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FUNDS TRANSFERS UNDER UCC

Senate Bill 458 (Substitute H-1)
First Analysis (3-5-92)

Sponsor: Sen. Dave Honigman
Senate Committee: Corporations & Economic Development
House Committee: Corporations & Finance

THE APPARENT PROBLEM:

According to information provided by the National Conference of Commissioners on Uniform State Laws, there currently is no comprehensive body of law that defines the rights and obligations that arise from wire transfers conducted over electronic funds transfer systems. Some aspects of such transfers are governed by rules of the principal transfer systems. For example, transfers made by FedWire are governed by Federal Reserve Regulation J, and transfers over Clearing House Interbank Payments Systems (CHIPS), which is operated by the New York Clearing House, are governed by CHIPS rules. These rules, however, apply only to limited aspects of wire transfer transactions. Outside of FedWire and CHIPS, common law contract rules apparently are the basis for determining and apportioning the liabilities of the various parties to a wire transfer. Serviceable, negotiated contracts, however, reportedly are rare. Bank customers usually need a funds transfer immediately and do not take the time to negotiate a contract. Transfers, thus, are frequently made in a legal void. This can be particularly problematic since, according to the uniform law commissioners, in 1989 about $1 trillion was transferred over the electronic funds transfer system on an average day, and on a record day that year $3 trillion was transferred--roughly the 1989 gross national product of the United States. It has been suggested, therefore, that provisions be added to the Uniform Commercial Code to regulate funds transfers, assess liability in such transactions, and provide remedies.

THE CONTENT OF THE BILL:

The bill would add Article 4a to the Uniform Commercial Code to regulate what are commonly referred to as wire fund transfers. The bill would provide for the rights and obligations of the sender, beneficiary, and banks and other parties to a funds transfer, and the procedures to follow when transactions went awry and damages and interest had to be paid.

Subject Matter and Definitions. Part 1 contains definitions for various terms and refers to Article 1 of the code for other definitions of terms used throughout the bill. Further, Part 1 specifies that:
* regulations of the board of governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks would supersede any inconsistent provision of the bill to the extent of the inconsistency;
* the bill would not apply to a funds transfer of which any part was governed by the Electronic Fund Transfer Act;
* the time of receipt of a payment order or communication canceling or amending a payment order would be determined by the rules applicable to receipt of notices about transactions, as provided in the act;
* a receiving bank could fix cutoff times on a funds-transfer business day of the receipt and processing of payment orders and communications canceling or amending payment orders.

Issue and Acceptance of Payment Order. The bill specifies that a payment order received by the receiving bank would be the authorized order of the person identified as sender if that person authorized the order or were otherwise bound by it under the law of agency. If a bank and its customer agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender would be verified pursuant to a security procedure, a payment order received by the receiving bank would be effective as the order of the customer, whether or not authorized, if the security procedure were a commercially reasonable method of providing security against unauthorized payment orders, and the bank proved that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the customer's name.

"Security procedure" would mean a procedure established by agreement of a customer and a receiving bank for the purpose of verifying that a payment order or communication amending or canceling a payment order was that of the customer, or detecting error in the transmission of the content of the payment order or communication. A security procedure would be deemed to be commercially reasonable if it were chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer.

The bill specifies what the rights and responsibilities of the sender and the receiving bank would be if an accepted payment order were transmitted pursuant to a security procedure for the detection of error and the order erroneously instructed payment to a beneficiary not intended by the sender or in an amount greater than the amount intended, or erroneously transmitted a duplicate of a payment order previously sent by the sender. The bill also provides that if a payment order addressed to a receiving bank were transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system would be deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. This would not apply to a funds-transfer system of the federal reserve banks.

If a payment order identified an intermediary bank or the beneficiary's bank only by a number, the receiving bank could rely on the number as proper identification and the sender would have to compensate the receiving bank for any loss and expenses incurred as a result of its reliance on the number in executing or attempting to execute the order. The bill specifies the conditions under which a bank could rely on a number or name as proper identification if the intermediary or beneficiary's bank or the beneficiary were identified by a name and number and the name and number identified different persons.

The bill specifies that a receiving bank, other than the beneficiary's bank, would accept a payment order when it executed the order, and specifies the time at which a beneficiary's bank would be considered to have accepted a payment order, depending on which set of circumstances occurred first. Additionally, the bill provides that a payment order issued to the originator's bank could not be accepted until the payment date if the bank were the beneficiary's bank, or the execution date if the bank were not the beneficiary's bank.

The bill specifies the conditions under which a payment order could be rejected, canceled, or amended. Acceptance of a payment order would preclude a later rejection of the order and rejection would preclude later acceptance. A payment order would not be revoked by the death or legal incapacity of the sender unless the receiving bank knew of the death or of an adjudication of incapacity by a court of competent jurisdiction and had reasonable opportunity to act before acceptance of the order.

If a receiving bank failed to accept a payment order that it was obligated by express agreement to accept, the bank would be liable for breach of the agreement to the extent provided in the agreement or the bill, but otherwise would not have any duty to accept a payment order or, before acceptance, take any action, or refrain from taking action, with respect to the order except as provided in the bill or by express agreement. Liability based on acceptance would arise only when acceptance occurred and would be limited to that provided in the bill.

<u>Execution of Sender's Payment Order by Receiving Bank</u>. The bill specifies that a payment order would be executed by the receiving bank when it issued a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank could be accepted but not executed. Generally, if a receiving bank accepted a payment order, the bank would have to:
* issue, on the execution date, a payment order complying with the sender's order and follow the sender's instructions concerning any intermediary bank or funds-transfer system to be used in carrying out the transfer, or the means by which payment orders were to be transmitted in the transfer. "Execution date" would mean the day on which the receiving bank properly could issue a payment order in execution of the sender's order.

* transmit its payment order by the most expeditious available means, and instruct any intermediary bank accordingly, if the sender's instructions requested that the transfer be carried out telephonically, by wire transfer, or by the most expeditious means.

Unless otherwise instructed, a receiving bank could use any funds-transfer system that was reasonable under the circumstances and issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order could be expeditiously issued to the beneficiary's bank if the receiving bank exercised ordinary care in selecting the intermediary bank. Further, the bank could execute a payment order by first-class mail or any means reasonable under the circumstances. Unless instructed by the sender, however, the receiving bank could not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and could not instruct a subsequent receiving bank to obtain payment in the same manner.

A receiving bank that executed a payment order of a sender by issuing an order greater than the sender's order, or issuing a duplicate order, would be entitled to payment of the amount of the sender's order if other requirements in the bill concerning the sender's payment obligations were met. If the bank issued a payment order that was less than the sender's order, the bank would be entitled to payment of the amount of the sender's order if other requirements of the bill were met and the bank issued an additional payment order for the beneficiary of the sender's order. If the bank issued a payment order to the wrong beneficiary and the funds transfer were completed on the basis of that error, neither the sender of the payment order that was erroneously executed nor any previous senders in the funds transfer would be obliged to pay the payment orders they issued. The bill also specifies the conditions concerning funds transfers under which a receiving bank would be obligated to pay interest, damages, and reasonable attorney's fees, and cover transaction and incidental expenses of the sender and originator and interest losses.

Payment. Acceptance of a payment order by the beneficiary's bank would obligate the sender to pay the bank the amount of the order, but payment would not be due until the day the amount of the order was payable to the beneficiary by the beneficiary's bank, i.e., the "payment date". If a payment order were made to a bank other than the beneficiary's bank, the sender would not have to make the payment until the execution date of the sender's order. If a sender were not obligated to pay all or part of the amount he or she paid for a payment order, the bank would have to refund the amount of the overpayment. The right of a sender to be excused from having to pay the order or from receiving a refund could not be varied by agreement.

Payment of a sender's obligation would occur when final settlement of the obligation was received through a federal reserve bank or a funds-transfer system, the credit was withdrawn or withdrawable and the receiving bank was notified, the sender's account was debited, the settlement was complete under the rules of a "funds-transfer system that nets obligations multilaterally among participants", or applicable principles of law concerning payment of obligations were satisfied, depending on the situation.

The bill includes similar provisions concerning the terms and conditions under which a beneficiary's bank that accepted a payment order would be required to pay the amount to the beneficiary, the beneficiary's right to receive payment and damages, and the beneficiary's obligation to make refund to his or her bank under certain conditions.

Miscellaneous Provisions. The bill provides that the rights and obligations of a party to a funds transfer could be varied by agreement of the affected party, except as otherwise provided by the bill. The bill specifies the conditions under which the creditor process would apply. "Creditor process" would mean levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

For proper cause and in compliance with applicable law, a court could restrain a person from issuing a payment order to initiate a funds transfer, an originator's bank from executing the payment order of the originator, or the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. A court could not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a funds transfer.

The bill specifies that the amount of interest a receiving bank would have to pay, if it had to pay interest, could be determined by agreement of the sender and the receiving bank, a funds-transfer rule, or a formula provided in the bill.

The bill describes the method that would be used to determine how the rights and obligations of the affected parties would be governed.

MCL 440.1105 et al.

HOUSE COMMITTEE ACTION:

The House Corporations and Finance Committee adopted Substitute H-1, which makes various technical changes to the Senate-passed version of the bill. (3-4-92)

FISCAL IMPLICATIONS:

According to the Senate Fiscal Agency, the bill would not affect state or local budget expenditures. (2-19-92)

ARGUMENTS:

For:

The bill would add much needed language to the Uniform Commercial Code to regulate wire transfers. Currently, many users of wire transfers depend on court cases or their own rules to apportion liability and resolve disputes, thus causing uncertainty and inconsistency in the way such problems are handled. The bill would provide a comprehensive, consistent body of law that would define the rights and obligations that arise from wire transfers.

POSITIONS:

The Michigan Bankers Association supports the bill. (3-4-92)

The Michigan League of Savings Institutions supports the bill. (3-4-92)

The Michigan Credit Union League supports the bill. (3-4-92)