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3/4/68

Memorandum 68-27

Subject: Study 63 - Evidence (Commercial Code Revisions)

At the last meeting, the Commission approved the substance of the attached tentative recommendation relating to revision of Section 4103 of the Commercial Code. This tentative recommendation should be distributed to interested persons for comment as soon as possible.

We attach an extra copy of the tentative recommendation on which you can mark the editorial changes you believe should be made before the tentative recommendation is distributed for comment. Please turn in the marked copy to the staff at the March meeting.

Respectfully submitted,

John H. DeMouilly
Executive Secretary

#63

March 4, 1968

STATE OF CALIFORNIA
CALIFORNIA LAW
REVISION COMMISSION

TEMPERATIVE RECOMMENDATION
relating to
COMMERCIAL CODE SECTION 4103

CALIFORNIA LAW REVISION COMMISSION
School of Law
Stanford University
Stanford, California 94305

TENTATIVE RECOMMENDATION OF THE CALIFORNIA
LAW REVISION COMMISSION

relating to

COMMERCIAL CODE SECTION 4103

The Evidence Code was enacted in 1965 upon recommendation of the Law Revision Commission. Resolution Chapter 130 of the Statutes of 1965 directs the Commission to continue its study of the newly enacted code.

The same legislation that enacted the Evidence Code also amended and repealed a substantial number of sections in other codes in order to harmonize those codes with the Evidence Code. One aspect of the continuing study of the Evidence Code involves the determination of what additional changes, if any, are needed in other codes.¹ In 1967, the Commission submitted a recommendation relating to the changes needed in the Commercial Code² and, upon Commission recommendation, several changes were made at the 1967 session of the Legislature to conform the Commercial Code to the provisions of the Evidence Code.³ The 1967 recommendation proposed an amendment to Commercial Code Section 4103, but this section was not amended in the legislation enacted in 1967 because the Commission concluded that the section needed further study.

1. For a description of this project, see 8 Cal. Law Revision Comm'n Reports 1314 (1967).

2. See Recommendation Relating to the Evidence Code: Number 3-- Commercial Code Revisions, 8 Cal. Law Revision Comm'n Reports 301 (1967).

3. See Cal. Stats. 1967, Ch. 703.

Subdivision (3) of Section 4103 of the Commercial Code, relating to a bank's responsibility for its failure to exercise ordinary care, provides in part:

in the absence of special instructions, action or nonaction consistent with clearinghouse rules and the like or with a general banking usage not disapproved by this division, prima facie constitutes the exercise of ordinary care.

The phrase "prima facie constitutes" is of uncertain meaning and does not indicate the nature of the proof that must be produced by the party contesting the standards established by clearinghouse rules and the like or by general banking usage. The comments of the drafters of the Uniform Commercial Code, however, clearly indicate that the standards so established constitute the exercise of ordinary care unless the party contesting those standards establishes that the standards manifestly are unreasonable. Subdivision (3) should be revised to make this clear.

The Commission's recommendation would be effectuated by the enactment of the following legislation:

An act to amend Section 4103 of the Commercial Code, relating to bank deposits and collections.

The people of the State of California do enact as follows:

Section 1. Section 4103 of the Commercial Code is amended to read:

4103. (1) The effect of the provisions of this division may be varied by agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

(2) Federal Reserve regulations and operating letters, clearinghouse rules, and the like, have the effect of agreements under subdivision (1), whether or not specifically assented to by all parties interested in items handled.

(3) Action or nonaction approved by this division or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care ~~and, in~~ In the absence of special instructions, action or nonaction consistent with clearinghouse rules and the like or with a general banking usage not disapproved by this division ~~, prima-facie~~ constitutes the exercise of ordinary care if the standards established by the clearinghouse rules and the like or by the general banking usage are not manifestly unreasonable .

(4) The specification or approval of certain procedures by this division does not constitute disapproval of other procedures which may be reasonable under the circumstances.

(5) The measure of damages for failure to exercise

ordinary care in handling an item is the amount of the item reduced by an amount which could not have been realized by the use of ordinary care, and where there is bad faith it includes other damages, if any, suffered by the party as a proximate consequence.

Comment. Subdivision (3) of Section 4103 is amended to delete "prima facie" and to add "if the standards established by the clearinghouse rules and the like or by the general banking usage are not manifestly unreasonable." The added language is substantially the same as that used in the last clause of subdivision (1) of Section 4103 and in subdivision (3) of Commercial Code Section 1102.

Under Commercial Code Section 4103, if a bank proves that it has acted in accordance with standards established by clearinghouse rules and the like or by a general banking usage not disapproved by the Commercial Code, the party asserting that the bank failed to exercise ordinary care has the burden of proving that the standards so established manifestly are unreasonable. The added language makes this clear and is consistent with the intent of the drafters of the Uniform Commercial Code. See Uniform Commercial Code Section 4-103, Comment 4 ("The prima facie rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair."). See also the Comment to Uniform Commercial Code Section 1-102, construing similar language in subdivision (3) of that section: "However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls."