or-
15 ders normally are executed on the execution date or the day after. An
16 order issued to the beneficiary's bank is normally accepted on the pay-
17 ment date or the day after. If a payment order is not accepted on its
18 execution or payment date or shortly thereafter, it is probable that
19 there was some problem with the terms of the order or the sender did not
20 have sufficient funds or credit to cover the amount of the order. De-
21 layed acceptance of such an order is normally not contemplated, but the
22 order may not have been cancelled by the sender. Subsection (d) pro-
23 vides for cancellation by operation of law to prevent an unexpected
24 delayed acceptance.

25 8. A funds transfer system rule can govern rights and obligations
26 between banks that are parties to payment orders transmitted over the
27 system even if the rule conflicts with Article 4A. In some cases, how-
28 ever, a rule governing a transaction between two banks can affect a
29 third party in an unacceptable way. Subsection (h) deals with such a
30 case. A funds transfer system rule cannot allow cancellation of a
31 payment order accepted by the beneficiary's bank if the rule conflicts
32 with subsection (c)(2). Because rights of the beneficiary and the orig-
33 inator are directly affected by acceptance, subsection (c)(2) severely
34 limits cancellation. These limitations cannot be altered by funds
35 transfer system rule.

36 § 4A-212. LIABILITY AND DUTY OF RECEIVING BANK REGARDING UNACCEPTED
37 PAYMENT ORDER

38 If a receiving bank fails to accept a payment order that it is
39 obliged by express agreement to accept, the bank is liable for
40 breach of the agreement to the extent provided in the agreement or
41 in this Article, but does not otherwise have any duty to accept a

1 payment order or, before acceptance, to take any action, or refrain
2 from taking action, with respect to the order except as provided in
3 this Article or by express agreement. Liability based on accept-
4 ance arises only when acceptance occurs as stated in Section 4A-
5 209, and liability is limited to that provided in this Article.
6 A receiving bank is not the agent of the sender or beneficiary of
7 the payment order it accepts, or of any other party to the funds
8 transfer, and the bank owes no duty to any party to the funds
9 transfer except as provided in this Article or by express
10 agreement.

11 COMMENT

12 With limited exceptions stated in this Article, the duties and
13 obligations of receiving banks that carry out a funds transfer arise
14 only as a result of acceptance of payment orders or of agreements made
15 by receiving banks. Exceptions are stated in Section 4A-209(b)(3) and
16 Section 4A-210(b). A receiving bank is not like a collecting bank under
17 Article 4. No receiving bank, whether it be an originator's bank, an
18 intermediary bank or a beneficiary's bank, is an agent for any other
19 party in the funds transfer.

20 PART 3

21 EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK

22 § 4A-301. EXECUTION AND EXECUTION DATE

23 (a) A payment order is "executed" by the receiving bank when
24 it issues a payment order intended to carry out the payment order
25 received by the bank. A payment order received by the benefi-
26 ciary's bank can be accepted but cannot be executed.

1 (b) "Execution date" of a payment order means the day on
2 which the receiving bank may properly issue a payment order in exe-
3 cution of the sender's order. The execution date may be determined
4 by instruction of the sender but cannot be earlier than the day the
5 order is received and, unless otherwise determined, is the day the
6 order is received. If the sender's instruction states a payment
7 date, the execution date is the payment date or an earlier date on
8 which execution is reasonably necessary to allow payment to the
9 beneficiary on the payment date.

10 COMMENT

11 1. The terms "executed," "execution" and "execution date" are
12 used only with respect to a payment order to a receiving bank other than
13 the beneficiary's bank. The beneficiary's bank can accept the payment
14 order that it receives, but it does not execute the order. Execution
15 refers to the act of the receiving bank in issuing a payment order
16 "intended to carry out" the payment order that the bank received. A
17 receiving bank has executed an order even if the order issued by the
18 bank does not carry out the order received by the bank. For example,
19 the bank may have erroneously issued an order to the wrong beneficiary,
20 or in the wrong amount or to the wrong beneficiary's bank. In each of
21 these cases execution has occurred but the execution is erroneous.
22 Erroneous execution is covered in Section 4A-303.

23 2. "Execution date" refers to the time a payment order should be
24 executed rather than the day it is actually executed. Normally the
25 sender will not specify an execution date, but most payment orders are
26 meant to be executed immediately. Thus, the execution date is normally
27 the day the order is received by the receiving bank. It is common for
28 the sender to specify a "payment date" which is defined in Section 4A-
29 401 as "the day on which the amount of the order is payable to the
30 beneficiary by the beneficiary's bank." Except for automated clearing
31 house transfers, if a funds transfer is entirely within the United
32 States and the payment is to be carried out electronically, the execu-
33 tion date is the payment date unless the order is received after the
34 payment date. If the payment is to be carried out through an automated
35 clearing house, execution may occur before the payment date. In an ACH
36 transfer the beneficiary is usually paid one or two days after issue of
37 the originator's payment order. The execution date is determined by the
38 stated payment date and is a date before the payment date on which exec-
39 ution is reasonably necessary to allow payment on the payment date. A
40 funds transfer system rule could also determine the execution date of
41 orders received by the receiving bank if both the sender and the receiv-

1 ing bank are participants in the funds transfer system. The execution
2 date can be determined by the payment order itself or by separate in-
3 structions of the sender or an agreement of the sender and the receiving
4 bank. The second sentence of subsection (b) must be read in the light
5 of Section 4A-106 which states that if a payment order is received after
6 the cut-off time of the receiving bank it may be treated by the bank as
7 received at the opening of the next funds transfer business day.

8 3. Execution on the execution date is timely, but the order can
9 be executed before or after the execution date. Section 4A-209(d) and
10 Section 4A-402(c) state the consequences of early execution and Section
11 4A-305(a) states the consequences of late execution.

12 § 4A-302. OBLIGATIONS OF RECEIVING BANK IN EXECUTION OF
13 PAYMENT ORDER

14 (a) Except as provided in subsections (b) through (d), if the
15 receiving bank accepts a payment order pursuant to Section 4A-209
16 (a), the bank has the following obligations in executing the order:

17 (1) The receiving bank is obliged to issue, on the
18 execution date, a payment order complying with the sender's order
19 and to follow the sender's instructions concerning (i) any interme-
20 diary bank or funds-transfer system to be used in carrying out the
21 funds transfer, or (ii) the means by which payment orders are to be
22 transmitted in the funds transfer. If the originator's bank issues
23 a payment order to an intermediary bank, the originator's bank is
24 obliged to instruct the intermediary bank according to the instruc-
25 tion of the originator. An intermediary bank in the funds transfer
26 is similarly bound by an instruction given to it by the sender of
27 the payment order it accepts.

28 (2) If the sender's instruction states that the funds
29 transfer is to be carried out telephonically or by wire transfer or

1 otherwise indicates that the funds transfer is to be carried out by
2 the most expeditious means, the receiving bank is obliged to trans-
3 mit its payment order by the most expeditious available means, and
4 to instruct any intermediary bank accordingly. If a sender's in-
5 struction states a payment date, the receiving bank is obliged to
6 transmit its payment order at a time and by means reasonably neces-
7 sary to allow payment to the beneficiary on the payment date or as
8 soon thereafter as is feasible.

9 (b) Unless otherwise instructed, a receiving bank executing a
10 payment order may (i) use any funds-transfer system if use of that
11 system is reasonable in the circumstances, and (ii) issue a payment
12 order to the beneficiary's bank or to an intermediary bank through
13 which a payment order conforming to the sender's order can expedi-
14 tiously be issued to the beneficiary's bank if the receiving bank
15 exercises ordinary care in the selection of the intermediary bank.
16 A receiving bank is not required to follow an instruction of the
17 sender designating a funds-transfer system to be used in carrying
18 out the funds transfer if the receiving bank, in good faith,
19 determines that it is not feasible to follow the instruction or
20 that following the instruction would unduly delay completion of the
21 funds transfer.

22 (c) Unless subsection (a)(2) applies or the receiving bank is
23 otherwise instructed, the bank may execute a payment order by
24 transmitting its payment order by first class mail or by any means
25 reasonable in the circumstances. If the receiving bank is
26 instructed to execute the sender's order by transmitting its

1 payment order by a particular means, the receiving bank may issue
2 its payment order by the means stated or by any means as expedi-
3 tious as the means stated.

4 (d) Unless instructed by the sender, (i) the receiving bank
5 may not obtain payment of its charges for services and expenses in
6 connection with the execution of the sender's order by issuing a
7 payment order in an amount equal to the amount of the sender's
8 order less the amount of the charges, and (ii) may not instruct a
9 subsequent receiving bank to obtain payment of its charges in the
10 same manner.

11 COMMENT

12 1. In the absence of agreement, the receiving bank is not obliged
13 to execute an order of the sender. Section 4A-212. Section 4A-302
14 states the manner in which the receiving bank may execute the sender's
15 order if execution occurs. Subsection (a)(1) states the residual rule.
16 The payment order issued by the receiving bank must comply with the
17 sender's order and, unless some other rule is stated in the section, the
18 receiving bank is obliged to follow any instruction of the sender con-
19 cerning which funds transfer system is to be used, which intermediary
20 banks are to be used, and what means of transmission is to be used. The
21 instruction of the sender may be incorporated in the payment order it-
22 self or may be given separately. For example, there may be a master
23 agreement between the sender and receiving bank containing instructions
24 governing payment orders to be issued from time to time by the sender to
25 the receiving bank. In most funds transfers, speed is a paramount con-
26 sideration. A sender that wants assurance that the funds transfer will
27 be expeditiously completed can specify the means to be used. The re-
28 ceiving bank can follow the instructions literally or it can use an
29 equivalent means. For example, if the sender instructs the receiving
30 bank to transmit by telex, the receiving bank could use telephone
31 instead. Subsection (c). In most cases the sender will not specify a
32 particular means but will use a general term such as "by wire" or "wire
33 transfer" or "as soon as possible." These words signify that the sender
34 wants a same-day transfer. In these cases the receiving bank is
35 required to use a telephonic or electronic communication to transmit its
36 order and is also required to instruct any intermediary bank to which it
37 issues its order to transmit by similar means. Subsection (a)(2). In
38 other cases, such as an automated clearing house transfer, a same-day
39 transfer is not contemplated. Normally the sender's instruction or the
40 context in which the payment order is received makes clear the type of
41 funds transfer that is appropriate. If the sender states a payment date

1 with respect to the payment order, the receiving bank is obliged to
2 execute the order at a time and in a manner to meet the payment date if
3 that is feasible. Subsection (a)(2). This provision would apply to
4 many ACH transfers made to pay recurring debts of the sender. In other
5 cases, involving relatively small amounts, time may not be an important
6 factor and cost may be a more important element. Fast means, such as
7 telephone or electronic transmission, are more expensive than slow means
8 such as mailing. Subsection (c) states that in the absence of instruc-
9 tions the receiving bank is given discretion to decide. It may issue
10 its payment order by first class mail or by any means reasonable in the
11 circumstances. Section 4A-305 states the liability of a receiving bank
12 for breach of the obligations stated in Section 4A-302.

13 2. Subsection (b) concerns the choice of intermediary banks to be
14 used in completing the funds transfer, and the funds transfer system to
15 be used. If the receiving bank is not instructed about the matter, it
16 can issue an order directly to the beneficiary's bank or can issue an
17 order to an intermediary bank. The receiving bank also has discretion
18 concerning use of a funds transfer system. In some cases it may be
19 reasonable to use either an automated clearinghouse system or a wire
20 transfer system such as Fedwire or CHIPS. Normally, the receiving bank
21 will follow the instruction of the sender in these matters, but in some
22 cases it may be prudent for the bank not to follow instructions. The
23 sender may have designated a funds transfer system to be used in carry-
24 ing out the funds transfer, but it may not be feasible to use the desig-
25 nated system because of some impediment such as a computer breakdown
26 which prevents prompt execution of the order. The receiving bank is
27 permitted to use an alternate means of transmittal in a good faith
28 effort to execute the order expeditiously. The same leeway is not given
29 to the receiving bank if the sender designates an intermediary bank
30 through which the funds transfer is to be routed. The sender's desig-
31 nation of that intermediary bank may mean that the beneficiary's bank is
32 expecting to obtain a credit from that intermediary bank and may have
33 relied on that anticipated credit. If the receiving bank uses another
34 intermediary bank the expectations of the beneficiary's bank may not be
35 realized. The receiving bank could choose to route the transfer to
36 another intermediary bank and then to the designated intermediary bank
37 if there were some reason such as a lack of a correspondent-bank rela-
38 tionship or a bilateral credit limitation, but the designated inter-
39 mediary bank cannot be circumvented. To do so violates the sender's
40 instructions.

41 3. The normal rule, under subsection (a)(1), is that the receiving
42 bank, in executing a payment order, is required to issue a payment order
43 that complies as to amount with that of the sender's order. In most
44 cases the receiving bank issues an order equal to the amount of the
45 sender's order and makes a separate charge for services and expenses in
46 executing the sender's order. In some cases, particularly if it is an
47 intermediary bank that is executing an order, charges are collected by
48 deducting them from the amount of the payment order issued by the ex-
49 ecuting bank. If that is done, the amount of the payment order accepted
50 by the beneficiary's bank will be slightly less than the amount of the

1 originator's payment order. For example, Originator, in order to pay an
2 obligation of \$1,000,000 owed to Beneficiary, issues a payment order to
3 Originator's Bank to pay \$1,000,000 to the account of Beneficiary in
4 Beneficiary's Bank. Originator's Bank issues a payment order to
5 Intermediary Bank for \$1,000,000 and debits Originator's account for
6 \$1,000,010. The extra \$10 is the fee of Originator's Bank. Intermediary
7 Bank executes the payment order of Originator's Bank by issuing a
8 payment order to Beneficiary's Bank for \$999,990, but under § 4A-402(c)
9 is entitled to receive \$1,000,000 from Originator's Bank. The \$10 difference
10 is the fee of Intermediary Bank. Beneficiary's Bank credits
11 Beneficiary's account for \$999,990. When Beneficiary's Bank accepts the
12 payment order of Intermediary Bank the result is a payment of \$999,990
13 from Originator to Beneficiary. Section 4A-406(a). If that payment
14 discharges the \$1,000,000 debt, the effect is that Beneficiary has paid
15 the charges of Intermediary Bank and Originator has paid the charges of
16 Originator's Bank. Subsection (d) of Section 4A-302 allows Intermediary
17 Bank to collect its charges by deducting them from the amount of the
18 payment order, but only if instructed to do so by Originator's Bank.
19 Originator's Bank is not authorized to give that instruction to Intermediary
20 Bank unless Originator authorized the instruction. Thus, Originator
21 can control how the charges of Originator's Bank and Intermediary
22 Bank are to be paid. Subsection (d) does not apply to charges of Beneficiary's
23 Bank to Beneficiary.

24 In the case discussed in the preceding paragraph the \$10 charge is
25 trivial in relation to the amount of the payment and it may not be
26 important to Beneficiary how the charge is paid. But it may be very
27 important if the \$1,000,000 obligation represented the price of exercising
28 a right such as an option favorable to Originator and unfavorable
29 to Beneficiary. Beneficiary might well argue that it was entitled to
30 receive \$1,000,000. If the option was exercised shortly before its
31 expiration date, the result could be loss of the option benefit because
32 the required payment of \$1,000,000 was not made before the option
33 expired. Section 4A-406(c) allows Originator to preserve the option
34 benefit. The amount received by Beneficiary is deemed to be \$1,000,000
35 unless Beneficiary demands the \$10 and Originator does not pay it.

36 § 4A-303. ERRONEOUS EXECUTION OF PAYMENT ORDER

37 (a) A receiving bank that (i) executes the payment order of
38 the sender by issuing a payment order in an amount greater than the
39 amount of the sender's order, or (ii) issues a payment order in
40 execution of the sender's order and then issues a duplicate order,
41 is entitled to payment of the amount of the sender's order under

1 Section 4A-402(c) if that subsection is otherwise satisfied. The
2 bank is entitled to recover from the beneficiary of the erroneous
3 order the excess payment received to the extent allowed by the law
4 governing mistake and restitution.

5 (b) A receiving bank that executes the payment order of the
6 sender by issuing a payment order in an amount less than the amount
7 of the sender's order is entitled to payment of the amount of the
8 sender's order under Section 4A-402(c) if (i) that subsection is
9 otherwise satisfied and (ii) the bank corrects its mistake by is-
10 suing an additional payment order for the benefit of the benefici-
11 ary of the sender's order. If the error is not corrected, the
12 issuer of the erroneous order is entitled to receive or retain
13 payment from the sender of the order it accepted only to the extent
14 of the amount of the erroneous order. This subsection does not
15 apply if the receiving bank executes the sender's payment order by
16 issuing a payment order in an amount less than the amount of the
17 sender's order for the purpose of obtaining payment of its charges
18 for services and expenses pursuant to instruction of the sender.

19 (c) If a receiving bank executes the payment order of the
20 sender by issuing a payment order to a beneficiary different from
21 the beneficiary of the sender's order and the funds transfer is
22 completed on the basis of that error, the sender of the payment
23 order that was erroneously executed and all previous senders in the
24 funds transfer are not obliged to pay the payment orders they
25 issued. The issuer of the erroneous order is entitled to recover

1 from the beneficiary of the order the payment received to the
2 extent allowed by the law governing mistake and restitution.

3 COMMENT

4 1. Section 4A-303 states the effect of erroneous execution of a
5 payment order by the receiving bank. Under Section 4A-402(c) the sender
6 of a payment order is obliged to pay the amount of the order to the re-
7 ceiving bank if the bank executes the order, but the obligation to pay
8 is excused if the beneficiary's bank does not accept a payment order
9 instructing payment to the beneficiary of the sender's order. If erro-
10 neous execution of the sender's order causes the wrong beneficiary to be
11 paid, the sender is not required to pay. If erroneous execution causes
12 the wrong amount to be paid the sender is not obliged to pay the receiv-
13 ing bank an amount in excess of the amount of the sender's order. Sec-
14 tion 4A-303 takes precedence over Section 4A-402(c) and states the lia-
15 bility of the sender and the rights of the receiving bank in various
16 cases of erroneous execution.

17 2. Subsections (a) and (b) deal with cases in which the receiving
18 bank executes by issuing a payment order in the wrong amount. If Orig-
19 inator ordered Originator's Bank to pay \$1,000,000 to the account of
20 Beneficiary in Beneficiary's Bank, but Originator's Bank erroneously in-
21 structed Beneficiary's Bank to pay \$2,000,000 to Beneficiary's account,
22 subsection (a) applies. If Beneficiary's Bank accepts the order of
23 Originator's Bank, Beneficiary's Bank is entitled to receive \$2,000,000
24 from Originator's Bank, but Originator's Bank is entitled to receive
25 only \$1,000,000 from Originator. Originator's Bank is entitled to re-
26 cover the overpayment from Beneficiary to the extent allowed by the law
27 governing mistake and restitution. Originator's Bank would normally
28 have a right to recover the overpayment from Beneficiary, but in unusual
29 cases the law of restitution might allow Beneficiary to keep all or part
30 of the overpayment. For example, if Originator owed \$2,000,000 to Ben-
31 eficiary and Beneficiary received the extra \$1,000,000 in good faith in
32 discharge of the debt, Beneficiary may be allowed to keep it. In this
33 case Originator's Bank has paid an obligation of Originator and under
34 the law of restitution, which applies through Section 1-103, Origina-
35 tor's Bank would be subrogated to Beneficiary's rights against Orig-
36 inator on the obligation paid by Originator's Bank.

37 If Originator's Bank erroneously executed Originator's order by
38 instructing Beneficiary's Bank to pay less than \$1,000,000, subsection
39 (b) applies. If Originator's Bank corrects its error by issuing another
40 payment order to Beneficiary's Bank that results in payment of
41 \$1,000,000 to Beneficiary, Originator's Bank is entitled to payment of
42 \$1,000,000 from Originator. If the mistake is not corrected, Origina-
43 tor's Bank is entitled to payment from Originator only in the amount of
44 the order issued by Originator's Bank.

45 3. Subsection (a) also applies to duplicate payment orders.
46 Assume Originator's Bank properly executes Originator's \$1,000,000 pay-

1 ment order and then by mistake issues a second \$1,000,000 payment order
2 in execution of Originator's order. If Beneficiary's Bank accepts both
3 orders issued by Originator's Bank, Beneficiary's Bank is entitled to
4 receive \$2,000,000 from Originator's Bank but Originator's Bank is
5 entitled to receive only \$1,000,000 from Originator. The remedy of
6 Originator's Bank is the same as that of a receiving bank that executes
7 by issuing an order in an amount greater than the sender's order. It
8 may recover the overpayment from Beneficiary to the extent allowed by
9 the law governing mistake and restitution and in a proper case as stated
10 in Comment 2 may have subrogation rights if it is not entitled to
11 recover from Beneficiary.

12 4. Suppose Originator instructs Originator's Bank to pay
13 \$1,000,000 to Account #12345 in Beneficiary's Bank. Originator's Bank
14 erroneously instructs Beneficiary's Bank to pay \$1,000,000 to Account
15 #12346 and Beneficiary's Bank accepted. Subsection (c) covers this
16 case. Originator is not obliged to pay its payment order, but Origina-
17 tor's Bank is required to pay \$1,000,000 to Beneficiary's Bank. The
18 remedy of Originator's Bank is to recover \$1,000,000 from the holder of
19 Account #12346 that received payment by mistake. Recovery based on the
20 law of mistake and restitution is described in Comment 2.

21 § 4A-304. DUTY OF SENDER TO REPORT ERRONEOUSLY EXECUTED PAYMENT
22 ORDER

23 If the sender of a payment order that is erroneously executed
24 as stated in Section 4A-303 receives notification from the receiv-
25 ing bank that the order was executed or that the sender's account
26 was debited with respect to the order, the sender has a duty to
27 exercise ordinary care to determine, on the basis of information
28 available to the sender, that the order was erroneously executed
29 and to notify the bank of the relevant facts within a reasonable
30 time not exceeding 90 days after the notification from the bank was
31 received by the sender. If the sender fails to perform that duty,
32 the bank is not obliged to pay interest on any amount refundable to
33 the sender under Section 4A-402(d) for the period before the bank
34 learns of the execution error. The bank is not entitled to any

1 recovery from the sender on account of a failure by the sender to
2 perform the duty stated in this section.

3 COMMENT

4 This section is identical in effect to Section 4A-204 which applies
5 to unauthorized orders issued in the name of a customer of the receiving
6 bank. The rationale is stated in Comment 2 to Section 4A-204.

7 § 4A-305. LIABILITY FOR LATE OR IMPROPER EXECUTION OR FAILURE TO
8 EXECUTE PAYMENT ORDER

9 (a) If a funds transfer is completed but execution of a pay-
10 ment order by the receiving bank in breach of Section 4A-302 re-
11 sults in delay in payment to the beneficiary, the bank is obliged
12 to pay interest to either the originator or the beneficiary of the
13 funds transfer for the period of delay caused by the improper exe-
14 cution. Except as provided in subsection (c), additional damages
15 are not recoverable.

16 (b) If execution of a payment order by a receiving bank in
17 breach of Section 4A-302 results in (i) noncompletion of the funds
18 transfer, (ii) failure to use an intermediary bank designated by
19 the originator, or (iii) issuance of a payment order that does not
20 comply with the terms of the payment order of the originator, the
21 bank is liable to the originator for its expenses in the funds
22 transfer and for incidental expenses and interest losses, to the
23 extent not covered by subsection (a), resulting from the improper
24 execution. Except as provided in subsection (c), additional
25 damages are not recoverable.

1 (c) In addition to the amounts payable under subsections (a)
2 and (b), damages, including consequential damages, are recoverable
3 to the extent provided in an express written agreement of the re-
4 ceiving bank.

5 (d) If a receiving bank fails to execute a payment order it
6 was obliged by express agreement to execute, the receiving bank is
7 liable to the sender for its expenses in the transaction and for
8 incidental expenses and interest losses resulting from the failure
9 to execute. Additional damages, including consequential damages,
10 are recoverable to the extent provided in an express written agree-
11 ment of the receiving bank, but are not otherwise recoverable.

12 (e) Reasonable attorney's fees are recoverable if demand for
13 compensation under subsection (a) or (b) is made and refused before
14 an action is brought on the claim. If a claim is made for breach
15 of an agreement under subsection (d) and the agreement does not
16 provide for damages, reasonable attorney's fees are recoverable if
17 demand for compensation under subsection (d) is made and refused
18 before an action is brought on the claim.

19 (f) Except as stated in this section, the liability of a
20 receiving bank under subsections (a) and (b) may not be varied by
21 agreement.

22 COMMENT

23 1. Subsection (a) covers cases of delay in completion of a funds
24 transfer resulting from an execution by a receiving bank in breach of
25 Section 4A-302(a). The receiving bank is obliged to pay interest on the
26 amount of the order for the period of the delay. The rate of interest
27 is stated in Section 4A-506. With respect to wire transfers (other than
28 ACH transactions) within the United States, the expectation is that the
29 funds transfer will be completed the same day. In those cases, the
30 originator can reasonably expect that the originator's account will be

1 debited on the same day as the beneficiary's account is credited. If
2 the funds transfer is delayed, compensation can be paid either to the
3 originator or to the beneficiary. The normal practice is to compensate
4 the beneficiary's bank to allow that bank to compensate the beneficiary
5 by back-valuing the payment by the number of days of delay. Thus, the
6 beneficiary is in the same position that it would have been in if the
7 funds transfer had been completed on the same day. Assume on Day 1,
8 Originator's Bank issues its payment order to Intermediary Bank which is
9 received on that day. Intermediary Bank does not execute that order
10 until Day 2 when it issues an order to Beneficiary's Bank which is ac-
11 cepted on that day. Intermediary Bank complies with subsection (a) by
12 paying one day's interest to Beneficiary's Bank for the account of
13 Beneficiary.

14 2. Subsection (b) applies to cases of breach of Section 4A-302
15 involving more than mere delay. In those cases the bank is liable for
16 damages for improper execution but they are limited to compensation for
17 interest losses and incidental expenses of the sender resulting from the
18 breach, the expenses of the sender in the funds transfer and attorney's
19 fees. This subsection reflects the judgment that imposition of conse-
20 sequential damages on a bank for commission of an error is not justified.

21 The leading common law case on the subject of consequential damages
22 is *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982), in
23 which Swiss Bank, an intermediary bank, failed to execute a payment ord-
24 er. Because the beneficiary did not receive timely payment the origin-
25 ator lost a valuable ship charter. The lower court awarded the origina-
26 tor \$2.1 million for lost profits even though the amount of the payment
27 order was only \$27,000. The Seventh Circuit reversed, in part on the
28 basis of the common law rule of *Hadley v. Baxendale* that consequential
29 damages may not be awarded unless the defendant is put on notice of the
30 special circumstances giving rise to them. Swiss Bank may have known
31 that the originator was paying the shipowner for the hire of a vessel
32 but did not know that a favorable charter would be lost if the payment
33 was delayed. "Electronic payments are not so unusual as to automatic-
34 ally place a bank on notice of extraordinary consequences if such a
35 transfer goes awry. Swiss Bank did not have enough information to infer
36 that if it lost a \$27,000 payment order it would face liability in
37 excess of \$2 million." 673 F.2d at 956.

38 If Evra means that consequential damages can be imposed if the
39 culpable bank has notice of particular circumstances giving rise to the
40 damages, it does not provide an acceptable solution to the problem of
41 bank liability for consequential damages. In the typical case transmis-
42 sion of the payment order is made electronically. Personnel of the re-
43 ceiving bank that process payment orders are not the appropriate people
44 to evaluate the risk of liability for consequential damages in relation
45 to the price charged for the wire transfer service. Even if notice is
46 received by higher level management personnel who could make an appro-
47 priate decision whether the risk is justified by the price, liability
48 based on notice would require evaluation of payment orders on an indi-
49 vidual basis. This kind of evaluation is inconsistent with the high-

1 speed, low-price, mechanical nature of the processing system that char-
2 characterizes wire transfers. Moreover, in Evra the culpable bank was an
3 intermediary bank with which the originator did not deal. Notice to the
4 originator's bank would not bind the intermediary bank, and it seems
5 impractical for the originator's bank to convey notice of this kind to
6 intermediary banks in the funds transfer. The success of the wholesale
7 wire transfer industry has largely been based on its ability to effect
8 payment at low cost and great speed. Both of these essential aspects of
9 the modern wire transfer system would be adversely affected by a rule
10 that imposed on banks liability for consequential damages. A banking
11 industry amicus brief in Evra stated: "Whether banks can continue to
12 make EFT services available on a widespread basis, by charging reason-
13 able rates, depends on whether they can do so without incurring unlimit-
14 ed consequential risks. Certainly, no bank would handle for \$3.25 a
15 transaction entailing potential liability in the millions of dollars."

16 As the court in Evra also noted, the originator of the funds trans-
17 fer is in the best position to evaluate the risk that a funds transfer
18 will not be made on time and to manage that risk by issuing a payment
19 order in time to allow monitoring of the transaction. The originator,
20 by asking the beneficiary, can quickly determine if the funds transfer
21 has been completed. If the originator has sent the payment order at a
22 time that allows a reasonable margin for correcting error, no loss is
23 likely to result if the transaction is monitored. The other published
24 cases on this issue reach the Evra result. *Central Coordinates, Inc. v.*
25 *Morgan Guaranty Trust Co.*, 40 U.C.C. Rep. Serv. 1340 (N.Y. Sup. Ct. 1985),
26 and *Gatoil (U.S.A.), Inc. v. Forest Hill State Bank*, 1 U.C.C. Rep. Serv.
27 2d 171 (D.Md. 1986).

28 Subsection (c) allows the measure of damages in subsection (b) to
29 be increased by an express written agreement of the receiving bank. An
30 originator's bank might be willing to assume additional responsibilities
31 and incur additional liability in exchange for a higher fee.

32 3. Subsection (d) governs cases in which a receiving bank has
33 obligated itself by express agreement to accept payment orders of a
34 sender. In the absence of such an agreement there is no obligation by a
35 receiving bank to accept a payment order. Section 4A-212. The measure
36 of damages for breach of an agreement to accept a payment order is the
37 same as that stated in subsection (b). As in the case of subsection
38 (b), additional damages, including consequential damages, may be
39 recovered to the extent stated in an express written agreement of the
40 receiving bank.

41 4. Reasonable attorney's fees are recoverable only in cases in
42 which damages are limited to statutory damages stated in subsection (a),
43 (b) and (d). If additional damages are recoverable because provided for
44 by an express written agreement, attorney's fees are not recoverable.
45 The rationale is that there is no need for statutory attorney's fees in
46 the latter case, because the parties have agreed to a measure of damages
47 which may or may not provide for attorney's fees.

1 5. The effect of subsection (f) is to prevent reduction of a
2 receiving bank's liability under Section 4A-305.

3 PART 4

4 PAYMENT

5 § 4A-401. PAYMENT DATE

6 "Payment date" of a payment order means the day on which the
7 amount of the order is payable to the beneficiary by the benefi-
8 ciliary's bank. The payment date may be determined by instruction of
9 the sender but cannot be earlier than the day the order is received
10 by the beneficiary's bank and, unless otherwise determined, is the
11 day the order is received by the beneficiary's bank.

12 COMMENT

13 "Payment date" refers to the day the beneficiary's bank is to pay
14 the beneficiary. The payment date may be expressed in various ways so
15 long as it indicates the day the beneficiary is to receive payment. For
16 example, in ACH transfers the payment date is the equivalent of "settle-
17 ment date" or "effective date." Payment date applies to the payment
18 order issued to the beneficiary's bank, but a payment order issued to a
19 receiving bank other than the beneficiary's bank may also state a date
20 for payment to the beneficiary. In the latter case, the statement of a
21 payment date is to instruct the receiving bank concerning time of
22 execution of the sender's order. Section 4A-301(b).

23 § 4A-402. OBLIGATION OF SENDER TO PAY RECEIVING BANK

24 (a) This section is subject to Sections 4A-205 and 4A-207.

25 (b) With respect to a payment order issued to the benefi-
26 ciliary's bank, acceptance of the order by the bank obliges the sender

1 to pay the bank the amount of the order, but payment is not due
2 until the payment date of the order.

3 (c) This subsection is subject to subsection (e) and to
4 Section 4A-303. With respect to a payment order issued to a re-
5 ceiving bank other than the beneficiary's bank, acceptance of the
6 order by the receiving bank obliges the sender to pay the bank the
7 amount of the sender's order. Payment by the sender is not due
8 until the execution date of the sender's order. The obligation o
9 that sender to pay its payment order is excused if the funds tran
10 fer is not completed by acceptance by the beneficiary's bank of a
11 payment order instructing payment to the beneficiary of that
12 sender's payment order.

13 (d) If the sender of a payment order pays the order and wa
14 not obliged to pay all or part of the amount paid, the bank
15 receiving payment is obliged to refund payment to the extent the
16 sender was not obliged to pay. Except as provided in Sections 4
17 204 and 4A-304, interest is payable on the refundable amount fro
18 the date of payment.

19 (e) If a funds transfer is not completed as stated in
20 subsection (c) and an intermediary bank is obliged to refund
21 payment as stated in subsection (d) but is unable to do so beca
22 not permitted by applicable law or because the bank suspends
23 payments, a sender in the funds transfer that executed a paymer
24 order in compliance with an instruction, as stated in Section 4
25 302(a)(1), to route the funds transfer through that intermediar
26 bank is entitled to receive or retain payment from the sender

1 the payment order that it accepted. The first sender in the funds
2 transfer that issued an instruction requiring routing through that
3 intermediary bank is subrogated to the right of the bank that paid
4 the intermediary bank to refund as stated in subsection (d).

5 (f) The right of the sender of a payment order to be excused
6 from the obligation to pay the order as stated in subsection (c) or
7 to receive refund under subsection (d) may not be varied by
8 agreement.

9 COMMENT

10 1. Subsection (b) states that the sender of a payment order to the
11 beneficiary's bank must pay the order when the beneficiary's bank ac-
12 cepts the order. At that point the beneficiary's bank is obliged to pay
13 the beneficiary. Section 4A-404(a). The last clause of subsection (b)
14 covers a case of premature acceptance by the beneficiary's bank. In
15 some funds transfers, notably automated clearing house transfers, a ben-
16 efiary's bank may receive a payment order with a payment date after
17 the day the order is received. The beneficiary's bank might accept the
18 order before the payment date by notifying the beneficiary of receipt of
19 the order. Although the acceptance obliges the beneficiary's bank to
20 pay the beneficiary, payment is not due until the payment date. The
21 last clause of subsection (b) is consistent with that result. The bene-
22 ficiary's bank is also not entitled to payment from the sender until the
23 payment date.

24 2. Assume that Originator instructs Bank A to order immediate pay-
25 ment to the account of Beneficiary in Bank B. Execution of Originator's
26 payment order by Bank A is acceptance under Section 4A-209(a). Under
27 the second sentence of Section 4A-402(c) the acceptance creates an ob-
28 ligation of Originator to pay Bank A the amount of the order. The last
29 clause of that sentence deals with attempted funds transfers that are
30 not completed. In that event the obligation of the sender to pay its
31 payment order is excused. Originator makes payment to Beneficiary when
32 Bank B, the beneficiary's bank, accepts a payment order for the benefit
33 of Beneficiary. Section 4A-406(a). If that acceptance by Bank B does
34 not occur, the funds transfer has miscarried because Originator has not
35 paid Beneficiary. Originator doesn't have to pay its payment order, and
36 if it has already paid it is entitled to refund of the payment with
37 interest. The rate of interest is stated in Section 4A-506. This
38 "money-back guarantee" is an important protection of Originator. Orig-
39 inator is assured that it will not lose its money if something goes
40 wrong in the transfer. For example, risk of loss resulting from payment
41 to the wrong beneficiary is borne by some bank, not by Originator. The
42 most likely reason for noncompletion is a failure to execute or an error.

1 neous execution of a payment order by Bank A or an intermediary bank.
2 Bank A may have issued its payment order to the wrong bank or it may
3 have identified the wrong beneficiary in its order. The money-back
4 guarantee is particularly important to Originator if noncompletion of
5 the funds transfer is due to the fault of an intermediary bank rather
6 than Bank A. In that case Bank A must refund payment to Originator, and
7 Bank A has the burden of obtaining refund from the intermediary bank
8 that it paid.

9 Subsection (c) can result in loss if an intermediary bank suspends
10 payments. Suppose Originator instructs Bank A to pay to Beneficiary's
11 account in Bank B and to use Bank C as an intermediary bank. Bank A
12 executes Originator's order by issuing a payment order to Bank C. Bank
13 A pays Bank C. Bank C fails to execute the order of Bank A and suspends
14 payments. Under subsections (c) and (d), Originator is not obliged to
15 pay Bank A and is entitled to refund from Bank A of any payment that it
16 may have made. Bank A is entitled to a refund from Bank C, but Bank C
17 is insolvent. Subsection (e) deals with this case. Bank A was required
18 to issue its payment order to Bank C because Bank C was designated as an
19 intermediary bank by Originator. Section 4A-302(a)(1). In this case
20 Originator takes the risk of insolvency of Bank C. Under subsection
21 (e), Bank A is entitled to payment from Originator and Originator is
22 subrogated to the right of Bank A under subsection (d) to refund of pay-
23 ment from Bank C.

24 3. A payment order is not like a negotiable instrument on which
25 the drawer or maker has liability. Acceptance of the order by the re-
26 ceiving bank creates an obligation of the sender to pay the receiving
27 bank the amount of the order. That is the extent of the sender's
28 liability to the receiving bank and no other person has any rights
29 against the sender with respect to the sender's order.

30 § 4A-403. PAYMENT BY SENDER TO RECEIVING BANK

31 (a) Payment of the sender's obligation under Section 4A-402
32 to pay the receiving bank occurs as follows:

33 (1) If the sender is a bank, payment occurs when the
34 receiving bank receives final settlement of the obligation through
35 a Federal Reserve Bank or through a funds-transfer system.

36 (2) If the sender is a bank and the sender (i) credited
37 an account of the receiving bank with the sender, or (ii) caused an
38 account of the receiving bank in another bank to be credited, pay-

1 ment occurs when the credit is withdrawn or, if not withdrawn, at
2 midnight of the day on which the credit is withdrawable and the
3 receiving bank learns of that fact.

4 (3) If the receiving bank debits an account of the
5 sender with the receiving bank, payment occurs when the debit is
6 made to the extent the debit is covered by a withdrawable credit
7 balance in the account.

8 (b) If the sender and receiving bank are members of a funds-
9 transfer system that nets obligations multilaterally among partici-
10 pants, the receiving bank receives final settlement when settlement
11 is complete in accordance with the rules of the system. The oblig-
12 ation of the sender to pay the amount of a payment order transmit-
13 ted through the funds-transfer system may be satisfied, to the
14 extent permitted by the rules of the system, by setting off and
15 applying against the sender's obligation the right of the sender to
16 receive payment from the receiving bank of the amount of any other
17 payment order transmitted to the sender by the receiving bank
18 through the funds-transfer system. The aggregate balance of oblig-
19 ations owed by each sender to each receiving bank in the funds-
20 transfer system may be satisfied, to the extent permitted by the
21 rules of the system, by setting off and applying against that
22 balance the aggregate balance of obligations owed to the sender by
23 other members of the system. The aggregate balance is determined
24 after the right of setoff stated in the second sentence of this
25 subsection has been exercised.

1 (c) If two banks transmit payment orders to each other under
2 an agreement that settlement of the obligations of each bank to the
3 other under Section 4A-402 will be made at the end of the day or
4 other period, the total amount owed with respect to all orders
5 transmitted by one bank shall be set off against the total amount
6 owed with respect to all orders transmitted by the other bank. To
7 the extent of the setoff, each bank has made payment to the other.

8 (d) In a case not covered by subsection (a), the time when
9 payment of the sender's obligation under Section 4A-402(b) or 4A-
10 402(c) occurs is governed by applicable principles of law that
11 determine when an obligation is satisfied.

12 COMMENT

13 1. This section defines when a sender pays the obligation stated
14 in Section 4A-402. If a group of two or more banks engage in funds
15 transfers with each other, the participating banks will sometimes be
16 senders and sometimes receiving banks. With respect to payment orders
17 other than Fedwires, the amounts of the various payment orders may be
18 credited and debited to accounts of one bank with another or to a clear-
19 ing house account of each bank and amounts owed and amounts due are
20 netted. Settlement is made through a Federal Reserve Bank by charges to
21 the Federal Reserve accounts of the net debtor banks and credits to the
22 Federal Reserve accounts of the net creditor banks. In the case of
23 Fedwires the sender's obligation is settled by a debit to the Federal
24 Reserve account of the sender and a credit to the Federal Reserve ac-
25 count of the receiving bank at the time the receiving bank receives the
26 payment order. Both of these cases are covered by subsection (a)(1).
27 When the Federal Reserve settlement becomes final the obligation of the
28 sender under Section 4A-402 is paid.

29 2. In some cases a bank does not settle an obligation owed to
30 another bank through a Federal Reserve Bank. This is the case if one of
31 the banks is a foreign bank without access to the Federal Reserve pay-
32 ment system. In this kind of case, payment is usually made by credits
33 or debits to accounts of the two banks with each other or to accounts of
34 the two banks in a third bank. Suppose Bank B has an account in Bank A.
35 Bank A advises Bank B that its account in Bank A has been credited
36 \$1,000,000 and that the credit is immediately withdrawable. Bank A also
37 instructs Bank B to pay \$1,000,000 to the account of Beneficiary in Bank
38 B. This case is covered by subsection (a)(2). Bank B may want to imme-
39 diately withdraw this credit. For example, it might do so by instruct-

1 ing Bank A to debit the account and pay some third party. Payment by
2 Bank A to Bank B of Bank A's payment order occurs when the withdrawal is
3 made. Suppose Bank B does not withdraw the credit. Since Bank B is the
4 beneficiary's bank, one of the effects of receipt of payment by Bank B
5 is that acceptance of Bank A's payment order automatically occurs at the
6 time of payment. Section 4A-209(b)(2). Acceptance means that Bank B is
7 obliged to pay \$1,000,000 to Beneficiary. Section 4A-404(a). Subsec-
8 tion (a)(2) of Section 4A-403 states that payment does not occur until
9 midnight if the credit is not withdrawn. This allows Bank B an opportu-
10 nity to reject the order if it does not have time to withdraw the credit
11 to its account and it is not willing to incur the liability to Benefi-
12 ciary before it has use of the funds represented by the credit.

13 3. Subsection (a)(3) applies to a case in which the sender (bank
14 or nonbank) has a funded account in the receiving bank. If Sender has
15 an account in Bank and issues a payment order to Bank, Bank can obtain
16 payment from Sender by debiting the account of Sender, which pays its
17 Section 4A-402 obligation to Bank when the debit is made.

18 4. Subsection (b) deals with multilateral settlements made through
19 a funds transfer system and is based on the CHIPS settlement system. In
20 a funds transfer system such as CHIPS, which allows the various banks
21 that transmit payment orders over the system to settle obligations at
22 the end of each day, settlement is not based on individual payment
23 orders. Each bank using the system engages in funds transfers with many
24 other banks using the system. Settlement for any participant is based
25 on the net credit or debit position of that participant with all other
26 banks using the system. Subsection (b) is designed to make clear that
27 the obligations of any sender are paid when the net position of that
28 sender is settled in accordance with the rules of the funds transfer
29 system. This provision is intended to invalidate any argument, based on
30 common-law principles, that multilateral netting is not valid because
31 mutuality of obligation is not present. Subsection (b) dispenses with
32 any mutuality of obligation requirements. Subsection (c) applies to
33 cases in which two banks send payment orders to each other during the
34 day and settle with each other at the end of the day or at the end of
35 some other period. It is similar to subsection (b) in that it recog-
36 nizes that a sender's obligation to pay a payment order is satisfied by
37 a setoff. The obligations of each bank as sender to the other as re-
38 ceiving bank are obligations of the bank itself and not as representa-
39 tive of customers. These two sections are important in the case of
40 insolvency of a bank. They make clear that liability under Section 4A-
41 402 is based on the net position of the insolvent bank after setoff.

42 5. Subsection (d) relates to the uncommon case in which the sender
43 doesn't have an account relationship with the receiving bank and doesn't
44 settle through a Federal Reserve Bank. An example would be a customer
45 that pays over the counter for a payment order that the customer issues
46 to the receiving bank. Payment would normally be by cash, check or bank
47 obligation. When payment occurs is determined by law outside Article
48 4A.

1 § 4A-404. OBLIGATION OF BENEFICIARY'S BANK TO PAY AND GIVE NOTICE
2 TO BENEFICIARY

3 (a) Subject to Sections 4A-211(e), 4A-405(d), and 4A-405(e),
4 if a beneficiary's bank accepts a payment order, the bank is
5 obliged to pay the amount of the order to the beneficiary of the
6 order. Payment is due on the payment date of the order, but if
7 acceptance occurs on the payment date after the close of the funds-
8 transfer business day of the bank, payment is due on the next
9 funds-transfer business day. If the bank refuses to pay after de-
10 mand by the beneficiary and receipt of notice of particular circum-
11 stances that will give rise to consequential damages as a result of
12 nonpayment, the beneficiary may recover damages resulting from the
13 refusal to pay to the extent the bank had notice of the damages,
14 unless the bank proves that it did not pay because of a reasonable
15 doubt concerning the right of the beneficiary to payment.

16 (b) If a payment order accepted by the beneficiary's bank
17 instructs payment to an account of the beneficiary, the bank is
18 obliged to notify the beneficiary of receipt of the order before
19 midnight of the next funds-transfer business day following the
20 payment date. If the payment order does not instruct payment to an
21 account of the beneficiary, the bank is required to notify the ben-
22 eficiary only if notice is required by the order. Notice may be
23 given by first class mail or any other means reasonable in the
24 circumstances. If the bank fails to give the required notice, the
25 bank is obliged to pay interest to the beneficiary on the amount of
26 the payment order from the day notice should have been given until

1 the day the beneficiary learned of receipt of the payment order by
2 the bank. No other damages are recoverable. Reasonable attorney's
3 fees are also recoverable if demand for interest is made and re-
4 fused before an action is brought on the claim.

5 (c) The right of a beneficiary to receive payment and damages
6 as stated in subsection (a) may not be varied by agreement or a
7 funds-transfer system rule. The right of a beneficiary to be noti-
8 fied as stated in subsection (b) may be varied by agreement of the
9 beneficiary or by a funds-transfer system rule if the beneficiary
10 is notified of the rule before initiation of the funds transfer.

11 COMMENT

12 1. The first sentence of subsection (a) states the time when the
13 obligation of the beneficiary's bank arises. The second and third sent-
14 ences state when the beneficiary's bank must make funds available to the
15 beneficiary. They also state the measure of damages for failure, after
16 demand, to comply. Since the Expedited Funds Availability Act, 12
17 U.S.C. 4001 et seq., also governs funds availability in a funds trans-
18 fer, the second and third sentences of subsection (a) may be subject to
19 preemption by that Act.

20 2. Subsection (a) provides that the beneficiary of an accepted
21 payment order may recover consequential damages if the beneficiary's
22 bank refuses to pay the order after demand by the beneficiary if the
23 bank at that time had notice of the particular circumstances giving rise
24 to the damages. Such damages are recoverable only to the extent the
25 bank had "notice of the damages." The quoted phrase requires that the
26 bank have notice of the general type or nature of the damages that will
27 be suffered as a result of the refusal to pay and their general magni-
28 tude. There is no requirement that the bank have notice of the exact or
29 even the approximate amount of the damages, but if the amount of damages
30 is extraordinary the bank is entitled to notice of that fact. For ex-
31 ample, in *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982),
32 failure to complete a funds transfer of only \$27,000 required to retain
33 rights to a very favorable ship charter resulted in a claim for more
34 than \$2,000,000 of consequential damages. Since it is not reasonably
35 foreseeable that a failure to make a relatively small payment will
36 result in damages of this magnitude, notice is not sufficient if the
37 beneficiary's bank has notice only that the \$27,000 is necessary to
38 retain rights on a ship charter. The bank is entitled to notice that an
39 exceptional amount of damages will result as well. For example, there

1 would be adequate notice if the bank had been made aware that damages of
2 \$1,000,000 or more might result.

3 3. Under the last clause of subsection (a) the beneficiary's bank
4 is not liable for damages if its refusal to pay was "because of a
5 reasonable doubt concerning the right of the beneficiary to payment."
6 Normally there will not be any question about the right of the benefi-
7 ciary to receive payment. Normally, the bank should be able to deter-
8 mine whether it has accepted the payment order and, if it has been
9 accepted, the first sentence of subsection (a) states that the bank is
10 obliged to pay. There may be uncommon cases, however, in which there is
11 doubt whether acceptance occurred. For example, if acceptance is based
12 on receipt of payment by the beneficiary's bank under Section 4A-403
13 (a)(1) or (2), there may be cases in which the bank is not certain that
14 payment has been received. There may also be cases in which there is
15 doubt about whether the person demanding payment is the person identi-
16 fied in the payment order as beneficiary of the order.

17 The last clause of subsection (a) does not apply to cases in which
18 a funds transfer is being used to pay an obligation and a dispute arises
19 between the originator and the beneficiary concerning whether the oblig-
20 ation is in fact owed. For example, the originator may try to prevent
21 payment to the beneficiary by the beneficiary's bank by alleging that
22 the beneficiary is not entitled to payment because of fraud against the
23 originator or a breach of contract relating to the obligation. The
24 fraud or breach of contract claim of the originator may be grounds for
25 recovery by the originator from the beneficiary after the beneficiary is
26 paid, but it does not affect the obligation of the beneficiary's bank to
27 pay the beneficiary. Unless the payment order has been cancelled pur-
28 suant to Section 4A-211(c), there is no excuse for refusing to pay the
29 beneficiary and, in a proper case, the refusal may result in consequen-
30 tial damages. Except in the case of a book transfer, in which the
31 beneficiary's bank is also the originator's bank, the originator of a
32 funds transfer cannot cancel a payment order to the beneficiary's bank,
33 with or without the consent of that bank, because the originator is not
34 the sender of that order. Thus, the beneficiary's bank may safely
35 ignore any instruction by the originator to withhold payment to the
36 beneficiary.

37 4. Subsection (b) states the duty of the beneficiary's bank to
38 notify the beneficiary of receipt of the order. If acceptance occurs
39 under Section 4A-209(b)(1) the beneficiary is normally notified. Thus,
40 subsection (b) applies primarily to cases in which acceptance occurs
41 under Section 4A-209(b)(2) or (3). Notice under subsection (b) is not
42 required if the person entitled to the notice agrees or a funds transfer
43 system rule provides that notice is not required and the beneficiary is
44 given notice of the rule. In ACH transactions the normal practice is
45 not to give notice to the beneficiary unless notice is requested by the
46 beneficiary. This practice can be continued by adoption of a funds
47 transfer system rule. Subsection (a) is not subject to variation by
48 agreement or by a funds transfer system rule.

1 § 4A-405. PAYMENT BY BENEFICIARY'S BANK TO BENEFICIARY

2 (a) If the beneficiary's bank credits an account of the bene-
3 ficiary of a payment order, payment of the bank's obligation under
4 Section 4A-404(a) occurs when and to the extent (i) the beneficiary
5 is notified of the right to withdraw the credit, (ii) the bank
6 lawfully applies the credit to a debt of the beneficiary, or (iii)
7 funds with respect to the order are otherwise made available to the
8 beneficiary by the bank.

9 (b) If the beneficiary's bank does not credit an account of
10 the beneficiary of a payment order, the time when payment of the
11 bank's obligation under Section 4A-404(a) occurs is governed by
12 principles of law that determine when an obligation is satisfied.

13 (c) Except as stated in subsections (d) and (e), if the bene-
14 ficiary's bank pays the beneficiary of a payment order under a
15 condition to payment or agreement of the beneficiary giving the
16 bank the right to recover payment from the beneficiary if the bank
17 does not receive payment of the order, the condition to payment or
18 agreement is not enforceable.

19 (d) A funds-transfer system rule may provide that payments
20 made to beneficiaries of funds transfers made through the system
21 are provisional until receipt of payment by the beneficiary's bank
22 of the payment order it accepted. A beneficiary's bank that makes
23 a payment that is provisional under the rule is entitled to refund
24 from the beneficiary if (i) the rule requires that both the
25 beneficiary and the originator be given notice of the provisional
26 nature of the payment before the funds transfer is initiated, (ii)

1 the beneficiary, the beneficiary's bank and the originator's bank
2 agreed to be bound by the rule, and (iii) the beneficiary's bank
3 did not receive payment of the payment order that it accepted. If
4 the beneficiary is obliged to refund payment to the beneficiary's
5 bank, acceptance of the payment order by the beneficiary's bank is
6 nullified and no payment by the originator of the funds transfer to
7 the beneficiary occurs under Section 4A-406.

8 (e) This subsection applies to a funds transfer that includes
9 a payment order transmitted over a funds-transfer system that (i)
10 nets obligations multilaterally among participants, and (ii) has in
11 effect a loss-sharing agreement among participants for the purpose
12 of providing funds necessary to complete settlement of the obliga-
13 tions of one or more participants that do not meet their settlement
14 obligations. If the beneficiary's bank in the funds transfer ac-
15 cepts a payment order and the system fails to complete settlement
16 pursuant to its rules with respect to any payment order in the
17 funds transfer, (i) the acceptance by the beneficiary's bank is
18 nullified and no person has any right or obligation based on the
19 acceptance, (ii) the beneficiary's bank is entitled to recover pay-
20 ment from the beneficiary, (iii) no payment by the originator to
21 the beneficiary occurs under Section 4A-406, and (iv) subject to
22 Section 4A-402(e), each sender in the funds transfer is excused
23 from its obligation to pay its payment order under Section 4A-
24 402(c) because the funds transfer has not been completed.

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COMMENT

1. This section defines when the beneficiary's bank pays the beneficiary and when the obligation of the beneficiary's bank under Section 4A-404 to pay the beneficiary is satisfied. In almost all cases the bank will credit an account of the beneficiary when it receives a payment order. In the typical case the beneficiary is paid when the beneficiary is given notice of the right to withdraw the credit. Subsection (a)(i). In some cases payment might be made to the beneficiary not by releasing funds to the beneficiary, but by applying the credit to a debt of the beneficiary. Subsection (a)(ii). In this case the beneficiary gets the benefit of the payment order because a debt of the beneficiary has been satisfied. The two principal cases in which payment will occur in this manner are setoff by the beneficiary's bank and payment of the proceeds of the payment order to a garnishing creditor of the beneficiary. These cases are discussed in Comment 2 to Section 4A-502.

2. If a beneficiary's bank releases funds to the beneficiary before it receives payment from the sender of the payment order, it assumes the risk that the sender may not pay the sender's order because of suspension of payments or other reason. Subsection (c). As stated in Comment 5 to Section 4A-209, the beneficiary's bank can protect itself against this risk by delaying acceptance. But if the bank accepts the order it is obliged to pay the beneficiary. If the beneficiary's bank has given the beneficiary notice of the right to withdraw a credit made to the beneficiary's account, the beneficiary has received payment from the bank. Once payment has been made to the beneficiary with respect to an obligation incurred by the bank under Section 4A-404(a), the payment cannot be recovered by the beneficiary's bank unless subsection (d) or (e) applies. Thus, a right to withdraw a credit cannot be revoked if the right to withdraw constituted payment of the bank's obligation. This principle applies even if funds were released as a "loan" (see Comment 5 to Section 4A-209), or were released subject to a condition that they would be repaid in the event the bank does not receive payment from the sender of the payment order, or the beneficiary agreed to return the payment if the bank did not receive payment from the sender.

3. Subsection (c) is subject to an exception stated in subsection (d) which is intended to apply to automated clearing house transfers. ACH transfers are made in batches. A beneficiary's bank will normally accept, at the same time and as part of a single batch, payment orders with respect to many different originator's banks. Comment 2 to Section 4A-206. The custom in ACH transactions is to release funds to the beneficiary early on the payment date even though settlement to the beneficiary's bank does not occur until later in the day. The understanding is that payments to beneficiaries are provisional until the beneficiary's bank receives settlement. This practice is similar to what happens when a depository bank releases funds with respect to a check forwarded for collection. If the check is dishonored the bank is entitled to recover the funds from the customer. ACH transfers are widely perceived as check substitutes. Section 4A-405(d) allows the

1 funds transfer system to adopt a rule making payments to beneficiaries
2 provisional. If such a rule is adopted, a beneficiary's bank that
3 releases funds to the beneficiary will be able to recover the payment if
4 it doesn't receive payment of the payment order that it accepted. There
5 are two requirements with respect to the funds transfer system rule.
6 The beneficiary, the beneficiary's bank and the originator's bank must
7 all agree to be bound by the rule and the rule must require that both
8 the beneficiary and the originator be given notice of the provisional
9 nature of the payment before the funds transfer is initiated. There is
10 no requirement that the notice be given with respect to a particular
11 funds transfer. Once notice of the provisional nature of the payment
12 has been given, the notice is effective for all subsequent payments to
13 or from the person to whom the notice was given. Subsection (d) pro-
14 vides only that the funds transfer system rule must require notice to
15 the beneficiary and the originator. The beneficiary's bank will know
16 what the rule requires, but it has no way of knowing whether the origin-
17 ator's bank complied with the rule. Subsection (d) does not require
18 proof that the originator received notice. If the originator's bank
19 failed to give the required notice and the originator suffered as a
20 result, the appropriate remedy is an action by the originator against
21 the originator's bank based on that failure. But the beneficiary's bank
22 will not be able to get the benefit of subsection (d) unless the benefi-
23 ciary had notice of the provisional nature of the payment because sub-
24 section (d) requires an agreement by the beneficiary to be bound by the
25 rule. Implicit in an agreement to be bound by a rule that makes a
26 payment provisional is a requirement that notice be given of what the
27 rule provides. The notice can be part of the agreement or separately
28 given. For example, notice can be given by providing a copy of the
29 system's operating rules.

30 With respect to ACH transfers made through a Federal Reserve Bank
31 acting as an intermediary bank, the Federal Reserve Bank is obliged
32 under Section 4A-402(b) to pay a beneficiary's bank that accepts the
33 payment order. Unlike Fedwire transfers, under current ACH practice a
34 Federal Reserve Bank that processes a payment order does not obligate
35 itself to pay if the originator's bank fails to pay the Federal Reserve
36 Bank. It is assumed that the Federal Reserve will use its right of pre-
37 emptation which is recognized in Section 4A-107 to disclaim the Section
38 4A-402(b) obligation in ACH transactions if it decides to retain the
39 provisional payment rule.

40 4. Subsection (e) is another exception to subsection (c). It
41 refers to funds transfer systems having loss-sharing rules described in
42 the subsection. CHIPS has proposed a rule that fits the description.
43 Under the CHIPS loss-sharing rule the CHIPS banks will have agreed to
44 contribute funds to allow the system to settle for payment orders sent
45 over the system during the day in the event that one or more banks are
46 unable to meet their settlement obligations. Subsection (e) applies
47 only if CHIPS fails to settle despite the loss-sharing rule. Since
48 funds under the loss-sharing rule will be instantly available to CHIPS
49 and will be in an amount sufficient to cover any failure that can be
50 reasonably anticipated, it is extremely unlikely that CHIPS would ever

1 fail to settle. Thus, subsection (e) addresses an event that should
2 never occur. If that event were to occur, all payment orders made over
3 the system would be cancelled under the CHIPS rule. Thus, no bank would
4 receive settlement, whether or not a failed bank was involved in a part-
5 icular funds transfer. Subsection (e) provides that each funds transfer
6 in which there is a payment order with respect to which there is a set-
7 tlement failure is unwound. Acceptance by the beneficiary's bank in
8 each funds transfer is nullified. The consequences of nullification are
9 that the beneficiary has no right to receive or retain payment by the
10 beneficiary's bank, no payment is made by the originator to the benefi-
11 ciary and each sender in the funds transfer is, subject to Section 4A-
12 402(e), not obliged to pay its payment order and is entitled to refund
13 under Section 4A-402(d) if it has already paid.

14 § 4A-406. PAYMENT BY ORIGINATOR TO BENEFICIARY; DISCHARGE OF
15 UNDERLYING OBLIGATION

16 (a) Subject to Sections 4A-211(e), 4A-405(d), and 4A-405(e),
17 the originator of a funds transfer pays the beneficiary of the
18 originator's payment order (i) at the time a payment order for the
19 benefit of the beneficiary is accepted by the beneficiary's bank in
20 the funds transfer and (ii) in an amount equal to the amount of the
21 order accepted by the beneficiary's bank, but not more than the
22 amount of the originator's order.

23 (b) If payment under subsection (a) is made to satisfy an
24 obligation, the obligation is discharged to the same extent dis-
25 charge would result from payment to the beneficiary of the same
26 amount in money, unless (i) the payment under subsection (a) was
27 made by a means prohibited by the contract of the beneficiary with
28 respect to the obligation, (ii) the beneficiary, within a reason-
29 able time after receiving notice of receipt of the order by the
30 beneficiary's bank, notified the originator of the beneficiary's
31 refusal of the payment, (iii) funds with respect to the order were

1 not withdrawn by the beneficiary or applied to a debt of the bene-
2 ficiary, and (iv) the beneficiary would suffer a loss that could
3 reasonably have been avoided if payment had been made by a means
4 complying with the contract. If payment by the originator does not
5 result in discharge under this section, the originator is subroga-
6 ted to the rights of the beneficiary to receive payment from the
7 beneficiary's bank under Section 4A-404(a).

8 (c) For the purpose of determining whether discharge of an
9 obligation occurs under subsection (b), if the beneficiary's bank
10 accepts a payment order in an amount equal to the amount of the
11 originator's payment order less charges of one or more receiving
12 banks in the funds transfer, payment to the beneficiary is deemed
13 to be in the amount of the originator's order unless upon demand by
14 the beneficiary the originator does not pay the beneficiary the
15 amount of the deducted charges.

16 (d) Rights of the originator or of the beneficiary of a funds
17 transfer under this section may be varied only by agreement of the
18 originator and the beneficiary.

19 COMMENT

20 1. Subsection (a) states the fundamental rule of Article 4A that
21 payment by the originator to the beneficiary is accomplished by provid-
22 ing to the beneficiary the obligation of the beneficiary's bank to pay.
23 Since this obligation arises when the beneficiary's bank accepts a pay-
24 ment order, the originator pays the beneficiary at the time of accep-
25 tance and in the amount of the payment order accepted.

26 2. In a large percentage of funds transfers, the transfer is made
27 to pay an obligation of the originator. Subsection (a) states that the
28 beneficiary is paid by the originator when the beneficiary's bank ac-
29 cepts a payment order for the benefit of the beneficiary. When that
30 happens the effect under subsection (b) is to substitute the obligation
31 of the beneficiary's bank for the obligation of the originator. The
32 effect is similar to that under Article 3 if a cashier's check payable

1 to the beneficiary had been taken by the beneficiary. Normally, payment
2 by funds transfer is sought by the beneficiary because it puts money
3 into the hands of the beneficiary more quickly. As a practical matter
4 the beneficiary and the originator will nearly always agree to the funds
5 transfer in advance. Under subsection (b) acceptance by the benefici-
6 ary's bank will result in discharge of the obligation for which payment
7 was made unless the beneficiary had made a contract with respect to the
8 obligation which did not permit payment by the means used. Thus, if
9 there is no contract of the beneficiary with respect to the means of
10 payment of the obligation, acceptance by the beneficiary's bank of a
11 payment order to the account of the beneficiary can result in discharge.

12 3. Suppose Beneficiary's contract stated that payment of an
13 obligation owed by Originator was to be made by a cashier's check of
14 Bank A. Instead, Originator paid by a funds transfer to Beneficiary's
15 account in Bank B. Bank B accepted a payment order for the benefit of
16 Beneficiary by immediately notifying Beneficiary that the funds were
17 available for withdrawal. Before Beneficiary had a reasonable opportu-
18 nity to withdraw the funds Bank B suspended payments. Under the unless
19 clause of subsection (b) Beneficiary is not required to accept the pay-
20 ment as discharging the obligation owed by Originator to Beneficiary if
21 Beneficiary's contract means that Beneficiary was not required to accept
22 payment by wire transfer. Beneficiary could refuse the funds transfer
23 as payment of the obligation and could resort to rights under the under-
24 lying contract to enforce the obligation. The rationale is that Origin-
25 ator cannot impose the risk of Bank B's insolvency on Beneficiary if
26 Beneficiary had specified another means of payment that did not entail
27 that risk. If Beneficiary is required to accept Originator's payment,
28 Beneficiary would suffer a loss that would not have occurred if payment
29 had been made by a cashier's check on Bank A, and Bank A has not sus-
30 pended payments. In this case Originator will have to pay twice. It is
31 obliged to pay the amount of its payment order to the bank that accepted
32 it and has to pay the obligation it owes to Beneficiary which has not
33 been discharged. Under the last sentence of subsection (b) Originator
34 is subrogated to Beneficiary's right to receive payment from Bank B
35 under Section 4A-404(a).

36 4. Suppose Beneficiary's contract called for payment by a Fedwire
37 transfer to Bank B, but the payment order accepted by Bank B was not a
38 Fedwire transfer. Before the funds were withdrawn by Beneficiary, Bank
39 B suspended payments. The sender of the payment order to Bank B paid
40 the amount of the order to Bank B. In this case the payment by Origina-
41 tor did not comply with Beneficiary's contract, but the noncompliance
42 did not result in a loss to Beneficiary as required by subsection (b)
43 (iv). A Fedwire transfer avoids the risk of insolvency of the sender of
44 the payment order to Bank B, but it does not affect the risk that Bank B
45 will suspend payments before withdrawal of the funds by Beneficiary.
46 Thus, the unless clause of subsection (b) is not applicable and the
47 obligation owed to Beneficiary is discharged.

48 5. Charges of receiving banks in a funds transfer normally are
49 nominal in relationship to the amount being paid by the originator to

1 the beneficiary. Wire transfers are normally agreed to in advance and
2 the parties may agree concerning how these charges are to be divided
3 between the parties. Subsection (c) states a rule that applies in the
4 absence of agreement. In some funds transfers charges of banks that
5 execute payment orders are collected by deducting the charges from the
6 amount of the payment order issued by the bank, i.e. the bank issues a
7 payment order that is slightly less than the amount of the payment order
8 that is being executed. The process is described in Comment 3 to Sec-
9 tion 4A-302. The result in such a case is that the payment order ac-
10 cepted by the beneficiary's bank will be slightly less than the amount
11 of the originator's order. Subsection (c) recognizes the principle that
12 a beneficiary is entitled to full payment of a debt paid by wire trans-
13 fer as a condition to discharge. On the other hand, Subsection (c)
14 prevents a beneficiary from denying the originator the benefit of the
15 payment by asserting that discharge did not occur because deduction of
16 bank charges resulted in less than full payment. The typical case is
17 one in which the payment is made to exercise a valuable right such as an
18 option which is unfavorable to the beneficiary. Subsection (c) allows
19 discharge notwithstanding the deduction unless the originator fails to
20 reimburse the beneficiary for the deducted charges after demand by the
21 beneficiary.

22 PART 5

23 MISCELLANEOUS PROVISIONS

24 § 4A-501. VARIATION BY AGREEMENT AND EFFECT OF FUNDS-TRANSFER

25 SYSTEM RULE

26 (a) Except as otherwise provided in this Article, the rights
27 and obligations of a party to a funds transfer may be varied by
28 agreement of the affected party.

29 (b) "Funds-transfer system rule" means a rule of an asso-
30 ciation of banks (i) governing transmission of payment orders by
31 means of a funds-transfer system of the association or rights and
32 obligations with respect to those orders, or (ii) to the extent the
33 rule governs rights and obligations between banks that are parties
34 to a funds transfer in which a Federal Reserve Bank, acting as an

1 intermediary bank, sends a payment order to the beneficiary's bank.
2 Except as otherwise provided in this Article, a funds-transfer sys-
3 tem rule governing rights and obligations between participating
4 banks using the system may be effective even if the rule conflicts
5 with this Article and indirectly affects another party to the funds
6 transfer who does not consent to the rule. A funds-transfer system
7 rule may also govern rights and obligations of parties other than
8 participating banks using the system to the extent stated in
9 Sections 4A-404(c), 4A-405(d), and 4A-507(c).

10 COMMENT

11 1. This section is designed to give some flexibility to Article
12 4A. Funds transfer system rules govern rights and obligations between
13 banks that use the system. They may cover a wide variety of matters
14 such as form and content of payment orders, security procedures, cancel-
15 lation rights and procedures, indemnity rights, compensation rules for
16 delays in completion of a funds transfer, time and method of settlement,
17 credit restrictions with respect to senders of payment orders and risk
18 allocation with respect to suspension of payments by a participating
19 bank. Funds transfer system rules can be very effective in supplement-
20 ing the provisions of Article 4A and in filling gaps that may be present
21 in Article 4A. To the extent they do not conflict with Article 4A there
22 is no problem with respect to their effectiveness. In that case they
23 merely supplement Article 4A. Section 4A-501 goes further. It states
24 that unless the contrary is stated, funds transfer system rules can
25 override provisions of Article 4A. Thus, rights and obligations of a
26 sender bank and a receiving bank with respect to each other can be
27 different from that stated in Article 4A to the extent a funds transfer
28 system rule applies. Since funds transfer system rules are defined as
29 those governing the relationship between participating banks, a rule can
30 have a direct effect only on participating banks. But a rule that
31 affects the conduct of a participating bank may indirectly affect the
32 rights of nonparticipants such as the originator or beneficiary of a
33 funds transfer, and such a rule can be effective even though it may
34 affect nonparticipants without their consent. For example, a rule might
35 prevent execution of a payment order or might allow cancellation of a
36 payment order with the result that a funds transfer is not completed or
37 is delayed. But a rule purporting to define rights and obligations of
38 nonparticipants in the system would not be effective to alter Article 4A
39 rights because the rule is not within the definition of funds transfer
40 system rule. Rights and obligations arising under Article 4A may also
41 be varied by agreement of the affected parties, except to the extent
42 Article 4A otherwise provides. Rights and obligations arising under

1 Article 4A can also be changed by Federal Reserve regulations and
2 operating circulars of Federal Reserve Banks. Section 4A-107.

3 2. Subsection (b)(ii) refers to ACH transfers. Whether an ACH
4 transfer is made through an automated clearing house of a Federal Re-
5 serve Bank or through an automated clearing house of another association
6 of banks, the rights and obligations of the originator's bank and the
7 beneficiary's bank are governed by uniform rules adopted by various
8 associations of banks in various parts of the nation. With respect to
9 transfers in which a Federal Reserve Bank acts as intermediary bank
10 these rules may be incorporated, in whole or in part, in operating
11 circulars of the Federal Reserve Bank. Even if not so incorporated
12 these rules can still be binding on the association banks. If a trans-
13 fer is made through a Federal Reserve Bank, the rules are effective
14 under subsection (b)(ii). If the transfer is not made through a Federal
15 Reserve Bank, the association rules are effective under subsection
16 (b)(i).

17 § 4A-502. CREDITOR PROCESS SERVED ON RECEIVING BANK; SETOFF BY
18 BENEFICIARY'S BANK

19 (a) As used in this section, "creditor process" means levy,
20 attachment, garnishment, notice of lien, sequestration, or similar
21 process issued by or on behalf of a creditor or other claimant with
22 respect to an account.

23 (b) This subsection applies to creditor process with respect
24 to an authorized account of the sender of a payment order if the
25 creditor process is served on the receiving bank. For the purpose
26 of determining rights with respect to the creditor process, if the
27 receiving bank accepts the payment order the balance in the author-
28 ized account is deemed to be reduced by the amount of the payment
29 order to the extent the bank did not otherwise receive payment of
30 the order, unless the creditor process is served at a time and in a
31 manner affording the bank a reasonable opportunity to act on it
32 before the bank accepts the payment order.

1 (c) If a beneficiary's bank has received a payment order for
2 payment to the beneficiary's account in the bank, the following
3 rules apply:

4 (1) The bank may credit the beneficiary's account. The
5 amount credited may be set off against an obligation owed by the
6 beneficiary to the bank or may be applied to satisfy creditor
7 process served on the bank with respect to the account.

8 (2) The bank may credit the beneficiary's account and
9 allow withdrawal of the amount credited unless creditor process
10 with respect to the account is served at a time and in a manner
11 affording the bank a reasonable opportunity to act to prevent with-
12 drawal.

13 (3) If creditor process with respect to the benefici-
14 ary's account has been served and the bank has had a reasonable
15 opportunity to act on it, the bank may not reject the payment order
16 except for a reason unrelated to the service of process.

17 (d) Creditor process with respect to a payment by the
18 originator to the beneficiary pursuant to a funds transfer may be
19 served only on the beneficiary's bank with respect to the debt owed
20 by that bank to the beneficiary. Any other bank served with the
21 creditor process is not obliged to act with respect to the process.

22 COMMENT

23 1. When a receiving bank accepts a payment order, the bank norm-
24 ally receives payment from the sender by debiting an authorized account
25 of the sender. In accepting the sender's order the bank may be relying
26 on a credit balance in the account. If creditor process is served on
27 the bank with respect to the account before the bank accepts the order
28 but the bank employee responsible for the acceptance was not aware of
29 the creditor process at the time the acceptance occurred, it is unjust
30 to the bank to allow the creditor process to take the credit balance on

1 which the bank may have relied. Subsection (b) allows the bank to ob-
2 tain payment from the sender's account in this case. Under that provi-
3 sion, the balance in the sender's account to which the creditor process
4 applies is deemed to be reduced by the amount of the payment order un-
5 less there was sufficient time for notice of the service of creditor
6 process to be received by personnel of the bank responsible for the
7 acceptance.

8 2. Subsection (c) deals with payment orders issued to the benefi-
9 ciary's bank. The bank may credit the beneficiary's account when the
10 order is received, but under Section 4A-404(a) the bank incurs no oblig-
11 ation to pay the beneficiary until the order is accepted pursuant to
12 Section 4A-209(b). Thus, before acceptance, the credit to the benefi-
13 ciary's account is provisional. But under Section 4A-209(b) acceptance
14 occurs if the beneficiary's bank pays the beneficiary pursuant to Sec-
15 tion 4A-405(a). Under that provision, payment occurs if the credit to
16 the beneficiary's account is applied to a debt of the beneficiary. Sub-
17 section (c)(1) allows the bank to credit the beneficiary's account with
18 respect to a payment order and to accept the order by setting off the
19 credit against an obligation owed to the bank or applying the credit to
20 creditor process with respect to the account.

21 Suppose a beneficiary's bank receives a payment order for the bene-
22 fit of a customer. Before the bank accepts the order, the bank learns
23 that creditor process has been served on the bank with respect to the
24 customer's account. Normally there is no reason for a beneficiary's
25 bank to reject a payment order, but if the beneficiary's account is
26 garnished, the bank may be faced with a difficult choice. If it rejects
27 the order, the garnishing creditor's potential recovery of funds of the
28 beneficiary is frustrated. It may be faced with a claim by the creditor
29 that the rejection was a wrong to the creditor. If the bank accepts the
30 order, the effect is to allow the creditor to seize funds of its cust-
31 omer, the beneficiary. Subsection (c)(3) gives the bank no choice in
32 this case. It provides that it may not favor its customer over the
33 creditor by rejecting the order. The beneficiary's bank may rightfully
34 reject only if there is an independent basis for rejection.

35 3. Subsection (c)(2) is similar to subsection (b). Normally the
36 beneficiary's bank will release funds to the beneficiary shortly after
37 acceptance or it will accept by releasing funds. Since the bank is
38 bound by a garnishment order served before funds are released to the
39 beneficiary, the bank might suffer a loss if funds were released without
40 knowledge that a garnishment order had been served. Subsection (c)(2)
41 protects the bank if it did not have adequate notice of the garnishment
42 when the funds were released.

43 4. A creditor may want to reach funds involved in a funds trans-
44 fer. The creditor may try to do so by serving process on the origina-
45 tor's bank, an intermediary bank or the beneficiary's bank. The purpose
46 of subsection (d) is to guide the creditor and the court as to the prop-
47 er method of reaching the funds involved in a funds transfer. A credi-
48 tor of the originator can levy on the account of the originator in the

1 originator's bank before the funds transfer is initiated, but that levy
2 is subject to the limitations stated in subsection (b). The creditor of
3 the originator cannot reach any other funds because no property of the
4 originator is being transferred. A creditor of the beneficiary cannot
5 levy on property of the originator and until the funds transfer is com-
6 pleted by acceptance by the beneficiary's bank of a payment order for
7 the benefit of the beneficiary, the beneficiary has no property interest
8 in the funds transfer which the beneficiary's creditor can reach. A
9 creditor of the beneficiary that wants to reach the funds to be received
10 by the beneficiary must serve creditor process on the beneficiary's bank
11 to reach the obligation of the beneficiary's bank to pay the beneficiary
12 which arises upon acceptance by the beneficiary's bank under Section 4A-
13 404(a).

14 5. "Creditor process" is defined in subsection (a) to cover a
15 variety of devices by which a creditor of the holder of a bank account
16 or a claimant to a bank account can seize the account. Procedure and
17 nomenclature varies widely from state to state. The term used in Sec-
18 tion 4A-502 is a generic term.

19 § 4A-503. INJUNCTION OR RESTRAINING ORDER WITH RESPECT TO FUNDS
20 TRANSFER

21 For proper cause and in compliance with applicable law, a
22 court may restrain (i) a person from issuing a payment order to
23 initiate a funds transfer, (ii) an originator's bank from executing
24 the payment order of the originator, or (iii) the beneficiary's
25 bank from releasing funds to the beneficiary or the beneficiary
26 from withdrawing the funds. A court may not otherwise restrain a
27 person from issuing a payment order, paying or receiving payment of
28 a payment order, or otherwise acting with respect to a funds
29 transfer.

30 COMMENT

31 This section is related to Section 4A-502(d) and to Comment 4 to
32 Section 4A-502. It is designed to prevent interruption of a funds
33 transfer after it has been set in motion. The initiation of a funds
34 transfer can be prevented by enjoining the originator or the origina-
35 tor's bank from issuing a payment order. After the funds transfer is
36 completed by acceptance of a payment order by the beneficiary's bank,

1 that bank can be enjoined from releasing funds to the beneficiary or the
2 beneficiary can be enjoined from withdrawing the funds. No other in-
3 junction is permitted. In particular, intermediary banks are protected,
4 and injunctions against the originator and the originator's bank are
5 limited to issuance of a payment order. Except for the beneficiary's
6 bank, nobody can be enjoined from paying a payment order, and no receiv-
7 ing bank can be enjoined from receiving payment from the sender of the
8 order that it accepted.

9 § 4A-504. ORDER IN WHICH ITEMS AND PAYMENT ORDERS MAY BE CHARGED TO
10 ACCOUNT; ORDER OF WITHDRAWALS FROM ACCOUNT

11 (a) If a receiving bank has received more than one payment
12 order of the sender or one or more payment orders and other items
13 that are payable from the sender's account, the bank may charge the
14 sender's account with respect to the various orders and items in
15 any sequence.

16 (b) In determining whether a credit to an account has been
17 withdrawn by the holder of the account or applied to a debt of the
18 holder of the account, credits first made to the account are first
19 withdrawn or applied.

20 COMMENT

21 1. Subsection (a) concerns priority among various obligations
22 that are to be paid from the same account. A customer may have written
23 checks on its account with the receiving bank and may have issued one or
24 more payment orders payable from the same account. If the account bal-
25 ance is not sufficient to cover all of the checks and payment orders,
26 some checks may be dishonored and some payment orders may not be accept-
27 ed. Although there is no concept of wrongful dishonor of a payment
28 order in Article 4A in the absence of an agreement to honor by the re-
29 ceiving bank, some rights and obligations may depend on the amount in
30 the customer's account. Section 4A-209(b)(3) and Section 4A-210(b).
31 Whether dishonor of a check is wrongful also may depend upon the balance
32 in the customer's account. Under subsection (a), the bank is not re-
33 quired to consider the competing items and payment orders in any part-
34 icular order. Rather it may charge the customer's account for the
35 various items and orders in any order. Suppose there is \$12,000 in the
36 customer's account. If a check for \$5,000 is presented for payment and
37 the bank receives a \$10,000 payment order from the customer, the bank

1 could dishonor the check and accept the payment order. Dishonor of the
2 check is not wrongful because the account balance was less than the
3 amount of the check after the bank charged the account \$10,000 on ac-
4 count of the payment order. Or, the bank could pay the check and not
5 execute the payment order because the amount of the order is not covered
6 by the balance in the account.

7 2. Subsection (b) follows Section 4-208(b) in using the first-in-
8 first-out rule for determining the order in which credits to an account
9 are withdrawn.

10 § 4A-505. PRECLUSION OF OBJECTION TO DEBIT OF CUSTOMER'S ACCOUNT

11 If a receiving bank has received payment from its customer
12 with respect to a payment order issued in the name of the customer
13 as sender and accepted by the bank, and the customer received
14 notification reasonably identifying the order, the customer is
15 precluded from asserting that the bank is not entitled to retain
16 the payment unless the customer notifies the bank of the customer'
17 objection to the payment within one year after the notification was
18 received by the customer.

19 COMMENT

20 This section is in the nature of a statute of repose for objecting
21 to debits made to the customer's account. A receiving bank that exe-
22 cutes payment orders of a customer may have received payment from the
23 customer by debiting the customer's account with respect to a payment
24 order that the customer was not required to pay. For example, the
25 payment order may not have been authorized or verified pursuant to
26 Section 4A-202 or the funds transfer may not have been completed. In
27 either case the receiving bank is obliged to refund the payment to the
28 customer and this obligation to refund payment cannot be varied by
29 agreement. Section 4A-204 and Section 4A-402. Refund may also be re-
30 quired if the receiving bank is not entitled to payment from the cust-
31 omer because the bank erroneously executed a payment order. Section 4A-
32 303. A similar analysis applies to that case. Section 4A-402(d) and
33 (f) require refund and the obligation to refund may not be varied by
34 agreement. Under 4A-505, however, the obligation to refund may not be
35 asserted by the customer if the customer has not objected to the deb-
36 iting of the account within one year after the customer received
37 notification of the debit.

1 § 4A-506. RATE OF INTEREST

2 (a) If, under this Article, a receiving bank is obliged to
3 pay interest with respect to a payment order issued to the bank,
4 the amount payable may be determined (i) by agreement of the sender
5 and receiving bank, or (ii) by a funds-transfer system rule if the
6 payment order is transmitted through a funds-transfer system.

7 (b) If the amount of interest is not determined by an agree-
8 ment or rule as stated in subsection (a), the amount is calculated
9 by multiplying the applicable Federal Funds rate by the amount on
10 which interest is payable, and then multiplying the product by the
11 number of days for which interest is payable. The applicable
12 Federal Funds rate is the average of the Federal Funds rates pub-
13 lished by the Federal Reserve Bank of New York for each of the days
14 for which interest is payable divided by 360. The Federal Funds
15 rate for any day on which a published rate is not available is the
16 same as the published rate for the next preceding day for which
17 there is a published rate. If a receiving bank that accepted a
18 payment order is required to refund payment to the sender of the
19 order because the funds transfer was not completed, but the failure
20 to complete was not due to any fault by the bank, the interest pay-
21 able is reduced by a percentage equal to the reserve requirement on
22 deposits of the receiving bank.

23 COMMENT

24 1. A receiving bank is required to pay interest on the amount of
25 a payment order received by the bank in a number of situations. Some-
26 times the interest is payable to the sender and in other cases it is
27 payable to either the originator or the beneficiary of the funds trans-
28 fer. The relevant provisions are Section 4A-204(a), Section 4A-209(b)
29 (3), Section 4A-210(b), Section 4A-305(a), Section 4A-402(d) and Section

1 4A-404(b). The rate of interest may be governed by a funds transfer
2 system rule or by agreement as stated in subsection (a). If subsection
3 (a) doesn't apply, the rate is determined under subsection (b). Subsec-
4 tion (b) is illustrated by the following example. A bank is obliged to
5 pay interest on \$1,000,000 for three days, July 3, July 4, and July 5.
6 The published Fed Funds rate is .082 for July 3 and .081 for July 5.
7 There is no published rate for July 4 because that day is not a banking
8 day. The rate for July 3 applies to July 4. The applicable Fed Funds
9 rate is .08167 (the average of .082, .082, and .081) divided by 360
10 which equals .0002268. The amount of interest payable is \$1,000,000 X
11 .0002268 X 3 = \$680.40.

12 2. In some cases, interest is payable in spite of the fact that
13 there is no fault by the receiving bank. The last sentence of subsec-
14 tion (b) applies to those cases. For example, a funds transfer might
15 not be completed because the beneficiary's bank rejected the payment
16 order issued to it by the originator's bank or an intermediary bank.
17 Section 4A-402(c) provides that the originator is not obliged to pay its
18 payment order and Section 4A-402(d) provides that the originator's bank
19 must refund any payment received plus interest. The requirement to pay
20 interest in this case is not based on fault by the originator's bank.
21 Rather, it is based on restitution. Since the originator's bank had the
22 use of the originator's money, it is required to pay the originator for
23 the value of that use. The value of that use is not determined by mult-
24 iplying the interest rate by the refundable amount because the origina-
25 tor's bank is required to deposit with the Federal Reserve a percentage
26 of the bank's deposits as a reserve requirement. Since that deposit
27 does not bear interest, the bank had use of the refundable amount re-
28 duced by a percentage equal to the reserve requirement. If the reserve
29 requirement is 12%, the amount of interest payable by the bank under the
30 formula stated in subsection (b) is reduced by 12%.

31 § 4A-507. CHOICE OF LAW

32 (a) The following rules apply unless the affected parties
33 otherwise agree or subsection (c) applies:

34 (1) The rights and obligations between the sender of a
35 payment order and the receiving bank are governed by the law of the
36 jurisdiction in which the receiving bank is located.

37 (2) The rights and obligations between the beneficiary's
38 bank and the beneficiary are governed by the law of the jurisdic-
39 tion in which the beneficiary's bank is located.

1 (3) The issue of when payment is made pursuant to a
2 funds transfer by the originator to the beneficiary is governed by
3 the law of the jurisdiction in which the beneficiary's bank is
4 located.

5 (b) If the parties described in each paragraph of subsection
6 (a) have made an agreement selecting the law of a particular
7 jurisdiction to govern rights and obligations between each other,
8 the law of that jurisdiction governs those rights and obligations,
9 whether or not the payment order or the funds transfer bears a
10 reasonable relation to that jurisdiction.

11 (c) A funds-transfer system rule may select the law of a
12 particular jurisdiction to govern (i) rights and obligations be-
13 tween participating banks with respect to payment orders transmit-
14 ted or processed through the system, or (ii) the rights and obliga-
15 tions of some or all parties to a funds transfer any part of which
16 is carried out by means of the system. A choice of law made pur-
17 suant to clause (i) is binding on participating banks. A choice of
18 law made pursuant to clause (ii) is binding on the originator,
19 other sender, or a receiving bank having notice that the funds-
20 transfer system might be used in the funds transfer and of the
21 choice of law by the system when the originator, other sender, or
22 receiving bank issued or accepted a payment order. The beneficiary
23 of a funds transfer is bound by the choice of law if, when the
24 funds transfer is initiated, the beneficiary has notice that the
25 funds-transfer system might be used in the funds transfer and of
26 the choice of law by the system. The law of a jurisdiction

1 selected pursuant to this subsection may govern, whether or not
2 that law bears a reasonable relation to the matter in issue.

3 (d) In the event of inconsistency between an agreement under
4 subsection (b) and a choice-of-law rule under subsection (c), the
5 agreement under subsection (b) prevails.

6 (e) If a funds transfer is made by use of more than one
7 funds-transfer system and there is inconsistency between choice-of-
8 law rules of the systems, the matter in issue is governed by the
9 law of the selected jurisdiction that has the most significant
10 relationship to the matter in issue

11 COMMENT

12 1. Funds transfers are typically interstate or international in
13 character. If part of a funds transfer is governed by Article 4A and
14 another part is governed by other law, the rights and obligations of
15 parties to the funds transfer may be unclear because there is no clear
16 consensus in various jurisdictions concerning the juridical nature of
17 the transaction. Unless all of a funds transfer is governed by a single
18 law it may be very difficult to predict the result if something goes
19 wrong in the transfer. Section 4A-507 deals with this problem. Subsec-
20 tion (b) allows parties to a funds transfer to make a choice-of-law
21 agreement. Subsection (c) allows a funds transfer system to select the
22 law of a particular jurisdiction to govern funds transfers carried out
23 by means of the system. Subsection (a) states residual rules if no
24 choice of law has occurred under subsection (b) or subsection (c).

25 2. Subsection (a) deals with three sets of relationships. Rights
26 and obligations between the sender of a payment order and the receiving
27 bank are governed by the law of the jurisdiction in which the receiving
28 bank is located. If the receiving bank is the beneficiary's bank the
29 rights and obligations of the beneficiary are also governed by the law
30 of the jurisdiction in which the receiving bank is located. Suppose
31 Originator, located in Canada, sends a payment order to Originator's
32 Bank located in a state in which Article 4A has been enacted. The order
33 is for payment to an account of Beneficiary in a bank in England. Under
34 subsection (a)(1), the rights and obligations of Originator and Origina-
35 tor's Bank toward each other are governed by Article 4A if an action is
36 brought in a court in the Article 4A state. If an action is brought in
37 a Canadian court, the conflict of laws issue will be determined by Cana-
38 dian law which might or might not apply the law of the state in which
39 Originator's Bank is located. If that law is applied, the execution of
40 Originator's order will be governed by Article 4A, but with respect to

1 the payment order of Originator's Bank to the English bank, Article 4A
2 may or may not be applied with respect to the rights and obligations
3 between the two banks. The result may depend upon whether action is
4 brought in a court in the state in which Originator's Bank is located or
5 in an English court. Article 4A is binding only on a court in a state
6 that enacts it. It can have extraterritorial effect only to the extent
7 courts of another jurisdiction are willing to apply it. Subsection (c)
8 also bears on the issues discussed in this Comment.

9 Under Section 4A-406 payment by the originator to the beneficiary
10 of the funds transfer occurs when the beneficiary's bank accepts a pay-
11 ment order for the benefit of the beneficiary. A jurisdiction in which
12 Article 4A is not in effect may follow a different rule or it may not
13 have a clear rule. Under Section 4A-507(a)(3) the issue is governed by
14 the law of the jurisdiction in which the beneficiary's bank is located.
15 Since the payment to the beneficiary is made through the beneficiary's
16 bank it is reasonable that the issue of when payment occurs be governed
17 by the law of the jurisdiction in which the bank is located. Since it
18 is difficult in many cases to determine where a beneficiary is located,
19 the location of the beneficiary's bank provides a more certain rule.

20 3. Subsection (b) deals with choice-of-law agreements and it
21 gives maximum freedom of choice. Since the law of funds transfers is
22 not highly developed in the case law there may be a strong incentive to
23 choose the law of a jurisdiction in which Article 4A is in effect be-
24 cause it provides a greater degree of certainty with respect to the
25 rights of various parties. With respect to commercial transactions, it
26 is often said that "[u]niformity and predictability based upon commer-
27 cial convenience are the prime considerations in making the choice of
28 governing law" R. Leflar, *American Conflicts Law*, § 185 (1977).
29 Subsection (b) is derived in part from recently enacted choice-of-law
30 rules in the States of New York and California. N.Y. Gen. Obligations
31 Law 5-1401 (McKinney's 1989 Supp.) and California Civil Code § 1646.5.
32 This broad endorsement of freedom of contract is an enhancement of the
33 approach taken by Restatement (Second) of Conflict of Laws § 187(b)
34 (1971). The Restatement recognizes the basic right of freedom of con-
35 tract, but the freedom granted the parties may be more limited than the
36 freedom granted here. Under the formulation of the Restatement, if
37 there is no substantial relationship to the jurisdiction whose law is
38 selected and there is no "other" reasonable basis for the parties'
39 choice, then the selection of the parties need not be honored by a
40 court. Further, if the choice is violative of a fundamental policy of a
41 state which has a materially greater interest than the chosen state, the
42 selection could be disregarded by a court. Those limitations are not
43 found in subsection (b).

44 4. Subsection (c) may be the most important provision in regard
45 to creating uniformity of law in funds transfers. Most rights stated in
46 Article 4A regard parties who are in privity of contract such as origin-
47 ator and beneficiary, sender and receiving bank, and beneficiary's bank
48 and beneficiary. Since they are in privity they can make a choice of
49 law by agreement. But that is not always the case. For example, an

1 intermediary bank that improperly executes a payment order is not in
2 privity with either the originator or the beneficiary. The ability of a
3 funds transfer system to make a choice of law by rule is a convenient
4 way of dispensing with individual agreements and to cover cases in which
5 agreements are not feasible. It is probable that funds transfer systems
6 will adopt a governing law to increase the certainty of commercial
7 transactions that are effected over such systems. A system rule might
8 adopt the law of an Article 4A state to govern transfers on the system
9 in order to provide a consistent, unitary, law governing all transfers
10 made on the system. To the extent such system rules develop, individual
11 choice-of-law agreements become unnecessary.

12 Subsection (c) has broad application. A system choice of law ap-
13 plies not only to rights and obligations between banks that use the
14 system, but may also apply to other parties to the funds transfer so
15 long as some part of the transfer was carried out over the system. The
16 originator and any other sender or receiving bank in the funds transfer
17 is bound if at the time it issues or accepts a payment order it had no-
18 tice that the funds transfer involved use of the system and that the
19 system chose the law of a particular jurisdiction. Under Section 4A-
20 107, the Federal Reserve by regulation could make a similar choice of
21 law to govern funds transfers carried out by use of Federal Reserve
22 Banks. Subsection (d) is a limitation on subsection (c). If parties
23 have made a choice-of-law agreement that conflicts with a choice of law
24 made under subsection (c), the agreement prevails.

25 5. Subsection (e) addresses the case in which a funds transfer
26 involves more than one funds transfer system and the systems adopt con-
27 flicting choice-of-law rules. The rule that has the most significant
28 relationship to the matter at issue prevails. For example, each system
29 should be able to make a choice of law governing payment orders trans-
30 mitted over that system without regard to a choice of law made by
31 another system.

TECHNICAL AMENDMENT TO ARTICLE 1

A state enacting Article 4A should amend Section 1-105(2) by adding the following:

"Governing law in the Article on Funds Transfers.
Section 4A-507."

LD0910484

GTA

1 D 1/3/90 Cramme C 1/8/90 skv

2 SENATE BILL NO. HOUSE BILL NO.

3 A BILL to amend and reenact § 8.1-105 of the Code of Virginia and to
4 amend the Code of Virginia by adding a title numbered 8.4A,
5 consisting of parts numbered 1 through 5, containing sections
6 numbered 8.4A-101 through 8.4A-507 of the Code of Virginia,
7 creating a comprehensive body of law within the Uniform
8 Commercial Code that defines the rights and obligations that
9 arise from funds transfers by wire.

10

11 Be it enacted by the General Assembly of Virginia:

12 1. That § 8.1-105 of the Code of Virginia is amended and reenacted
13 and that the Code of Virginia is amended by adding a title numbered
14 8.4A, consisting of parts numbered 1 through 5, containing sections
15 numbered 8.4A-101 through 8.4A-507, as follows:

16 § 8.1-105. Territorial application of the act; parties' power to
17 choose applicable law.--(1) Except as provided hereafter in this
18 section, when a transaction bears a reasonable relation to this State
19 and also to another state or nation the parties may agree that the law
20 either of this State or of such other state or nation shall govern
21 their rights and duties. Failing such agreement this act applies to
22 transactions bearing an appropriate relation to this State.

23 (2) Where one of the following provisions of this act specifies
24 the applicable law, that provision governs and a contrary agreement is
25 effective only to the extent permitted by the law (including the
26 conflict of laws rules) so specified:

27 Rights of creditors against sold goods. § 8.2-402.

28 Applicability of the title on bank deposits and collections.

1 8.4-102.

Applicability of the title on funds transfers. § 8.4A-507.

3 Bulk transfers subject to the title on bulk transfers. § 8.6-102.

4 Applicability of the title on investment securities. § 8.8-106.

5 Perfection provisions of the title on secured transactions. §

6 8.9-103.

7 TITLE 8.4A.

8 COMMERCIAL CODE--FUNDS TRANSFERS.

9 PART 1.

10 SUBJECT MATTER AND DEFINITIONS.

11 § 8.4A-101. Short title.--This title may be cited as Uniform
12 Commercial Code--Funds Transfers.

13 § 8.4A-102. Subject matter.--Except as otherwise provided in §
14 8.4A-108, this title applies to funds transfers defined in § 8.4A-104.

§ 8.4A-103. Definitions: "Payment order"; "Beneficiary";
16 "Beneficiary's bank"; "Receiving bank"; "Sender."--(a) In this title:

17 (1) "Payment order" means an instruction of a sender to a
18 receiving bank, transmitted orally, electronically, or in writing, to
19 pay, or to cause another bank to pay, a fixed or determinable amount
20 of money to a beneficiary if: (i) the instruction does not state a
21 condition to payment to the beneficiary other than time of payment,
22 (ii) the receiving bank is to be reimbursed by debiting an account of
23 or otherwise receiving payment from, the sender, and (iii) the
24 instruction is transmitted by the sender directly to the receiving
25 bank or to an agent, funds-transfer system, or communication system
26 for transmittal to the receiving bank.

7 (2) "Beneficiary" means the person to be paid by the
28 beneficiary's bank.

1 (3) "Beneficiary's bank" means the bank identified in a payment
2 order in which an account of the beneficiary is to be credited
3 pursuant to the order or which otherwise is to make payment to the
4 beneficiary if the order does not provide for payment to an account.

5 (4) "Receiving bank" means the bank to which the sender's
6 instruction is addressed.

7 (5) "Sender" means the person giving the instruction to the
8 receiving bank.

9 (b) If an instruction complying with subdivision (a)(1) of this
10 section is to make more than one payment to a beneficiary, the
11 instruction is a separate payment order with respect to each payment.

12 (c) A payment order is issued when it is sent to the receiving
13 bank.

14 § 8.4A-104. Definitions: "Funds transfer"; Intermediary bank";
15 "Originator"; "Originator's bank."--In this title:

16 (a) "Funds transfer" means the series of transactions, beginning
17 with the originator's payment order, made for the purpose of making
18 payment to the beneficiary of the order. The term includes any
19 payment order issued by the originator's bank or an intermediary bank
20 intended to carry out the originator's payment order. A funds
21 transfer is completed by acceptance by the beneficiary's bank of a
22 payment order for the benefit of the beneficiary of the originator's
23 payment order.

24 (b) "Intermediary bank" means a receiving bank other than the
25 originator's bank or the beneficiary's bank.

26 (c) "Originator" means the sender of the first payment order in a
27 funds transfer.

28 (d) "Originator's bank" means (i) the receiving bank to which

1 payment order of the originator is issued if the originator is not a
2 bank, or (ii) the originator if the originator is a bank.

3 § 8.4A-105. Other definitions.--(a) In this title:

4 (1) "Authorized account" means a deposit account of a customer in
5 a bank designated by the customer as a bank designated by the customer
6 as a source of payment of payment orders issued by the customer to the
7 bank. If a customer does so designate an account, any account of the
8 customer is an authorized account if payment of a payment order from
9 that account is not inconsistent with a restriction on the use of that
10 account.

11 (2) "Bank" means a person engaged in the business of banking and
12 includes a savings bank, savings and loan association, credit union,
13 and trust company. A branch or separate office of a bank is a
14 separate bank for purposes of this title.

15 (3) "Customer" means a person, including a bank, having an
16 account with a bank or from whom a bank has agreed to receive payment
17 orders.

18 (4) "Funds-transfer business day" of a receiving bank means the
19 part of a day during which the receiving bank is open for the receipt,
20 processing, and transmittal of payment orders and cancellations and
21 amendments of payment orders.

22 (5) "Funds-transfer system" means a wire transfer network,
23 automated clearing house, or other communication system of a clearing
24 house or other association of banks through which a payment order by a
25 bank may be transmitted to the bank to which the order is addressed.

26 (6) "Good faith" means honesty in fact and the observance of
27 reasonable commercial standards of fair dealing.

(7) "Prove" with respect to a fact means to meet the burden of

1 establishing the fact as provided in subdivision (8) of § 8.1-201.

2 (b) Other definitions applying to this title and the sections
 3 which they appear are:

4	<u>"Acceptance"</u>	§ 8.4A-209.
5	<u>"Beneficiary"</u>	§ 8.4A-103.
6	<u>"Beneficiary's bank"</u>	§ 8.4A-103.
7	<u>"Executed"</u>	§ 8.4A-301.
8	<u>"Execution date"</u>	§ 8.4A-301.
9	<u>"Funds transfer"</u>	§ 8.4A-104.
10	<u>"Funds-transfer system rule"</u>	§ 8.4A-501.
11	<u>"Intermediary bank"</u>	§ 8.4A-104.
12	<u>"Originator"</u>	§ 8.4A-104.
13	<u>"Originator's" bank"</u>	§ 8.4A-104.
14	<u>"Payment by beneficiary's bank</u>	
15	<u>to beneficiary"</u>	§ 8.4A-405.
16	<u>"Payment by originator to beneficiary"</u>	§ 8.4A-406.
17	<u>"Payment by sender to receiving bank"</u>	§ 8.4A-403.
18	<u>"Payment date"</u>	§ 8.4A-401.
19	<u>"Payment order"</u>	§ 8.4A-103.
20	<u>"Receiving bank"</u>	§ 8.4A-103.
21	<u>"Security procedure"</u>	§ 8.4A-201.
22	<u>"Sender"</u>	§ 8.4A-103.

23 (c) The following definitions in Title 8.4 apply to this title:

24	<u>"Clearing house"</u>	§ 8.4-104.
25	<u>"Item"</u>	§ 8.4-104.
26	<u>"Suspends payments"</u>	§ 8.4-104.

27 (d) In addition Title 8.1 contains general definitions and
 28 principles of construction and interpretation applicable throughout

1 this title.

2 § 8.4A-106. Time payment order is received.--(a) The time of
3 receipt of a payment order or communication cancelling or amending a
4 payment order is determined by the rules applicable to receipt of a
5 notice stated in subdivision (27) of § 8.1-201. A receiving bank may
6 fix a cut-off time or times on a funds-transfer business day for the
7 receipt and processing of payment orders and communications cancelling
8 or amending payment orders. Different cut-off times may apply to
9 payment orders, cancellations, or amendments, or to different
10 categories of payment orders, cancellations, or amendments. A cut-off
11 time may apply to senders generally or different cut-off times may
12 apply to different senders or categories of payment orders. If a
13 payment order or communication cancelling or amending a payment order
14 is received after the close of a funds-transfer business day or after
15 the appropriate cut-off time on a funds-transfer business day, the
16 receiving bank may treat the payment order or communication as
17 received at the opening of the next funds-transfer business day.

18 (b) If this title refers to an execution date or payment date or
19 states a day on which a receiving bank is required to take action, and
20 the date or day does not fall on a funds-transfer business day, the
21 next day that is a funds-transfer business day is treated as the date
22 or day stated, unless the contrary is stated in this title.

23 § 8.4A-107. Federal Reserve regulations and operating
24 circulars.--Regulations of the Board of Governors of the Federal
25 Reserve System and operating circulars of the Federal Reserve Banks
26 supersede any inconsistent provision of this title to the extent of
27 the inconsistency.

28 § 8.4A-108. Exclusion of consumer transactions governed by

1 federal law.--This title does not apply to a funds transfer any part
2 of which is governed by the Electronic Fund Transfer Act of 1978
3 (Title XX, Public Law 95-630, 92 Stat. 3728, 15 U.S.C. § 1693 et
4 seq.), as amended from time to time.

5 PART 2.

6 ISSUE AND ACCEPTANCE OF PAYMENT ORDER.

7 § 8.4A-201. Security procedure.--"Security procedure" means a
8 procedure established by agreement of a customer and a receiving bank
9 for the purpose of (i) verifying that a payment order or communicatio:
10 amending or cancelling a payment order is that of the customer, or
11 (ii) detecting error in the transmission or the content of the payment
12 order or communication. A security procedure may require the use of
13 algorithms or other codes, identifying words or numbers, encryption,
14 callback procedures, or similar security devices. Comparison of a
15 signature on a payment order or communication with an authorized
16 specimen signature of the customer is not by itself a security
17 procedure.

18 § 8.4A-202. Authorized and verified payment orders.--(a) A
19 payment order received by the receiving bank is the authorized order
20 of the person identified as sender if that person authorized the orde:
21 or is otherwise bound by it under the law of agency.

22 (b) If a bank and its customer have agreed that the authenticity
23 of payment orders issued to the bank in the name of the customer as
24 sender will be verified pursuant to a security procedure, a payment
25 order received by the receiving bank is effective as the order of the
26 customer, whether or not authorized, if (i) the security procedure is
27 a commercially reasonable method of providing security against
28 unauthorized payment orders, and (ii) the bank proves that it acc

1 the payment order in good faith and in compliance with the security
2 procedure and any written agreement or instruction of the customer
3 restricting acceptance of payment orders issued in the name of the
4 customer. The bank is not required to follow an instruction that
5 violates a written agreement with the customer or notice of which is
6 not received at a time and in a manner affording the bank a reasonable
7 opportunity to act on it before the payment order is accepted.

8 (c) Commercial reasonableness of a security procedure is a
9 question of law to be determined by considering the wishes of the
10 customer expressed to the bank, the circumstances of the customer
11 known to the bank, including the size, type, and frequency of payment
12 orders normally issued by the customer to the bank, alternative
13 security procedures offered to the customer, and security procedures
14 in general use by customers and receiving banks similarly situated. A
15 security procedure is deemed to be commercially reasonable if (i) the
16 security procedure was chosen by the customer after the bank offered,
17 and the customer refused, a security procedure that was commercially
18 reasonable for that customer, and (ii) the customer expressly agreed
19 in writing to be bound by any payment order, whether or not
20 authorized, issued in its name and accepted by the bank in compliance
21 with the security procedure chosen by the customer.

22 (d) The term "sender" in this title includes the customer in
23 whose name a payment order is issued if the order is the authorized
24 order of the customer under subsection (a) of this section, or it is
25 effective as the order of the customer under subsection (b) of this
26 section.

27 (e) This section applies to amendments and cancellations of
28 payment orders to the same extent it applies to payment orders.

1 (f) Except as provided in this section and in subdivision (a) (1)
2 of § 8.4A-203, rights and obligations arising under this section o
3 8.4A-203 may not be varied by agreement.

4 § 8.4-203. Unenforceability of certain verified payment
5 orders.--(a) If an accepted payment order is not, under subsection (a)
6 § 8.4A-202, an authorized order of a customer identified as sender,
7 but is effective as an order of the customer pursuant to subsection
8 (b) of § 8.4A-202, the following rules apply:

9 (1) By express written agreement, the receiving bank may limit
10 the extent to which it is entitled to enforce or retain payment of the
11 payment order.

12 (2) The receiving bank is not entitled to enforce or retain
13 payment of payment order if the customer proves that the order was not
14 caused, directly or indirectly, by a person (i) entrusted at any time
15 with duties to act for the customer with respect to payment orders
16 the security procedure, or (ii) who obtained access to transmitting
17 facilities of the customer or who obtained, from a source controlled
18 by the customer and without authority of the receiving bank,
19 information facilitating breach of the security procedure, regardless
20 of how the information was obtained or whether the customer was at
21 fault. Information includes any access device, computer software, or
22 the like.

23 (b) This section applies to amendments of payment orders to the
24 same extent it applies to payment orders.

25 § 8.4A-204. Refund of payment and duty of customer to report
26 with respect to unauthorized payment order.--(a) If a receiving bank
27 accepts a payment order issued in the name of its customer as sender
28 which is (i) not authorized and not effective as the order of the

1 customer under § 8.4A-202, or (ii) not enforceable, in whole or in
2 part, against the customer under § 8.4A-203, the bank shall refund any
3 payment of the payment order received from the customer to the extent
4 the bank is not entitled to enforce payment and shall pay interest on
5 the refundable amount calculated from the date the bank received
6 payment to the date of the refund. However, the customer is not
7 entitled to interest from the bank on the amount to be refunded if the
8 customer fails to exercise ordinary care to determine that the order
9 was not authorized by the customer and to notify the bank of the
10 relevant facts within a reasonable time not exceeding ninety days
11 after the date the customer received notification from the bank that
12 the order was accepted or that the customer's account was debited with
13 respect to the order. The bank is not entitled to any recovery from
14 the customer on account of a failure by the customer to give
notification as stated in this section.

16 (b) Reasonable time under subsection (a) of this section may be
17 fixed by agreement as stated in subsection (1) of § 8.1-204, but the
18 obligation of a receiving bank to refund payment as stated in
19 subsection (a) of this section may not otherwise be varied by
20 agreement.

21 § 8.4A-205. Erroneous payment orders.--(a) If an accepted
22 payment order was transmitted pursuant to a security procedure for the
23 detection of error and the payment order (i) erroneously instructed
24 payment to a beneficiary not intended by the sender, (ii) erroneously
25 instructed payment in an amount greater than the amount intended by
26 the sender, or (iii) was an erroneously transmitted duplicate of a
27 payment order previously sent by the sender, the following rules
apply:

1 (1) If the sender proves that the sender or a person acting on
2 behalf of the sender pursuant to § 8.4A-206 complied with the secu
3 procedure and that the error would have been detected if the receiving
4 bank had also complied, the sender is not obliged to pay the order to
5 the extent stated in subdivisions (2) and (3) of this subsection.

6 (2) If the funds transfer is completed on the basis of an
7 erroneous payment order described in clause (i) or (iii) of subsection
8 (a) of this section, the sender is not obliged to pay the order and
9 the receiving bank is entitled to recover from the beneficiary any
10 amount paid to the beneficiary to the extent allowed by the law
11 governing mistake and restitution.

12 (3) If the funds transfer is completed on the basis of a payment
13 order described in clause (ii) of subsection (a) of this section, the
14 sender is not obliged to pay the order to the extent the amount
15 received by the beneficiary is greater than the amount intended by
16 sender. In that case, the receiving bank is entitled to recover from
17 the beneficiary the excess amount received to the extent allowed by
18 the law governing mistake and restitution.

19 (b) If (i) the sender of an erroneous payment order described in
20 subsection (a) of this section is not obliged to pay all or part of
21 the order, and (ii) the sender receives notification from the
22 receiving bank that the order was accepted by the bank or that the
23 sender's account was debited with respect to the order, the sender has
24 a duty to exercise ordinary care, on the basis of information
25 available to the sender, to discover the error with respect to the
26 order and to advise the bank of the relevant facts within a reasonable
27 time, not exceeding ninety days, after the bank's notification was
28 received by the sender. If the bank proves that the sender failed

1 perform that duty, the sender is liable to the bank for the loss the
2 bank proves it incurred as a result of the failure, but the liability
3 of the sender may not exceed the amount of the sender's order.

4 (c) This section applies to amendments to payment orders to the
5 same extent it applies to payment orders.

6 § 8.4A-206. Transmission of payment order through funds-transfer
7 or other communication system.--(a) If a payment order addressed to a
8 receiving bank is transmitted to a funds-transfer system or other
9 third-party communication system for trasmittal to the bank, the
10 system is deemed to be an agent of the sender for the purpose of
11 transmitting the payment order to the bank. If there is a discrepancy
12 between the terms of the payment order transmitted to the system and
13 the terms of the payment order transmitted by the system to the bank,
14 the terms of the payment order of the sender are those transmitted by
15 the system. This section does not apply to a funds-transfer system of
16 the Federal Reserve Banks.

17 (b) This section applies to cancellations and amendments of
18 payment orders to the same extent it applies to payment orders.

19 § 8.4A-207. Misdescription of beneficiary.--(a) Subject to
20 subsection (b) of this section, if, in a payment order received by the
21 beneficiary's bank, the name, bank account number, or other
22 identification of the beneficiary refers to a nonexistent or
23 unidentifiable person or account, no person has rights as a
24 beneficiary of the order and acceptance of the order cannot occur.

25 (b) If a payment order received by the beneficiary's bank
26 identifies the beneficiary both by name and by an identifying or bank
27 account number and the name and number identify different persons, the
28 following rules apply:

1 (1) Except as otherwise provided in subsection (c) of this
2 section, if the beneficiary's bank does not know that the name and
3 number refer to different persons, it may rely on the number as the
4 proper identification of the beneficiary of the order. The
5 beneficiary's bank need not determine whether the name and number
6 refer to the same person.

7 (2) If the beneficiary's bank pays the person identified by name
8 or knows that the name and number identify different persons, no
9 person has rights as beneficiary except the person paid by the
10 beneficiary's bank if that person was entitled to receive payment from
11 the originator of the funds transfer. If no person has rights as
12 beneficiary, acceptance of the order cannot occur.

13 (c) If (i) a payment order described in subsection (b) of this
14 section is accepted, (ii) the originator's payment order described the
15 beneficiary inconsistently by name and number, and (iii) the
16 beneficiary's bank pays the person identified by number as permitted
17 by subdivision (b)(1) of this section, the following rules apply:

18 (1) If the originator is a bank, the originator is obliged to pay
19 its order.

20 (2) If the originator is not a bank and proves that the person
21 identified by number was not entitled to receive payment from the
22 originator, the originator is not obliged to pay its order unless the
23 originator's bank proves that the originator, before acceptance of the
24 originator's order, had notice that payment of a payment order issued
25 by the originator might be made by the beneficiary's bank on the basis
26 of an identifying or bank account number even if it identifies a
27 person different from the named beneficiary. Proof of notice may be
28 made by any admissible evidence. The originator's bank satisfies

1 burden of proof if it proves that the originator, before the payment
2 order was accepted, signed a writing stating the information to which
3 the notice relates.

4 (d) In a case governed by subdivision (b)(1) of this section, if
5 the beneficiary's bank rightfully pays the person identified by number
6 and that person was not entitled to receive payment from the
7 originator, the amount paid may be recovered from that person to the
8 extent allowed by the law governing mistake and restitution as
9 follows:

10 (1) If the originator is obliged to pay its payment order as
11 stated in subsection (c) of this section, the originator has the right
12 to recover.

13 (2) If the originator is not a bank and is not obliged to pay its
14 payment order, the originator's bank has the right to recover.

15 § 8.4A-208. Misdescription of intermediary bank or beneficiary's
16 bank.--(a) This subsection applies to a payment order identifying an
17 intermediary bank or the beneficiary's bank only by an identifying
18 number.

19 (1) The receiving bank may rely on the number as the proper
20 identification of the intermediary or beneficiary's bank and need not
21 determine whether the number identifies a bank.

22 (2) The sender is obliged to compensate the receiving bank for
23 any loss and expenses incurred by the receiving bank as a result of
24 its reliance on the number in executing or attempting to execute the
25 order.

26 (b) This subsection applies to a payment order identifying an
27 intermediary bank or the beneficiary's bank both by name and an
identifying number if the name and number identify different persons.

1 (1) If the sender is a bank, the receiving bank may rely on the
2 number as the proper identification of the intermediary or
3 beneficiary's bank if the receiving bank, when it executes the
4 sender's order, does not know that the name and number identify
5 different persons. The receiving bank need not determine whether the
6 name and number refer to the same person or whether the number refers
7 to a bank. The sender is obliged to compensate the receiving bank fo
8 any loss and expenses incurred by the receiving bank as a result of
9 its reliance on the number in executing or attempting to execute the
10 order.

11 (2) If the sender is not a bank and the receiving bank proves
12 that the sender, before the payment order was accepted, had notice
13 that the receiving bank might rely on the number as the proper
14 identification of the intermediary or beneficiary's bank even if it
15 identifies a person different from the bank identified by name, t
16 rights and obligations of the sender and the receiving bank are
17 governed by subdivision (b)(1) of this section, as though the sender
18 were a bank. Proof of notice may be made by any admissible evidence.
19 The receiving bank satisfies the burden of proof if it proves that the
20 sender, before the payment order was accepted, signed in writing
21 stating the information to which the notice relates.

22 (3) Regardless of whether the sender is a bank, the receiving
23 bank may rely on the name as the proper identification of the
24 intermediary or beneficiary's bank if the receiving bank, at the time
25 it executes the sender's order, does not know that the name and number
26 identify different persons. The receiving bank need not determine
27 whether the name and number refer to the same person.

28 (4) If the receiving bank knows that the name and number ide

1 different persons, reliance on either the name or the number in
2 executing the sender's payment order is a breach of the obligation
3 stated in subdivision (a)(1) of § 8.4A-302.

4 § 8.4A-209. Acceptance of payment order.--(a) Subject to
5 subsection (d) of this section, a receiving bank other than the
6 beneficiary's bank accepts a payment order when it executes the order.

7 (b) Subject to subsections (c) and (d) of this section, a
8 beneficiary's bank accepts a payment order at the earliest of the
9 following times:

10 (1) When the bank (i) pays the beneficiary as stated in
11 subsection (a) or (b) of § 8.4A-405, or (ii) notifies the beneficiary
12 of receipt of the order or that the account of the beneficiary has
13 been credited with respect to the order unless the notice indicates
14 that the bank is rejecting the order or that funds with respect to the
15 order may not be withdrawn or used until receipt of payment from the
16 sender of the order;

17 (2) When the bank receives payment of the entire amount of the
18 sender's order pursuant to subdivision (a)(1) or (a)(2) of § 8.4A-403;
19 or

20 (3) The opening of the next funds-transfer business day of the
21 bank following the payment date of the order if, at that time, the
22 amount of the sender's order is fully covered by a withdrawable credit
23 balance in an authorized account of the sender or the bank has
24 otherwise received full payment from the sender, unless the order was
25 rejected before that time or is rejected within (i) one hour after
26 that time, or (ii) one hour after the opening of the next business day
27 of the sender following the payment date if that time is later. If
3 notice of rejection is received by the sender after the payment date

1 and the authorized account of the sender does not bear interest, the
2 bank is obliged to pay interest to the sender on the amount of the
3 order for the number of days elapsing after the payment date to the
4 day the sender receives notice or learns that the order was not
5 accepted, counting that day as an elapsed day. If the withdrawable
6 credit balance during that period falls below the amount of the order,
7 the amount of interest payable is reduced accordingly.

8 (c) Acceptance of a payment order cannot occur before the order
9 is received by the receiving bank. Acceptance does not occur under
10 subdivision (b)(2) or (b)(3) of this section if the beneficiary of the
11 payment order does not have an account with the receiving bank, the
12 account has been closed, or the receiving bank is not permitted by law
13 to receive credits for the beneficiary's account.

14 (d) A payment order issued to the originator's bank cannot be
15 accepted until the payment date if the bank is the beneficiary's ba
16 or the execution date if the bank is not the beneficiary's bank. If
17 the originator's bank executes the originator's payment order before
18 the execution date or pays the beneficiary of the originator's payment
19 order before the payment date and the payment order is subsequently
20 canceled pursuant to subsection (b) of § 8.4A-211, the bank may
21 recover from the beneficiary any payment received to the extent
22 allowed by the law governing mistake and restitution.

23 § 8.4A-210. Rejection of payment order.--(a) A payment order is
24 rejected by the receiving bank by a notice of rejection transmitted to
25 the sender orally, electronically, or in writing. A notice of
26 rejection need not use any particular words and is sufficient if it
27 indicates that the receiving bank is rejecting the order or will not
28 execute or pay the order. Rejection is effective when the notice is

1 given if transmission is by a means that is reasonable in the
2 circumstances. If notice of rejection is given by a means that is not
3 reasonable, rejection is effective when the notice is received. If an
4 agreement of the sender and receiving bank establishes the means to be
5 used to reject a payment order, (i) any means complying with the
6 agreement is reasonable and (ii) any means not complying is not
7 reasonable unless no significant delay in receipt of the notice
8 resulted from the use of the noncomplying means.

9 (b) This subsection applies if a receiving bank other than the
10 beneficiary's bank fails to execute a payment order despite the
11 existence on the execution date of a withdrawable credit balance in an
12 authorized account of the sender sufficient to cover the order. If
13 the sender does not receive notice of rejection of the order on the
14 execution date and the authorized account of the sender does not bear
15 interest, the bank is obliged to pay interest to the sender on the
16 amount of the order for the number of days elapsing after the
17 execution date to the earlier of the day the order is canceled
18 pursuant to subsection (d) of § 8.4A-211 or the day the sender
19 receives notice or learns that the order was not executed, counting
20 the final day of the period as an elapsed day. If the withdrawable
21 credit balance during that period falls below the amount of the order,
22 the amount of interest is reduced accordingly.

23 (c) If a receiving bank suspends payments, all unaccepted payment
24 orders issued to it are deemed rejected at the time the bank suspends
25 payments.

26 (d) Acceptance of a payment order precludes a later rejection of
27 the order. Rejection of a payment order precludes a later acceptance
28 of the order.

1 § 8.4A-211. Cancellation and amendment of payment order.--(a) A
2 communication of the sender of a payment order cancelling or amend:
3 the order may be transmitted to the receiving bank orally,
4 electronically, or in writing. If a security procedure is in effect
5 between the sender and the receiving bank, the communication is not
6 effective to cancel or amend the order unless the communication is
7 verified pursuant to the security procedure or the bank agrees to the
8 cancellation or amendment.

9 (b) Subject to subsection (a) of this section, a communication by
10 the sender cancelling or amending a payment order is effective to
11 cancel or amend the order if notice of the communication is received
12 at a time and in a manner affording the receiving bank a reasonable
13 opportunity to act on the communication before the bank accepts the
14 payment order.

15 (c) After a payment order has been accepted, cancellation or
16 amendment of the order is not effective unless the receiving bank
17 agrees or a funds-transfer system rule allows cancellation or
18 amendment without agreement of the bank.

19 (1) With respect to a payment order accepted by a receiving bank
20 other than the beneficiary's bank, cancellation or amendment is not
21 effective unless a conforming cancellation or amendment of the payment
22 order issued by the receiving bank is also made.

23 (2) With respect to a payment order accepted by the beneficiary's
24 bank, cancellation or amendment is not effective unless the order was
25 issued in execution of an unauthorized payment order, or because of a
26 mistake by a sender in the funds transfer which resulted in the
27 issuance of a payment order (i) that is a duplicate of a payment order
28 previously issued by the sender, (ii) that orders payment to a

1 beneficiary not entitled to receive payment from the originator, or
2 (iii) that orders payment in an amount greater than the amount the
3 beneficiary was entitled to receive from the originator. If the
4 payment order is canceled or amended, the beneficiary's bank is
5 entitled to recover from the beneficiary any amount paid to the
6 beneficiary to the extent allowed by the law governing mistake and
7 restitution.

8 (d) An unaccepted payment order is canceled by operation of law
9 at the close of the fifth funds-transfer business day of the receiving
10 bank after the execution date or payment date of the order.

11 (e) A canceled payment order cannot be accepted. If an accepted
12 payment order is canceled, the acceptance is nullified and no person
13 has any right or obligation based on the acceptance. Amendment of a
14 payment order is deemed to be cancellation of the original order at
15 the time of amendment and issue of a new payment order in the amended
16 form at the same time.

17 (f) Unless otherwise provided in an agreement of the parties or
18 in a funds-transfer system rule, if the receiving bank, after
19 accepting a payment order, agrees to cancellation or amendment of the
20 order by the sender or is bound by a funds-transfer system rule
21 allowing cancellation or amendment without the bank's agreement, the
22 sender, whether or not cancellation or amendment is effective, is
23 liable to the bank for any loss and expenses, including reasonable
24 attorney's fees, incurred by the bank as a result of the cancellation
25 or amendment or attempted cancellation or amendment.

26 (g) A payment order is not revoked by the death or legal
27 incapacity of the sender unless the receiving bank knows of the death
28 or of an adjudication of incapacity by a court of competent

1 jurisdiction and has reasonable opportunity to act before acceptance
2 of the order.

3 (h) A funds-transfer system rule is not effective to the extent
4 it conflicts with subdivision (c)(2)of this section.

5 § 8.4A-212. Liability and duty of receiving bank regarding
6 unaccepted payment order.--If a receiving bank fails to accept a
7 payment order that it is obliged by express agreement to accept, the
8 bank is liable for breach of the agreement to the extent provided in
9 the agreement or in this title, but does not otherwise have any duty
10 to accept a payment order or, before acceptance, to take any action,
11 or refrain from taking action, with respect to the order except as
12 provided in this title or by express agreement. Liability based on
13 acceptance arises only when acceptance occurs as stated in § 8.4A-209,
14 and liability is limited to that provided in this title. A receiving
15 bank is not the agent of the sender or beneficiary of the payment
16 order it accepts, or of any other party to the funds transfer, and the
17 bank owes no duty to any party to the funds transfer except as
18 provided in this title or by express agreement.

19 PART 3.

20 EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK.

21 § 8.4A-301. Execution and execution date.--(a) A payment order
22 is "executed" by the receiving bank when it issues a payment order
23 intended to carry out the payment order received by the bank. A
24 payment order received by the beneficiary's bank can be accepted but
25 cannot be executed.

26 (b) "Execution date" of a payment order means the day on which
27 the receiving bank may properly issue a payment order in execution of
28 the sender's order. The execution date may be determined by

1 instruction of the sender but cannot be earlier than the day the order
2 is received and, unless otherwise determined, is the day the order is
3 received. If the sender's instruction states a payment date, the
4 execution date is the payment date or an earlier date on which
5 execution is reasonably necessary to allow payment to the beneficiary
6 on the payment date.

7 § 8.4A-302. Obligations of receiving bank in execution of
8 payment order.--(a) Except as provided in subsections (b) through (d)
9 of this section, if the receiving bank accepts a payment order
10 pursuant to subsection (a) of § 8.4A-209, the bank has the following
11 obligations in executing the order:

12 (1) The receiving bank is obliged to issue, on the execution
13 date, a payment order complying with the sender's order and to follow
14 the sender's instructions concerning (i) any intermediary bank or
15 funds-transfer system to be used in carrying out the funds transfer,
16 or (ii) the means by which payment orders are to be transmitted in the
17 funds transfer. If the originator's bank issues a payment order to an
18 intermediary bank, the originator's bank is obliged to instruct the
19 intermediary bank according to the instruction of the originator. An
20 intermediary bank in the funds transfer is similarly bound by an
21 instruction given to it by the sender of the payment order it accepts.

22 (2) If the sender's instruction states that the funds transfer is
23 to be carried out telephonically or by wire transfer or otherwise
24 indicates that the funds transfer is to be carried out by the most
25 expeditious means, the receiving bank is obliged to transmit its
26 payment order by the most expeditious available means, and to instruct
27 any intermediary bank accordingly. If a sender's instruction states a
28 payment date, the receiving bank is obliged to transmit its payment

1 order at a time and by means reasonably necessary to allow payment to
2 the beneficiary on the payment date or as soon thereafter as is
3 feasible.

4 (b) Unless otherwise instructed, a receiving bank executing a
5 payment order may (i) use any funds-transfer system if use of that
6 system is reasonable in the circumstances, and (ii) issue a payment
7 order to the beneficiary's bank or to an intermediary bank through
8 which a payment order conforming to the sender's order can
9 expeditiously be issued to the beneficiary's bank if the receiving
10 bank exercises ordinary care in the selection of the intermediary
11 bank. A receiving bank is not required to follow an instruction of
12 the sender designating a funds-transfer system to be used in carrying
13 out the funds transfer if the receiving bank, in good faith,
14 determines that it is not feasible to follow the instruction or that
15 following the instruction would unduly delay completion of the fu
16 transfer.

17 (c) Unless subdivision (a)(2) of this section applies or the
18 receiving bank is otherwise instructed, the bank may execute a payment
19 order by transmitting its payment order by first class mail or by any
20 means reasonable in the circumstances. If the receiving bank is
21 intructed to execute the sender's order by transmitting its payment
22 order by a particular means, the receiving bank may issue its payment
23 order by the means stated or by any means as expeditious as the means
24 stated.

25 (d) Unless instructed by the sender, (i) the receiving bank may
26 not obtain payment of its charges for services and expenses in
27 connection with the execution of the sender's order by issuing a
28 payment order in an amount equal to the amount of the sender's or

1 less the amount of the charges, and (ii) may not instruct a subsequent
2 receiving bank to obtain payment of its charges in the same manner.

3 § 8.4A-303. Erroneous execution of payment order.--(a) A
4 receiving bank that (i) executes the payment order of the sender by
5 issuing a payment order in an amount greater than the amount of the
6 sender's order, or (ii) issues a payment order in execution of the
7 sender's order and then issues a duplicate order, is entitled to
8 payment of the amount of the sender's order under subsection (c) of §
9 8.4A-402 if that subsection is otherwise satisfied. The bank is
10 entitled to recover from the beneficiary of the erroneous order the
11 excess payment received to the extent allowed by the law governing
12 mistake and restitution.

13 (b) A receiving bank that executes the payment order of the
14 sender by issuing a payment order in an amount less than the amount of
15 the sender's order is entitled to a payment of the amount of the
16 sender's order under subsection (c) of § 8.4A-402 if (i) that
17 subsection is otherwise satisfied and (ii) the bank corrects its
18 mistake by issuing an additional payment order for the benefit of the
19 beneficiary of the sender's order. If the error is not corrected, the
20 issuer of the erroneous order is entitled to receive or retain payment
21 from the sender of the order it accepted only to the extent of the
22 amount of the erroneous order. This subsection does not apply if the
23 receiving bank executes the sender's payment order by issuing a
24 payment order in an amount less than the amount of the sender's order
25 for the purpose of obtaining payment of its charges for services and
26 expenses pursuant to instruction of the sender.

27 (c) If a receiving bank executes the payment order of the sender
3 by issuing a payment order to a beneficiary different from the

1 beneficiary of the sender's order and the funds transfer is completed
2 on the basis of that error, the sender of the payment order that w
3 erroneously executed and all previous senders in the funds transfer
4 are not obliged to pay the payment orders they issued. The issuer of
5 the erroneous order is entitled to recover from the beneficiary of the
6 order the payment received to the extent allowed by the law governing
7 mistake and restitution.

8 § 8.4A-304. Duty of sender to report erroneously executed
9 payment order.--If the sender of a payment order that is erroneously
10 executed as stated in § 8.4A-303 receives notification from the
11 receiving bank that the order was executed or that the sender's
12 account was debited with respect to the order, the sender has a duty
13 to exercise ordinary care to determine, on the basis of information
14 available to the sender, that the order was erroneously executed and
15 to notify the bank of the relevant facts within a reasonable time
16 exceeding ninety days after the notification from the bank was
17 received by the sender. If the sender fails to perform that duty, the
18 bank is not obliged to pay interest on any amount refundable to the
19 sender under subsection (d) of § 8.4A-402 for the period before the
20 bank learns of the execution error. The bank is not entitled to any
21 recovery from the sender on account of a failure by the sender to
22 perform the duty stated in this section.

23 § 8.4A-305. Liability for late or improper execution or failure
24 to execute payment order.--(a) If a funds transfer is completed but
25 execution of a payment order by the receiving bank in breach of §
26 8.4A-302 results in delay in payment to the beneficiary, the bank is
27 obliged to pay interest to either the originator or the beneficiary of
28 the funds transfer for the period of delay caused by the improper

1 execution. Except as provided in subsection (c) of this section,
2 additional damages are not recoverable.

3 (b) If execution of a payment order by a receiving bank in breach
4 of § 8.4A-302 results in (i) noncompletion of the funds transfer, (ii)
5 failure to use an intermediary bank designated by the originator, or
6 (iii) issuance of a payment order that does not comply with the terms
7 of the payment order of the originator, the bank is liable to the
8 originator for its expenses in the funds transfer and for incidental
9 expenses and interest losses, to the extent not covered by subsection
10 (a) of this section, resulting from the improper execution. Except as
11 provided in subsection (c) of this section, additional damages are not
12 recoverable.

13 (c) In addition to the amounts payable under subsections (a) and
14 (b) of this section, damages, including consequential damages, are
15 recoverable to the extent provided in an express written agreement of
16 the receiving bank.

17 (d) If a receiving bank fails to execute a payment order it was
18 obliged by express agreement to execute, the receiving bank is liable
19 to the sender for its expenses in the transaction and for incidental
20 expenses and interest losses resulting from the failure to execute.
21 Additional damages, including consequential damages, are recoverable
22 to the extent provided in an express written agreement of the
23 receiving bank, but are not otherwise recoverable.

24 (e) Reasonable attorney's fees are recoverable if demand for
25 compensation under subsection (a) or (b) of this section is made and
26 refused before an action is brought on the claim. If a claim is made
27 for breach of an agreement under subsection (d) of this section, and
28 the agreement does not provide for damages, reasonable attorney's fees

1 are recoverable if demand for compensation under subsection (d) of
2 this section, is made and refused before an action is brought on the
3 claim.

4 (f) Except as stated in this section, the liability of a
5 receiving bank under subsections (a) and (b) of this section, may not
6 be varied by agreement.

7 PART 4.

8 PAYMENT.

9 § 8.4A-401. Payment date.--"Payment date" of a payment order
10 means the day on which the amount of the order is payable to the
11 beneficiary by the beneficiary's bank. The payment date may be
12 determined by instruction of the sender but cannot be earlier than the
13 day the order is received by the beneficiary's bank and, unless
14 otherwise determined, is the day the order is received by the
15 beneficiary's bank.

16 § 8.4A-402. Obligation of sender to pay receiving bank.--(a)
17 This section is subject to §§ 8.4A-205 and 8.4A-207.

18 (b) With respect to a payment order issued to the beneficiary's
19 bank, acceptance of the order by the bank obliges the sender to pay
20 the bank the amount of the order, but payment is not due until the
21 payment date of the order.

22 (c) This subsection is subject to subsection (e) of this section,
23 and to § 8.4A-303. With respect to a payment order issued to a
24 receiving bank other than the beneficiary's bank, acceptance of the
25 order by the receiving bank obliges the sender to pay the bank the
26 amount of the sender's order. Payment by the sender is not due until
27 the execution date of the sender's order. The obligation of that
28 sender to pay its payment order is excused if the funds transfer is

1 not completed by acceptance by the beneficiary's bank of a payment
2 order instructing payment to the beneficiary of that sender's payment
3 order.

4 (d) If the sender of a payment order pays the order and was not
5 obliged to pay all or part of the amount paid, the bank receiving
6 payment is obliged to refund payment to the extent the sender was not
7 obliged to pay. Except as provided in §§ 8.4A-204 and 8.4A-304,
8 interest is payable on the refundable amount from the date of payment.

9 (e) If a funds transfer is not completed as stated in subsection
10 (c) of this section, and an intermediary bank is obliged to refund
11 payment as stated in subsection (d) of this section, but is unable to
12 do so because not permitted by applicable law or because the bank
13 suspends payments, a sender in the funds transfer that executed a
14 payment order in compliance with an instruction, as stated in
15 subdivision (a)(1) of § 8.4A-302, to route the funds transfer through
16 that intermediary bank is entitled to receive or retain payment from
17 the sender of the payment order that it accepted. The first sender in
18 the funds transfer that issued an instruction requiring routing
19 through that intermediary bank is subrogated to the right of the bank
20 that paid the intermediary bank to refund as stated in subsection (d)
21 of this section.

22 (f) The right of the sender of a payment order to be excused from
23 the obligation to pay the order as stated in subsection (c) of this
24 section, or to receive refund under subsection (d) of this section,
25 may not be varied by agreement.

26 § 8.4A-403. Payment by sender to receiving bank.--(a) Payment of
27 the sender's obligation under § 8.4A-402 to pay the receiving bank
occurs as follows:

1 (1) If the sender is a bank, payment occurs when the receiving
2 bank receives final settlement of the obligation through a Federal
3 Reserve Bank or through a funds-transfer system.

4 (2) If the sender is a bank and the sender (i) credited an
5 account of the receiving bank with the sender, or (ii) caused an
6 account of the receiving bank in another bank to be credited, payment
7 occurs when the credit is withdrawn or, if not withdrawn, at midnight
8 of the day on which the credit is withdrawable and the receiving bank
9 learns of that fact.

10 (3) If the receiving bank debits an account of the sender with
11 the receiving bank, payment occurs when the debit is made to the
12 extent the debit is covered by a withdrawable credit balance in the
13 account.

14 (b) If the sender and receiving bank are members of a
15 funds-transfer system that nets obligations multilaterally among
16 participants, the receiving bank receives final settlement when
17 settlement is complete in accordance with the rules of the system.
18 The obligation of the sender to pay the amount of a payment order
19 transmitted through the funds-transfer system may be satisfied, to the
20 extent permitted by the rules of the system, by setting off and
21 applying against the sender's obligation the right of the sender to
22 receive payment from the receiving bank of the amount of any other
23 payment order transmitted to the sender by the receiving bank through
24 the funds-transfer system. The aggregate balance of obligations owed
25 by each sender to each receiving bank in the funds-transfer system may
26 be satisfied, to the extent permitted by the rules of the system, by
27 setting off and applying against that balance the aggregate balance of
28 obligations owed to the sender by other members of the system. The

1 aggregate balance is determined after the right of setoff stated in
2 the second sentence of this subsection has been exercised.

3 (c) If two banks transmit payment orders to each other under an
4 agreement that settlement of the obligations of each bank to the other
5 under § 8.4A-402 will be made at the end of the day or other period,
6 the total amount owed with respect to all orders transmitted by one
7 bank shall be set off against the total amount owed with respect to
8 all orders transmitted by the other bank. To the extent of the
9 setoff, each bank has made payment to the other.

10 (d) In a case not covered by subsection (a) of this section, the
11 time when payment of the sender's obligation under subsection (b) or
12 (c) of § 8.4A-402 occurs is governed by applicable principles of law
13 that determine when an obligation is satisfied.

14 § 8.4A-404. Obligation of beneficiary's bank to pay and give
15 notice to beneficiary.--(a) Subject to subsection (e) of § 8.4A-211,
16 and subsections (d) and (e) of § 8.4A-405, if a beneficiary's bank
17 accepts a payment order, the bank is obliged to pay the amount of the
18 order to the beneficiary of the order. Payment is due on the payment
19 date of the order, but if acceptance occurs on the payment date after
20 the close of the funds-transfer business day of the bank, payment is
21 due on the next funds-transfer business day. If the bank refuses to
22 pay after demand by the beneficiary and receipt of notice of
23 particular circumstances that will give rise to consequential damages
24 as a result of nonpayment, the beneficiary may receive damages
25 resulting from the refusal to pay to the extent the bank had notice of
26 the damages, unless the bank proves that it did not pay because of a
27 reasonable doubt concerning the right of the beneficiary to payment.

(b) If a payment order accepted by the beneficiary's bank

1 instructs payment to an account of the beneficiary, the bank is
2 obliged to notify the beneficiary of receipt of the order before
3 midnight of the next funds-transfer business day following the payment
4 date. If the payment order does not instruct payment to an account of
5 the beneficiary, the bank is required to notify the beneficiary only
6 if notice is required by the order. Notice may be given by first
7 class mail or any other means reasonable in the circumstances. If the
8 bank fails to give the required notice, the bank is obliged to pay
9 interest to the beneficiary on the amount of the payment order from
10 the day notice should have been given until the day the beneficiary
11 learned of receipt of the payment order by the bank. No other damages
12 are recoverable. Reasonable attorney's fees are also recoverable if
13 demand for interest is made and refused before an action is brought on
14 the claim.

15 (c) The right of a beneficiary to receive payment and damages
16 stated in subsection (a) of this section, may not be varied by
17 agreement or a funds-transfer system rule. The right of a beneficiary
18 to be notified as stated in subsection (b) of this section may be
19 varied by agreement of the beneficiary or by a funds-transfer system
20 rule if the beneficiary is notified of the rule before initiation of
21 the funds transfer.

22 § 8.4A-405. Payment by beneficiary's bank to beneficiary.--(a)
23 If the beneficiary's bank credits an account of the beneficiary of a
24 payment order, payment of the bank's obligation under subsection (a)
25 of § 8.4A-404 occurs when and to the extent (i) the beneficiary is
26 notified of the right to withdraw the credit, (ii) the bank lawfully
27 applies the credit to a debt of the beneficiary, or (iii) funds with
28 respect to the order are otherwise made available to the beneficia:

1 by the bank.

2 (b) If the beneficiary's bank does not credit an account of the
3 beneficiary of a payment order, the time when payment of the bank's
4 obligation under subsection (a) of § 8.4A-404 occurs is governed by
5 principles of law that determine when an obligation is satisfied.

6 (c) Except as stated in subsections (d) and (e) of this section,
7 if the beneficiary's bank pays the beneficiary of a payment order
8 under a condition to payment or agreement of the beneficiary giving
9 the bank the right to recover payment from the beneficiary if the bank
10 does not receive payment of the order, the condition to payment or
11 agreement is not enforceable.

12 (d) A funds-transfer system rule may provide that payments made
13 to beneficiaries of funds transfers made through the system are
14 provisional until receipt of payment by the beneficiary's bank of the
15 payment order is accepted. A beneficiary's bank that makes a payment
16 that is provisional under the rule is entitled to refund from the
17 beneficiary if (i) the rule requires that both the beneficiary and the
18 originator be given notice of the provisional nature of the payment
19 before the funds transfer is initiated, (ii) the beneficiary, the
20 beneficiary's bank, and the originator's bank agreed to be bound by
21 the rule, and (iii) the beneficiary's bank did not receive payment of
22 the payment order that it accepted. If the beneficiary is obliged to
23 refund payment to the beneficiary's bank, acceptance of the payment
24 order by the beneficiary's bank is nullified and no payment by the
25 originator of the funds transfer to the beneficiary occurs under §
26 8.4A-406.

27 (e) This subsection applies to a funds transfer that includes a
payment order transmitted over a funds-transfer system that (i) nets

1 obligations multilaterally among participants, and (ii) has in effect
2 a loss-sharing agreement among participants for the purpose of
3 providing funds necessary to complete settlement of the obligations of
4 one or more participants that do not meet their settlement
5 obligations. If the beneficiary's bank in the funds transfer accepts
6 a payment order and the system fails to complete settlement pursuant
7 to its rules with respect to any payment order in the funds transfer,
8 (i) the acceptance by the beneficiary's bank is nullified and no
9 person has any right or obligation based on the acceptance, (ii) the
10 beneficiary's bank is entitled to recover payment from the
11 beneficiary, (iii) no payment by the originator to the beneficiary
12 occurs under § 8.4A-406 and (iv) subject to subsection (e) of §
13 8.4A-402, each sender in the funds transfer is excused from its
14 obligation to pay its payment order under subsection (c) of § 8.4A-402
15 because the funds transfer has not been completed.

16 § 8.4A-406. Payment by originator to beneficiary; discharge of
17 underlying obligation.--(a) Subject fo subsection (e) of § 8.4A-211
18 and subsections (d) and (e) of § 8.4A-405, the originator of a funds
19 transfer pays the beneficiary of the originator's payment order (i) at
20 the time a payment order for the benefit of the beneficiary is
21 accepted by the beneficiary's bank in the funds transfer and (ii) in
22 an amount equal to the amount of the order accepted by the
23 beneficiary's bank, but not more than the amount of the originator's
24 order.

25 (b) If payment under subsection (a) of this section is made to
26 satisfy an obligation, the obligation is discharged to the same extent
27 discharge would result from payment to the beneficiary of the same
28 amount in money, unless (i) the payment under subsection (a) of th

1 section was made by a means prohibited by the contract of the
2 beneficiary with respect to the obligation, (ii) the beneficiary,
3 within a reasonable time after receiving notice of receipt of the
4 order by the beneficiary's bank, notified the originator of the
5 beneficiary's refusal of the payment, (iii) funds with respect to the
6 order were not withdrawn by the beneficiary or applied to a debt of
7 the beneficiary, and (iv) the beneficiary would suffer a loss that
8 could reasonably have been avoided if payment had been made by a means
9 complying with the contract. If payment by the originator does not
10 result in discharge under this section, the originator is subrogated
11 to the rights of the beneficiary to receive payment from the
12 beneficiary's bank under subsection (a) of § 8.4A-404.

13 (c) For the purpose of determining whether discharge of an
14 obligation occurs under subsection (b) of this section, if the
15 beneficiary's bank accepts a payment order in an amount equal to the
16 amount of the originator's payment order less charges of one or more
17 receiving banks in the funds transfer, payment to the beneficiary is
18 deemed to be in the amount of the originator's order unless upon
19 demand by the beneficiary the originator does not pay the beneficiary
20 the amount of the deducted charges.

21 (d) Rights of the originator or of the beneficiary of a funds
22 transfer under this section may be varied only by agreement of the
23 originator and the beneficiary.

24 PART 5.

25 MISCELLANEOUS PROVISIONS.

26 § 8.4A-501. Variation by agreement and effect of funds-transfer
27 system rule.--(a) Except as otherwise provided in this title, the
28 rights and obligations of a party to funds transfer may be varied by

1 agreement of the affected party.

2 (b) "Funds-transfer system rule" means a rule of an association
3 of banks (i) governing transmission of payment orders by means of a
4 funds-transfer sytem of the association or rights and obligations with
5 respect to those orders, or (ii) to the extent the rule governs rights
6 and obligations between banks that are parties to a funds transfer in
7 which a Federal Reserve Bank, acting as an intermediary bank, sends a
8 payment order to the beneficiary's bank. Except as otherwise provided
9 in this title, a funds-transfer system rule governing rights and
10 obligations between participating banks using the system may be
11 effective even if the rule conflicts with this title and indirectly
12 affects another party to the funds transfer who does not consent to
13 the rule. A funds-transfer system rule may also govern rights and
14 obligations of parties other than participating banks using the system
15 to the extent stated in subsection (c) of § 8.4A-404, subsection (d
16 of § 8.4A-405, and subsection (c) of § 8.4A-507.

17 § 8.4A-502. Creditor process served on receiving bank; setoff by
18 beneficiary's bank.--(a) As used in this section, "creditor process"
19 means levy, attachment, garnishment, notice of lien, sequestration, or
20 similar process issued by or on behalf of a creditor or other claimant
21 with respect to an account._____

22 (b) This subsection applies to creditor process with respect to
23 an authorized account of the sender of a payment order if the creditor
24 process is served on the receiving bank. For the purpose of
25 determining rights with respect to the creditor process, if the
26 receiving bank accepts the payment order the balance in the authorized
27 account is deemed to be reduced by the amount of the payment order to
28 the extent the bank did not otherwise receive payment of the order,

1 unless the creditor process is served at a time and in a manner
2 affording the bank a reasonable opportunity to act on it before the
3 bank accepts the payment order.

4 (c) If a beneficiary's bank has received a payment order for
5 payment to the beneficiary's account in the bank, the following rules
6 apply:

7 (1) The bank may credit the beneficiary's account. The amount
8 credited may be set off against an obligation owed by the beneficiary
9 to the bank or may be applied to satisfy creditor process served on
10 the bank with respect to the account.

11 (2) The bank may credit the beneficiary's account and allow
12 withdrawal of the amount credited unless creditor process with respect
13 to the account is served at a time and in a manner affording the bank
14 a reasonable opportunity to act to prevent withdrawal.

15 (3) If creditor process with respect to the beneficiary's account
16 has been served and the bank has had a reasonable opportunity to act
17 on it, the bank may not reject the payment order except for a reason
18 unrelated to the service of process.

19 (d) Creditor process with respect to a payment by the originator
20 to the beneficiary pursuant to a funds transfer may be served only on
21 the beneficiary's bank with respect to the debt owed by that bank to
22 the beneficiary. Any other bank served with the creditor process is
23 not obliged to act with respect to the process.

24 § 8.4A-503. Injunction or restraining order with respect to
25 funds transfer.--For proper cause and in compliance with applicable
26 law, a court may restrain (i) a person from issuing a payment order to
27 initiate a funds transfer, (ii) an originator's bank from executing
28 the payment order of the originator, or (iii) the beneficiary's bank

1 from releasing funds to the beneficiary or the beneficiary from
2 withdrawing the funds. A court may not otherwise restrain a person
3 from issuing a payment order, paying or receiving payment of a payment
4 order, or otherwise acting with respect to a funds transfer.

5 § 8.4A-504. Order in which items and payment orders may be
6 charged to account; order of withdrawals from account.--(a) If a
7 receiving bank has received more than one payment order of the sender
8 or one or more payment orders and other items that are payable from
9 the sender's account, the bank may charge the sender's account with
10 respect to the various orders and items in any sequence.

11 (b) In determining whether a credit to an account has been
12 withdrawn by the holder of the account or applied to a debt of the
13 holder of the account, credits first made to the account are first
14 withdrawn or applied.

15 § 8.4A-505. Preclusion of objection to debit of customer's
16 account.--If a receiving bank has received payment from its customer
17 with respect to a payment order issued in the name of the customer as
18 sender and accepted by the bank, and the customer received
19 notification reasonably identifying the order, the customer is
20 precluded from asserting that the bank is not entitled to retain the
21 payment unless the customer notifies the bank of the customer's
22 objection to the payment within one year after the notification was
23 received by the customer.

24 § 8.4A-506. Rate of interest.--(a) If, under this title, a
25 receiving bank is obliged to pay interest with respect to a payment
26 order issued to the bank, the amount payable may be determined (i) by
27 agreement of the sender and receiving bank, or (ii) by a
28 funds-transfer system rule if the payment order is transmitted throug

1 a funds-transfer system.

2 (b) If the amount of interest is not determined by an agreement
3 or rule as stated in subsection (a) of this section, the amount is
4 calculated by multiplying the applicable Federal Funds rate by the
5 amount on which interest is payable, and then multiplying the product
6 by the number of days for which interest is payable. The applicable
7 Federal Funds rate is the average of the Federal Funds rates published
8 by the Federal Reserve Bank of New York for each of the days for which
9 interest is payable divided by 360. The Federal Funds rate for any
10 day on which a published rate is not available is the same as the
11 published rate for the next preceding day for which there is a
12 published rate. If a receiving bank that accepted a payment order is
13 required to refund payment to the sender of the order because the
14 funds transfer was not completed, but the failure to complete was not
15 due to any fault by the bank, the interest payable is reduced by a
16 percentage equal to the reserve requirement on deposits of the
17 receiving bank.

18 § 8.4A-507. Choice of law.--(a) The following rules apply unless
19 the affected parties otherwise agree or subsection (c) of this section
20 applies:

21 (1) The rights and obligations between the sender of a payment
22 order and the receiving bank are governed by the law of the
23 jurisdiction in which the receiving bank is located.

24 (2) The rights and obligations between the beneficiary's bank and
25 the beneficiary are governed by the law of the jurisdiction in which
26 the beneficiary's bank is located.

27 (3) The issue of when payment is made pursuant to a funds
28 transfer by the originator to the beneficiary is governed by the law

1 of the jurisdiction in which the beneficiary's bank is located.

2 (b) If the parties described in each subdivision of subsectio.
3 (a) of this section have made an agreement selecting the law of a
4 particular jurisdiction to govern rights and obligations between each
5 other, the law of that jurisdiction governs those rights and
6 obligations, whether or not the payment order or the funds transfer
7 bears a reasonable relation to that jurisdiction.

8 (c) A funds-transfer system rule may select the law of a
9 particular jurisdiction to govern (i) rights and obligations between
10 participating banks with respect to payment orders transmitted or
11 processed through the system, or (ii) the rights and obligations of
12 some or all parties to a funds transfer any part of which is carried
13 out by means of the system. A choice of law made pursuant to clause
14 (i) of this subsection is binding on participating banks. A choicr
15 law made pursuant to clause (ii) of this subsection is binding on
16 originator, other sender, or a receiving bank having notice that the
17 funds-transfer system might be used in the funds transfer and of the
18 choice of law by the system which the originator, other sender, or
19 receiving bank issued or accepted a payment order. The beneficiary of
20 a funds transfer is bound by the choice of law if, when the funds
21 transfer is initiated, the beneficiary has notice that the funds
22 transfer system might be used in the funds transfer and of the choice
23 of law by the system. The law of a jurisdiction selected pursuant to
24 this subsection may govern, whether or not that law bears a reasonable
25 relation to the matter in issue.

26 (d) In the event of inconsistency between an agreement under
27 subsection (b) of this section, and a choice-of-law rule under
28 subsection (c) of this section, the agreement under subsection (b) or

1 this section prevails.

2 (e) If a funds transfer is made by use of more than one
3 funds-transfer system and there is inconsistency between choice-of-law
4 rules of the systems, the matter in issue is governed by the law of
5 the selected jurisdiction that has the most significant relationship
6 to the matter in issue.

7 2. That the provisions of this act shall become effective January 1,
8 1991.

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2 HOUSE JOINT RESOLUTION NO.....

3 Continuing the Joint Subcommittee Studying Modifications of the
4 Uniform Commercial Code.

5

6 WHEREAS, the 1988 and 1989 Sessions of the General Assembly,
7 pursuant to House Joint Resolutions 59 and 248, established and
8 continued, respectively, a joint subcommittee to review modifications
9 of the Uniform Commercial Code (U.C.C.); and

10 WHEREAS, the joint subcommittee has received testimony on adding
11 Article 2A (Leases) and Article 4A (Wire Transfers) and testimony on
12 modifying Article 6 (Bulk Sales); and

13 WHEREAS, the joint subcommittee is recommending legislation to
14 the 1990 General Assembly to enact Article 4A, but has been unable to
15 complete its work on the other two articles due to new developments
16 nationwide; and

17 WHEREAS, the joint subcommittee believes there is a great
18 interest in the revisions being suggested to the remaining two
19 articles, the modifications they will bring to the Uniform Commercial
20 Code and private industry, and the need to more thoroughly address in
21 detail these suggested changes; now, therefore, be it

22 RESOLVED by the House of Delegates, the Senate concurring, That
23 the joint subcommittee established in 1988 and continued in 1989 to
24 review modifications to the Uniform Commercial Code be continued. The
25 membership of the joint subcommittee shall remain the same and any

1 vacancies that occur shall be filled in the same manner as provided in
2 House Joint Resolution 59 of 1988. The joint subcommittee shall
3 complete its work in time to submit its recommendations to the
4 Governor and the 1991 Session of the General Assembly as provided in
5 the procedures of the Division of Legislative Automated Systems for
6 processing legislative documents.

7 The indirect costs of this study are estimated to be \$7,250; the
8 direct costs of this study shall not exceed \$3,250.

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