BAD NEWS SHOULD TRAVEL FAST:
HOT CHECKS, TARDY BANKS, AND THE
UNIFORM COMMERCIAL CODE’S
RUDE SURPRISE

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The bottom line is a bank’s relationship with its customer is built on trust.


[Article 4 of the U.C.C.] was drafted entirely with the purpose of protecting the banks so that they could carry on their business at the risk of the customer.


I.
INTRODUCTION

Each day the check collection system processes approximately 174 million checks, many of which are payable to consumers who trustingly deposit them in their bank accounts and soon spend the deposited funds on

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5. However, not much trust has been demonstrated lately by vocal opponents of the 1999 Gramm-Leach Act and critics of high ATM fees. See, e.g., David M. Herszenhorn, Council Seeks to Ban A.T.M. Fees for Noncustomers, N.Y. TIMES, Nov. 16, 1999, at B1 (describing how New York City, like San Francisco and Santa Monica, moved to prohibit banks from charging ATM fees to noncustomers); Molly Ivins, Friends, Prepare for Bank Bill Hell, DET. FREE PRESS, Oct. 31, 1999, at 5F (“The inevitable result will be a wave of mergers creating gigantic financial entities... When was the last time you saw a vast concentration of wealth and power that didn’t create abuses?”).
goods and services, necessities, and luxuries. From a consumer’s perspective, the check collection system usually works well. Indeed, less than one percent of checks are dishonored.\(^6\) In absolute numbers, however, dishonored checks exceed one million daily.

Not long ago, I was told a disturbing story about one of these dishonored checks:

A babysitter visited a low-income legal clinic asking for help. She had deposited her last paycheck from a long-term job in her checking account and had soon gained access to the deposit, which she used for various living expenses. Several months later, the babysitter’s bank notified her that the deposited check had bounced and that her account had been charged for the amount of the check. Because she had no cushion of extra funds to cover this charge, outstanding checks the babysitter had drawn against her account would soon bounce. Upset and frightened, she turned to a legal clinic intern.

“Can the bank charge the babysitter’s account so long after the deposit?” the student intern asked me. “Even after she spent the account balance?”

“Yes,” I said, unhappily.

Through a process termed charge-back,\(^7\) Article 4 of the Uniform Commercial Code\(^8\) (“U.C.C.” or “Code”) authorizes a depository bank to charge its depositor’s account in the amount of a dishonored check, without regard to the length of time since the deposit.\(^9\) No matter that the check might have been paid if processed promptly. Too bad for the consumer who weeks or months earlier relied on her access to the deposit and on her bank’s failure to notify her that the deposited check was drawn on insufficient funds. Too bad that the depositor now faces an overdraft or a credit card bill she cannot pay. Too bad that new checks already drawn

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\(^6\) Canning, supra note 3.

\(^7\) Section 4-214(a) provides in pertinent part:
If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor . . . to receive settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer’s account or obtain refund from its customer . . . .

U.C.C. § 4-214(a) (1996) (emphasis added). This section gives the depository bank three options: (1) revoke provisional credit, (2) charge back against an account balance, or (3) obtain a refund. Id. While, strictly speaking, the first case involves a revocation and the second case a charge-back, this technical distinction makes little difference to the depositor who in both cases loses access to an account balance. For this reason and for convenience, the bank’s self-help right against its depositor in both of these cases is termed herein a charge-back right.

\(^8\) Article 4, Bank Deposits and Collections, applies to checks and is supplemented by Article 3, which applies to negotiable instruments generally. U.C.C. §§ 4-102(a), 3-102(a), (b).

\(^9\) U.C.C. § 4-214(a).
against her account will soon bounce because a surprise charge-back has reduced or wiped out her account balance.\(^\text{10}\) Even where it is readily apparent that one or more banks has mishandled a check, Article 4 authorizes a bank to engage in self-help to shift loss to its depositor when a check bounces. The depositor's recourse is to initiate litigation against her bank to establish that bank delay and perhaps negligence caused her a loss. Such litigation is an expensive proposition for any customer and one that is likely to be prohibitive for a consumer whose resources are vastly inferior to those of a bank.\(^\text{11}\) In the ordinary case, loss will thus remain with the consumer even where bank misbehavior caused the loss.\(^\text{12}\)

Commercial depositors have challenged this tardy charge-back rule, sometimes successfully.\(^\text{13}\) Their victories, however, were won under a pre-1990 version of Article 4, which some sympathetic courts interpreted to condition charge-back on timeliness.\(^\text{14}\) The language of revised Article 4 expressly protects a tardy bank's right to charge-back.\(^\text{15}\)

Although consumers may be less able than commercial depositors to bear the costs of tardy charge-back, consumers are even less likely to challenge it. A consumer's typical inability to bear litigation costs, together with the small amount of many consumer checks relative to those costs

\(^{10}\) The Consumer Federation of America complains that banks collect $5.6 billion annually from consumers in bounced check fees, an amount "11 to 32 times more than what it costs to process bounced checks." Banks collect another $1.1 billion for returning deposited checks, an amount that is "9 to 11 times what it costs to process deposited checks that bounce." Canning, supra note 3, citing CONSUMER FED'N OF AM., BOUNCED CHECKS: BILLION DOLLAR PROFITS II (1998). Gail Hillebrand has urged state legislators to protect consumers by enacting dollar caps on not sufficient funds (NSF) fees. Gail K. Hillebrand, Revised Articles 3 and 4 of the Uniform Commercial Code: A Consumer Perspective, 42 ALA. L. REV. 679, 716 (1991).


\(^{12}\) So one-sided is the bank's tardy charge-back right that if it were the product of contract rather than statute, it might well be stricken as unconscionable. For a much-cited application of the doctrine of unconscionability, see Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965) which explains that "[u]nconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." Id. at 449.


\(^{14}\) See infra notes 90-95 and accompanying text.

\(^{15}\) See infra notes 94-95 and accompanying text. As of June 1999, 49 states had adopted the 1990 revision to Article 4. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: SECURED TRANSACTIONS 23 (5th ed. 2000).
ensure that few disappointed consumers will sue their financial institutions. Yet the possibility of tardy charge-back negatively impacts all consumers who, over time, develop a false sense that their account balance is secure. Hardest hit are consumers who can least afford to maintain a protective balance as a buffer against the continuing threat of surprise charge-back long after deposit.

The inequity of tardy charge-back against consumers has been exacerbated by Regulation CC which, since 1988, has required banks to make deposited funds available within a specified period, now generally two to five business days following the banking day of deposit. Such access to a deposit may induce a consumer to believe that a deposited check is "good"—i.e., that she may spend the deposited funds without fear that her bank will later take the funds back. In a trap for the unwary consumer, however, Article 4 protects a bank's right to recapture withdrawn funds, even months after deposit, and long after the Regulation CC availability deadline has passed.

Through this article, I hope to expose the inequity of tardy charge-back on behalf of consumers who cannot afford to challenge it in the courts. I begin by briefly exploring the role of charge-back within the check collection system and then review the mechanics of charge-back, including sanctions for bank failure to comply with charge-back directives. I then confront the general Article 4 rationale for negligence-blind charge-back and question the social equity and economic efficiency of tardy charge-back. Finally, I propose a rule precluding charge-back against consumer checks beyond six to ten banking days after deposit, a period drawn from Regulation CC's timetable for expeditious return of dishonored checks. Throughout this article, I interject Beutelisms in the hope that his

16. In two rare cases of consumers suing their financial institutions over issues other than charge-back, the plaintiffs were both unhappy lawyers. Telephone Interview with Edward Rubin, Professor of Law, University of Pennsylvania (Oct. 1999). See Gray v. Am. Express Co., 743 F.2d 10, 13 (D.C. Cir. 1984) (attorney-plaintiff challenged defendant's right to cancel credit card without notice and allegedly without cause); Drier v. Chase Manhattan Bank, 37 U.C.C. Rep. Serv. 520, 520-21 (N.Y. Civ. Ct. 1983) (attorney-plaintiff challenged depository bank's failure to credit deposit of $201.50).


18. 12 C.F.R. § 229.12.

19. Many of my commercial transactions students hold a surprisingly tenacious, though erroneous, belief that a depositor's right to access funds has a finality that protects her from charge-back. Article 4, however, clearly provides that a depository bank may charge back despite withdrawal against a deposit. U.C.C. § 4-214(d) (1996) (stating that "right to charge back not affected by . . . previous use of a credit"); see also John M. Norwood, Charge-Back Rights of Collecting Banks, 113 Banking L.J. 360, 373-74 (1996) (noting that in most cases collecting bank's rights are unaffected by withdrawal).

20. The term "Beutelism" seems to have been coined by Grant Gilmore. Grant Gilmore, The Uniform Commercial Code: A Reply to Professor Beutel, 61 Yale L.J. 364
irreverence will provoke skepticism, inspire indignation, or at least deter somnolence.

II.
THE CHARGE-BACK RIGHT: CONTEXT, MECHANICS, AND SANCTIONS

It is doubtful if the majority of the members [of the American Law Institute and the Commission on Uniform Laws] would have approved [Article 4] if they had known what they were doing . . . .

A. The Collection Context

[Article 4] is a deliberate sell-out of the American Law Institute and the Commission on Uniform Laws to the bank lobby . . . .

When a depository bank's collection effort fails and it receives the bad news that a check has bounced, the bank will protect itself by attempting to shift loss to its depositor. The bank's right to do so rests fundamentally on its status as an agent for collection.

1. Depository Bank as Customer Agent

When a consumer deposits a check in her account at a depository bank, she authorizes her bank to act as her agent to collect payment on the check. The depository bank begins this collection effort by forwarding the check either to the payor bank directly or to an intermediary collecting bank such as a Federal Reserve Bank. The depository bank exercises ordinary care if it forwards the check before its midnight deadline. Section 4-104(10) defines a bank's “midnight deadline” as “midnight on its

(1952). Professor Beutel was but one critic of the drafting of Article 4, a process Gilmore characterized as “the bloodiest battleground in the entire history of the Code.” Donald J. Rapson, The Law of Modern Payment Systems and Notes by Fred H. Miller & Alvin C. Harrell, 41 Bus. Law. 675, 677 (1986) (book review). According to Gilmore, while some attacked Article 4 as pro-bank, “bank counsel (particularly the New York group) attacked it as a Communist plot designed to destroy the American banking system.” Id. Ultimately, however, the banks won out, as a committee of bank counsel undertook the final draft, an outcome Gilmore described as “tantamount to appointing a committee of dogs to draw up a protective ordinance for cats.” Id.

22. Id. at 362.
23. This description of the check collection process is drawn largely from E. Allan Farnsworth, John O. Honnold, Steven L. Harris & Curtis R. Reitz, Cases, Problems and Materials on Commercial Law 125-34 (5th ed. 1993) [hereinafter Farnsworth]. For a more extensive discussion, see Clark & Clark, supra note 17.
24. “Collecting bank” is defined as “a bank handling an item for collection except the payor bank.” U.C.C. § 4-105(5) (1996). Under this definition, a collecting bank includes a depository bank unless the depository bank is also the payor bank.
25. Id. § 4-202(b).
next banking day following the banking day on which it receives the rele-
vant item or notice or from which the time for taking action commences to
run, whichever is later.”26 In some cases, the bank may gain an extra day
by setting a daily cutoff hour, which allows it to treat checks received after
that hour as having been received the following day.27

Once the check reaches the payor bank, it is usually charged to the
drafter’s account and later returned to the drafter with her monthly state-
ment.28 The payor bank does not ordinarily notify either the drafter or the
depository bank that a check has been paid. If, however, the payor bank
intends to dishonor the check, it must do so before its midnight deadline,29
and it must provide the depository bank with “expeditious” notice of dis-
honor.30 In this system of “no news is good news,”31 the depository bank
thus receives notice only when a check is not paid.

At least in a well-ordered world, the payor bank’s duty of expeditious
return ensures that a depository bank will receive notice of dishonor before
Regulation CC32 requires it to make a deposit available to its customer. If
this is the case, and the customer has not drawn against the deposit, the
depository bank has a simple recourse: notify the customer that she may
not draw against the deposit, i.e., that provisional credit for the deposited
check has been reversed. If the customer has already drawn against the
deposit, before the depository bank receives notice of dishonor, the deposi-
tory bank’s recourse is to charge back against other funds in the depositor’s
account or, if the depositor has a zero account balance, to seek a refund.33
After charge-back, the disappointed depositor ordinarily is left to her rights
against the drafter34 or any indorser35 on the check, no matter how unpro-
ductive they may be.

26. Id. § 4-104. A collecting bank thus takes timely action if it forwards a check re-
ceived on Monday by Tuesday midnight. Section § 4-202(b) protects tardy banks by provid-
ing that “[t]aking proper action within a reasonably longer time may constitute the exercise
of ordinary care, but the bank has the burden of establishing timeliness.” For a discussion
of this provision, see infra note 50 and accompanying text.

27. U.C.C. § 4-108(a). Article 4 authorizes a bank to fix “an afternoon hour of two
P.M. or later as a cutoff hour for the handling of money and items and the making of entries
on its books,” and provides that a check “received on any day after a cutoff hour so fixed . . .
may be treated as being received at the opening of the next banking day.” See id. § 4-
108(a), (b). Thus, if a depository bank with a 2:00 P.M. cutoff hour receives a check on
Monday at 3:00 P.M., the bank exercises ordinary care in forwarding the check if it acts by
Wednesday midnight.

28. The 1990 revision to Article 4 removes impediments to check truncation. U.C.C.
§ 4-110 (authorizing electronic presentment of checks); see also id. § 4-406(a) (authorizing
bank to return paid check, make paid check available, or provide information in statement
to allow customer to identify paid check).

29. Id. § 4-301(a).
31. See FARNSWORTH, supra note 23, at 126.
32. Id.
33. For a more detailed discussion of the charge-back right, see infra Part II.B.
34. See U.C.C. § 3-414(b) (1996) (dishonor triggers obligation of drafter on
instrument).
A depository bank's right to shift loss to its depositor upon dishonor rests historically in the bank's status as an agent for collection, as a status which Article 4 expressly recognizes. As an agent rather than a stakeholder in the check, the depository bank normally does not guarantee payment, agreeing only to attempt to obtain payment on the deposited check. Just as the depository bank forwards payment to the depositor, it passes loss occasioned by nonpayment to the depositor through its powerful right of charge-back.

One might expect that as Article 4 guards the bank's ability as agent to shift loss to a customer, it will also police the bank's agency functions to afford some protection to customers. Such policing seems especially important in the case of consumer customers. Unfortunately, Article 4 is likely to disappoint those expecting significant consumer protection.

2. Depository Bank Duties of Good Faith and Ordinary Care

The U.C.C. requires a depository bank to act with good faith and ordinary care in performing its collection tasks. The meaning of these duties, however, may be less than clear and may depend at least partly on standards established by banks themselves.

The depository bank's duty of good faith reflects the general principle of Article 1 requiring good faith in the performance or enforcement of every contract or duty. Under the pre-1990 version of Article 3, a bank's good faith is tested under the Article 1 definition of "honesty in fact," a subjective test that disregards the reasonableness of one's position. The 1990 revision to Article 3 adds an objective component to this test, defining good faith as "honesty in fact and the observance of reasonable commercial
standards of fair dealing.”42 One court recently interpreted this new language as asking, “first, whether the conduct of the holder comported with industry or ‘commercial’ standards applicable to the transaction and, second, whether those standards were reasonable standards intended to result in fair dealing.”43 The same court, however, observed that this new test is “not a model of drafting clarity.”44

In addition to its duty of good faith, a collecting bank must exercise “ordinary care” in the performance of basic collection tasks.45 Like good faith, ordinary care is a chameleon; its meaning is relational, taken from surrounding circumstances and reflecting the limited duty to act in ways others think is reasonable. Ordinary care, explains section 3-103, is the “observance of reasonable commercial standards prevailing in the area in which the person is located . . . .”46

While the objective test of good faith and ordinary care establishes a more rigorous standard than a subjective test of actual honesty, the objective standard offers limited protection to consumers since it allows banks at least partly to define, through their own practices, the standard of good faith and care to which they are held. It is true that nothing in the U.C.C. “prevent[s] a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair,”47 and, indeed, the objective test of good faith has been interpreted to invite such a challenge.48 For the consumer, however, this opportunity to establish unfairness in generally followed procedures may be an expensive proposition and therefore one that is more significant in theory than in practice.

Furthermore, special rules protect banks against potential charges of untimely action. Here, Article 4 partially abandons the relational test of ordinary care, opting for a bright-line rule that creates a safe harbor for banks falling within its boundaries. Section 4-202 thus provides that “[a] collecting bank exercises ordinary care . . . by taking proper action before

42. U.C.C. § 3-103(a)(4) (1996). This Article 3 definition applies to all negotiable instruments, including checks. Gail Hillebrand suggests that this new definition of good faith may be the most significant benefit to consumers offered by revised Articles 3 and 4. See Hillebrand, supra note 10, at 694.
43. Maine Family Fed. Credit Union, 727 A.2d at 343. Applying this test, the court found a rational basis for a jury finding that a credit union did not act in good faith when it allowed customers to draw against a large insurance check on the day of deposit, a conclusion that has been questioned by commentators. See, e.g., ROBERT L. JORDAN, WILLIAM D. WARREN & STEVEN D. WALT, NEGOTIABLE INSTRUMENTS, PAYMENTS AND CREDITS 49 (5th ed. 2000) (opining that court's conclusion is "a stretch").
44. Maine Family Fed. Credit Union, 727 A.2d at 341.
45. Section 4-202 expressly directs collecting banks to act with ordinary care in performing four tasks: (1) presentment (the transfer of an item to the payor bank), (2) sending notice of dishonor or nonpayment, (3) settling for an item upon receiving final payment, and (4) notifying its transferor of any loss or delay in transit. U.C.C. § 4-202(a).
46. Id. § 3-103(a)(7). Section 4-104(c) provides that this Article 3 definition of ordinary care is applicable to Article 4. Id. § 4-104(c).
47. Id. § 3-103 cmt. 5.
its midnight deadline following receipt of an item, notice or settlement.\textsuperscript{49} Under this provision, a bank receiving a check on Monday, for example, can establish its ordinary care simply by showing it forwarded the check before Tuesday midnight.\textsuperscript{50}

As Article 4 offers a safe harbor for a bank acting within its midnight deadline, one might expect it to create serious risks for a bank overshooting that harbor. Not so. To protect tardy banks, an Article 4 official comment explains that the subsection provides “flexibility from the standard norm” so that taking “action within a reasonably longer time may be timely but the bank has the burden of proof.”\textsuperscript{51} The message under this bright-line, midnight deadline rule is thus: timeliness is care; tardiness is care if other banks say so.

Conspicuously absent from this timeliness rule is any safe harbor for a depositor, who even in extreme cases cannot establish an absence of ordinary care simply by counting days. As Professor Beutel might say, this rule is curiously “one-sided.”\textsuperscript{52} Much more troublesome are the Code’s exaggeratedly one-sided charge-back rules.

\section*{B. Charge-Back Mechanics}

\[\text{[Banks] have succeeded, with the aid of their lawyers, in shifting many of the risks of the banking business to their customers, where fairness in bank collections would require that the bank be the insurer of the paper which it is to collect.}\textsuperscript{53}\]

\subsection*{1. A Self-Help Remedy\textsuperscript{54}}

Upon notice of nonpayment, Article 4 broadly authorizes the depository bank to proceed against its depositor in three ways: (1) where credit has been extended but has not been drawn upon, the depository bank may simply revoke this credit; (2) where a depositor has drawn against the deposit, but there is a remaining account balance, the bank may charge back

\textsuperscript{49.} U.C.C. § 4-202(b). For definition of “collecting bank,” see \textit{supra} notes 24-25 and accompanying text.

\textsuperscript{50.} Article 4 allows a bank to fix “an afternoon hour of two P.M. or later as a cutoff hour for the handling of money and items and the making of entries on its books.” U.C.C. § 4-108(a). For a brief discussion of this section, see \textit{supra} note 27 and accompanying text.

\textsuperscript{51.} See \textit{id.} § 4-202 cmt. 3. The official comment also notes that the standard time frame may be varied in cases of excused delay. \textit{Id.; see also} § 4-109 (excusing delay “caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank” where “the bank exercises such diligence as the circumstances require.”)

\textsuperscript{52.} Beutel, \textit{supra} note 2, at 362.

\textsuperscript{53.} \textit{Id.} at 361.

\textsuperscript{54.} Self-help has been defined as “one party's ability to take control of an item or sum of money in dispute without judicial intervention.” Rubin, \textit{supra} note 11, at 36.
the account against this balance; and (3) where a depositor has a zero accoun­
tabalance, the bank may obtain a refund from the depositor. In the first two of these cases, the depository bank may shift loss to a depositor through a simple “bookkeeping maneuver,” a self-help remedy that is virtu­
ally cost-free for the bank.

After offering a depository bank this powerful right of charge-back, the Code makes clear that a bank is not obliged to use it. A depository bank may thus waive charge-back and seek recovery against the drafter of the check, against an indorser (including the depositor), or against a third party.

The right of charge-back “terminates if and when a settlement for the item received by the bank is or becomes final.” When the depository bank thus receives payment on the check, its collection task is complete, its agency status ceases, and it has no need or basis for charge-back. In practice, this termination principle serves less to limit the right of charge-back than to extend it to cases in which a check is paid but for some reason (likely involving a breakdown in the collection chain) the depository bank does not receive final settlement. In such cases, the depository bank’s charge-back right continues despite the payor bank’s payment.

55. In the second and third of these scenarios, the Regulation CC funds-availability schedule may have required the depository bank to make the deposited check available for withdrawal. 12 C.F.R. § 229.12 (2000).
56. WILLIAM D. HAWKLAND & LARY LAWRENCE, UNIFORM COMMERCIAL CODE SERIES § 4-212:1 (1994) [hereinafter HAWKLAND & LAWRENCE] (“Charging back an item against the customer’s account is simply a bookkeeping maneuver removing a provisional credit from the customer’s account.”).
57. U.C.C. § 4-214(e) (1996) (“[F]ailure to charge back . . . does not affect other rights of the bank against the customer or any other party.”).
58. Dishonor of the check triggers the drafter’s obligation to pay the instrument. Id. § 3-414(b). This obligation is owed “to a person entitled to enforce the draft or to an indorser who paid the draft . . . .” Id.
59. Dishonor of the check triggers the indorser’s obligation to pay the instrument. Id. § 3-415(a). This obligation is owed “to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.” Id.
61. U.C.C. § 4-214(a).
62. HAWKLAND & LAWRENCE, supra note 56, at § 4-212:5. A few depository banks have run afoul of this termination provision, however, by charging back after the payor bank had made final payment. See, e.g., Sun Bank v. Merrill Lynch, 637 So. 2d 279, 282–83 (Fla. Dist. Ct. App. 1994) (charge-back upon allegation of forged indorsement improper more than one year after final settlement); Boggs v. Citizens Bank & Trust Co. of Md., 363 A.2d 247, 250 (Md. Ct. Spec. App. 1976) (charge-back improper seven months after final settlement). In such cases of forgery, the depository bank may recover upstream on a breach of warranty theory. See U.C.C. § 4-207(1)(a) (transferor of instrument warrants that it is person entitled to enforce instrument).
63. As an Article 4 official comment explains, charge-back is available “in those cases in which the item being collected is not finally paid or if for various reasons the bank making the provisional settlement does not itself receive final payment . . . .” U.C.C. § 4-214 cmt. 1.
2. A Hidden-Clock Timeliness Directive

Article 4 directs a depository bank to act promptly in exercising its charge-back right. The Code’s definition of timeliness, however, subverts the potential of this directive to offer meaningful consumer protection.

Section 4-214(a) directs a depository bank to return the dishonored check or notify its customer of the dishonor by the bank’s “midnight deadline or within a longer reasonable time after it learns the facts...” Because the facts that trigger this charge-back clock are the facts that establish nonpayment, the charge-back clock begins to tick only when the depository bank receives notice of dishonor. Under this test of timeliness, a depository bank receiving notice of dishonor on Tuesday morning, for example, should charge back before midnight on Wednesday. In an alternative measure that compromises the certainty of this midnight deadline, Article 4 assures the depository bank that if Wednesday seems too soon, it may take a “longer reasonable time.”

This charge-back timeliness directive is fundamentally troublesome because it marks time by reference to a clock the consumer cannot see. The date the depository bank receives notice of nonpayment will usually be unknown to the consumer prior to charge-back. Meanwhile, the consumer has been counting the days since deposit in an effort to gauge the integrity of her account balance. To the surprise of the unwary consumer, Article 4 makes charge-back timely many months after deposit, so long as it occurs promptly after the depository bank receives notice of dishonor. Too bad

64. This promptness directive is consistent with the general Article 4 scheme of encouraging efficient handling of checks. For a sampling of other rules designed to encourage efficiency, see U.C.C. § 4-202(b) (collecting bank exercises ordinary care in handling check “by taking proper action before its midnight deadline following receipt of an item, notice or settlement”). See also U.C.C. § 4-302(a)(1) (payor bank becomes accountable for amount of check it fails to dishonor by midnight deadline).

65. Id. § 4-214(a) (emphasis added). For a definition of the midnight deadline, see supra notes 25–27 and accompanying text. Oral notice has been held sufficient to satisfy the notice directive. See, e.g., Yoder v. Cromwell State Bank, 478 N.E.2d 131 (Ind. App. 1985). See generally Norwood, supra note 19, at 371–72.

66. A bank may be able to extend this time frame by designating a cutoff hour of 2:00 P.M. or later. See U.C.C. § 4-108(a); supra note 27. Such a cutoff hour would allow a bank to treat notice received on Monday after 2:00 P.M. as having been received on Tuesday. See U.C.C. § 4-108(b). At least one court, however, has held a bank's cutoff hour inapplicable to questions regarding receipt of notice of dishonor. Merrill Lynch, Pierce, Fenner & Smith v. Devon Bank, 702 F. Supp. 652, 662–63 (N.D. Ill. 1988) (reasoning that cutoff right applies only to items and deposits of money, not to notice of dishonor); see also Norwood, supra note 19, at 371.

67. See U.C.C. § 4-214(a) (1996). For an application of this alternative time frame, see Pandol Bros. Inc. v. NCNB Nat’l Bank of Fla., 450 So. 2d 592 (Fla. Dist. Ct. App. 1984) (reversing summary judgment for bank that failed to meet its midnight deadline and demanding for determination of whether notice was given within “a longer reasonable time”).

for the consumer who has been lulled into a false reliance on her account balance by a time-lag between deposit and charge-back.

The Code's rejection of the date of deposit as a benchmark for timeliness is not only consumer-hostile, but curiously inconsistent with the Code's no-news-is-good-news collection scheme. Under this scheme, a depository bank, like a consumer, assumes that the passage of time since deposit without news of nonpayment means that a check has been paid. Consumer reliance on the deposit date therefore can hardly be said to be unreasonable, for banks themselves engage in similar reliance.

Central to the Code's no-news-is-good-news scheme is the duty of all banks in the collection chain to handle a check in a timely manner. Overlapping the Article 4 rules encouraging efficient handling of checks by collecting banks and payor banks is the federal Regulation CC requirement that paying and returning banks send expeditious notice of any dishonor. Because all banks involved in collection are required to act promptly, in a well-ordered world the depository bank will receive any notice of dishonor within a short time after deposit. Thus it is reasonable to presume that any extended delay between the date of deposit and the date of charge-back involves tardiness by one or more banks in the collection chain. The Code's use of the date of notice of dishonor rather than the date of deposit may serve primarily to make charge-back timely in cases of apparent bank mishandling.

Rejection of the date of deposit as a benchmark for timely charge-back thus reflects a departure from banking practice that offers extraordinary protection to misbehaving banks at the expense of surprised consumers. To make matters worse for the consumer, the Code delivers a mere slap on the wrist to a bank that fails to meet even this generous timeliness directive.

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69. See supra text accompanying notes 28–32.
70. See supra note 24 and accompanying text.
71. See supra note 29 and accompanying text.
72. 12 C.F.R. § 229.30(a), (f) (2000) (paying bank); id. § 229.31(a), (f) (returning bank).
73. In unusual cases, bank tardiness may be excused by such factors as computer failure, bank failure, and war. U.C.C. § 4-109 (1996). Related notice of a forged indorsement long after deposit and after payment of the check does not raise an issue of timely charge-back since the depository bank lost its charge-back right earlier when it received payment for the check. See Sun Bank, N.A. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 637 So. 2d 279 (Fla. Dist. Ct. App. 1994) (interpreting FLA. STAT. chs. 671.212–213 (1991) [corresponding to U.C.C. §§ 4-214, 4-215 (1996)] to disallow charge-back where final payment was made prior to discovery of forgery); see also James J. White & Robert S. Summers, 2 Uniform Commercial Code § 20-6 (Practitioner's ed., 1997 pocket part). For a discussion of termination of the right of charge-back due to payment, see supra notes 61–63 and accompanying text.
C. Consequences of Bank Misbehavior

By a trick provision of section 4-103 and sub-section 4, the bank is not bound to follow any of the collection procedures set out in the act.74

Banks have many opportunities to behave badly. Among other things, a depository bank may mislay the deposited check, delay in forwarding it, or fail to charge back in a timely manner.75 In any case of depository bank misbehavior, two questions arise. The first issue is one of ultimate liability: Would the misbehaving bank be liable to a depositor who initiates litigation against it? The second question is one of temporary loss: May a misbehaving bank shift loss to its depositor through charge-back? While these questions are distinct, they are also necessarily related, for even though a naughty bank may in theory be liable ultimately to its customer, if the customer cannot bear the costs of initiating litigation to establish this liability, loss will remain where charge-back places it—with the customer.

1. Ultimate Liability: The “Penalty”

If a depository bank negligently handles a check, section 4-103 makes the bank liable for “the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care.”76 Under this basic rule, a depository bank is liable to its depositor if the check would have been paid had the bank properly handled it.77 Conversely, if the check would not have been paid even if properly handled, the bank’s negligence has caused no actual loss and thus triggers no ultimate bank liability. Under this rule, the babysitter whose account was charged back months after deposit could shift ultimate loss to her bank upon proof that her paycheck would have been paid if properly handled.

74. Beutel, supra note 2, at 360. At the time Professor Beutel wrote, section 4-103(4) provided, “[t]he specification or approval of certain procedures by this Article does not preclude an agreement authorized by sub-section (1), nor constitute disapproval of other procedures which may be reasonable under the circumstances.” U.C.C. § 4-103(4) (1951). A similar provision now appears in section 4-103(d) which provides, “[t]he specification or approval of certain procedures by this article is not disapproval of other procedures that may be reasonable under the circumstances.” U.C.C. § 4-103(d) (1996).

75. Additional opportunities for negligence include the careless choosing of intermediary banks, forwarding items to banks known to be insolvent, or misrouting an item, though liability attaches should the bank’s activities breach its “duty of ordinary care.” See HAWKLAND & LAWRENCE, supra note 56, at § 4-202:2.

76. As the official comment to this section explains, “[w]hen it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount that would have been in any event uncollectible.” U.C.C. § 4-103 cmt. 6 (1996).

77. A depository bank acting in bad faith is liable additionally for “any other damages the party suffered as a proximate consequence.” Id. § 4-103(e). The official comment to this section explains that “if bad faith is established the rule opens to allow the recovery of other damages, whose proximateness is to be tested by the ordinary rules applied in comparable cases.” Id. § 4-103 cmt. 6.
When a depository bank's negligence is its tardy exercise of the charge-back right, this loss rule makes the bank liable ultimately only to the depositor who suffers actual loss because of the bank's tardiness. Thus, a depositor might prevail against her tardy bank by proving that if the bank had timely notified her that the check had bounced, she would not have released funds to the drawer.

The Code's preference for this common law loss rule over a rule of strict liability for negligence seems grounded in a determination that a depositor should not unfairly profit from bank negligence. Indeed, under a rule of strict liability, a depositor might recover against a negligent bank even though the deposited check would not have been paid even if properly handled, thus affording the depositor a windfall. As persuasive as it may initially appear, this windfall rationale is troublesome in its willingness to leave loss with a consumer depositor who may be unable to initiate litigation to establish that bank misbehavior caused her an actual loss, even where this is so. Because consumers typically lack the resources necessary to sue their banks, the Code in practice places ultimate loss on consumers without regard to whether bank misbehavior caused an actual loss. Such a rule creates little incentive for banks to exercise care in handling consumer checks since there is little danger that a consumer will call a bank to task for its misbehavior. Given the financial inability of most consumers to shift ultimate loss to a bank, the critical issue for a consumer is whether a naughty bank can shift "temporary" loss to her through charge-back.

2. "Temporary" Loss-Shifting: The Right

Suppose a depository bank negligently handles a deposited check that is subsequently dishonored for insufficient funds. Suppose further that depository or other bank negligence seems very likely because of a time lag between the dates of deposit and charge-back. May the depository bank nonetheless charge back its depositor's account, thereby shifting to the depositor the burden of initiating litigation to prove bank negligence and resulting loss? Stated differently, is there any charge-back sanction for bank misbehavior? Article 4 offers a surprising answer to these questions.

Section 4-214(d) provides that the "right to charge back is not affected by ... failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable." Preempting any consumer-
friendly interpretation of this language, however tenuous, the official comment to this section candidly observes that “charge-back is permitted even if nonpayment results from the depository bank’s own negligence.” The rule authorizing charge-back, explains the comment, “applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment.” Thus, while a depository bank may be ultimately liable to a consumer who proves bank negligence and resulting loss, the bank’s right to charge back is not compromised by its negligence. Although it would be possible to preclude charge-back while leaving open the possibility of ultimate loss-shifting, the Code protects the negligent bank’s right to engage in self-help against a consumer.

Similarly, Article 4 expressly provides that a bank whose misbehavior is tardiness retains its right to charge back its customer’s account. The consumer’s recourse in cases of tardiness, as in cases of other bank negligence, lies in her theoretical ability to initiate litigation against her bank to fix ultimate liability.

Article 4 did not always so clearly protect a tardy bank’s right of charge-back. The pre-1990 language of Article 4 contained a timely notice requirement, but did not specify the consequence of tardiness. This gap inspired some courts to interpret this language as creating a condition precedent to the right of charge-back. A Tennessee court, for example, held charge-back improper five months after deposit and five weeks after the depository bank received notice of nonpayment. A New York court similarly found charge-back improper six months after deposit, and a Utah court found it improper two months after deposit.

Such holdings conditioning the right of charge-back on timely notice were expressly rejected in the 1990 revision to Article 4. In addition to inserting new language that protects the right of charge-back in cases of tardiness, the official comment to section 4-214 rejects the view that

84. Id. § 4-214 cmt. 5.
85. Id.
86. For such a proposal, see infra Parts III-IV.
87. Section 4-214(a) provides in pertinent part: “If the return or notice is delayed beyond the bank’s midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain a refund from its customer, but is liable for any loss resulting from the delay.” U.C.C. § 4-214(a).
88. See id.
89. Prior to 1990, section 4-212(1) authorized a depository bank to charge back “if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts.” U.C.C. § 4-212 (1988) (renumbered in 1990 as 4-214(a)).
93. In 1990, the following sentence was added to the charge-back section: “If the return or notice is delayed beyond the bank’s midnight deadline or a longer reasonable time
charge-back is conditioned on timeliness, specifying that “a [tardy] collecting bank loses its rights only to the extent of damages for any loss resulting from the delay.”\footnote{Id. § 4-214 cmt. 3.} A tardy bank, like a negligent bank, is therefore entitled to shift loss to its depositor through charge-back notwithstanding the bank’s misbehavior.

The injured customer’s recourse after charge-back lies in her theoretical opportunity to shift loss back to her bank through litigation establishing that bank negligence or tardiness caused her an actual loss. The class of depositors actually protected by this litigation-recourse rule consists only of depositors who are empowered to initiate litigation against banks, a class likely to include a disparately small number of consumers.\footnote{See infra text accompanying notes 112-15.} As a practical matter, therefore, the bank’s charge-back right will very likely fix ultimate liability on the consumer who is financially unable to shift loss to her bank even where banking misconduct caused actual loss. The charge-back rule that facilitates this inequity must be justified, or it must be changed.

III. Justifying Tardy Charge-Back

\textit{Article [4] is so one-sidedly drawn in favor of the banking interests that any banker who insisted on exercising the rights given him by this “Code” would probably be under suspicion by the better business bureau.}\footnote{Beutel, \textit{supra} note 2, at 362.}

The simplest explanation for Article 4’s tolerance of tardy charge-back may lie in the nightmare of a depositor who receives a windfall because of bank delay.\footnote{For a critique of the windfall possibility as a justification for the Code’s ultimate loss rule, see \textit{supra} text accompanying notes 80-81.} In this dreadful vision, the deposited check was never properly payable. The depositor ordinarily therefore would not receive payment, yet the happenstance of bank tardiness allows her to recover against her bank. Like nightmares generally, this one exaggerates the stakes. Charge-back does not fix ultimate liability, but rather enables a bank to shift to its customer temporary loss and thus the burden of initiating litigation to establish ultimate loss.\footnote{For a discussion of the distinction between temporary loss-shifting through charge-back and ultimate liability, see \textit{supra} text accompanying notes 75-95.} If a tardy bank were precluded from charging back a consumer, the bank would nonetheless retain the right to shift ultimate loss to the consumer upon proof that tardiness caused no harm. Because charge-back does not necessarily fix ultimate loss, the windfall nightmare offers an unconvincing rationale for tardy charge-back.

\footnote{after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but is liable for any loss resulting from the delay.” U.C.C. § 4-214(a) (1996).}
A. A Dubious Code Rationale

Article 4 on Bank Deposits and Collections is an unfair piece of class legislation.\textsuperscript{99}

Article 4 does not attempt to provide a specific justification for its rule permitting charge-back by a tardy bank. An official comment, however, does attempt to justify the general rule permitting charge-back by a negligent bank. Since tardiness may constitute negligence, this comment might also offer a justification for tardy charge-back.

Permitting a negligent bank to charge back, explains the comment to section 4-214, is necessary to protect banks because “[a]ny other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item.”\textsuperscript{100} Any other rule, continues the comment, “would require a bank to determine difficult questions of fact.”\textsuperscript{101} Apparently, these “difficult questions,” which if wrongly answered would subject the bank to excessive liability, involve determinations of bank negligence and resulting depositor loss, facts which would make a depository bank ultimately liable to its depositor.\textsuperscript{102} One can indeed imagine the unfairness of requiring a depository bank to resolve such issues in the fleeting moments during which charge-back is authorized.

The problem with this reasoning is that these “difficult questions” need not be answered prior to charge-back. Because charge-back does not fix ultimate liability,\textsuperscript{103} a depository bank could forego charge-back while retaining the right to shift ultimate loss to its customer if it later concludes this is appropriate. The comment, however, altogether fails to distinguish between temporary and ultimate liability, apparently assuming that issues determining ultimate loss must be resolved prior to shifting temporary loss.

Moreover, the comment’s “difficult questions” rationale erroneously assumes the existence of difficult questions. In some cases, such as those involving bank tardiness in handling a check, negligence can be identified presumptively by comparing the date of deposit with the date of intended charge-back.\textsuperscript{104} In the babysitter’s case, the depository bank could hardly

\begin{itemize}
  \item \textsuperscript{99} Beutel, \textit{supra} note 2, at 335.
  \item \textsuperscript{100} U.C.C. § 4-214 cmt. 5 (1996).
  \item \textsuperscript{101} \textit{Id} (emphasis added).
  \item \textsuperscript{102} The comment thus suggests that if the depository bank erroneously answered these questions, incorrectly concluding that it could properly charge back, it would be liable to a depositor whose subsequent checks were dishonored because her account balance had been reduced by an improper charge-back. \textit{See id.}
  \item \textsuperscript{103} \textit{See supra} text accompanying notes 74–81.
  \item \textsuperscript{104} Since all banks are required to handle a check properly, a time-lag between deposit and charge-back strongly indicates misbehavior by one or more banks. \textit{See supra} text accompanying notes 69–73.
\end{itemize}
claim difficulty in identifying probable bank negligence since checks normally do not require several months for collection. While issues of depositor injury in such cases may be more difficult to resolve swiftly, these issues need not be resolved prior to charge-back, but rather in the more deliberative setting necessary to fix ultimate liability. Should a bank claim an excuse for the delayed handling, this issue also could be resolved as part of the ultimate liability determination. It would thus be possible to preclude charge-back in cases of bank tardiness without requiring a bank to answer any difficult questions.105

Certainly not all negligence can be identified as easily as bank tardiness. The official comment to section 4-214, however, offers only a global justification for negligence-blind charge-back that fails to distinguish between ultimate and temporary liability, and between tardiness and other negligence. That the rule permitting tardy charge-back is not necessary to protect banks compounds its injustice.

B. Social Equity

Uniform Commercial Code is a misnomer; it should be called the Lawyers and Bankers Relief Act.106

Professor Beutel's indignation over Article 4 rests on the critical assumption that its rules should be fair. Indeed, there is no reason why the rules applicable to banks should be exempt from the general principles of equity and fair play that underscore less arcane bodies of law.

Professor Rubin suggests two impressionistic exercises to identify rules that violate norms of social equity.107 The first exercise, based on empathy, is “to place oneself in the position of a particular person, and ask whether one would reasonably experience a sense of unfairness or resentment.”108 A second exercise, based on rationality, “is to imagine addressing a person who felt disadvantaged, and see if one can formulate a satisfactory way of explaining to the person why the situation must continue.”109

Placing oneself in the shoes of the babysitter110 is likely to provoke a sense of unfairness and resentment because of the rude surprise she has suffered. Long after the babysitter reasonably assumed her account balance was secure, her bank exercised its statutory right of self-help against her, reducing her account balance by the amount of her bounced paycheck, and thus depriving her of funds needed to cover outstanding checks drawn in reliance on her balance. Her bank’s entitlement to help itself to her

105. For such a proposal, see infra Parts III–IV.
106. Beutel, supra note 2, at 363.
108. Id.
109. Id.
110. See supra Part I.
account balance is unaffected by the appearance of bank misbehavior inherent in the long delay between deposit and charge-back.

The general Article 4 answer to the babysitter is that she can initiate litigation to recapture her account balance in an appropriate case. This litigation recourse rationale is hardly a satisfactory answer for the babysitter. As a threshold matter, the babysitter is probably unaware that she can shift loss to her bank by proving that bank tardiness caused her a loss.\textsuperscript{111} Even if she is aware of her rights against her bank, she may be intimidated by the prospect of combat with a bank in a legal system that seems “arcane, complex and dangerous.”\textsuperscript{112} Should she decide to undertake such combat, the babysitter will surely require the aid of a commercial lawyer, with whom she is unlikely to have an existing relationship, and whom she may have difficulty locating.\textsuperscript{113}

Even if she can overcome these initial hurdles, she may conclude that litigation is too expensive, either because she lacks necessary funds or because litigation costs would exceed the benefits sought, i.e., the face amount of her paycheck.\textsuperscript{114} Indeed, the bank may be able to ensure this unfavorable cost-benefit ratio by driving up the babysitter’s litigation costs. Babysitters and banks do not come to court as equals.\textsuperscript{115} As a repeat player in litigation, a bank’s litigation costs are almost certain to be less than those of a consumer. The bank can more easily acquire the services of an attorney, through its own legal department, or through its ongoing relationship with outside counsel; it may deduct attorney fees from its taxes,\textsuperscript{116} and it has the resources to acquire information about the failed collection attempt. Moreover, as repeat players, banks are willing to spend more on litigation than consumers who, as one-time players, are concerned only with the immediate outcome. In a worst case scenario, a bank will initiate a game of financial “chicken” against a consumer plaintiff who sooner or later must yield to the bank’s superior resources.\textsuperscript{117}

For all these reasons, litigation against a tardy bank to shift loss imposed by charge-back may be an unreasonable alternative for a babysitter. Consequently, loss will very probably remain with the babysitter even

\textsuperscript{111} Most consumers are unlikely to be aware of the U.C.C. loss allocation rules. \textit{See}, e.g., Robert D. Cooter & Edward L. Rubin, \textit{A Theory of Loss Allocation for Consumer Payments}, 66 \textit{Tex. L. Rev.} 63, 68 n.32 (1987). Indeed, some of my commercial transactions students would argue this ignorance is rational since the cost of obtaining such information exceeds its expected value.

\textsuperscript{112} \textit{See} Rubin, \textit{supra} note 11, at 23.

\textsuperscript{113} \textit{Id.} at 21.

\textsuperscript{114} Professor Rubin suggests that $2500 is the minimum amount in controversy for which it is rational for a consumer to hire a lawyer. \textit{See id.} at 21–22.

\textsuperscript{115} As Professor Rubin observes, “[I]t is an essential element of our socially developed sense of fairness that litigants should come to court as equals. Their chances of prevailing should depend upon the strength of their legal positions, and not upon attributes external to the case such as their appearance, religion, or personal wealth.” \textit{Id.} at 43.

\textsuperscript{116} \textit{Id.} at 27.

\textsuperscript{117} \textit{Id.} at 29.
though she has been wronged. In Professor Rubin’s words, “[t]his is the paradigmatic case of unfairness: to feel that one is right but know that one has no redress.”

C. Economic Efficiency

[The U.C.C.] has been hurriedly drafted and relentlessly pushed through . . . [with] little or no impartial research into the economic needs of the business community which the Code attempts to regulate in detail.

The principal objection to tardy charge-back is that it unfairly allocates to consumers costs they cannot bear, frustrating their efforts to assert legitimate rights. An important follow-up question is whether principles of economic efficiency support, conflict with, or are neutral toward the Article 4 rule allowing belated charge-back against consumers. If efficiency principles support such a rule, then consumers collectively may be better off with it although some individuals may be hard-hit.

Generally, an economically efficient payment system will keep costs to a minimum, benefiting both banks (which can provide services at lower cost) and consumers (who will pay less for banking services). In a well-ordered market, parties seek to negotiate agreements that are cost-reducing. In a market that is not well-ordered, possibly because of information asymmetry between the parties, market failure may produce inefficiency—namely, agreements that do not reduce the parties’ costs. In the case of consumers and their banks, where actual negotiation is rare, the efficiency question is whether an asymmetry between financial institutions and consumers in the drafting of Article 4 produced a tardy charge-back rule that inefficiently allocates loss.

118. Rubin, supra note 107, at 577.
119. Beutel, supra note 2, at 334.
120. Rubin, supra note 107, at 561.
121. Cooter & Rubin, supra note 111, at 68–69. Other sources of market failure include monopoly and externalities (costs imposed on third parties). Rubin, supra note 107, at 561–64.
122. For a history of the drafting process and an observation that consumers were seriously underrepresented, see Edward L. Rubin, Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4, 26 Loy. L.A. L. REV. 743 (1993). According to Professor Rubin, “in the ABA Committee and, as far as I could tell, in the ALI-NCCUSL [American Law Institute-National Conference of Commissioners on Uniform State Laws] Drafting Committee, only two of the three principal interests—financial institutions, corporate users and consumers—were represented.” Id. at 759–60. Professor Rubin reports that prior to initiation of the drafting process, NCCUSL agreed with the banking industry that the revision “would not alter the balance between banks and consumers that existed in the original Articles 3 and 4, nor would it add any new provisions dealing with consumer protection.” Id. at 746.

Donald Rapson, a member of the Article 3 and 4 drafting committee has a different view. “Contrary to the comments of Professors Rubin and Patchel—who did not attend the
Professors Rubin and Cooter suggest that the Code's loss-allocation rules should be tested against three general principles of economic efficiency: loss-spreading, loss-reduction, and loss-imposition. Application of these principles initially requires an identification of the loss that tardy charge-back allocates. As previously noted, charge-back generally enables a tardy bank to shift to a consumer: (1) temporary loss, and (2) the burden of initiating litigation to shift ultimate loss. The loss-allocation question raised by charge-back is thus not the ultimate one of who should bear the loss resulting from dishonor, but rather the more immediate one of who should bear temporary loss and thus the burden of initiating litigation to shift ultimate loss.

In addition to the direct loss of account funds allocated to the consumer through charge-back, bank tardiness may create additional indirect losses for the consumer who has relied on bank inaction. When a bank fails to alert a consumer within a reasonable time that a deposited check has been dishonored, the bank may induce the consumer to release funds or incur irreversible obligations in reliance on the bank's inaction. If the babysitter, for example, had known several months earlier that her paycheck was drawn on insufficient funds, she might have confronted her employers before they left town, or accepted an additional babysitting job, or foregone the new coat or the trip to grandma's house that generated the credit card bill she cannot now pay or the personal check she cannot now cover. The bank's tardiness in charging back her account deprived her of these and other self-help options. Such indirect loss caused by reasonable

meetings—the Articles 3, 4 and 4A Drafting Committees were not dominated by the banking interests.” Donald J. Rapson, Who is Looking Out for the Public Interest? Thoughts About the UCC Revision Process in the Light (And Shadows) of Professor Rubin's Observations, 28 Loy. L.A. L. Rev. 249, 255 (1994). In support, Rapson cites “important substantive changes” that generally benefit users rather than banks, including expansion of the definition of “good faith” and recognition of a bank’s duty to exercise ordinary care in opening accounts. Id. at 254–55. For an analysis and critique of the process of drafting commercial law generally, see Kathleen Patchel, Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons From the Uniform Commercial Code, 78 Minn. L. Rev. 3 (1993).

123. See generally Cooter & Rubin, supra note 111.

124. See supra text accompanying notes 80–93. If the underlying fault issue is never resolved, this temporary loss allocation will of course become permanent. For a discussion of the likelihood of this result in cases of consumer depositors, see supra notes Parts II.A–B.

consumer reliance on bank inaction is a significant potential consequence of bank tardiness. The losses at issue in tardy charge-back thus include both the direct loss of an account balance imposed on the consumer through charge-back and the potential for additional indirect consumer loss caused by bank tardiness. In assessing the efficiency of the Article 4 tardy charge-back rule, both these losses must be considered.

1. **Loss-Spreading**

   Loss-spreading principles identify an efficient rule as one that places loss on the party who “can bear risk at a lower cost than another.”\(^{126}\) Generally this party is the one with greater economic resources who is better positioned to spread loss effectively.\(^{127}\) Clearly, the Article 4 rule permitting tardy charge-back was not designed to further principles of loss-spreading since this rule places loss on consumer depositors who are usually less able to bear and to spread loss than depository banks. The loss-spreading principle, however, cannot be dispositive of the efficiency question since, taken alone, it would place all losses on banks rather than consumers, a consequence that would surely create distorting incentives for both parties.

2. **Loss-Reduction**

   The loss-reduction principle suggests that loss should be placed on the party who most cheaply can reduce loss and who, as loss-bearer, will be inspired to do so.\(^{128}\) Such a party is one who can respond to loss-allocation rules, take precautions against loss, and develop innovations to prevent loss.\(^{129}\)

   In the case of tardy charge-back, the narrowly focused loss-reduction question is: who can most efficiently avoid loss caused by banking delay in charging back? The obvious answer is that only a bank can avoid bank tardiness. Clearly, it is within the power of a depository bank to avoid its own tardy handling of a check. Where a bank other than the depository bank is responsible for the delay between deposit and charge-back, placing temporary loss on the depository bank would inspire all banks to develop procedures to insure timely action. By contrast, a consumer depositor has no control over the timeliness with which banks handle her check. Loss-reduction principles thus identify a bank rather than a consumer depositor as the most appropriate temporary loss-bearer in cases of bank tardiness.

\(^{126}\) Cooter & Rubin, *supra* note 111, at 71.

\(^{127}\) Id.

\(^{128}\) Id. at 73.

\(^{129}\) Id. at 73–77; *see also* Rubin, *supra* note 107, at 568 (observing that “[b]anks design the [check collection] system and can avoid losses by restructuring it, training their employees, or developing new technologies”).
One might argue, however, that the depositor herself could have avoided loss altogether by declining to take the drafter’s bad check, demanding instead cash payment, or by refusing to deal with a disreputable drafter or with subsequent indorsers of her check. Because these opportunities allow the drafter to avoid the dishonor itself, they allow her to avoid all dishonor-related losses. Such reasoning supports the Code principle that a depositor rather than a bank generally should bear loss caused by dishonor. This reasoning, however, fails to support an allocation of loss to the depositor in cases where bank tardiness itself creates a significant potential for loss in addition to that caused by dishonor of the check. By failing to charge back promptly after deposit, the bank has induced the consumer to believe that the check is good and to take action in reliance on the bank’s implied representation to this effect. As to these potential losses caused by reasonable reliance on bank inaction, the bank is clearly the least-cost loss avoider.

3. Loss-Imposition

A loss-imposition principle seeks reduction of enforcement costs, the “deadweight loss” that distorts the underlying allocation of loss. An efficient enforcement scheme would thus leave losses where they fall or allocate loss cheaply through simple and clear rules that avoid expensive fact-finding.

The Article 4 rule permitting tardy charge-back initially appears consistent with loss-imposition principles as it places immediate loss upon the depositor of a hot check through a simple and clear rule that requires no fact-finding and allocates loss to the depositor at virtually no cost to the bank. This observation is not dispositive of the loss-imposition issue, however, since temporary loss could be allocated to a tardy bank as cheaply as it is allocated to a depositor. Just as charge-back is virtually cost-free for a bank, a prohibition of charge-back that leaves temporary loss with the depository bank would also be cost-free. Expensive fact-finding could be avoided under such a rule by prohibiting charge-back beyond a specified number of days after deposit.

Since both charge-back and charge-back preclusion are virtually cost-free, the focus must turn from questions of the direct costs of temporary

130. Traditionally this principle is stated in terms of the bank’s role as agent of the depositor. See supra notes 36–37 and accompanying text.
131. Cooter & Rubin, supra note 111, at 78.
132. Id. at 78–80.
133. As Professors Cooter and Rubin note, “[t]he cost of making even a single factual determination would quickly surpass all but the most catastrophic losses on a consumer account.” Id. at 79. In designing rules for loss-shifting, the loss-imposition principle suggests rules such as strict liability, single factor standards, objective tests, and statutory liquidated damages. Id. at 78.
134. See supra text accompanying notes 54–55.
135. For such a proposal, see infra Part III.
loss-allocation to the follow-up question of who can most cheaply bear the burden imposed by temporary loss—that is, those who can most cheaply initiate litigation to shift ultimate loss in appropriate cases. Under the Article 4 tardy charge-back rule, the consumer now bears this burden. Placing this burden on a bank rather than a consumer would likely reduce enforcement costs since a bank generally can litigate more cheaply than a consumer.\(^\text{136}\) Moreover, banks are generally better positioned than consumers to predict litigation costs and thus better able to determine whether litigation is a wise allocation of resources in view of the face value of a particular check.\(^\text{137}\) If tardy charge-back were prohibited, then in cases where potential litigation costs exceed potential gain, a bank rather than a consumer would bear ultimate loss, thus furthering principles of loss-spreading.

Principles of loss-imposition thus are furthered by the Article 4 tardy charge-back rule only because financial constraints prevent consumers from asserting their rights.\(^\text{138}\) Consequently, consumers typically will leave the “temporary” charge-back loss where it falls, thus eliminating any enforcement costs necessary to shift ultimate loss.

IV.

PROTECTING BABYSITTERS: A PROPOSAL

A code is not formulated to follow the current of decisions when the current is wrong, and the law ought to be changed.\(^\text{139}\)

The Article 4 rule permitting tardy charge-back against consumers is wrong and ought to be changed. A more equitable and more efficient rule could be implemented through two simple changes to Article 4: (1) defining timeliness by reference to the date of deposit, and (2) precluding tardy charge-back.

A. New Definition of Timeliness

[That Commercial Code has created an entirely new and strange vocabulary.\(^\text{140}\)]

The Article 4 definition of timely charge-back is counterintuitive in its rejection of the date of deposit as a benchmark. By instead choosing the

\(^{136}\) See supra notes 112–15 and accompanying text.

\(^{137}\) Where potential enforcement costs exceed the check amount, a bank is positioned to evaluate whether precedential value warrants proceeding.

\(^{138}\) As Professors Cooter and Rubin note, even a “modest fact-finding procedure would probably require a consumer to write a check that is substantially larger than the one at issue in the litigation.” Cooter & Rubin, supra note 111, at 79.


\(^{140}\) Beutel, supra note 2, at 337.
date a depository bank receives notice of nonpayment as the benchmark, the Code definition permits charge-back to be timely long after deposit, so long as it promptly follows the payor bank’s notice of dishonor. This Article 4 definition will likely surprise the consumer who ordinarily gauges the likelihood that a deposited check is good by reference to the date of deposit, a view encouraged by Regulation CC, and shared by the depository bank under the Code’s “no-news-is-good-news” collection scheme.

Both consumer expectation and the duty of all banks to act promptly in handling a check suggest that counting days since deposit can provide a reasonable test of timeliness. Such a definition should quantify the number of days within which charge-back is timely in order to allow consumers to rely on their bank account balances and to encourage timely handling by banks eager to fall within the definition’s safe harbor. Regulation CC which requires a payor bank to send expeditious notice of nonpayment suggests a means for measuring this period. The regulation specifies that a local check is returned expeditiously if it meets either of two tests: the forward collection test (requiring the payor bank to return a check as swiftly as it would have forwarded it) or the two-day/four-day test (requiring the payor bank to return a local check within two banking days and nonlocal checks within four banking days). Interestingly, the Regulation CC commentary explains that the two-day/four-day time frame is based on the estimated time required to forward a check for payment. Drawing on this Regulation CC timetable, a reasonable time limit for charge-back would be six banking days from the date of deposit for local checks and ten banking days from the date of deposit for nonlocal checks. This period is

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141. See supra text accompanying notes 62–64.
142. See supra text accompanying notes 66–67.
143. Farnsworth, supra note 23, at 126; see also supra text accompanying notes 29–31.
144. As Donald Rapson observes, “the public interest is best served by having clear, concise, and efficient statutory rules so that the parties to a transaction can anticipate the issues and answers that may arise and guide their actions accordingly.” Rapson, supra note 122, at 257.
145. 12 C.F.R. § 229.30(a) (2000). For purposes of the regulation, a check is local if it is drawn on a local paying bank. Id. § 229.2(r). A local paying bank is “a paying bank that is located in the same check processing region as the physical location of the branch, contractual branch, or proprietary ATM of the depository bank in which that check was deposited.” Id. § 229.2(s).

A definition of timeliness less generous to banks might be based on the Regulation CC funds availability timetable, which generally requires a depository bank to make funds available within two days after deposit for local checks and within five days after deposit for nonlocal checks. Id. § 229.12. Interestingly, the Regulation CC commentary suggests that the depository bank will often have notice of dishonor before availability is required. Id. § 229.30(a) (anticipating that a check will often be returned before funds must be made available under the temporary availability schedule).

146. Id. § 229.30. Appendix E to part 229 commentary states: “The times specified in this two-day/four-day test are based on estimated forward-collection times, but take into account the particular difficulties that may be encountered in handling returned checks.” Id.
calculated by: (1) doubling the two-day/four-day test of expeditious return to allow for both forwarding the check and sending any notice of dishonor; (2) adding one banking day within which the payor bank must determine whether to pay the check; and (3) adding another banking day within which the depository bank may charge back a depositor. As the collection system continues its conversion from a paper-based system to an electronic one, this period should be shortened significantly. Adoption of this six-day/ten-day rule today, however, would establish the principle that charge-back timeliness is defined by reference to the date of deposit and would offer the immediate protection to consumers that equity and efficiency mandate. As a practical matter, however, this new definition of timeliness may have little impact on consumer confidence or bank behavior unless it is accompanied by meaningful sanctions for tardiness.

B. A Timeliness Mandate

All liability of the bank for improper handling of paper so carefully and fairly set up in the earlier drafts is removed.\(^\text{147}\)

Under revised Article 4, delay does not deprive a bank of its right of charge-back, but only makes the bank theoretically liable to a depositor who can prove loss caused by the delay.\(^\text{148}\) Since consumer depositors are unlikely to initiate litigation to prove such loss, Article 4 imposes no real sanction against a depository bank that belatedly charges back a consumer account. Article 4 should be re-revised to impose a meaningful sanction against a tardy bank by precluding delayed charge-back.

1. Charge-Back Preclusion

A depository bank should be prohibited from charging back a consumer account more than six banking days after deposit of a local check and more than ten banking days after deposit of a nonlocal check.\(^\text{149}\) Such charge-back preclusion would prohibit a depository bank from resorting to self-help to shift loss to a consumer where banking tardiness has likely occurred during the collection effort.\(^\text{150}\) The timeliness directive of Article 4 would thus become a mandate in cases of consumer deposits.

Charge-back preclusion would not produce a windfall for the depositor “lucky” enough to avoid charge-back of a hot check. While this depositor has avoided the temporary loss of funds associated with charge-back, she remains vulnerable under Article 4 to a subsequent depository bank

\(^{147}\) Beutel, \textit{supra} note 2, at 360.  
\(^{148}\) See \textit{supra} Part II.C.1.  
\(^{149}\) See \textit{supra} Part III.A.  
\(^{150}\) The depository bank that violates this mandate should be liable for the wrongful dishonor of new checks the depositor draws against the improperly-depleted account. An additional penalty could also be imposed, perhaps a multiple of the face amount of the check.
action to shift ultimate loss to her. In cases presumptively involving bank tardiness, the essential effect of charge-back preclusion is simply to leave immediate loss where it falls—on the depository bank, which then bears the burden of initiating litigation to shift ultimate loss in appropriate cases.151

A rule clearly defining and precluding tardy charge-back would satisfy the concerns of the drafters of the Article 4 official comment who sought to justify the general rule allowing charge-back by a negligent bank.152 The proposed rule would raise no “difficult questions” for the depository bank,153 which could very easily determine whether six to ten banking days had passed since the date of deposit. No further facts would be necessary to determine the right of charge-back. The date of deposit should be readily available to the depository bank since this date determines when funds must be made available under Regulation CC.154

Moreover, a time-limited charge-back rule is consistent with consumer expectations and norms of fair play. Where bank tardiness is evident, the proposed rule would preclude a bank from shifting loss to a consumer who is thereafter financially unable to assert her right to attempt to shift loss. Charge-back preclusion would instead leave immediate loss and the burden of initiating litigation on the depository bank, which may pursue its depositor or, in an appropriate case, another bank that mishandled the check.

2. Ultimate Loss

Where a bank has been tardy in charging back, Article 4 places ultimate loss on the bank only if the depositor can prove injury caused by bank delay. While charge-back preclusion places temporary loss and the burden of acting to shift ultimate loss on the bank rather than the depositor, it does not alter the Article 4 rule on ultimate loss-shifting. Revising the rules of temporary loss-allocation, however, provides an opportunity to rethink the underlying rules on ultimate loss-shifting.

One possibility is to preclude both charge-back and ultimate loss-shifting beyond the six-day/ten-day banking period after deposit.155 The depository bank that failed to charge back within its window of opportunity thus would lose any right to shift loss to the depositor of a dishonored check. Such a bank would be left either to absorb the loss or to shift it to another

151. See supra Part II.C.1–2. Such an action would resemble an action against a customer with a zero account balance. See U.C.C. § 4-214(a) (1996) (authorizing, in addition to charge-back, an action by bank “to obtain refund from its customer”).
152. See supra Part II.A.
153. See id.
154. 12 C.F.R. §§ 229.10 to .21 (2000). The date of deposit is also critical to the depository bank seeking to fall within the safe harbor of the Article 4 provision that a depository bank exercises ordinary care if it forwards a check before midnight on the day after deposit. See U.C.C. § 4-202(b), discussed at supra notes 47–49 and accompanying text.
155. For a discussion of the distinction between immediate and ultimate loss-shifting, see supra Part I.C.
bank that mishandled the check. The depository bank, for example, may have an action against a payor bank that delayed in sending notice of dishonor under either Article 4 or Regulation CC. The depository bank may also have an action against an intermediary collecting bank that delayed in handling the check or sending expeditious notice of dishonor. In cases where multiple banks mishandled the check, loss may be allocated among them.

Such a rule of ultimate loss-allocation would have obvious appeal for the depositor who would know with certainty that a deposited check could be accessed safely once the six-day/ten-day statutory period had expired. Such a rule would also serve principles of economic efficiency since banks are better able to spread loss and to avoid delay in handling the check. Moreover, enforcement costs in shifting loss would be eliminated since loss would remain with the bank, where it falls initially upon dishonor. Fairness concerns, however, are less clearly furthered by imposing ultimate loss on a bank since banks would bear losses even where their delay caused no harm. Additionally, consumers might ultimately be disadvantaged by such a rule as banks increase consumer banking costs in order to spread loss.

Alternatively, the current ultimate loss-allocation rule might be kept essentially intact with three revisions and clarifications to protect the consumer depositor. Thus, a bank would retain the right to shift ultimate loss to the customer who was not injured by banking tardiness. This rule, however, should be changed in three ways.

First, in any case of charge-back preclusion, a depository bank should be required to inform the consumer depositor in plain language of the bank’s intent to shift ultimate loss to her and of her right to resist this effort by establishing actual loss caused by delayed news of dishonor. This notice should be sent promptly, perhaps by midnight on the banking day after the bank receives notice of dishonor. The notice should clearly inform the consumer depositor that she can successfully resist the bank’s attempt to shift loss to her by establishing either: (1) a lost opportunity to collect funds from the drafter, or (2) a release of funds or irreversible commitments undertaken in reliance on a bank’s failure to charge back within the six-day/ten-day window. Under this revised rule, an informed depositor could prevail against her bank, for example, by showing that timely notice of dishonor would have allowed her to recover against the drafter of the check.

156. U.C.C. § 4-302(a)(1).
157. See 12 C.F.R. § 229.38(a). A payor bank that fails to timely return a check may be liable under Article 4 and Regulation CC, but not both. Id. § 229.38(b).
158. Regulation CC requires a returning bank to return a dishonored check expeditiously. Id. § 229.31(a). A bank that fails in this duty may be liable for resulting loss. Id. § 229.38(a).
159. Id. § 229.38(c). See, e.g., USAA Inv. Mgmt. Co. v. Fed. Reserve Bank of Boston, 906 F. Supp. 770 (D. Conn. 1995) (where check was lost for one year following dishonor, loss to be shared by depositor’s agent and depository bank—who were 40% at fault—and collecting bank).
who has since become judgment-proof. Alternatively, the customer might show that she spent funds she would not have spent had she been timely notified that a deposited check was dishonored.

Second, the informed depositor should be given a reasonable and inexpensive opportunity to claim tardiness-induced loss. The bank could provide this opportunity by sending the depositor a simple form along with notice of the dishonor and of the bank's intent to shift ultimate loss.

Third, any depositor who returned the form claiming specific tardiness-induced loss should receive an evidentiary advantage. Such a completed form should be sufficient to establish a prima facie defense to a bank's attempt to shift ultimate loss to the depositor.\textsuperscript{160}

V.

CONCLUSION

The Article 4 rule allowing a bank to charge back an unsuspecting consumer depositor's account long after deposit is unnecessary, unfair, and inefficient. Even where bank tardiness is evident, the rule blindly allows a bank to engage in a cost-free, self-help maneuver that shifts to a consumer the costly burden of initiating litigation to recapture account funds. The typical consumer who is unwilling or unable to bear this burden has no real opportunity to assert legitimate rights against a misbehaving bank, and loss thus remains where charge-back places it.

A more equitable and efficient rule would preclude charge-back in cases of evident bank tardiness. A depository bank thus would be precluded from charging back more than six to ten days after deposit, a period drawn from the expeditious return rules of Regulation CC. Once this charge-back window closes, the bank would, however, retain the right to initiate litigation, either against its depositor or another bank, to shift ultimate loss in appropriate cases. This incremental change would bring the Article 4 charge-back rule in line with the principles of reasonableness and fair play that inspire babysitters and others to trust their banks.

160. During the drafting of the Article 4 revision, the reporters considered use of an affidavit to protect the customer whose bank had paid a check contrary to her stop payment order. The provision would have required the bank to recredit the customer's account unless the customer refused to sign an affidavit setting out facts sufficient to establish a prima facie defense to payment on the check. See Rubin, supra note 122, at 750–51. Use of such an affidavit to protect consumers is not without its potential pitfalls. As Gail Hillebrand of Consumers Union observed during the Article 4 revision, consumers may be intimidated by the prospect of signing a legal document and uncomfortable about their potential involvement in legal proceedings. \textit{Id.} at 751.

Alternatively, a presumption of actual loss in the face amount of the check could arise in all cases of bank tardiness, thus placing on the bank the burden of going forward to rebut this presumption. See Appliance Buyers Credit Corp. v. Prospect Nat'l Bank of Peoria, 708 F.2d 290, 296–97 (7th Cir. 1983) (Coffey, J., dissenting).

A final possibility would be to provide attorney fees to a consumer who prevails against her bank, though such a provision might create economic inefficiencies. See Rubin, supra note 11, at 32–36, 53.
APPENDIX

Proposed Revision to U.C.C. § 4-214(a) (1996)

If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer’s account, or obtain refund from its customer, whether or not it is able to return the item, only if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts within six banking days after deposit of a local check or ten banking days after deposit of a nonlocal check. If the return or notice is delayed beyond the bank’s midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.