

HB

294

DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

240 Main Street, Suite 500
Juneau, Alaska 99801-2101

MEMORANDUM

March 23, 1992

SUBJECT: Uniform Commercial Code funds transfers bill
(CSHB 294 (L&C), Work Order No. 7-GH0001\G,
dated 3/18/92)

TO: Representative David Finkelstein
Attn: Steve

FROM: Theresa L. Bannister *TB*
Legislative Counsel

The above-mentioned bill draft contains a new chapter on funds transfers (AS 45.12), and other modifications of the UCC that are necessary to add the chapter to the UCC.

When preparing the draft, changes were made to put the material into the form normally required for Alaska statutes. However, certain approaches were left in the material to keep the material uniform with other states.

1. AS 45.12.205 was added to the funds transfer chapter; it appears in the Uniform Act, but appeared to have been inadvertently dropped from the material provided to us.
2. AS 45.12.209(b) was somewhat rewritten to make it clearer.
3. A new reference in AS 45.03.102 to AS 45.12 was deleted; although it appeared in the material provided to us, it did not appear in the Uniform Act as a change necessary to enact AS 45.12.
4. Some of the sections were rearranged to comply with our drafting style (e.g. sec. 45.14.205).
5. The word "any" was replaced with "an" or "a", or deleted, where appropriate.
6. To a limited degree, definitions were rearranged to comply with our drafting style.

Representative David Finkelstein

March 23, 1992

Page 2

7. A new term, "code", was inserted, used, and defined to refer to the expanded UCC provided in the bill.
8. The structure of a sentence was changed when a sentence used the form "No delivery is necessary" (changed to "Delivery is not necessary").
9. An applicability section was added in sec. 14 to provide some guidance for the application of the amendments and new chapter; there was no guidance on this in the uniform laws; this section should be examined in detail to determine if it handles the transition as you want it handled.
10. In sec. 7, "Notwithstanding AS 01.05.006, section headings" was added to AS 45.01.109 in order to coordinate AS 45.01.109 with the section that provides that section headings are not part of state law.
11. In AS 45.12.105(b), references to definitions in AS 45.12.103 and 45.12.104 were deleted since the terms were already defined for the chapter in those sections, which immediately precede this section.
12. Miscellaneous style changes were made.

If you wish to have the changes identified further, please advise.

You may wish to consider deleting AS 45.12.305(e) and the last sentence of AS 45.12.404(b), which authorize the award of attorney fees in certain situations. These provisions are helpful in those jurisdictions that do not routinely allow the award of attorney fees. However, Alaska Rule of Civil Procedure 82 already provides generally for the award of attorney fees to the party who prevails in a court action. If the attorney fee provisions in the bill were deleted, Rule 82 would fill in to govern the award of attorney fees in cases under AS 45.12, the bill's new chapter on funds transfers.

If I may be of further assistance, please advise.

TLB:gc:lmb:mi
92-070.lmb

Enclosure

DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101


240 Main Street, Suite 500
Juneau, Alaska 99801-2101

MEMORANDUM

April 9, 1992

SUBJECT: Amendment of court rule in draft CSHB 294 (L&C) (Work Order No. 7-GH0001\G, dated 3-18-92)

TO: Representative David Finkelstein
Attn: Steve

FROM: Theresa L. Bannister 
Legislative Counsel

You have asked for a brief memo stating the oral opinion I had provided on the extent to which AS 45.12.305(e) and 45.12.404(b) amend Alaska Rule of Civil Procedure 82, which relates to the award of attorney's fees. Essentially the issue is whether under the two subsections attorney fees are only recoverable where a demand is made and refused (therefore eliminating Rule 82 from applying at all to the situations where a demand is not made and refused), or whether the making and refusing of a demand creates a special situation in which Rule 82 does not apply (thus allowing Rule 82 to apply to the situations where a demand is not made and refused). It is my conclusion that the language in both subsections is unclear on this point and may be read either way. Therefore, I would recommend that the language of the subsections be rewritten to clearly state the approach that the committee chooses. If the committee does not want to rewrite the language because this is a uniform act, the committee may wish to consider providing the bill with a letter of intent on this point. Please remember, though, that although courts do give some consideration to letters of intent when interpreting statutes, letters of intent are not binding and the statute itself should state its intent clearly.

If I may be of further assistance, please advise.

TLB:pl
92-255.plm

FISCAL NOTE

STATE OF ALASKA
1992 LEGISLATIVE SESSION

BILL NO. HB 294

Revision Date: _____

Department Affected: Commerce & Econ. Dev.

Title: Personal property under the Uniform
Commercial Code

BRU: Banking, Securities & Corporations

Component: _____

Sponsor: Rules Committee

Requestor: House Labor & Commerce

COMPONENT SERIAL NO.

1	2	3	3
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EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE FUND RESOURCE:	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER FUND SOURCE:						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

Estimate of current year Impact: None

ANALYSIS (Attach a separate page if necessary.)

Prepared By: Willis F. Kirkpatrick, Director *Willis* Phone: 465-2521

Division: Banking, Securities & Corporations Date: 4/9/92

Approved by Commissioner: Glenn A. Olds *Glenn A. Olds* *Don Coma*

Agency: Department of Commerce & Economic Development Date: 4.9.92

Distribution (by preparer): Leg. Fin., Legislative Sponsor, Requestor, OMB/DBR, Gov. Legls. Ofc., and Impacted Agency(ies).

HOUSE COMMITTEE REPORT

(7)
 Date Referred: April 10, 1992 FURTHER REFERRALS: Finance

Date of Committee Action: 5/4/92

The JUDICIARY Committee considered: HB 294

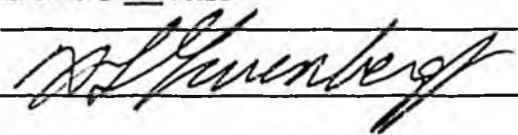
HOUSE BILL NO. 294 UCC: LEASES OF PERSONAL PROPERTY

"An Act relating to leases of personal property under the Uniform Commercial Code."

RECOMMENDATIONS:
 be replaced with CS HB 294 (JUD) the same title
 a new title
 have attached amendments(s)
 do pass
 do not pass
 no recommendations
 individual recommendations
 additional referral to the ~~the~~ _____ Committee

ADOPTS: House L&C Committee letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept) APPROVES PREVIOUS: (Dept/Date)
 fiscal impact _____ fiscal note(s) _____
 zero fiscal note _____ zero fiscal note(s) Commerce 4-10-92

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	DNP	NR	AM
		Dan Donley		✓	
		Kevin J. Donnell		✓	
		Mike Hill		✓	
		Terry Marshall		✓	


 CHAIRMAN'S SIGNATURE

CSHB 294 (Labor & Commerce)
HOUSE LABOR AND COMMERCE COMMITTEE
LETTER OF INTENT

It is the intent and understanding of House Labor and Commerce Committee that the reasonable attorney's fees provisions in proposed Sections 45.12.305(e) and 45.12.404(b) are to operate in addition to, but do not replace or preempt, the operation of Rule 82 of the Alaska Rules of Civil Procedure.



Rep. David Finkelstein

FISCAL NOTE

No. 4
 Bill Version: CSHB 294(L&C)
 (H) Publish Date: 4-10-92

STATE OF ALASKA
 1992 LEGISLATIVE SESSION

Revision Date: _____

Department Affected: Commerce & Econ. Dev.

Title: Personal property under the Uniform
Commercial Code

BRU: Banking, Securities & Corporations

Component: _____

Sponsor: Rules Committee

Requestor: House Labor & Commerce

COMPONENT SERIAL NO.

1	2	3	3
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EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE FUND RESOURCE:	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER FUND SOURCE:						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

Estimate of current year impact: None

ANALYSIS (Attach a separate page if necessary.)

Prepared By: Willis F. Kirkpatrick, Director Phone: 465-2521

Division: Banking, Securities & Corporations Date: 4/9/92

Approved by Commissioner: Glenn A. Olds _____

Agency: Department of Commerce & Economic Development Date: 4.9.92

Distribution (by preparer): Leg. Fin., Legislative Sponsor, Requestor, OMB/DBR, Gov. Legis. Ofc., and Impacted Agency(ies).

FISCAL NOTE

No. 3

Bill Version: HB 294

(H) Publish Date: 4/22/91

STATE OF ALASKA
1991 LEGISLATIVE SESSION

Revision Date: _____ Department Affected: Natural Resources

Title: Personal Property Leases / UCC BRU: Administration and Management

Component: Recorder's Office and UCC

Sponsor: Rules (Gov)

Requestor: Governor

COMPONENT SERIAL NO.

	8	0	2
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
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REVENUE	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: 0

ANALYSIS: (Attach a separate page if necessary.)

Prepared By: Carol Wilson Phone: 465-2400

Division: Commissioner's Office Date: 3/25/91

Approved by Commissioner: _____ Date: 3-26-91

Agency: Department of Natural Resources

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

FISCAL NOTE

No. 2

STATE OF ALASKA
1991 LEGISLATIVE SESSION

Bill Version: HB 294

(H) Publish Date: 4/22/91

Revision Date: _____
Title: Personal property under the
Uniform Commercial Code

Department Affected: Commerce & Economic Dev.
BRU: Banking, Securities & Corporations
Component: _____

Sponsor: Rules Committee
Requestor: Governor

COMPONENT SERIAL NO.	1	2	3	3
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary.)

Prepared By: Willis F. Kirkpatrick, Director Phone: 465-2521

Division: Banking, Securities & Corporations Date: _____

Approved by Commissioner: Glenn A. Olds *Glenn A. Olds* Asst. Comm.

Agency: Department of Commerce & Economic Development Date: 3-20-91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

FISCAL NOTE

No. 1

Bill Version: HB 294

(H) Publish Date: 4/22/91

STATE OF ALASKA
1991 LEGISLATIVE SESSION

Revision Date: _____ Department Affected: Administration

Title: Leases of Personal Property BRU: General Services

Under the Uniform Commercial Code Component: Purchasing

Sponsor: Governor

Requestor: _____ COMPONENT SERIAL NO.

6	0		
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	-0-	-0-	-0-	-0-	-0-	-0-
TRAVEL	-0-	-0-	-0-	-0-	-0-	-0-
CONTRACTUAL	-0-	-0-	-0-	-0-	-0-	-0-
SUPPLIES	-0-	-0-	-0-	-0-	-0-	-0-
EQUIPMENT	-0-	-0-	-0-	-0-	-0-	-0-
LAND & STRUCTURES	-0-	-0-	-0-	-0-	-0-	-0-
GRANTS, CLAIMS	-0-	-0-	-0-	-0-	-0-	-0-
MISCELLANEOUS	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
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REVENUE	-0-	-0-	-0-	-0-	-0-	-0-
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FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS	-0-	-0-	-0-	-0-	-0-	-0-
OTHER	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME	-0-	-0-	-0-	-0-	-0-	-0-
TEMPORARY	-0-	-0-	-0-	-0-	-0-	-0-

Estimate of current year impact: -0-

ANALYSIS: (Attach a separate page if necessary.)

This bill should have no impact on purchasing activities.

Prepared By: Robert J. Link Phone: 465-2250

Division: General Services Date: March 22, 1991

Approved by Commissioner: Milton Koller

Agency: Administration Date: 3/22/91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

(7) Date Referred: April 22, 1991

FURTHER REFERRALS:

Judiciary
Finance

Date of Committee Action: 4/9/92

The LABOR AND COMMERCE Committee considered:

HB 294

HOUSE BILL NO. 294

UCC: LEASES OF PERSONAL PROPERTY

An Act relating to leases of personal property under the Uniform Commercial Code."

RECOMMENDATIONS:
be replaced with C S H B 294 (L+C) the same title
 a new title

- have attached amendments(s)
- do pass
- do not pass
- no recommendations
- individual recommendations
- additional referral to the _____ Committee

ADOPTS: House Labor + Comm. letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept) APPROVES PREVIOUS: (Dept/Date)

fiscal impact: _____ fiscal note(s) _____

zero fiscal note D.C.E.D. zero fiscal note(s) _____

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	DNP	NR	AM
<i>Allen L. Taylor</i>	<input checked="" type="checkbox"/>				
<i>[Signature] (BRUCKMAN)</i>	<input type="checkbox"/>	<i>[Signature] (IVAN)</i>		<input checked="" type="checkbox"/>	
<i>[Signature] (Finkelstein)</i>	<input checked="" type="checkbox"/>				

[Signature]
CHAIRMAN'S SIGNATURE

CSHB 294 (Labor & Commerce)

LETTER OF INTENT

It is the intent and understanding of House Labor and Commerce Committee that the reasonable attorney's fees provided by proposed Sections 45.12.305(e) and 45.12.404(b) are additional to, but do not replace or preempt, the operation of Rule 82 of the Alaska Rules of Civil Procedure.

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 link in the string of links, 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.

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.

A Few Facts About
New Article 4A of the Uniform Commercial Code
— Funds Transfers —

Purpose: To provide a comprehensive body of law on the rights and obligations connected with funds transfers.

Origin: Completed by the Uniform Law Commissioners in 1989.

Endorsed by: American Law Institute
American Bankers Association
American Bar Association

State Adoptions:

Arizona *	Montana *
Arkansas *	Nebraska *
California	Nevada *
Colorado	New York
Connecticut	North Dakota *
Florida *	Ohio *
Hawaii *	Oklahoma
Idaho *	Oregon *
Illinois	Rhode Island *
Indiana *	South Dakota *
Kansas	Tennessee *
Louisiana	Utah
Maryland *	Virginia
Massachusetts *	Washington *
Minnesota	West Virginia
Mississippi *	Wyoming *

1991 Introductions:

District of Columbia	New Jersey
Georgia	New Mexico
Iowa	Pennsylvania
Michigan	Texas
Missouri	Vermont

For any further information regarding Article 4A of the Uniform Commercial Code, please contact John McCabe or Katie Robinson at 312-915-0195.

* 1991 Adoption

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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 \$800 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 now 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."

Early Warning

ONE OF THE BEST and worst aspects of the law is the speed with which it changes. A slow, deliberate pace of legislative enactments produces the most error-free laws. And the doctrine of *stare decisis* — by which courts generally adhere to decided cases — helps to guarantee stability in the law.

But none of this is helpful in confronting the megaleaps of today's technology, and nowhere is this more apparent than in computers, banking and high finance.

In an era when trillions of dollars move across state and international borders in electronic blips, the law has failed to keep pace. Eventually mistakes, even big ones that could cause banks to fail, are bound to occur. There is currently no comprehensive body of law that will help lawyers and the courts unscramble the ensuing mess. As one bank lawyer noted, "When you look at the amount of money moving, it's striking that there are no backstop rules. People are transferring the net worth of their companies routinely and relying on private agreements with their banks, or no agreements at all."

For the past 3½ years, one group — the Uniform Law Commissioners — has been drafting a model law that tries to apportion risks and liability fairly when problems arise in these multibillion-dollar wire transfers. The ULC, bringing to the process its unique approach to building consensus, apparently has succeeded in gathering together such disparate interests as the nation's banking community, corporate users and the federal government.

But the ULC's effort is just the first step toward bringing the law into the 21st century of finance. The real challenge rests with the states. If fairness and certainty — the two primary goals of the model law — are to govern, the states must move quickly to enact this model legislation. For the entire legal profession — from bar groups to legislators — the ULC effort should serve as one more lesson on the need for early warning systems to detect and confront changes in the law mandated by rapidly changing technology.

Business and the Law

Stephen Labaton

States to Regulate Money Transfers

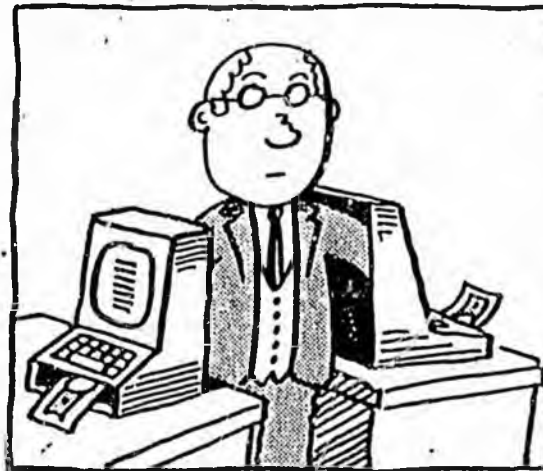
THE sweeping set of regulations for commercial transactions is about to get the most significant addition in decades.

The Uniform Commercial Code is the law in all states except Louisiana and governs everything from checks to the sale of all goods of more than \$500. Despite its broad scope, the Code has failed to keep pace with technology: It does not address the electronic transfer of money among banks, a process that has grown in recent times more than 20 percent a year.

But that is about to change. Within the coming months, a new chapter is expected to be adopted by several large states that will for the first time regulate the computerized transfer of funds between banks. Businesses and banks now move more than \$1 trillion a day electronically without any clear guidelines about what happens if someone goes wrong. The average transfer is \$5 million.

As a practical matter, the courts have tended to define the liabilities and rights of businesses who use the system in terms of contract law. Yet lawyers and banks say only a small percentage of those businesses have signed any contracts with the banks or other businesses on the transfer of funds.

In a typical transfer, the computer of a corporate customer notifies the computer of a bank, which then forwards the information about the transfer to a clearinghouse's computer. It, in turn, notifies the computer of the receiving bank to credit the account of the intended beneficiary of the funds.



Stuart Goldenberg

While the clearinghouses have their own sets of rules, no established laws govern the relationship between the sender and receiver of money. As a result, it is left uncertain who bears the loss for a glitch in the system, a mistake in the transaction, an unauthorized transfer or the meddling of a computer hacker. In many of the dozens of cases that have cropped up, courts have had to draw imprecise analogies to other provisions of the code that do not directly speak to the issue of computer transfers.

A four-year effort to draft the new chapter, known as Article 4A, has recently been completed and legislators say it will soon be introduced in New York, California, Massachusetts, Connecticut, Virginia and West Virginia. With the support of the American Bankers Association and the expected approval soon of the American Bar Association, some legislators in New York and California say the chapter will likely be approved by the summer.

"It will bring a substantial amount of certainty to these kinds of transactions," said Carlyle C. Ring Jr., a co-chairman of the committee that wrote the new rules. "No one really knew in the event of a mishap what would happen. And since such a large amount of money is being transmitted, there is a substantial incentive to litigate these issues."

The draft was completed by the National Conference of Commissioners on Uniform State Laws, the organization that drafted the code more than 30 years ago. The nonprofit organization consists of lawyers, judges and academics, many of whom are selected as commissioners by state governors.

Like the other sections of the code, Article 4A will operate as a safety net. It will enable the banks and businesses in most instances to write contracts that differ from the Code. It would generally be applicable in those instances in which there are no contracts or when the contracts are ambiguous.

By adopting Article 4A, the states will enter an area of regulation in which the Treasury Department has also announced its intention to intervene. Earlier this year, the Bush Administration said that to combat the use of the electronic transferring system to launder money to avoid taxes and evade narcotics laws, Treasury regulations would be adopted to make it easier to trace the flow of money through the banking system.

One rule will require that the banks that send and receive transfers keep records, including the name and account of the customer transmitting and receiving the funds. Another rule would require that financial institutions receive more information about the nature of the business of a customer who makes use of international transfers. The Treasury guidelines, which do not appear to pre-empt any move by the states, are expected to go into effect this spring.

Sending Large Dollars U.C.C. Article 4A to Provide Safety Net

Funds transferred by check amount to millions and millions of dollars each year. The legal rules for the check system, although recently somewhat shaken up by federal legislation and regulation CC, basically are well established. Funds transferred by electronic means, including FedWire (operated by the Federal Reserve System) and CHIPS (a funds transfer system operated by the New York Clearing House), often exceed \$2 trillion a day. Yet any resulting problems are resolved only to a limited extent by regulation J for FedWire, a few published cases, the Electronic Funds Transfer Act and regulation E for some consumer aspects, and in some cases by the agreements of the parties. In short, the transfers involving the really large dollars, and the most risk if the transfer goes awry, have the least settled guidelines for conduct and for resolving disputes. Uniform Commercial Code article 4A, the U.C.C.'s newest, will fill this void.

As part of the U.C.C., article 4A is the product of the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and the American Law Institute ("ALI"). The drafting committee also was assisted by two Reporters, whose role was to advise the members of the drafting committee as to the pertinent legal issues and what law exists to resolve those issues, and to embody the decisions of the drafting committee in proper statutory form with comments to elaborate on the meaning of the statute. In addition, a number of advisers from the Federal Reserve System, the banking industry, and the businesses that use funds transfers (including banks) worked with the drafting committee. The American Bar Association also appointed an adviser to the drafting committee from the Business Law Section, and members of the Section's Ad Hoc Committee on Payment Systems and its U.C.C. Committee scrutinized and commented on drafts prepared by the drafting committee.

Preparation of article 4A took almost three years. The new article was approved by the ALI at its annual meeting in May 1989 and by NCCUSL at its annual meeting in July-August 1989. Final approval by the ALI is anticipated in December at the latest.

The Council of the Business Law Sec-

tion has tentatively decided to recommend ABA approval of article 4A when requested by NCCUSL and the ALI. Thus article 4A is ready for enactment by the state legislatures. A number of key commercial states are expected to introduce it soon. Expeditious enactment is contemplated because of the recognized need for greater legal certainty in the governing rules, the general support for article 4A by the interests involved in funds transfers, and the expressed concern of the Federal Reserve System that, unless the states address the significant issues involved in these types of transfers, federal law may become necessary to avoid unacceptable risks to the payment system.

Funds transfers under article 4A

Article 4A creates a series of rules to govern the resolution of legal issues that may arise out of funds transfers. The effect of these rules, like most of those in the U.C.C., may be varied by the agreements of the parties and operating rules of a funds transfer system, with some specific exceptions necessary to protect fundamental policy choices that should not be subject to variance due to fortuitous circumstances of a particular bargain (U.C.C. § 4A-501; *see also* § 4A-107). The ability to vary the effect of the statutory rules allows flexibility and development of new methods, but at the same time, the statutory rules stand as a "safety net" to resolve matters upon which the parties either do not or cannot agree.

Under article 4A, a "funds transfer" (§ 4A-104(1)) is the payment order (§ 4A-103(1)) or series of payment orders by which an originator (§ 4A-104(2)) accomplishes payment to the beneficiary (§ 4A-103(6)) of the originator's order. It can be a very simple transaction in which a corporate originator orders its bank to debit one of its accounts and credit an account of another party at the same bank. In this instance the funds transfer and the payment order are co-extensive. If the originator instructs its bank ("originator's bank"—§ 4A-104(3)) to pay a beneficiary that is a customer of another bank, however, that payment order will require the originator's bank, in turn, to issue at least another payment order, perhaps to the beneficiary's bank directly, perhaps over

a funds transfer system like FedWire or CHIPS (§ 4A-105(1)(e)), or perhaps to an intermediary bank (§ 4A-104)) that will then issue another order to the beneficiary's bank (§ 4A-103(7)).

Payment orders, unlike checks, do not embody independent rights and liabilities for the payment of money. Rather, the rights and liabilities of the parties to a payment order arise out of the contract formed, generally subject to article 4A and any agreement of the parties, when the payment order is accepted by the receiving bank (§ 4A-103(5)). Apart from contract outside article 4A, a bank has no duty under article 4A to accept a payment order (§ 4A-209). A receiving bank other than the beneficiary's bank accepts a payment order if it executes it (§ 4A-209(1)), and need not reject those orders it does not accept, unless otherwise provided by agreement or the receiving bank had sufficient funds of the sender on hand to cover the order (§§ 4A-210(2), 4A-212).

A receiving bank that accepts a payment order and that is not the beneficiary's bank is obliged to issue a payment order complying with the order of the sender (§ 4A-103(4)) that it accepted and generally to follow any instructions as to routing and method (§ 4A-302). If the resulting payment order does not comply, the sender is not responsible for the error and need not pay the bank other than to the extent of proper execution (§ 4A-303) but, upon learning of improper execution, may have a duty to notify the bank of that fact (§ 4A-304). Indeed, if a funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary in accordance with the sender's order, the sender is not obligated to pay for its order, or is entitled to its money back (§ 4A-402(3), (4)).

A beneficiary's bank may accept a payment order in a variety of ways, such as by paying or notifying the beneficiary, and acceptance also may occur when the bank receives payment of the sender's order (§ 4A-403) or by the passage of time if the amount of the sender's order is fully covered by a withdrawable credit balance (§ 4A-209(2)). Acceptance of the order entitles the bank to payment by the sender (§ 4A-402(2)) and generally obliges it to pay the amount of the order to the beneficiary (§§ 4A-404, 4A-405). Failure to do so and to give notice of the receipt of the order may subject the bank to liability. If the beneficiary's bank ac-

cepts the order, generally at this point the debt of the originator to the beneficiary for which the order was issued is discharged (§ 4A-406).

Scope of article 4A

A payment order can be oral, in writing, or electronic. Like a check, a payment order is an unconditional (except as to timing) instruction to pay a fixed or determinable amount of money to a beneficiary (§ 4A-103(1)). However, a check is not a payment order because a payment order must be transmitted by the sender, not to the payee, but directly to the receiving bank or to an agent, funds transfer system, or communication system for transmittal to the receiving bank

part of which is governed by the Electronic Funds Transfer Act and its implementing regulation E, which protect consumer rights, is excluded from article 4A to avoid conflicting rules (§ 4A-108). However, a consumer purpose transfer over FedWire, for example, outside of the scope of the federal law could be subject to article 4A.

Salient aspects of article 4A

Three matters in particular are presently a source of litigation concerning funds transfers. These are: responsibility for unauthorized and erroneous orders, liability for damages caused by orders that are improperly executed, and finality of payment. For discussions of the litiga-

it, and the bank complied with any instructions of the customer as to a proper account to debit and the like, even an unauthorized order will be effective (§ 4A-202). There is one exception. Even if the order passed an appropriate security procedure, the customer will not bear the loss if the customer proves the order is not attributable to any cause related to the customer's operation (the interloper situation) (§ 4A-203). However, the customer may lose interest owed on any refundable amounts if it does not use ordinary care to detect any unauthorized orders and notify the bank (§ 4A-204).

Payment orders erroneous as to beneficiary, bank, time, amount, or duplicate orders caused by the sender are the sender's responsibility (§ 4A-303). However, such orders only bind the sender as to the intended beneficiary and amount if a security procedure for the detection of error was in effect and the sender complied with it but the bank did not (§ 4A-201). However, again the sender has a duty of ordinary care to discover and report an error (§ 4A-205). A funds transfer or third party communications system to which an order is first transmitted is the agent of the sender; any error made by it is attributed to the sender (§ 4A-206).

Often in fraud schemes or because of mistake, a payment order will identify the beneficiary both by account number and by name, each referring to a different person. Under section 4A-207(2)(a) and (3), the beneficiary's bank is entitled to pay the account if it does not know of the discrepancy and the originator is a bank, or if a nonbank originator received notice that payment might be made by account number even if a name was given. If the bank pays the person identified by name or knows of the discrepancy (§ 4A-402(3)), no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to payment from the originator. If no person has rights as a beneficiary, acceptance of the order cannot occur (§ 4A-207(2)(b)). If the person paid is not a correct payee, the money back guaranty applies (§ 4A-402(3)). Article 4A also contains provisions resolving situations where the beneficiary's bank or an intermediary bank is misdescribed instead of the beneficiary (§ 4A-208), and governing cancellation (stop payment) and amendment of payment orders (§ 4A-211).

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V I D E O S E M I N A R

Our Section will co-sponsor with the ABA Division for Professional Education "Fundamentals of Asset-Based Financing," to be broadcast via satellite to more than 50 locations nationwide on February 15, 1990, from noon to 4:00 p.m. EST.

Focusing on the basics of asset-based lending, the program will examine the loan from preliminary investigation through closing, including: preparation of loan documents; various types of collateral; guaranties, letters of credit, and debt subordination agreements; relationships between lenders; and usury and regulatory acts.

The program chair is Maury B. Poscover, chair of the Committee on Commercial Financial Services. Other faculty members will include Howard Ruda, Donald Rapson, and E. Carolan Berkley. Registrants at all viewing locations will be able to question the panelists.

The registration fee, which includes study materials, is \$135 (\$85 for government employees, \$65 for law students). To register or to obtain further information, readers should contact Theresa Kittridge, ABA Satellite Seminars, at (800) 621-8986 (outside Illinois) or (312) 988-6200 (within Illinois).

(§ 4A-103(1)(c)). For the same reason, the concept of payment order excludes payment by credit card.

Because payment orders must involve banks (§ 4A-105(1)(b)), funds transfers made by Western Union and the like are excluded; they are sufficiently different from the large, commercial transfers that are the subject of article 4A as to make it inadvisable to employ the same rules. Credit transfers through Automated Clearing Houses ("ACH") are included under article 4A, but ACH debit transfers are excluded, again for the reason they involve sufficiently different considerations (§ 4A-103(1)(b)). Finally, a funds transfer any

tion, see the U.C.C. annual surveys at 35 Bus. Law 1129 (1980); 38 Bus. Law. 1130 (1983); 39 Bus. Law 1333 (1984); 41 Bus. Law. 1412 (1986); and 42 Bus. Law. 1291 (1987). Article 4A addresses each of these problem areas.

An authorized payment order may be properly executed by the receiving bank and binds the person identified as the sender. The order may be expressly or impliedly authorized, or the sender may be bound by apparent authority. If the order is not authorized, the bank will have acted improperly in executing the order. However, if a commercially reasonable security procedure (§ 4A-201) was in place, the payment order cleared

Sending Large Dollars

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A funds transfer is used instead of a cashier's or similar check because it is fast and cheap. However, because of the large amounts involved, there is considerable risk if something goes awry; if the banks transmitting the orders had to bear the risk of improper or late execution, funds transfers would cease to be either fast or cheap. Accordingly, absent a contrary agreement, section 4A-305 generally relieves a bank from potential liability for consequential damages because of improper or late execution or the failure to execute a payment order, and provides that for delay, noncompletion, or failure to follow instructions (including the order itself), a bank is liable only for interest losses and expenses, as applicable. Reasonable attorney's fees also are recoverable if a justified demand for compensation is made and refused (§ 4A-305(5)).

Acceptance of a payment order by the beneficiary's bank generally obliges it to pay the amount of the order to the beneficiary (§ 4A-404(1)). However, in some cases the bank itself may not receive settlement for the order. In such event,

the obligation of payment and payment are still final as to the beneficiary and any attempt to make it conditional by agreement is ineffective, unless (1) a rule of a funds transfer system used in the funds transfer provides for provisional payment and this rule is accepted by the affected parties after notice before initiation of a transfer, or (2) the order was transmitted over a funds transfer system that has a loss-sharing agreement among participants and nonetheless the system fails to complete settlement under its rules with respect to any payment order in the funds transfer (the "doomsday scenario") (§ 4A-405(3)-(5)).

Conclusion

Article 4A contains a variety of other provisions governing creditor process served on a receiving bank and set-off by the beneficiary's bank (§ 4A-5032); injunctions prohibiting funds transfers (§ 4A-503); preclusion against a customer contesting a payment order made by its bank (§ 4A-505); and the amount of interest payable (§ 4A-506). In addition, section 4A-507 contains rules on choice of law that seek to maximize the certainty of the law governing funds trans-

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fers. Indeed, that is the goal of all of article 4A, and its rapid and uniform enactment is necessary to achieve that goal under state law.

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