



1987

Bank's Right to Charge-Back in New York: A Brief Look at § 4-212

Richard E. Weiner

Follow this and additional works at: <https://digitalcommons.tourolaw.edu/lawreview>



Part of the [Banking and Finance Law Commons](#), and the [Commercial Law Commons](#)

Recommended Citation

Weiner, Richard E. (1987) "Bank's Right to Charge-Back in New York: A Brief Look at § 4-212," *Touro Law Review*. Vol. 4: No. 1, Article 5.

Available at: <https://digitalcommons.tourolaw.edu/lawreview/vol4/iss1/5>

This Article is brought to you for free and open access by Digital Commons @ Touro Law Center. It has been accepted for inclusion in Touro Law Review by an authorized editor of Digital Commons @ Touro Law Center. For more information, please contact lross@tourolaw.edu.

BANK'S RIGHT TO CHARGE-BACK IN NEW YORK: A BRIEF LOOK AT § 4-212

Richard E. Weiner*

INTRODUCTION

In the banking industry in New York and throughout the United States, a bank which accepts a check deposited by one of its customers generally sends it to the payor bank for collection. Within a few days, the funds owed to the customer, which are evidenced by the amount of indebtedness signified on the face of the check, are transferred to the bank. In some instances, however, the check is returned to the bank unpaid. In such an event, the bank may attempt to "charge-back," or retrieve the amount of funds which it originally credited to its customer's account.¹

Courts which have considered the question of how long a period of time the bank may have to charge-back its customer's account have sought judicial guidance from the New York Uniform Commercial Code.² Section 4-212(1) of the New York Uniform Commercial Code, which deals with a bank's right to charge-back, provides that a bank may charge-back a customer's account or obtain a refund from him for any amount which it has credited to his account if it does so within a certain period of time after it receives word that the amount which it credited to his account will be dishonored by the payor bank. The right of the bank to charge-back the account or obtain a refund terminates immediately upon the payment in full by the payor bank of the amount credited to the customer's account.³

* Associate, Oppenheimer, Wolff & Donnelly, Minneapolis, Minnesota. B.A., Cornell University, 1976; M.A., University of Michigan, 1977; J.D., University of Virginia, 1982.

1. See *infra* notes 5, 8, 11 and accompanying text.

2. N.Y. U.C.C. LAW § 4-212(1) (McKinney 1964).

3. Section 4-212(1) states that:

Right of Charge-Back or Refund.

1) If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge-back the amount of any credit given for the item to its customer's account or obtain refund from its customer, whether or not it is able to return the items, if by its midnight deadline or within a longer reasonable time after it learns the facts, it returns the item or sends notification of the facts. These rights to

Courts in New York which have analyzed this provision have concluded that a bank has the right to charge-back a customer's account unless and until the bank receives either: (i) a final payment or settlement of the deposited item; or (ii) a notice of dishonor of the deposited item which states that a final payment or settlement will never be made.⁴

I. RIGHT TO CHARGE-BACK PRIOR TO FINAL SETTLEMENT

It has long been the case in New York that "if the collecting bank has credited its customer's account for an item, but fails to receive a final settlement for the item, it may charge-back the customer's account."⁵ This is true regardless of the period of time that has elapsed since the bank first sent the deposited item to the payor bank for collection of funds. As one court succinctly explained: "[I]t is clear that the rule as governed by the U.C.C. allows a bank to charge back or obtain a refund of a provisional settlement, *as long as* final payment has not been made."⁶ This is the case because prior to final settlement, the bank acts merely as the agent for collection of the check or other item deposited by its customer.⁷ Hence, prior to final payment to a bank of the proceeds of a deposited item, the risk of loss from non-payment remains with the bank's customer.⁸

Once the bank receives full payment for a deposited item, however, final settlement is automatically deemed to occur.⁹ At that point, the bank's right to charge-back is lost.¹⁰ Any bank that thereafter attempts to charge-back a customer's account may be held lia-

revoke, charge-back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

Id.

4. See *Allen v. Carver Fed. Sav. & Loan Ass'n*, 123 Misc. 2d 704, 477 N.Y.S.2d 537 (Sup. Ct. 1984); *622 W. 113th St. Corp. v. Chemical Bank New York Trust Co.*, 52 Misc. 2d 444, 276 N.Y.S.2d 85 (Civ. Ct. 1966).

5. *622 W. 113th St. Corp.*, 52 Misc. 2d at 446, 276 N.Y.S.2d at 88.

6. *Regal Tour Inc. v. European American Bank*, 108 Misc. 2d 699, 703, 438 N.Y.S.2d 947, 949 (Civ. Ct. 1981) (emphasis added); see also N.Y. U.C.C. Law §§ 4-212, 4-213, 4-301 (McKinney 1964).

7. *Bank of Commerce v. De Santis*, 114 Misc. 2d 491, 499, 451 N.Y.S.2d 974, 979 (Civ. Ct. 1982); accord *Mercantile Bank & Trust Co. v. Hunter*, 31 Colo. App. 200, 501 P.2d 486 (1972).

8. *622 W. 113th St. Corp.*, 52 Misc. 2d at 446, 276 N.Y.S.2d at 88.

9. *622 W. 113th St. Corp.*, 52 Misc. 2d at 446, 276 N.Y.S.2d at 89; accord *Riggs v. Maryland*, 34 Md. App. 324, 330 n.5, 367 A.2d 22, 26 n.5 (Ct. Spec. App. 1976) (citing *Boggs v. Citizens Bank & Trust Co.*, 32 Md. App. 500, 363 A.2d 247 (Ct. Spec. App. 1976)).

10. *Id.*

ble for any funds which it removes therefrom.¹¹ As one New York court correctly noted: "After final settlement, and the charging of the amount of the check against the drawer's account, a voluntary refund by the collecting bank is at its own peril, for there are defenses it could interpose to resist payment."¹² The collecting bank, once final settlement takes place, no longer acts as the agent of the customer and is deemed to own the proceeds of the deposited items.¹³ It must deposit such proceeds in its customer's account and thereafter maintain a debtor-creditor relationship with him.¹⁴ Thus, when a bank attempted to charge-back funds from a customer's account for a check that had been deposited and for which final settlement had been made approximately seven months earlier, the court held that the bank could not do so with impunity, and could be held accountable by its customer for any losses incurred by him due to the charge-back.¹⁵ In similar fashion, another court in New York held that where the final settlement of a customer's check had taken place six months prior to the bank's attempt to charge-back funds from his account, the bank would be held liable for any losses which he incurred thereby.¹⁶

II. RIGHT TO CHARGE-BACK UPON NOTICE OF DISHONOR

A bank may also charge-back funds from a customer's account if it receives notification that the deposited item has been dishonored due to fraud,¹⁷ forgery,¹⁸ or some other banking irregularity,¹⁹ and

11. *Fromer Distribs., Inc. v. Bankers Trust Co.*, 36 A.D.2d 840, 840, 321 N.Y.S.2d 428, 430 (2d Dep't 1971).

12. *622 W. 113th St. Corp.*, 52 Misc. 2d at 446, 276 N.Y.S.2d at 89; see also *W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 212:05, Art. 4* (1984) (right to revoke settlement ends when settlement becomes final).

13. *622 W. 113th St. Corp.*, 52 Misc. 2d at 446, 276 N.Y.S.2d at 89 (citing *First Nat'l Bank of Blanchester v. Stengel*, 169 N.Y.S. 217 (Sup. Ct.), *aff'd*, 185 A.D. 906, 171 N.Y.S. 1085 (1918), *aff'd*, 227 N.Y. 659, 126 N.E. 906 (1920) (relationship one of agent and principal)).

14. *Id.*

15. *Boggs v. Citizens Bank & Trust Co.*, 32 Md. App. 500, 363 A.2d 247 (Cl. Spec. App. 1976).

16. See *622 W. 113th St. Corp.*, 52 Misc. 2d at 444, 276 N.Y.S.2d at 85.

17. See generally *Northpark Nat'l Bank v. Bankers Trust Co.*, 572 F. Supp. 524, 534-35 (S.D.N.Y. 1983) (collecting bank, satisfied that there is some indication of fraud, may take steps under the U.C.C., upon notification, to charge-back its customer's account).

18. *622 W. 113th St. Corp.*, 52 Misc. 2d at 445-46, 276 N.Y.S.2d at 88 (on modification of a forged endorsement, collecting bank may refund drawee bank and charge-back that amount against depositor of the check) (citing *Geering v. Metropolitan Bank*, 170 A.D. 751, 156 N.Y.S. 582 (1st Dep't 1915)).

that the proceeds from the deposited item will never be delivered to the customer's account. In such an event, the bank must normally charge-back funds from its customer's account within the time period established by section 4-301 of the New York Uniform Commercial Code, which is commonly known as the "Midnight Deadline Rule."²⁰ Courts in New York have interpreted this rule to signify that a bank will lose its right to charge-back a customer's account unless it notifies the customer of the dishonored item and subsequently charges-back his account before "midnight on its next banking day following the banking day on which it receives the relevant item or notice [of dishonor]."²¹

Under unusual circumstances, where a bank is unable to act within the timeframe established by the Midnight Deadline Rule through no fault of its own, New York courts have allowed a bank to charge-back its customer's account at a later date.²² Thus, a bank may be given a "longer reasonable time" during which to charge-back a customer's account.²³ New York courts continue to disagree, however, as to what constitutes a "longer reasonable time." In *Bank of Commerce v. De Santis*,²⁴ the court held that a four-day delay by

19. See, e.g., *Isaacs v. Chartered New England Corp.*, 378 F. Supp. 370, 373 (S.D.N.Y. 1974) (check dishonored for insufficient funds in drawer's account may be charged back to the depositor) (citing N.Y. U.C.C. LAW § 4-201 (McKinney 1964)).

20. Section 4-301(1) states that:

Where an authorized settlement for a demand item (other than a documentary draft) received by a payor bank otherwise than for immediate payment over the counter has been made before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover any payment if before it has made final payment (subsection (1) of Section 4-213) and before its midnight deadline, it

- (a) returns the item; or
- (b) sends written notice of dishonor or nonpayment if the item is held for protest or is otherwise unavailable for return.

N.Y. U.C.C. LAW § 4-301(1) (McKinney 1964).

21. *Wertling v. Manufacturers Hanover Trust Co.*, 118 Misc. 2d 722, 724, 461 N.Y.S.2d 157, 159 (Civ. Ct. 1983) (citing N.Y. U.C.C. LAW § 4-104(h) (McKinney 1964)); see also *Isaacs*, 378 F. Supp. at 370 (since bank used ordinary care in dealing with a check drawn on a foreign bank, it did not lose right to charge-back amount of uncollected funds); *Manufacturers & Traders Trust Co. v. County Trust Region of the Bank of New York*, 59 A.D.2d 645, 398 N.Y.S.2d 298 (4th Dep't 1977) (payor bank held accountable for amount of check it failed to dishonor and return prior to midnight deadline).

22. See, e.g., *Bank of Commerce v. De Santis*, 114 Misc. 2d 491, 498-99, 451 N.Y.S.2d 974, 979 (Civ. Ct. 1982) (where midnight deadline fell on the day after Christmas—Friday—since businesses usually give extended holiday weekend to employees, notice of dishonor sent on Monday constituted notice within a reasonable time) (construing N.Y. U.C.C. LAW § 4-212(1) (McKinney 1964)).

23. See, e.g., *Lufthansa German Airlines v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 478 F. Supp. 1195, 1198-99 (N.D. Cal. 1979).

24. 114 Misc. 2d at 491, 451 N.Y.S.2d at 974.

the bank in notifying its customer that it had received notice of dishonor of a deposited item was reasonable, because the Christmas holidays had prevented the bank from communicating with him earlier.²⁵ Yet, in *Manufacturers Hanover Trust Co. v. Apkan*,²⁶ the court held that a delay of even two days was unreasonable when it was caused by bureaucratic complications between two branches of the same bank, and thus denied the bank the right to charge-back its customer's account.²⁷ In similar fashion, the court in *Sunshine v. Bankers Trust Co.*²⁸ refused to permit a bank to charge-back its customer's account after it had failed to send him a notice of dishonor until three banking days following the receipt of an item of deposit.²⁹

CONCLUSION

According to the language of section 4-212(1) of the New York Uniform Commercial Code and the case law in New York interpreting this section, a bank has the right to charge-back the account of a customer in an amount equal to that of an item which it deposited in such customer's account until it either: (i) receives final payment for the item; or (ii) is notified that the item has been dishonored due to fraud, forgery or other banking irregularity.

As long as a bank does not receive final payment or settlement for a check or other deposited item, it retains the right to charge-back the account of its customer, regardless of the period of time that has elapsed since the item was first deposited with the bank.³⁰ But once the bank receives final payment or settlement for the item, it automatically loses the right to charge-back its customer's account with impunity, and may be held liable for any proceeds which it removes therefrom.³¹

If a bank receives a notice of dishonor regarding a deposited item, it has the right to charge-back a customer's account, but it must do so within the limited period of time specified in section 4-301 of the New York Uniform Commercial Code, commonly known as the

25. *Id.* at 498-99, 451 N.Y.S.2d at 979.

26. 91 Misc. 2d 622, 398 N.Y.S.2d 477 (Civ. Ct. 1977).

27. *Id.* at 624, 398 N.Y.S.2d at 479.

28. 34 N.Y.2d 404, 314 N.E.2d 860, 358 N.Y.S.2d 113, *modified on other grounds*, 34 N.Y.2d 994, 318 N.E.2d 608, 360 N.Y.S.2d 419 (1974).

29. *Id.* at 409, 314 N.E.2d at 863, 358 N.Y.S.2d at 118 (funds available for withdrawal as of right).

30. *See supra* notes 5-7 and accompanying text.

31. *See supra* notes 8-12 and accompanying text.

“Midnight Deadline Rule.”³² This section permits the bank to notify its customer and charge-back his account until midnight of the banking day following the one on which the bank receives the notice of dishonor. Under very unusual circumstances which prevent a bank, through no fault of its own, from charging-back a customer’s account within the time period specified by this Midnight Deadline Rule, a bank might be permitted to charge-back a customer’s account within a “longer reasonable time.”³³ Courts in New York disagree, however, as to when a *longer reasonable time* should be granted and how long an extension of time is *reasonable*.

32. See *supra* notes 19-20 and accompanying text.

33. See *supra* notes 23-29 and accompanying text.