

Bank Counsel Seminar, September 13, 2023, Caesars Palace, Las Vegas
Senate Bill 95
Uniform Commercial Code Amendments (2022)

UCC section 4A-202(b), Article 4A is Division 11 in California:

(b) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if (i) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and (ii) the bank proves that it accepted the payment order in good faith and in compliance with the bank's obligations under the security procedure and any (written) agreement or instruction of the customer, *evidenced by a record*, restricting acceptance of payment orders issued in the name of the customer. The bank is not required to follow an instruction that violates (a written) an agreement with the customer, *evidenced by a record*, or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

UCC section 4A-202(c):

(c) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if (i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer expressly agreed in (writing) *a record* to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the bank's obligations under the security procedure chosen by the customer.

UCC section 4A-202, official comment 4, as amended, providing in part with emphasis supplied:

The issue of whether a particular security procedure is commercially reasonable is a question of law. Whether the receiving bank complied with the procedure is a question of fact. It is appropriate to make the finding concerning commercial reasonability a matter of law because security procedures are likely to be standardized in the banking industry

and a question of law standard leads to more predictability concerning the level of security that a bank must offer to its customers. The purpose of subsection (b) is to encourage banks to institute reasonable safeguards against fraud but not to make them insurers against fraud. A security procedure is not commercially unreasonable simply because another procedure might have been better or because the judge deciding the question would have opted for a more stringent procedure. For example, the use of a computer program to detect fraud is not commercially unreasonable merely because it does not detect all fraud or because another system or approach might be more successful at detecting fraud. The standard is not whether the security procedure is the best available. Rather it is whether the procedure is reasonable for the particular customer and the particular bank, which is a lower standard. What is reasonable for a particular customer requires the court to consider the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank. Article 4A does not create an affirmative obligation on the receiving bank to obtain information about its customer. However, whatever knowledge the bank does have about the customer is relevant in determining the commercial reasonableness of the security procedure. On the other hand, a security procedure that fails to meet prevailing standards of good banking practice applicable to the particular bank and customer should not be held to be commercially reasonable. Subsection (c) states factors to be considered by the judge in making the determination of commercial reasonableness. The reasonableness of a security procedure is to be determined at the time that a payment order is processed, not at the time the customer and the bank agree to the security procedure. Accordingly, a security procedure that was reasonable when agreed to might become unreasonable as technologies emerge, prevailing practices change, or the bank acquires knowledge about the customer. Sometimes an informed customer refuses a security procedure that is commercially reasonable and suitable for that customer and insists on using a higher-risk procedure because it is more convenient or cheaper. In that case, under the last sentence of subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in (writing) a record to assume that risk. It is implicit in the last sentence of subsection (c) that a bank that accedes to the wishes of its customer in this regard is not acting in bad faith by so doing so long as the customer is made aware of the risk. In all cases, however, a receiving bank cannot get the benefit of subsection (b) unless it has made available to the customer a security procedure that is commercially reasonable and suitable for use by that customer. In most cases, the mutual interest of bank and customer to protect against fraud should lead to agreement to a security procedure which is commercially reasonable.

UCC section 4A-203, new official comment 4A, emphasis supplied:

4A. Subsection (b) generally allows a receiving bank to treat a payment order as

authorized by the customer if the bank accepts the payment order in good faith and in compliance with the bank's obligations under a commercially reasonable, agreed-upon security procedure. For this purpose, "good faith" requires the exercise of reasonable commercial standards of fair dealing, see Section 4A-105(a)(6), not the absence of negligence. Consequently, the bank has no duty, beyond that to which the bank has agreed, to investigate suspicious activity or to advise its customer of such activity. However, a bank that obtains knowledge that a customer's operations have been infiltrated or knowledge that the customer is the victim of identity fraud might not be acting in good faith if the bank, without receiving some assurance from the customer that the issue has been remediated, thereafter accepts a payment order.

UCC section 4A-207:

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

* * *

(2) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing record stating the information to which the notice relates.

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UCC section

(31) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

UCC section 1-302, emphasis supplied:

(a) Except as otherwise provided in subdivision (b) or elsewhere in this code, the effect of provisions of this code may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed by this code may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever this code requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(c) The presence of certain provisions of this code of the phrase “unless otherwise agreed,” or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

UCC section 4A-501, emphasis supplied:

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

(b) "Funds-transfer system rule" means a rule of an association of banks (i) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Federal Reserve Bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this division, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this division and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in subdivision (c) of Section 11404, subdivision (d) of Section 11405, and subdivision (c) of Section 11507.

Wells Fargo Deposit Account Agreement, July 25, 2023, page 18:

Erroneous payment orders:

You could lose funds if you provide incomplete or inaccurate information in your payment orders. We have no obligation to detect errors you make in payment orders (for example, paying the wrong person or the wrong amount). Just because we detect an error once, we won't be obligated to detect future errors. We'll rely on the beneficiary account number and beneficiary bank identification

number (e.g., IBAN [International Bank Account Number], RTN [Routing Transit Number] or SWIFT BIC [Business Identifier Code]) you provide with an instruction or order.

Amended:

You could lose funds if you provide incomplete or inaccurate information in your payment orders. We have no obligation to detect errors you make in payment orders (for example, paying the wrong person or the wrong amount). Just because we detect an error once, we won't be obligated to detect future errors. We'll rely on the beneficiary account number *or other identifying record* and beneficiary bank identification number (e.g., IBAN [International Bank Account Number], RTN [Routing Transit Number] or SWIFT BIC [Business Identifier Code]) you provide with an instruction or order.

Peter E. Shapiro, P.A. v. Wells Fargo Bank, N.A., 352 F.Supp.3d 1226 (S.D.Fla. 2018).