Spring 1980

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Recommended Citation
Mark E. Wilson, New Checks: Thrift Institution Check-Like Instruments and the Uniform Commercial Code, The, 45 Mo. L. REV. (1980)
Available at: https://scholarship.law.missouri.edu/mlr/vol45/iss2/1

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THE "NEW CHECKS": THRIFT INSTITUTION CHECK-LIKE INSTRUMENTS AND THE UNIFORM COMMERCIAL CODE

Mark E. Wilson*†

I. INTRODUCTION

For more than a century the community of banking institutions in the United States has consisted of entities offering differentiated banking services. During the 1800s and early 1900s the principal endeavors of commercial banks were the extension of commercial credit, the purchase of bills and notes at discount, the issue of specie, and the offering of corporate and personal demand deposit accounts. What have come to be called "thrift" institutions—mutual savings banks, savings and loan associations and, more recently, credit unions—on the other hand, restricted their purview to personal savings accounts, consumer loans, and the home mortgage market. The distinction between thrifts and commercial banks began to shade a bit during and after the depression as commercial banks began cultivating the market for personal loans, savings accounts, and home mortgages. Nevertheless, the differences between these two types of banking institutions with respect to the nature of services they offered largely survived through the decade of the 1960s. The widespread and intensive

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†The author wishes to express special appreciation to Charles Lempesis, J.D., Gonzaga University School of Law, 1979, a colleague and friend, for his research assistance, innovative analysis, and general collaboration. The author also owes a particular debt of gratitude to Ralph Swoboda, General Counsel to I.C.U. Services, the technical assistance arm of the credit union trade organization, Credit Union National Association. Thanks is further due Keith Trefry, a colleague in the thrift banking community, and Professor Fairfax Leary, the original reporter of Article 4 of the UNIFORM COMMERCIAL CODE.

1. The nation's financial intermediaries are comprised of commercial banks, life insurance companies, finance companies, pension funds, investment companies, savings and loan associations, mutual savings banks, and credit unions. Because the latter three historically developed as institutions for savings, and are nonstock enterprises whose earnings inure to members, they have come to be known in the argot of the banking trade as "thrift institutions" or "thrifts."
marketing by thrift institutions of "checking" services during the 1970s may significantly affect this historical distinction. Starting in 1974, deposits subject to "check-like" instruments at thrift institutions multiplied from an insignificant amount to more than $3.4 billion by July, 1979. Because many thrift institutions have been given the authority to create these deposits only in the last year or two, that figure appears destined to increase geometrically.

The growth of thrift institution "checkable deposits" has been an unanticipated phenomenon caused by market place pressures and acquiesced in by regulatory, legislative, and judicial bodies. The law of negotiable instruments as codified in Articles 3 and 4 of the Uniform Commercial Code probably did not foresee this development. Those articles, particularly Article 4, were drafted with a view toward the customary bank check which has been in use in this country for nearly two hundred years. Together, Articles 3 and 4 provide an integrated, tightly knit set of rules governing check issuance, collection, and payment; they carefully define the relationship between a customer and the bank at which he maintains his checking account. The concern examined in this article is whether this body of law can accommodate thrift institution "new checks." The salient inquiries are: (1) is a thrift institution "check-like" instrument negotiable and, more specifically, is it a demand item? and (2) does a drawee thrift institution qualify as a "bank" as that term is defined by the Code for Articles 3 and 4 purposes?

The precise nature of thrift institution third-party payment instruments is examined at length later in this article. For introductory purposes, the departure point is a brief analysis of the principal new "check-like" instruments and a review of the market place pressures that gave impetus to their evolution. The balance of the article is divided into four sections. The first section surveys the historical development of thrift institutions; an analysis of the differences and likenesses of thrifts and commercial banks is necessary to answer the question of what constitutes a bank for Articles 3 and 4 purposes. The second section reviews the

2. Federal Reserve Board, Statistical Release H-6, "Money Stock Measures" (Oct. 25, 1979). The figure for deposits in thrift institutions earning interest but subject to "check" has not yet reached statistical significance when compared to total demand deposits in the nation's banks, which were estimated at $259.8 billion in July, 1969. Id. Nonetheless, the rapid growth rate of "new check" "checkable deposits" indicates that the deposits soon will become statistically as well as conceptually important.

3. See text accompanying notes 203-296 infra.

4. The terms "checkable deposits" and "check-like instruments" have been used by the Federal Reserve Board to refer to those new instruments, and therefore are adopted by the author. See Federal Reserve System Request for Comments on Federal Reserve Handling of Noninterest Bearing Negotiable Orders of Withdrawal (NINOWs) and other "Check-Like" Payment Instruments, 44 Fed. Reg. 24,929 (1979).

5. The term is defined in the "General Definitions" part of the Code as "any person engaged in the business of banking." U.C.C. § 1-201 (4).
development of what has come to be called a "check." The term is assigned a simple and inclusive definition by the Code;6 nonetheless, a brief examination of the evolution of negotiable instruments called "checks" is useful in determining whether a thrift institution "check-like" instrument satisfies that simple Code definition. The third section surveys the recent administrative, judicial, and legislative activity that has attended the growth of thrift checkable deposits. Finally, section four analyzes the applicability of Articles 3 and 4 to the "new checks," and focuses on whether a "new check" is a negotiable demand item as well as whether a thrift institution offering checkable deposits should be considered a "bank" for purposes of Articles 3 and 4.

Most "new checks" are of two kinds: credit union "share drafts" and mutual savings bank or savings and loan association "negotiable orders of withdrawal" (NOWs). Their features are functions of the banking capabilities of the respective thrift institutions. A credit union share draft is a three-party instrument similar in appearance to an ordinary check, except that it carries on its face the identification of a commercial bank through which it is payable.7 Credit unions do not have direct access to the Federal Reserve collection system; they are not eligible for membership in the Federal Reserve System and cannot gain access to that system through the Federal Deposit Insurance Corporation. Since the collection of the item through the Federal Reserve collection system is a practical necessity, credit unions offering share draft accounts usually collaborate with commercial banks that do have that access. These institutions serve as "payable through" banks.

A negotiable order of withdrawal is in appearance even more similar to a check. It customarily is a simple three-party instrument reflecting the account-holding thrift institution as drawee.8 Unlike a credit union, a mutual savings bank or a savings and loan association can gain access to

6. U.C.C. § 3-104(2) provides in part: "A writing which complies with the requirements of this section is . . . (b) a 'check' if it is a draft drawn on a bank and payable on demand."

7. A "payable through" bank serves as a collecting bank through which presentment is made to the drawee, and is not responsible for payment of the instrument. See U.C.C. § 3-120. "Payable through" instruments have for some time been widely used by insurance companies to settle claims. See H. BAILEY, BRADY ON BANK CHECKS § 1.15 (1979). They are also utilized for corporate dividend payments and, to a limited degree, payroll checks. AMERICAN BANKERS ASSOCIATION, PAYABLE THROUGH DRAFTS 13 (1975).

8. About half of this country's mutual savings banks that offer NOW accounts, particularly those in the eastern states, use a commercial "payable through" bank, often a commercial bank that is wholly-owned by groups of mutuals. Conversation with Jack Rubinson, Director of Research, National Association of Mutual Savings Banks (Nov. 26, 1979). Savings and loan associations that offer NOW accounts, on the other hand, customarily do not utilize "payable through" banks, but rather furnish NOW customers with simple three party instruments drawn on the depository savings and loan. Conversation with R. Lamar Brantley, Assistant Director, Funds Transfer Research, U.S. League of Savings Associations (Nov. 26, 1979).
the federal collection system. While mutuals are eligible for Federal Reserve System membership, they commonly participate in the collection system as FDIC insured nonmember banks through membership in regional clearinghouse associations. Savings and loan associations, which are not eligible for membership or FDIC insured nonmember status, usually gain access to the collection system through the vehicle of a correspondent commercial bank.

In the case of both share drafts and negotiable orders of withdrawal, the accounts on which the instruments are drawn are interest bearing. By nearly uniform statute and regulation, such a savings account must be subject to the right of the depository institution to require advance notice of withdrawal, usually thirty or sixty days. Consequently, such thrift institution accounts subject to share draft or NOW withdrawals by definition are not demand accounts.

Generally, the impetus for the development of thrift institution check-like programs was provided by the competition with commercial banks for savers' funds. The NOW account was the marketing brainchild of Ronald Haselton, a banker who spent his career with commercial banks. The single most important moving force, however, was probably the 1972 amendment of 12 U.S.C. § 492 which permitted direct electronic deposit of recurring payments, such as social security benefits or paychecks, in financial intermediaries of the recipient's choice. The amendment produced a double effect. First, thrift institutions were required to develop the necessary electronic funds transfer technology in order to receive the direct electronic deposits and, for electronic transfer purposes, were assigned individual bank collection routing and transit numbers. The development of that electronic funds transfer capability and the assignment of Federal

10. The phrase "savings account" is used here in the more limited sense that it is an account subject to the depository institutions' right to require advance notice of withdrawal. In a broader lay sense, the phrase customarily refers to accounts that are not transaction accounts, which these accounts of course are.
11. Technically, a credit union customer savings vehicle is a share account, different from an ordinary savings account in that the customer receives dividends calculated periodically, rather than a predetermined level of interest. The share account confers membership status on the customer, who acquires in the credit union an equity ownership subordinate to creditors on liquidation.
12. See, e.g., 12 U.S.C. § 1464 (b) (1) (1976) and 12 C.F.R. § 545.4 (1979), requiring federally chartered savings and loan associations to reserve the right to require 30 days advance notice of withdrawals, and 13 C.F.R. § 329.1 (c) (1979), imposing that requirement on mutual savings banks insured by FDIC. The Administrator of the National Credit Union Administration is authorized by 12 U.S.C. § 1758 (1976) to prepare a standard set of bylaws, which must be adopted by federally chartered credit unions; those Standard Form Bylaws reserve to federal credit unions the right to require 60 days advance notice of withdrawal.
Reserve collection system forwarding numbers made entry into the national check collection system significantly easier. Second, the advent of a direct deposit system had a pronounced effect on the competitive stance of thrift institutions vis-a-vis commercial banks. Thrift institutions were forced to either develop more efficient and marketable means for customers to "access" their deposit accounts, or face the likelihood of a substantial outflow of funds to commercial banks that could offer that convenient access through a conventional checking account. While that potential outflow of funds might not have threatened the survival of thrift institutions, it would have substantially narrowed their market penetration, and perhaps relegated them to a permanent inconsequential status among the nation's financial institutions. The result was, of course, that thrifts undertook to enter the "checkable deposit" market.16

II. HISTORICAL DEVELOPMENT OF ALTERNATIVE BANKING INSTITUTIONS

A. Mutual Savings Banks

Commercial banks in this country initially were organized to facilitate commerce through the granting of business loans, offering of demand deposits, printing of specie, and the like, 17 and not to assist small borrowers or savers. An early need existed for financial institutions that could offer those limited and less remunerative services. The Philadelphia Savings Fund Society and The Provident Institution for Savings (Boston), both nonstock ventures to afford small savers a secure depository, were organized in 1816 to fill that need.18 During the ensuing fifty years, mutual savings bank growth in the eastern seaboard states was considerable; by 1900 there were some 626 mutuals,19 clustered predominately in the northeastern United States. Perhaps because the nation's industrial growth occurred first in the northeast, and led to the development there of a wage earner class that did not exist in the predominately agricultural west and south, mutual savings banks were, and still remain, a geographical phenomenon. Of the seventeen jurisdictions that currently charter mutual savings banks, only six are outside of the northeastern or east-central United States.20

The structural organization of mutual savings banks has remained

16. It should be made explicit at the outset that what is involved with "new checks" is access by a "demand" instrument to a "non-demand" deposit account.
19. Id. at 41.
20. States chartering mutual savings banks are Maine, New Hampshire, Vermont, Massachusetts, Connecticut, Rhode Island, New York, New Jersey, Pennsylvania, Maryland, Delaware, Indiana, Wisconsin, Minnesota, Oregon, Washington, and Alaska. The geographic focus of mutual savings banks can be seen even more clearly with an examination of their location and assets: As of December 31, 1978, of some 465 mutual savings banks with aggregate deposits of $142.7 billion, 444 with deposits of $137.4 billion were located in the northeastern or east-central states. National Association of Mutual Savings Banks, 1979 National Fact Book of Mutual Savings Banking, Table 6 at 14, Table 18 at 20 (1979).
fairly constant from its inception—mutual ownership by depositors, management directed by a self-perpetuating board of trustees—but the financial function has steadily expanded from the initial somewhat moralistic emphasis on member-depositor self-reliance through thrift. Mutuals gradually moved into the mortgage market, and by 1900 mortgage investments represented the predominant asset of mutual savings banks. Personal demand deposit accounts were an added financial service of some mutuals in the 1800s and are now offered by 228 savings banks in 10 states. The number of services has continued to grow to the point where savings banks now offer a full panoply of personal banking services.

Savings banks were exclusively creatures of state law until very recently, a fact that may account for their relatively unfettered expansion of services. By depression-era legislation, however, mutual savings banks were made eligible for membership in the Federal Reserve System and for insured status under the Federal Deposit Insurance Corporation. While few mutual savings banks have opted for the former, the majority have chosen FDIC insured status and the FDIC regulatory authority that attends that status. By a provision of the Federal Financial Institutions Regulatory and Interest Rate Control Act of 1978, mutual savings banks were made eligible for federal chartering and thus have been accorded access to the dual banking system that has been available to commercial banks, credit unions, and savings and loan associations at least since the 1930s. Although savings banks are geographically focused and fairly small in number, individually they tend to be large compared to other financial intermediaries, with an average holding in excess of $340 million in assets.

B. Savings and Loan Associations

Savings and loan associations evolved slightly later than mutual savings banks, and initially filled a restricted function by providing member

21. J. White, supra note 17, at 37.
22. National Association of Mutual Savings Banks, supra note 20, Table 1 at 10.
23. Id., Table 26 at 23, Table 77 at 53.
24. A majority of this country's mutual savings banks are authorized the following banking powers or services: mortgage lending, including multi-family and non-residential building; home improvement; personal and education loans, both secured and unsecured; time and savings deposit accounts; sale of bank money orders and travelers checks; safe deposit boxes; retirement accounts; and savings bank life insurance. Id., Table 76 at 52.
27. Of the 465 mutual savings banks in this country as of December 31, 1978, are FDIC insured. National Association of Mutual Savings Banks, supra note 20, Table 7 at 14.
30. National Association of Mutual Savings Banks, supra note 20, Table 1 at 10, Table 5 at 14.
loans for dwelling construction or purchase. The first such "building society," the Oxford Provident in Philadelphia, was formed in 1831. In that cooperative venture, members purchased shares in the society through regular periodic payments. When sufficient capital was raised, one of the members was awarded a mortgage loan through a bidding process. The spread of these "building societies," or what were known until fairly recently as "building and loan associations," was rapid. Not only did the societies offer a service generally not provided by commercial banks, but since the home loan function was important to the agricultural and mercantile classes as well as to wage earners, "building societies" followed population growth throughout the country. By 1900 every state and territory had chartered such institutions. Because of that geographic dispersal, building and loan associations expanded their savings functions and gradually became a principal savings institution in this country, a position they still hold.

Federal depression-era legislation created the Federal Home Loan Bank Board, which had federal chartering authority, and the Federal Savings and Loan Insurance Corporation, which offered insurance on member deposits. Because of benefits accompanying federal chartering, nearly half of the savings and loan institutions in this country are federally chartered, and some eighty-six percent are insured members of FSLIC.

Savings and loan associations structurally are akin to mutual savings banks. They are predominantly nonstock mutual enterprises owned by members and governed by a board of directors. In function, savings and loans have tended to be more restrictive in the kinds of financial services offered than mutual savings banks, and less aggressive in expanding that range of services. Savings deposits and mortgage loans still constituted eighty-two percent of the industry's liabilities and assets as of 1978.

32. Id.
33. J. White, supra note 17, at 42.
34. As of year end 1978, savings and loan associations held $431 billion in savings, commercial banks held $546.3 billion, mutual savings banks some $142.6 billion, and credit unions $53 billion. United States League of Savings Associations, Savings and Loan Fact Book '79, Table 4 at 14 (1979).
37. As of December 31, 1978, 2,000 of the 4,723 savings and loan associations in this country were federally chartered. United States League of Savings Associations, supra note 34, Table 38 at 48.
38. Id.
40. United States League of Savings Associations, supra note 34, Chart 38 at 82.
In recent years the scope of personal banking services offered by savings and loan associations has expanded considerably, particularly in the fund transfer area. A few states allow ordinary demand deposits at savings and loans,\textsuperscript{41} a growing number permit NOW accounts or variations on the negotiable order of withdrawal schemes,\textsuperscript{42} and recent regulations of the Federal Home Loan Bank Board permit savings and loans' operation of "remote service units"\textsuperscript{43}—automated off-premise terminals that dispense cash, accept deposits, and handle withdrawals and loan payments.

Although savings and loan associations represent the second largest category of financial institutions in this country, they tend to be somewhat smaller than mutual savings banks. The average association had assets as of 1978 of $110 million,\textsuperscript{44} about one-third the size of the average mutual savings bank, but still larger than the average commercial bank.\textsuperscript{45}

C. Credit Unions

Credit unions were relative late-comers in this country and were patterned after the cooperative credit societies and "peoples banks" that flourished in central Europe during the last half of the nineteenth century.\textsuperscript{46} The first credit union established in the United States was La Caisse Populaire Ste. Marie, in Manchester, New Hampshire. It was organized in 1909 to serve the savings and small loan needs of the French descendant members of a Catholic parish.\textsuperscript{47} Although by 1920 some nine states had adopted credit union chartering statutes, the spread of credit unions initially was slow, and there were by then fewer than 200 operating credit unions,\textsuperscript{48} all quite small. In the ensuing decade, however, an additional twenty-three states passed chartering legislation, and by 1930 there were 1,100 credit unions in this country.\textsuperscript{49} The organization in 1934 of the Credit Union National Association,\textsuperscript{50} a permanent credit union trade

\textsuperscript{41} CONN. GEN. STAT. ANN. § 36-182a (West Supp. 1979); ME. REV. STAT. tit. 9-B, § 761 (Supp. 1979); N.Y. BANKING LAW § 390.5 (McKinney Supp. 1979).
\textsuperscript{42} See text accompanying notes 124-146 infra.
\textsuperscript{43} 12 C.F.R. § 545.4-2 (1979).
\textsuperscript{44} United States League of Savings Associations, supra note 34, at 51.
\textsuperscript{45} There are 14,390 commercial banks in this country. 65 Fed. Res. Bull., No. 11, Table A-19 (Nov. 1979). As of year end 1978, commercial banks had $1.284 trillion in assets. United States League of Savings Associations, supra note 34, at 46. The average commercial bank thus had roughly $90 million in assets.
\textsuperscript{46} The cooperative credit movement had its beginning around 1850 in Germany, and grew rapidly there and in surrounding countries. By 1913, the number of cooperative credit societies had grown to 25,576 in Germany, 11,599 in Austria, and over 2,000 in Italy. J. Moody & G. Fite, THE CREDIT UNION MOVEMENT: ORIGINS AND DEVELOPMENT, 1850-1970 1-25 (1971).
\textsuperscript{47} Id. at 34-36.
\textsuperscript{49} J. Moody & G. Fite, supra note 46, at 126.
\textsuperscript{50} Id. at 180-82.
association, and the passage that year of the Federal Credit Union Act,\(^51\) which provided for federal chartering by the Credit Union Division of the Farm Credit Administration,\(^52\) further accelerated the growth of these institutions. By 1976 there were some 22,600 credit unions chartered by the National Credit Union Administration and by forty-six states.\(^53\)

Credit unions are structurally quite different from mutual savings banks and savings and loan associations. The organization is cooperative, rather than mutual, and while earnings in either setting eventually inure to members, cooperative ventures are more egalitarian in character. Earnings are distributed in proportion to patronage and each member has one vote on association policy.\(^54\) From the time of the first credit societies established in Germany in the 1840s, membership in credit unions traditionally has been restricted to associational or occupational groupings, or to persons living in a limited geographical area.\(^55\) The restricted membership field of most credit unions—sometimes referred to as the “common bond”—is a chartering requirement of nearly all states and the National Credit Union Administration.\(^56\) This, of course, has inhibited the growth of most credit unions, with the majority remaining small and volunteer-operated.\(^57\) The average credit union had about $1.9 million in assets in 1976.\(^58\) Nonetheless, there are credit unions approaching the billion dollar figure in total assets,\(^59\) and several are in the hundred million dollar category.\(^60\)

The function of credit unions traditionally has been to encourage and facilitate member thrift. Indeed, the definition given a credit union in the federal chartering statute asserts that function: “[A] cooperative association . . . for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.”\(^61\) Most small volunteer-staffed credit unions offer only limited services: savings or share accounts and small loans for personal, family, or household purposes. The credit union trade organization in recent years has sought an expansion of credit union powers, however, and the services now offered by

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54. Id. at 37.
55. Id. at 41-43.
56. Id. at 41-44. The Federal Credit Union Act requires that membership be limited to “groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district.” 12 U.S.C. § 1759 (1976).
58. Id. at 103.
60. At the end of 1978, eight credit unions had assets in excess of $200 million. Id.
many of the larger credit unions approximate those offered by mutual savings banks and savings and loans, and even commercial banks with regard to personal banking services.\textsuperscript{62}

A comparison of thrift institutions with commercial banks requires a cursory examination of interest rate differentials on savings deposits, a fairly recent federal regulatory development. In 1966, Congress passed Public Law 89-597,\textsuperscript{63} a measure addressed to a disintermediation\textsuperscript{64} phenomenon the nation's thrift institutions were experiencing. The Act gave the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board the authority to establish interest rate ceilings on savings deposits. While the Act did not require a rate differential for thrift institutions, it did encourage regulatory bodies to establish such a differential so that thrift institutions might attract more savings for mortgage lending purposes.\textsuperscript{65} The measure provided that such interest rate limitations would be effective for a one-year period only, but the measure has been renewed eleven times,\textsuperscript{66} and has become a semi-permanent part of the banking regulatory scenery. Until summer, 1979, the differential was .25%; thrift institutions were permitted a maximum interest payment of 5.25\% on ordinary savings deposits, and commercial banks were permitted 5.0\%. In July, 1979, each limitation was raised .25\%.\textsuperscript{67} Credit unions are not regulated with regard to dividend payments, but the most recent figures show dividends as slightly above 6\% on share accounts.

The bank regulatory measure, known for some time as Regulation Q, appears to have an uncertain future. Adapted to stem inflationary

\begin{footnotesize}
\begin{enumerate}
\item Act of September 21, 1966, Pub. L. No. 89-597, 80 Stat. 823 (codified at 12 U.S.C. §§ 461, 1425 (b), and 1828 (g) (1976)).
\item The term “disintermediation” is used to describe a deleterious outflow of funds from financial intermediaries.
\end{enumerate}
\end{footnotesize}
tendencies prevalent fourteen years ago, the regulatory measure is now being accused of contributing both to inflation and to the disintermediation thrift institutions are again experiencing. Although some in the thrift community have fought hard for the perpetuation of Regulation Q, the Senate twice has passed measures to abolish it, and a Senate-passed bill authorizing thrift institution "new checks" provided for the phase-out of interest level differentiation and limitation over a ten-year period.

A survey of the development and growth of thrift institutions in this country must include an acknowledgment of the dominance of commercial banks among the nation's financial intermediaries. Nonetheless, some thrifts have exhibited remarkable staying powers, not only in the areas of commercial lending and investment, but also with regard to trust powers, correspondent services, international banking services, and personal banking services.

III. A BRIEF HISTORY OF BANK CHECKING SERVICES

The precise origins of banking and negotiable instruments are obscure; the former seems to have had its genesis in Italy, the latter an accretive development of the law merchant. While what we now recognize as "checks"—demand drafts drawn on certain financial institutions—appeared much later, several kinds of widely recognized contracts for the

68. S. REP. No. 368, supra note 66, at 4.
69. Id. at 3.
71. As of year end 1978, commercial banks had assets of $1.28 trillion, savings and loan associations held $523 billion, mutual savings banks $158 billion, and credit unions $62 billion. United States League of Savings Associations, supra note 34, Table 37 at 46.
72. Collectors of miscellany may find it interesting that three of the original thrift institutions survive in healthy form. The Oxford Provident was by its nature self-terminating: as soon as all initial members had procured loans to build houses and had repaid them, the entity was wrapped up. L. KENDALL, supra note 31, at 5. The Philadelphia Savings Fund Society in 1979 entered its 165th year as the largest mutual in this country, with assets of $5.58 billion, and The Provident Institution then held some $992 million in assets. National Association of Mutual Savings Banks, supra note 20, Table 8 at 15. La Caisse Populaire Ste. Marie, while not the largest of this country's credit unions, began its 71st year with a reasonably solid $30,479,000 in assets. Financial Statement to Members, La Caisse Populaire Ste. Marie (June 30, 1979).
73. The business of banking has been traced to the Lombardy region of Italy, in the early Ninth Century. The word "bank" probably derives from the old Italian "banca," meaning "bank," or the germanic "bank," carrying a similar meaning, referring to a table set up in the market place for the exchange of money. Apparently Lombard Street in London, which in England in the late middle ages and early renaissance was synonymous with banking, derives its name from the Italian money changers who settled there. Paton, The Law of Bank Checks: History and Utility, 21 BANKING L. J. 7, 8 (1904).
74. The "law merchant" was a phrase that referred to a well-established body of legal customs, covering in addition to negotiable paper such areas as insurance, partnership, suretyship, sales, bankruptcy, admiralty, and much of early international law. Beutel, The Development of Negotiable Instruments in Early English Law, 51 HARV. L. REV. 813, 816 (1938).
payment of money, called "obligatory writings," were common in England in the 1300s. Partly because an early statute provided for the registration of debts before certain crown officers, the so-called obligatory writings developed a trait of rather free transferability. On the other hand, the concept of negotiability—transferability of an evidence of debt with attendant elimination of the obligor's defenses against remote transferees—developed fitfully in England. In certain courts of limited jurisdiction where the "law merchant" was enforced, negotiability appears to have been accorded as early as the 1400s, but the common law courts refused to acknowledge that attribute of a promissory note even as late as 1704. In fact, it was not until 1758, in the well-known case of Miller v. Race, that such an instrument was determined to be negotiable.

Well prior to the decision in Miller v. Race there appeared in commercial usage in England the "inland bill of exchange," the historical antecedent of the current check. An instrument of limited purpose, it was recognized as negotiable by at least two statutes as of the turn of the eighteenth century. By the mid-eighteenth century, such a bill, at least when drawn on the Bank of England, had come to be denominated a "check." Toward the end of that century instruments called "checks" appeared in common usage in this country.

The principal difference between this early "check" and that found today was that the former had to be issued to a named payee or bearer; a bill of exchange drawn on a bank could not be drawn to "order," although a bill not drawn on a bank could be. Part of the reason for this

75. Four recognized types during this period were: a simple promise to pay; a promise to pay X or his attorney; a promise to pay X or his attorney bearing this instrument; and a promise to pay X or bearer. Id. at 817.
77. Beutel, supra note 74, at 820.
78. During the period 1350-1550, suits on obligatory writings were within the nearly exclusive purview of the "Staple Courts," created by the Statute of Staples in 1353. The Staple Courts declined during the 1500s, but were replaced in part of their function by the Admiralty Courts during that period. Both court systems freely applied the developing law merchant. Id. at 826-34.
79. Id. at 831-32.
82. The case allowed recovery against the drawer by a purchaser from a thief.
83. A "bill of exchange" of that time was a demand draft, usually payable to the payee or bearer. An "inland bill of exchange," recognized by The Bank of England Act, 1694, 5 W. & M., c. 20, § 29, and by The Statute of Anne, 1704, 3 & 4 Anne, c. 9, was a demand draft on which the drawer and drawee were residents of the same country.
84. The Bank of England Act, supra note 83.
86. Paton, supra note 73, at 80-81.
87. I.e., payable according to the order or direction of the payee, necessitating his and subsequent holder's indorsement for negotiation.
88. See, e.g., Woodruff v. The Merchant's Bank, 25 Wend. 672 (N.Y. Sup.
distinction derived from the self-interest of bankers. A bearer instrument imposed upon a paying drawee bank only the responsibility for determining the regularity of the drawer's signature. Payment of order instruments, however, involved the additional burden of determining the genuineness of indorsements by payees and other indorsers.

In both England and the United States there understandably was pressure at that time to allow the drawing of an order draft against a bank. In England, order drafts were recognized by statute in 1853, but the banking community was successful in obtaining provisos immunizing banks from liability for paying checks bearing forged indorsements. In this country the "bearer" requirement was eliminated by the same judicial construction that created it, and by the 1860s bank checks payable to order were common.

From the time of the Civil War the checking system developed rather rapidly, although even at the turn of this century one commentator observed that there existed "a deplorable lack of system for the collection of distant checks." The former Uniform Negotiable Instruments Law, drafted in 1896 and subsequently adopted by all jurisdictions, did not touch upon check collection. In fact, the Uniform Negotiable Instruments Law treated checks somewhat peripherally, and a unified collection mechanism was not imposed until the Federal Reserve Act of 1913 gave authority to the new Federal Reserve System to establish such a mechanism by regulation.

Once an adequate mechanism for collection was established, the growth of the checking system in this country was phenomenal. By 1930, the number of checks clearing rose to 2.5 billion. By 1970 that number had

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Ct. 1841), where the court stated: "It is essential to a check, co nominee, or bank draft, that it be payable to bearer, and on demand. . . ." Id. at 673.
90. A paid order instrument, properly indorsed, could be used as evidence of payment; since bearer instruments were by definition not indorsed, they could not serve that purpose.
92. Paton, supra note 78, at 85-86. Of course the paying bank had at that time, as it has now, recourse against the party presenting the check and receiving payment, and that person had recourse against prior indorsers, and so on back to the person who dealt with the forger or wrongdoer.
93. Id. at 88.
95. With regard to definition, time for presentment, and effect of acceptance, of checks, see N.I.L. §§ 185-188, 5 U.L.A. §§ 185-188.
96. Ch. 6, 38 Stat. 251 (1913) (codified at 12 U.S.C. §§ 221 & 226 (1976)).
98. No precise figures for the number of checks clearing in any given year are available, because only a fraction—between one-fourth and one-third—clear through the Federal Reserve System. The Annual Report of the Board of Governors of the Federal Reserve System for the following years reflect federal clearing of 84,697,000 items in 1917 (the first year for which data was compiled), 904,975,000 in 1930, and 7,903,994,000 in 1970.
increased to approximately 24 billion. In 1980 an estimated 40 billion checks will be paid by depository institutions, with checks indisputably being the principal method of payment for personal as well as commercial purposes.

A discussion of the development of the checking system in this country would be incomplete without a consideration of the federal prohibition on interest-bearing demand accounts since thrift institution accounts subject to "access" by the "new checks" are in the main interest-bearing. In 1933, Congress passed the Glass-Steagall Act, a federal legislative response to the banking crisis this country was then experiencing. Principal among the provisions of the Act was the creation of the Federal Deposit Insurance Corporation. Apparently because of a concern that the payment of interest by banks on demand accounts added to their instability, the measure included a provision forbidding those interest payments by banks that were Federal Reserve members. The provision was amended in 1935 to prohibit interest on demand accounts on all banks that were insured by the Federal Deposit Insurance Corporation. Since the provision was not mentioned in the Conference Report to the House and Senate, its legislative purpose cannot be authoritatively stated. During the late 1920s and early 1930s there evidently was considerable competition among the nation's commercial banks for demand deposits, which resulted in the payment of gradually increasing interest on the deposits to attract them. As a result, interest rates reached a level that forced banks to engage in progressively less secure investments and to lower their deposit reserves in order to realize the earnings necessary to satisfy the high interest rates on demand deposits then prevalent. These policy goals, however, had little application to personal demand accounts.

99. See note 98 supra.
104. The measure was part of the Glass-Steagall Act, but was enacted as Ch. 89, § 11 (b), 48 Stat. 181 (1933) (codified at 12 U.S.C. § 371 (a) (1976)).
107. The interest-bearing demand accounts that give rise to the interest rate competition were in the main deposits of rural banks with urban ones, or deposits held by correspondent banks. The large majority of banks did not pay interest on personal demand accounts. C. Arlt, "Changing Character of Bank Deposits," Changing Role of Banking 56 (Prochnow & Prochnow 1974). It was not until after World War II that personal checking accounts became popular. In fact, as recently as 1946, only about one-third of all households had checking accounts. B. Klebaner, Commercial Banking in the U.S., A History 176 (1974).
It has been suggested that Congress may have acted hastily, and that interest payments on checking account balances may have played an insignificant part in the phenomenon of bank failures of the early 1930s. Nonetheless, the prohibition has become an entrenched feature of this country's federal banking regulatory scheme and was relied upon by adversaries of thrift institution checking services in early efforts to thwart the development of those services.

Commercial banks traditionally have dominated the field of ordinary checking services, and while they continue to do so, that dominance has never been complete. Thrift institutions have been offering ordinary checking services at least since the 1860s. Some 228 mutual savings banks offer demand deposit accounts, state chartered savings and loan associations are authorized to offer them in Maine, Connecticut, and New York, and state chartered credit unions have that authority in Rhode Island and Nevada.

IV. Recent Developments Concerning the Authority of Thrift Institutions to Offer Check-Like Services

While certain thrift institutions have been offering checking account services since before the turn of the century, this offering primarily has been a development of the last decade. As credit unions, savings and loans, and mutuals have sought to develop check-like services, they have generated a good deal of administrative activity in their governing state or federal agencies. That administrative activity in turn has led to litigation which in a number of cases has resulted in a legislative response.

Most regulatory activity in this area has involved credit unions, for several apparent reasons. Savings and loan associations traditionally have

109. See Riordan, supra note 13, at 4-5.
110. The phrase "ordinary checking" services is used here to refer to demand deposit accounts accessible by demand drafts rather than the "new checking" service, in which a savings account is subject to access by a demand draft.
111. See note 2 supra.
112. See note 119 infra.
113. National Association of Mutual Savings Banks, supra note 20, Table 26 at 23.
been governed by statutes that prohibit checking services\textsuperscript{120} and, for financial reasons, have not aggressively sought an expansion of their powers.\textsuperscript{121} Far fewer in number than either other category of thrift,\textsuperscript{122} mutual savings banks also did not undertake any nationally coordinated effort to assert or obtain checking powers. Credit unions, on the other hand, acting through their trade association,\textsuperscript{123} undertook a sophisticated national campaign beginning in the mid-1970s to assert or obtain authority to offer those services to members.

The initial activity of the decade involved mutual savings banks and savings and loan associations. In 1970, Consumer Savings Bank of Worcester, Massachusetts,\textsuperscript{124} sought permission from the State Department of Banking to offer customers a check-like service which the bank intended to market under what was then its own trademarked designation NOW accounts.\textsuperscript{125} On denial of the petition, an original action was commenced in the Supreme Judicial Court of Massachusetts which subsequently overruled the banking commissioner.\textsuperscript{126} At issue was the statutory language: "The deposits in such corporation may be withdrawn at such time and in such manner as the bylaws direct."\textsuperscript{127} The court reasoned that the statute "leaves the establishment of methods of withdrawal to the individual banks."\textsuperscript{128}

The Consumer Savings Bank case, which was preceded by two state court decisions which approved checking services long offered by mutual savings banks,\textsuperscript{129} led to the adoption of similar "checking-like" services by savings banks in neighboring New Hampshire,\textsuperscript{130} and was further indirectly responsible for federal legislative intervention. In 1973, President

\begin{footnotes}
\item 120. See, e.g., 12 C.F.R. § 545.4-1 (1979), which provides, "Savings accounts in a federal association shall not be subject to check." See also RSMo § 369.209.1 (1978).
\item 121. Evidently, there was concern early on in the savings and loan industry that a likely trade-off for the industry's gain of "checkable deposit" powers would be the loss of the quarter percent interest rate advantage the industry had over commercial banks. See text accompanying notes 63-67 supra.
\item 122. A total of 465 mutual savings banks were in existence as of year end 1978. See note 20 supra.
\item 123. The extent of the marketing campaign launched by Credit Union National Association and its technical assistance arm, I.C.U. Services Corp., can best be seen in account growth. Since 1974, share-draft checkable accounts had grown, by March 31, 1979, from zero to $1.2 billion, with over 1.32 million accounts at 1327 credit unions. Credit Union National Association, Save Our Share Draft Survey (Dec. 1979).
\item 124. The earlier name of the bank, The Worcester Five Cents Savings Bank, see text accompanying note 13 supra, was changed to Consumer Savings Bank in 1970. Riordan, supra note 13.
\item 126. Id.
\item 127. Id. at 718, 282 N.E.2d at 417.
\item 128. Id.
\item 130. Riordan, supra note 13, at 4.
\end{footnotes}
Nixon signed Public Law 93-100, a compromised bill permitting federally chartered thrift institution and commercial bank NOW accounts in Massachusetts and New Hampshire, but prohibiting the offering of that service by those financial institutions in all other states. In 1976, the Act was amended to permit interest bearing NOW accounts in the additional northeastern states of Connecticut, Rhode Island, Maine, and Vermont. The Act was amended again in 1978 to extend NOW account authority to New York, and in 1979 to New Jersey. Because governing state law in each of those northeastern states either already allowed state institutions to furnish that service or permitted state thrifts to offer the same service that federally chartered savings and loans were authorized to offer, NOW accounts are currently available at state chartered institutions in all eight states as well.

Litigation concerning the authority of these two kinds of thrift institutions to offer check-like services since the Consumer Savings Bank case has been sporadic. In Wisconsin Bankers Association v. Mutual Savings & Loan Association, the Wisconsin Court of Appeals approved a non-interest bearing NOW account offered by a state chartered savings and loan association. The court reasoned that the NOW account is not a statutorily proscribed account since a NOW instrument is not a check. In Washington Bankers Association v. Washington Mutual Savings Bank, the Washington Supreme Court approved a check-like service marketed as a NOW account, but functionally different because the service involved two accounts: a non-interest bearing account accessed by a negotiable instrument, and a companion interest-bearing savings account. The language of the Washington statute is somewhat unusual. A Washington chartered mutual savings bank is expressly authorized to "pay . . . any check drawn on it by a depositor." Therefore the court had little difficulty upholding the service. Finally, in Pennsylvania Bankers Association v. Secretary of Banking, the Pennsylvania Supreme Court upheld a

135. See, e.g., CONN. GEN. STAT. ANN. §§ 36-104c, 36-182a (1979).
137. 87 Wis. 2d 470, 275 N.W.2d 190 (1978), review granted, 87 Wis. 2d 917, 278 N.W.2d 280 (1979).
138. 87 Wis. 2d at 484, 275 N.W.2d at 134. The Wisconsin Court of Appeals may be mistaken at this point, at least insofar as Articles 3 and 4 of the U.C.C. are involved. See text accompanying notes 220-238 infra.
139. 92 Wash. 2d 455, 598 P.2d 719 (1979).
141. 92 Wash. 2d at 458, 598 P.2d at 722.
challenged Department of Banking regulation which permitted a uniquely restricted negotiable instrument drawn on a mutual savings bank. The court reasoned that it had a limited scope of review of the agency’s action, that the agency in fact had a mandate to promulgate rules providing “the opportunity for institutions subject to [the Banking Code] to serve effectively the convenience and needs of their depositors,” and that the service provided was not prohibited by law. The only other cases involving savings bank check-like services to reach state appellate courts, both holding thrift institutions to be without authority to offer such services, were effectively overruled by Public Law 93-100.

By comparison, regulatory agency action regarding credit union check-like services has been almost frenetic. Trade organization activity started in 1974 with representatives of CUNA approaching Herman Nickerson, Jr., the administrator of the National Credit Union Administration, with a proposal for a pilot project under which a limited number of federally chartered credit unions would offer “share draft” services to members. The proposal was in substance approved, and in 1974 three federal credit unions began share draft programs. The experimental program, which by late 1977 had grown to include 514 federal credit unions, was viewed as a success by the participants and the agency, and on December 8, 1977, NCUA promulgated a permanent rule permitting the offering of approved share draft programs by federally chartered credit unions. A suit challenging the agency action was commenced two days later by the commercial bankers national trade association.

In American Bankers Association v. Connell, the trial court found authority for a federal credit union share draft plan in the “incidental

143. The regulation, 7 PA. BULL. 699 (1977), 10 PA. ADMIN. CODE §§ 30.1, 30.2, required a NOW instrument drawn on a Pennsylvania mutual savings bank to state on its face that the savings bank reserves the right to require not less than 14 days prior withdrawal notice before paying the instrument. See text accompanying notes 286-291 infra.
144. 481 Pa. at 338, 392 A.2d at 1323.
146. Both Maine and New York have since legislatively permitted NOW accounts for state-chartered institutions, to avoid competitive advantage for federally chartered thrifts. See ME. REV. STAT. tit. 9-B, § 424 (West Supp. 1979); N.Y. BANKING LAW §§ 234, 287, 288 (McKinney Supp. 1979).
148. Approval was granted pursuant to 12 C.F.R. § 721.3 (1979) (permits certain experimental electronic funds transfer programs by credit unions).
151. 447 F. Supp. 296 (D.D.C. 1978). An earlier action, American Bankers Ass’n v. Montgomery, No. 76-1661 (D.D.C. 1976), was dismissed without prejudice when the National Credit Union Administration agreed to undertake formal rule-making proceedings. Id. at 298.
powers" language of 12 U.S.C. § 1757(15).\textsuperscript{152} The court found share drafts to be merely a more efficient device by which a credit union can offer withdrawal services, a variation on established and unquestionably valid methods of accessing customer accounts. The court found the legislative history at best equivocal, and the agency had a fully developed record upon which to base its rulemaking.\textsuperscript{153}

Coincident with the federal administrative activity, a large number of state regulatory agencies entertained requests by state chartered credit unions for share draft authority. Such petitions resulted in temporary or final administrative agency approval in Virginia,\textsuperscript{154} Connecticut,\textsuperscript{155} Oklahoma,\textsuperscript{156} Pennsylvania,\textsuperscript{157} Illinois,\textsuperscript{158} Michigan,\textsuperscript{159} and Florida.\textsuperscript{160} More commonly, regulatory bodies sought advice of their state attorneys general on the legality of share draft plans. Those opinions resulted in the approval of share draft plans in Ohio,\textsuperscript{161} Oregon,\textsuperscript{162} North Carolina,\textsuperscript{163} Utah,\textsuperscript{164} Texas,\textsuperscript{165} Maryland,\textsuperscript{166} Washington,\textsuperscript{167} Montana,\textsuperscript{168} and Arizona.\textsuperscript{169} While the rationales underlying approval have varied, several attorney general opinions have relied on the reasoning of the

\textsuperscript{152} The section provides: "A federal credit union shall have succession in its corporate name during its existence and shall have power . . . to exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectually the business for which it is incorporated."

\textsuperscript{153} 447 F. Supp. at 800-01.


\textsuperscript{155} Op. of the Connecticut Banking Comm’n (April 7, 1978).

\textsuperscript{156} Order of the Oklahoma Credit Union Bd. (Feb. 12, 1979).

\textsuperscript{157} Letter Order of the Pennsylvania Sec. of Banking (March 3, 1976).

\textsuperscript{158} "Share Draft Guidelines" (Oct. 1, 1977) (issued by the Director, Dept. of Fin. Inst.).


\textsuperscript{160} Order of the Compt. of the Dept. of Banking and Fin., In re Leon County Teachers Credit Union (Sept. 6, 1977).


Massachusetts court in Consumer Savings Bank: the service is not expressly statutorily prohibited, and the governing statute provides that a credit union has such powers as its bylaws authorize.\textsuperscript{170} Anticipating the approach used by the trial court in American Bankers Association v. Connell, one state attorney general asserted a credit union’s “incidental powers" as the basis for approval.\textsuperscript{171}

Attorney general opinions disapproving share draft plans have been issued in Arkansas,\textsuperscript{172} New Mexico,\textsuperscript{173} and Idaho.\textsuperscript{174} While the rationales have varied, they generally have focused on the absence of statutory authorization.\textsuperscript{175} The Arkansas opinion asserts that a share draft of the kind involved is indistinguishable from a check, and credit unions in that state are prohibited from offering checking services.\textsuperscript{176}

The administrative activity surveyed above sparked a flurry of litigation and legislative activity. Administrative orders approving share drafts were overturned by trial courts in Illinois and Oklahoma.\textsuperscript{177} In both cases the absence of statutory authority for state chartered credit union share draft programs was the basis for reversal. In Michigan, on the other hand, administrative approval of share draft programs was upheld.\textsuperscript{178} The court found implicit legislative sanction in the fact that the legislature in 1976, after credit unions had received administrative approval for share drafts, significantly amended the Michigan Credit Union Act without treating share draft services.\textsuperscript{179}

Appellate courts in two states have ruled on share draft plans, with opposite results. The Iowa Supreme Court overturned a trial court’s approval of a share draft plan. The court reasoned that since by case law financial institutions in that state possess only enumerated powers, and since the legislature had not granted credit unions the power they sought to exercise, the plan was unlawful.\textsuperscript{180} In contrast, the Florida Court of

\textsuperscript{170} That rationale was expressed by state attorneys general in Maryland (referring to Md. Code Ann. Corp. & Ass’n §§ 6-307 (1975)); North Carolina (referring to N.C. Gen. Stat. §§ 54-109.53, .54 (1979)); and Utah (referring to Utah Code Ann. § 7-9-6 (5) (Supp. 1979)).


\textsuperscript{175} See New Mexico and Idaho Opns., notes 173 & 174 supra.


\textsuperscript{177} Ill. Bankers Ass’n v. Callahan, No. 77 L 22948 (Cir. Ct., Cook County, Ill., May 17, 1979); Oklahoma Bankers Ass’n v. Oklahoma Credit Union Board, No. CD-77-623 (Dist. Ct., 7th Jud. Dist. Okla., June 28, 1979).


\textsuperscript{179} Id. at 5-8.

\textsuperscript{180} Iowa Credit Union League v. Iowa Dept. of Banking, 268 N.W.2d 165 (Iowa 1978).
Appeals held that since the practice was not statutorily prohibited, it was therefore permissible. Anticipating the logic used in *American Bankers Association v. Connell*, the Florida court referred to credit unions' statutory "incidental" powers.181

State legislative responses to the litigation surveyed has been definitive. During 1979 sessions, legislatures enacted laws permitting credit union share draft programs in Illinois,182 Iowa,183 and Idaho,184 thus effectively overruling agency or court action in those states. Bills specifically granting share draft powers were also passed in Louisiana185 and Georgia;186 two other states, Vermont187 and Tennessee,188 passed similar measures somewhat earlier.

During the height of successful legislative activity, the credit union campaign suffered what seemed a major setback: *American Bankers Association v. Connell* reached the court of appeals where the district court holding was reversed.189 Consolidated on appeal were two other cases involving trial court approval of regulations permitting expanded financial services by banking institutions: automatic fund transfer services of commercial banks,190 and remote service units by savings and loans.191 The court of appeals struck all three regulations, stating:

This court is convinced that the methods of transfer authorized by the agency regulations have outpaced the methods and technology of fund transfer authorized by the existing statutes. We are neither empowered to rewrite the language of statutes which may be antiquated in dealing with the most recent technological advance, nor are we empowered to make a policy judgment as to whether the utilization of these new methods of fund transfer is in the overall public interest. Therefore, we have no option but to set aside the regulations authorizing such fund transfers as being in violation of statute.192

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181 Florida Bankers Ass'n v. Leon County Teachers Credit Union, 359 So. 2d 886, 889 (Fla. Dist. Ct. App. 1978), cert. denied, 368 So. 2d 1366 (Fla. Sup. Ct. 1979).
183 Iowa Acts ch. 130 (1979) (to be codified in Iowa Code ch. 533).
189 American Bankers Ass'n v. Connell, 595 F.2d 887 (D.C. Cir. 1979) (decided under Local Rule 13 (c) without opinion; under Local Rule 8 (b), such a decision may not be cited in briefs or memoranda of counsel as precedent).
190 U.S. League of Sav. Ass'n v. Board of Governors, 463 F. Supp. 342 (D.D.C. 1978) (Upheld amendments by the Federal Reserve Board to Regulation Q. 12 C.F.R. § 217.5 (c) (1979), and by the Federal Deposit Insurance Corporation to 12 C.F.R. § 329.5 (c) (1979). The two regulations permitted automatic fund transfer accounts at insured Federal Reserve member and non-member banks).
191 Independent Bankers Ass'n v. Federal Home Loan Bank Bd., No. 76-0105 (D.D.C. 1977) (approving a regulation by the FHLBB, 12 C.F.R. § 545.4-2 (1979), permitting remote service units (RSUs)).
192 Id., slip op. at 2-3.
A subsequent petition for writ of certiorari was denied.\textsuperscript{193}

The Connell court, in treating the matter as one of substantial public interest and potential economic impact, stayed the effective date of the judgment to January 1, 1980, to allow Congress to make necessary policy judgments and, if appropriate, to rewrite the applicable governing statutes.\textsuperscript{194} On September 11, 1979, the House of Representatives passed and sent to the Senate a bill specifically permitting federally chartered credit unions to offer share draft services, and permitting federally chartered savings and loan associations and federally insured mutual savings banks to offer NOW accounts.\textsuperscript{195} The Senate passed that bill in a heavily amended form,\textsuperscript{196} but the House-Senate Conference Committee was unable to reconcile the differences between the two measures. The two houses finally agreed on yet another bill\textsuperscript{197} which approved share drafts,\textsuperscript{198} Federal Reserve member bank automatic transfer services,\textsuperscript{199} and savings and loan association remote service units.\textsuperscript{200} The bill did not approve nationwide NOW accounts, and limited expansion of that service to the addition of savings and loan associations in New Jersey.\textsuperscript{201} The measure was effective for only ninety days,\textsuperscript{202} but further federal legislation in early 1980 making the provisions permanent is virtually insured.

Because of the passage of that bill, successful state litigation challenging thrift institution check-like services is now practically foreclosed. A desire to protect state chartered thrifts from competitive inequality will likely lead to identical powers being granted to those institutions. In addition, since the bill also grants to commercial banks interest-bearing check-
ing account authority, by means of an interest-bearing account accessible
by check through a zero-balance checking account, the prospective litigants'
principal basis for dispute has been eliminated. The effect of this legis-
lation, however, may go beyond eliminating major differences between com-
mmercial banks and thrifts; the legislation also may have an impact on the
proper characterization of a draft drawn on a thrift institution for com-
mmercial law purposes.

V. "New Checks" and the UCC

The focal area of this article is the applicability of the Uniform Com-
mmercial Code to these "new checks." Are these instruments "negotiable"
as that term is defined and particularized by Article 3 of the UCC? The
question is surely an important one since the answer governs the status
of remote transferees. If an instrument is negotiable, a subsequent taker
may qualify as a holder in due course, immunizing him from ordinary de-
fenses the issuer may later assert.203 If the instrument is not negotiable,
no transferee can qualify as a holder in due course.204 Assuming negoti-
ability, the next logical question is whether the "new checks" are governed
as are ordinary commercial bank checks by the rather detailed collection
process set out in Article 4.205 Parts 2 and 3 of that Article establish a
tight time schedule for the collection and payment of checks, and impose
rather stringent liability on tardy banks.206 Finally, part 4 establishes the
framework of the bank-customer relationship, and provides certain basic
customer protections. The right of the customer to stop payment,207 the
drawee bank's liability for improper payment208 or improper dishonor,209
and the customer's access to paid items to review them for unauthorized sig-
natures or alterations210 may depend on the applicability of the pro-
visions in part 4.

A. Credit Union Share Drafts

1. Negotiability

While all thrift institution "checkable deposit" instruments present
the above questions to some degree, credit union share draft accounts
raise certain issues in bolder relief. Section 3-104 (1) of the Code establishes
four requirements for negotiability:

Any writing to be a negotiable instrument within this Article must
(a) be signed by the maker or drawer; and

203. U.C.C. §§ 3-302, 3-305.
204. U.C.C. § 3-202.
205. U.C.C. §§ 4-201 to 4-213. It should be noted here that non-negotiable in-
struments are also covered by the collection provisions of Article 4. See U.C.C.
§ 4-104 (g).
206. See U.C.C. §§ 4-202, 4-213, 4-302.
207. U.C.C. § 4-403 (1), (2).
208. U.C.C. § 4-403 (3).
209. U.C.C. § 4-402.
210. U.C.C. § 4-406.
(b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and  
(c) be payable on demand or at a definite time; and  
(d) be payable to order or to bearer.

Subsection (2) states that an instrument, if negotiable, must be either a draft, check, note, or certificate of deposit, and defines each.\(^{211}\)

The negotiability requirements of section 3-104 are elaborated upon by other provisions in part 1 of Article 3. Section 3-105 defines unconditional promises. An instrument which states on its face that it is governed by another agreement cannot be negotiable. The instrument can, however, be subject to implied or constructive conditions, and it can refer to separate agreements. The official comment to this section states, “The section is intended to make it clear that, so far as negotiability is affected, the conditional or unconditional character of the promise or order is to be determined by what is expressed in the instrument itself. . . .” That assertion is a restatement of the timeworn characterization of a negotiable instrument as a “carrier without baggage.”\(^{212}\) The common share draft makes no explicit reference to other conditions or agreements and therefore meets the requirement of unconditionality.

Section 3-108 defines a demand instrument. The general definition of section 3-104 provides that a negotiable instrument must be payable either on demand or at a definite time. Since no definite time for payment is stated, the instrument is negotiable only if it is a demand instrument. The section does not provide much help by identifying a demand instrument as one “payable on demand,” including “those payable at sight or on presentation and those in which no time for payment is stated.” In any event, a common share draft, like an ordinary commercial bank check, provides no time for payment and would qualify as a demand instrument.\(^{213}\)

\(^{211}\) U.C.C. § 3-104 (2) provides:
A writing which complies with the requirements of this section is:
(a) a “draft” (bill of exchange) if it is an order;
(b) a “check” if it is a draft drawn on a bank and payable on demand;
(c) a “certificate of deposit” if it is an acknowledgement by a bank of receipt of money with an engagement to repay it;
(d) a “note” if it is a promise other than a certificate of deposit.

\(^{212}\) Overton v. Tyler, 3 Pa. 346 (1846).

\(^{213}\) The instrument may qualify as a “demand” instrument even though the account it is being used to access is not a demand account. Since the 1930s, both commercial banks and thrift institutions have largely been prohibited from paying interest on demand deposits. Regulation Q of The Board of Governors of the Federal Reserve System defines a “demand deposit” as any deposit “which is not a ‘time deposit’ or ‘savings deposit’ as defined in this section,” and defines “time and savings deposits” as deposits, \textit{inter alia}, which are subject to actual or optional notice of withdrawal prerogatives of the depository institution of not less than 30 days. 12 C.F.R. § 217.1 (a)-(c) (1979). A credit union share draft account is manifestly not a demand account because it is usually subject to that notice of with-
The general definition of negotiability also requires that the instrument be payable either to "order" or to "bearer." An instrument is payable to bearer if it is payable, without more, to the one who has possession of it; it is payable to order if it is payable according to the particular direction of a holder. Sections 3-110 and 3-111 define the two terms. A common commercial bank check is an "order" instrument. Invariably imprinted on the check is the language "pay to the order of." This language is necessary. An instrument issued "Pay to John Doe," while transferable, is not negotiable: it is payable only to John Doe, not the bearer (if one other than John Doe), and not, so far as negotiability is concerned, according to the instructions of John Doe. The point may seem an obscure one to the uninitiated, but by a long line of cases construing these sections as well as their predecessors, sections 8 and 9 of the Negotiable Instruments Law, the "pay to" instrument is nonnegotiable. Indeed, that result was apparently intended in an early credit union share draft experiment. Credit union share drafts in current use, however, meet the requirements of sections 3-110 and 3-111.

Section 3-119, entitled "Other Writings Affecting Instrument," may be of consequence to the inquiry concerning share draft negotiability because of a frequent credit union practice. Credit union share draft account agreements commonly contain a clause reserving to the credit union a right to require advance notice of withdrawals. Arguably, an instance might arise where a remote holder of a credit union share draft presents the draft through ordinary channels for payment and finds the draft dishonored, not because the draft was stop ordered or the customer had insufficient funds on account, but because the credit union exercised its option to require advance notice of withdrawal, and the customer failed to comply. Section 3-119(2) dispells any doubt as to the effect these

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214. Such an instrument is still subject to Article 3. See U.C.C. § 3-805.

215. A "pay to" share draft offered by the John Deere Employees Credit Union of Waterloo, Iowa, was the subject of litigation in Iowa Credit Union League v. Iowa Dept. of Banking, 268 N.W.2d 165 (Iowa 1978).

216. The purpose of the right to require advance notice of withdrawal is to prevent a liquidity crisis. An ordinary commercial bank, should it confront such a crisis and be unable to pay checks on presentment, is faced with the singular option of declaring insolvency. A credit union or other thrift institution on the threshold of a severe cash flow problem, on the other hand, can impose the notice requirement, suspend payments for the 30-day period, and subsequently reinstitute payments, thus avoiding insolvency.
agreements have on the negotiability of the draft. It states, “A separate agreement does not affect the negotiability of an instrument.”

While this result might at first glance seem curious, the rationale supporting it is clear. The issuer of a check or draft does not guarantee payment by a third-party financial institution, but only that, upon the holder’s taking appropriate steps,\textsuperscript{217} he will pay it. Indeed, a check drawn on a nonexistent bank could still be negotiable.\textsuperscript{218} That a draft might not be paid by a third-party financial institution owing to some underlying separate agreement will not render it nonnegotiable.

A review of the foregoing sections and those less directly applicable\textsuperscript{219} leads to an unambiguous conclusion: credit union share drafts commonly in use today are negotiable demand instruments. A determination as to the precise character of the share draft—"is it merely a draft ("an order"), or is it in addition a check ("a draft drawn on a bank and payable on demand")—will be answered in the next inquiry: What, for purposes of the UCC, is a "bank"?

2. The Bank Collection Process

a. What is a "bank"?

The word "bank" is defined only in section 1-201 (4), which states, "‘Bank’ means any person engaged in the business of banking.” The comment to this subsection is not helpful,\textsuperscript{220} necessitating recourse to the conventional statutory construction aids and other interpretative tools.

A word in a statute not used in a technical sense, in the absence of an expressed legislative intent to the contrary, generally is to be accorded its common meaning.\textsuperscript{221} The “common meaning” of a word is customarily that attributed to it by a standard dictionary.\textsuperscript{222} Webster’s Third New International Dictionary defines the word “bank” as “an establishment for the custody, loan, exchange, or issue of money, for the extension of credit, and for facilitating the transmission of funds by drafts or bills of exchange.”

\textsuperscript{217} For provisions regarding presentment and notice of dishonor, see U.C.C. §§ 3-501 to 3-508.

\textsuperscript{218} Such a draft would still meet the basic requirements of U.C.C. § 3-104 (1) (a)-(d) relating to negotiability.

\textsuperscript{219} Section 3-120, “Instruments ‘Payable Through’ Bank,” provides that an instrument can designate a “payable through” bank. That section and the accompanying official comments explain that a “payable through” bank is not ordered or even authorized to make payment on the instrument out of drawer’s funds on deposit, but is merely authorized “as a collecting bank through which presentment is properly made to the drawee.”

\textsuperscript{220} The Official Comment to U.C.C. § 1-201 (4) merely makes reference to § 191 of the Uniform Negotiable Instruments Law. That section provides: “In this act, unless the context otherwise requires: . . . ‘Bank’ includes any person or association of persons carrying on the business of banking, whether incorporated or not.”

\textsuperscript{221} 2A C. SANDS, SUTHERLAND STATUTORY CONSTRUCTION §§ 45.14, 47.01, 47.28 (4th ed. 1972).

\textsuperscript{222} Id.
A credit union embarked upon a share draft program probably satisfies this definition.

A standard secondary approach to statutory construction—recourse to a pronounced legislative statement of purpose—reinforces that conclusion. Section 1-102, adopted in all states without significant amendment, states the drafters' purposes and rules of construction. The first two provisions of that section offer guidance:

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.
(2) Underlying purposes and policies of this Act are:
   (a) to simplify, clarify and modernize the law governing commercial transactions;
   (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
   (c) to make uniform the law among the various jurisdictions.

The nationwide development of a sophisticated checking-like service by credit unions, and the recognition of that service in the market place and by companion financial institutions, is precisely the "expansion of commercial practices through ... usage and agreement of the parties" which the Code seeks to permit. With that declared legislative purpose in mind, it becomes apparent that a credit union offering a share draft plan fits the Code's definition of a bank.

In support of a contrary view, it might be argued that the language of section 1-201 (4), which defines "bank" as "any person engaged in the business of banking," implicitly means the business of commercial banking. It also could be argued that a credit union may not be engaged in the "business of" anything. By definition, a credit union is cooperative in nature; the institutional structure is not-for-profit. Only those joined by a common bond, usually of employment, are entitled to participate. Earnings not appropriately invested in expansion are periodically returned to the membership. Although some credit unions have reached sizes shadowing many commercial banks, most are small and continue to be operated informally.

223. Id. at §§ 48.01-02.
224. Certain states did not adopt U.C.C. § 1-102 (5) relating to use of gender.
225. A variation on this analysis was used by the court in La Caisse Populaire Ste. Marie v. United States, 563 F.2d 505 (1st Cir. 1977), in determining that a credit union is not a bank for Internal Revenue Service purposes.
229. See, e.g., authorities cited note 228 supra.
230. As of December 31, 1978, the Navy Federal Credit Union had total assets of $765.5 million. See note 59 supra.
231. For example, of 194 state chartered credit unions in Washington state as of December 31, 1978, 97 had total assets of less than $1 million. State of Washington Dept. of Gen. Admin., Div. of Sav. & Loan Ass'n, Roster of State Chartered Sav. & Loan Ass'n and Credit Unions with Comparative Statements 7-11 (Dec. 31, 1978).
While commercial banking is not statutorily defined, the phrase has been subjected to judicial interpretation. In United States v. Philadelphia National Bank, the Supreme Court asserted that the phrase described “a congeries of services and credit devices,” and in a footnote enumerated a representative sampling of banking services. The Court in Philadelphia National Bank understandably did not intend its sampling of commercial bank services to serve a precise definitional function. To determine the character of a financial institution by a tally of the number and nature of financial services offered would not be practical. Nonetheless, it is interesting to note that the personal financial services offered by a representative medium sized credit union with a share draft program approximate those listed by the Court in Philadelphia National Bank. This relatively wide scope of banking services provided by a credit union offering share draft services is undoubtedly the rule rather than the exception; credit unions with share draft programs tend to be, and are often required by regulatory authorities to be, large, well-established, and professionally operated.

Interpreting “business of banking” to mean exclusively the business of commercial banking flounders in view of the scant authority for the proposition that the word “business” excludes cooperative ventures, or refers to undertakings of a particular size or level of sophistication. In addition, a credit union should be regarded as a “bank” because the question is whether, for Articles 3 and 4 purposes alone, a credit union offering share draft services is a “bank,” not whether a credit union embarked

233. Id. at 326-27 n.5. The list included: unsecured personal and business loans; mortgage loans; loans secured by securities or accounts receivable; automobile installment and consumer goods installment loans; tuition financing; bank credit cards; revolving credit funds, acceptance of demand deposits from individuals, corporations, governmental agencies, and other banks; acceptance of time and savings deposits; estate and trust planning and trusteeship services; lock boxes and safety deposit boxes; account reconciliation services; foreign department services; correspondent services; and investment advice.
234. The scope of banking services offered by financial institutions of all categories often will depend upon their relative sizes. Small rural commercial banks probably offer their customers fewer financial services than large urban mutual savings banks.
235. A recent prospectus of such a credit union offered members the following services: the making of unsecured and secured personal loans; the making of real estate loans; the making of consumer installment loans; the offering of share draft accounts; the sale of travellers checks and money orders; the offering of financial counseling; the making of student education loans; the accepting of time and savings deposits; the offering of safe deposit boxes; and the offering of share and credit insurance. Prospectus of Spokane Teachers Credit Union, Spokane, Washington (July 1, 1979). One might conclude, on some sort of sliding scale evaluation, that this credit union is more nearly a “bank” than “not-a-bank.”
upon a share draft program is a "bank" for every purpose under the law.\footnote{237} Because share drafts are treated by other banks and by the Federal Reserve System very similarly to ordinary checks, to construe the Code definition of "bank" so as to exclude credit unions would likely give rise to a number of serious legal problems, and would achieve no discernible useful social policy. Nonetheless, thoughtful commentators differ\footnote{238} and the question today could be characterized as fairly close. Judicial interpretation might be helpful, but an amendment to section 1-201 (4), clearly including or excluding thrift institutions and others, would make the answer clear.

b. Collection

Article 4 of the UCC governs the collection and final payment of checks, as well as the relationship between a customer and his bank. More specifically, the article covers the collection and payment process as it relates to what are called "items." The term is broadly defined in section 4-104 (g) as "any instrument for the payment of money even though

\footnote{237} It does not necessarily follow from the analysis in the text that a credit union is engaged in the "business of banking" for other purposes. For example, the following authorities are not dispositive in our narrow inquiry:

(A) The definition of "bank" in The Bank Holding Company Act, 12 U.S.C. § 1841 (c) (1976): "[A]ny institution organized under the laws of [the several jurisdictions of the United States] which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."

(B) The usual but narrow definition of the "business of banking" for the purpose of chartering state commercial banks, as in Missouri: "[T]he business of discounting bills, notes or other evidence of debt, of receiving deposits, of buying and selling bills of exchange, or of issuing bills, notes or other evidences of debt for circulation as money, or of engaging in any other form of banking." RSMo § 362.420 (1978).

(C) The determination of what is a bank for the purpose of state "unit-banking" or "branch-banking" regulations: Texas State Chartered Credit Operating draft withdrawal program is not a "corporate body with banking and discounting privileges" within the meaning of the Art. 16, § 16 Texas constitutional prohibition against branch banking. Texas Bankers Ass'n v. Government Employees Credit Union, No. 78-CI-4577 (Dist. Ct., Bexar Co., Tex., Oct. 15, 1979).

(D) The "scope" or "reach" section of the National Banking Act, 12 U.S.C. § 37 (1976), which provides: "The provisions of this chapter, which are expressed without restrictive words, as applying to 'national banking associations', or to 'associations', apply to all associations organized to carry on the business of banking under any Act of Congress."

\footnote{238} Professor Fairfax Leary, the Reporter for Article 4 during much of the initial drafting stage, has suggested that the word "bank" is used throughout the Code in the more restricted sense, and refers to a financial institution chartered to embark upon an especial undertaking. Thus, institutions organized under particular state or federal statutes relating to the chartering of ordinary commercial banks are "banks." Institutions organized and chartered under statutes relating to savings and loan associations, mutual savings banks, and credit unions remain, in spite of their services, respectively savings and loan associations, mutual savings banks, and credit unions. This approach serves the function of maintaining the traditional distinctions between these four kinds of financial associations. Remarks of Professor Fairfax Leary, 13th Annual Uniform Commercial Code Institute, Washington, D.C. (Nov. 1, 1979).
it is not negotiable but does not include money." A section 3-104 (2) (b) check is an "item" under this definition. Given the breadth of the definition, however, a credit union share draft qualifies whether or not it is a check. A share draft will thus fit neatly into the collection scheme established by Article 4, at least as it governs collection by depository\textsuperscript{239} and collecting\textsuperscript{240} banks.\textsuperscript{241} In fact, both the Federal Reserve System, through its district banks, and the nation's commercial banks have cleared share drafts in the fashion accorded checks for some time.\textsuperscript{242}

Certain responsibilities and potential liabilities arise from a bank's assisting in check collection under Article 4. It must use ordinary care and act timely—usually within its midnight deadline\textsuperscript{243}—in sending, presenting, or settling for an item, and is liable for the amount of the item if it fails to do so.\textsuperscript{244} It must indorse and guarantee prior indorsements and must make certain warranties regarding the item on transfer and presentment.\textsuperscript{245} While a liability incurred under one of these sections or

\textsuperscript{239} "Depository bank" means the first bank to which an item is transferred for collection even though it is also the payor bank . . . ." U.C.C. § 4-105 (a).

\textsuperscript{240} "Collecting bank" means any bank handling the item for collection except the payor bank . . . ." U.C.C. § 4-105 (d).

\textsuperscript{241} To facilitate appreciation of how a credit union share draft would be subjected to the Article 4 collection process requirements, the following tracing of the collection of an ordinary commercial bank check is offered: Assume Jones, a San Francisco resident, determines to buy an ermine-lined backgammon board from Nieman-Marcus in Dallas. He sends them his check in payment, drawn on San Francisco Bank, on December 1, 1979. On December 3 the check is received by Nieman-Marcus in Dallas, and on December 4 the mercantile company deposits it in its bank, Dallas Bank. Dallas Bank sorts it out in a group of checks drawn on banks in other Federal Reserve districts, and on December 5 forwards it with those other items to the Federal Reserve Bank of Dallas. Dallas Bank is given conditional credit for Jones' check, and FRB Dallas forwards the check on December 6 to FRB San Francisco. On December 7 the check is presented to and received by FRB San Francisco, which grants FRB Dallas a conditional credit for the item. On December 10 the item is presented by FRB San Francisco to San Francisco Bank. The latter then has until midnight of the day following presentment to honor or dishonor the item. It must give conditional credit the day of receipt, and ordinarily, should Jones have sufficient funds in his account, will simply allow the "midnight deadline" to lapse, thereby becoming "accountable" for the item, and "firming up" the sequential conditional credits already given in the collection chain.

\textsuperscript{242} The Federal Reserve System undertook to assist in the collection of share drafts as Regulation J (12 C.F.R. § 210 (1979)) "cash items" in 1974.

\textsuperscript{243} The midnight deadline ends the next banking day following receipt of an item. See U.C.C. § 4-104 (1) (d).

\textsuperscript{244} U.C.C. § 4-103 (5). The section establishes as the measure of DAMAGES the amount of the item reduced by an amount which could not have been realized by the use of ordinary care.

\textsuperscript{245} Section 4-207, detailing implied warranties on transfer or presentment of an item, is a lengthy but extremely important section of Article 4. Under the transfer warranty, a collecting bank guarantees to immediate and remote transferees, when it transfers an item and receives a settlement, that it has good title (i.e., that prior indorsements are regular), that the item has not been materially altered or the drawer's signature forged, that it is immune to defenses on the item, and that it is unaware of the drawer's insolvency. The presentment warranty is narrower in scope but is made by all in the collection chain. Both collecting and pre-
others\textsuperscript{248} often can be passed on,\textsuperscript{247} at times this is not possible and the exposure is of some consequence. There appear to be no reasons for excusing collecting banks from these responsibilities when share drafts rather than checks are the subject of collection. Indeed, Federal Reserve Board regulations which parallel Code collection requirements apply to share draft collection.\textsuperscript{248}

c. Presentment

In the collection of ordinary bank checks, the individual checks are physically presented to the drawee bank which, after sorting and determining to pay them, cancels the checks and returns them to its customers. The typical final stage of share draft collection, however, is different. The instrument is photocopied by the "payable through" bank, and the original is then destroyed. Communication with the affected credit union concerning its payment is handled electronically. Customers receive periodic statements reflecting the payment of items indicating share draft number and amount; they do not recover the paid item itself. The process, called presenting banks warrant to a payor bank or other payor who in good faith pays that they have good title, no knowledge of a forged drawer's signature, and that the item has not been materially altered.

Applying the presentment warranty provisions of § 4-207 to the collection of share drafts might seem to present a conceptual difficulty because, under the truncated collection process used, see note 241 supra, the paid share draft is kept by the "payable through" bank, having been only electronically presented to the payor credit union. If a credit union customer's account is recredited on discovery of a forged indorsement, could the credit union recover from the "payable through" bank for breach of a presentment warranty of good title? The answer is probably yes. The section can be applied in this setting because whether a credit union is a "payor bank" or not, it clearly qualifies as an "other payor." Further, an electronic presentment qualifies as an appropriate presentment under Article 3. See text accompanying notes 250-252 infra. The rather clear applicability of the Code warranty provisions to banks collecting share drafts, however, may have little practical impact. Because of the nature of credit unions, large item share drafts are apt to be rare. A credit union recrediting a customer's account for a small unauthorized payment is likely to forego any claim against a prior collecting bank because of the disproportionate expense. The applicability of the presentment warranty to a "payable through" bank is probably of even less practical consequence. A credit union seeking to recover on a presentment warranty can and probably would skip the presenting "payable through" bank and proceed against prior collecting banks, resulting in the discharge of the "payable through" bank. See U.C.C. § 3-208. In fact, credit unions might enter into agreements with their collaborating "payable through" banks exonerating them completely from warranty liability. Apparently such agreements, permissible under § 4-103, are in fact common.

\textsuperscript{246} E.g., conversion liability incurred for paying a draft over a forged indorsement under U.C.C. § 3-419.

\textsuperscript{247} The U.C.C. § 4-207 warranty provisions, see note 245 supra, generally allow an action over against the prior bank in the chain of collection, as does Federal Reserve System Regulation J (12 C.F.R. § 210.5(b) (1979)).

\textsuperscript{248} Share drafts have received treatment as "cash items" ("a check . . . or [a]ny other item payable on demand and collectible at par," 12 C.F.R. § 210.2 (i) (1979)) since the inception of credit union share draft plans, and are thus subject to the general Federal Reserve regulations concerning collection and handling of demand instruments. 12 C.F.R. §§ 210.3-14 (1979).
“truncation,” is not conceptually new, and commercial banks have for
some time indicated interest in adopting it.249

The problem in this area is that the act of presentment for payment, a pivotal step in the collection process, generally evokes the notion of the
physical act of presenting the item. How, then, is presentment to take
place in a “truncated” collection process? While the Code is rather specific
in its requirement regarding time of presentment,250 it sets out no re-
quirements concerning manner or place. Section 3-504 defines presentment
as “a demand for acceptance or payment made upon the . . . drawee or
other payor by or on behalf of the holder.” Because the balance of that
section, and section 3-505 (“Rights of Party to Whom Presentment is
Made”) are permissive rather than mandatory, a party to whom the in-
strument is presented may require exhibition of the instrument, identifi-
cation, a signed receipt, etc.,251 but these rights may be waived. It would
appear that at least as far as presentment is concerned,252 the truncated
approach does not run afoul of the Code.

d. Payment

The final stage in the collection of demand items is the payment stage,
governed by sections 4-213, 4-301, and 4-302. These sections control pay-
ment of an item by a “payor bank,” which the Code defines as “a bank by
which an item is payable as drawn or accepted.”253 Given the assumption
that a credit union fits the Code’s definition of a “bank,” it will then fit
this definition: the share draft is an item payable as drawn by the credit
union.

Section 4-301 sets out a payor bank’s responsibility once an item has
been presented to it for payment. By its midnight deadline, a payor bank
must either pay the item, return it, or send notice of dishonor of the item.
Failure to act timely will result in the payor bank becoming accountable,
generally to the presenting party, under sections 4-302 and 4-213, for the
amount of the item.

The truncation of the collection process involving share drafts does
not materially affect a credit union’s ability to comply with this tight
time framework. Indeed, the advent of electronic data transmission capa-
bility which initially gave rise to the truncated collection process, also en-
ables the credit union and its “payable through” bank to comply with the

249. On March 31, 1980, some 23 commercial banks, including 8 of the
country’s 10 largest, began a pilot test of check truncation sponsored by the
was the subject of recent study by the American Bankers Association. AMERICAN
BANKERS ASSOCIATION, CHECK SAFEKEEPING: A TASK FORCE REPORT ON CHECK
TRUNCATION (1978).
250. U.C.C. § 3-503.
251. U.C.C. § 3-505.
252. But see text accompanying notes 257-267 infra (discussion of U.C.C. §
4-105, the “bank statement rule”).
253. U.C.C. § 4-105 (b).
Code's requirements. In any event, the time deadlines imposed by these provisions and those imposed by other provisions of Article 4 can be varied by agreement. Finally, banks commonly participate in an association of banks formed for the purpose of clearing items—called a clearinghouse—which may by rule alter the midnight deadline.

3. The Bank-Customer Relationship

The final area of inquiry is part 4 of Article 4, which deals with the bank-customer relationship generally and certain customer protections specifically. Within part 4 the initial focus must be on section 4-406, the "bank statement rule." That section protects the customer against improper payment of forged or altered checks. It provides that the payor bank must send or otherwise make available to its customer the cancelled checks and an accompanying statement. The onus is then upon the customer to discover and report forgeries or alterations within a reasonable time, not to exceed stated outer limits. If the customer fails to report irregularities, he may not recover unless he shows that his bank lacked ordinary care—a sort of "double contributory negligence" standard.

A result of truncated collection is the retention of the share draft by the payable through bank. The participating credit union does not recover the paid share draft, and of course it is not returned to the customer. The credit union does not send its share draft customer a statement of account accompanied by items paid in good faith. Instead, the customer

254. In fact, Federal Reserve Board Regulation J requires that "payable through" banks comply with their own "midnight deadline" in paying items. A "payable through" bank falls within the meaning of a "paying bank" under the regulation, 12 C.F.R. § 210.2 (k) (2) (1979); such a "paying bank" is under an obligation to pay or dishonor cash items presented to it for payment by midnight of the banking day next following receipt of the item. 12 C.F.R. § 210.12 (a) (1979).
255. U.C.C. § 4-103 (1).
256. U.C.C. § 4-103 (2).
257. U.C.C. § 4-406 (1) provides:
When a bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries or holds the statement and items pursuant to a request or instructions of its customer or otherwise in a reasonable manner makes the statement and items available to the customer, the customer must exercise reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof.
While the subsection does not literally require that a bank furnish its customer a statement and the paid checks, the effect may be to impose that requirement; otherwise the bank's liability for improper payment of a check under U.C.C. § 4-401 might be open-ended and of indefinite duration.
258. U.C.C. § 4-406 (1).
259. See U.C.C. § 4-406 (4) (usually one year).
260. U.C.C. § 4-406 (2) (a).
261. U.C.C. § 4-406 (3).
will receive only a statement. The paid share drafts are photocopied by the payable through bank and then destroyed. While a customer generally may obtain copies of these drafts upon request after complying with his agreement with the credit union, the question remains: Does the retention by a distant payable through bank of a copy of the item, available to the customer upon request, constitute making the statement and items available to the customer in a reasonable manner?

The question is a problematic one, but given the ease with which a customer can obtain a paid share draft—all he need do is identify the item requested, pay the required fee, and the item will be sent to him for inspection—there appears to be ample support for truncation. Elimination of truncation would force credit unions to increase significantly share draft account charges to customers. Further, the customer's need to review cancelled checks for alterations and forgeries may not be terribly consequential; the incidence of that kind of malefaction is extremely low. Finally, a customer can detect in almost all instances apparent inappropriate charges to his account by reviewing his periodic statement.

The balance of the "bank statement rule" presents questions which, while of less practical consequence, are perhaps as thorny. Section 4-406 (2) (b) articulates what has come to be called "the 14-day rule." In settings where the same wrongdoer is forging or altering a customer's checks, the customer has a maximum of 14 days after receiving the statement and the first forged or altered item to notify his bank of that forgery or alteration. If the customer does not so notify his bank within that time,

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262. A statement is required by regulatory authorities. See, e.g., 12 C.F.R. § 701.34 (c) (viii) (1979), covering federally chartered credit unions.

263. Share draft agreements uniformly provide, either explicitly or implicitly, for return of copies of paid items upon request.

264. The applicability of the "bank statement rule," U.C.C. § 4-406, is discussed at length in American Bankers Association, supra note 249, at 53-57. The report contemplates the truncation of the check at the bank of first deposit, but the delivery of an imaged (electronically reproduced) copy to the payor bank, and the subsequent delivery to the customer of such an imaged copy. The report further notes that following this procedure might well not satisfy the § 4-406 time frames. Id. at 55.

265. Also required by regulatory authorities; see, e.g., 12 C.F.R. § 701.34 (c) (xi) (1979). A charge of $.75 to $2.00 is usually rendered for furnishing a copy of a paid item.

266. A useful, precise estimate of the collection cost of a non-truncated demand item, including return of the cancelled check to the customer, is not generally available; those costs differ depending upon the level of sophistication of check processing used. One authority has placed the per item handling cost of a non-truncated item at $.25-.30 and that of a truncated share draft at $.02-.16. Conversation with Ralph Swoboda, General Counsel, I.C.U. Services (Nov. 1, 1979).

267. The conventional share draft periodic statement contains the number, amount, and date processed of paid share drafts. With that information and his share draft payment records—which include carbon copies of share drafts issued—a customer can detect payments that were wholly unauthorized or that were in unauthorized amounts. He cannot, however, detect forged indorsements, nor can he detect proper and improper payments should he lose his share draft booklet.
he may not demand recredit for subsequent checks which were forged or altered by the same wrongdoer, and paid prior to actual notification. Truncation ought to excuse the customer from this accelerated reporting duty, at least until he obtains a copy of that first forged item and is able to positively identify the wrongdoing.

Section 4-406 (4) requires that a customer notify his bank of his forged signature or any alteration within one year of his receipt of the statement and items; and of forged indorsements within three years. Those time periods represent statutory definitions of the outer limits of reasonably prompt notification; they are not statutes of limitations. Since a customer without serious difficulty may identify from his statement instances of wrongdoing, the one year notice provision should apply equally to share drafts. While a customer cannot review indorsements, this also is of little consequence. Even where the item is returned to him for physical inspection, he usually will not be in a position to identify forged indorsements. Instead, he normally would rely on notification of the theft or forgery by the prior holder. There appears no reason not to hold a share draft customer to that same standard.

Finally, section 4-406 (5) requires that should a customer demand recredit because items paid were forged or altered, the payor bank must raise whatever defenses it has concerning the timeliness of his notification, or be barred from recovering against prior collecting and presenting banks for breach of warranty. As noted earlier, application of the bank statement rule to a credit union share draft customer may impose upon him, in the accelerated reporting requirement of the 14-day rule, a burden he cannot meet. It was suggested that the requirement might have to be relaxed. The thrust of subsection (5) is that the bank must raise against its customer defenses to his demand for recredit that it has under that section. In settings where the customer's reporting obligation is thus made less stringent, a credit union's duty to raise that defense before pursuing claims against prior collecting banks also would have to be relaxed.

4. Errata

A bank may charge a customer's account only with items that are "properly payable." Conversely, it may not pay items not properly payable. These seemingly self-evident propositions are amplified in the Code by sections governing improper payment and improper dishonor. Section 4-403 establishes the right of a customer to stop payment of an item

268. This one-year period has been reduced legislatively in some states to 60 days. See Ga. Code Ann. § 109A-4-406 (4) (1979); Wash. Rev. Code Ann. § 62A.4-406 (4) (Supp. 1978).
270. For a discussion of warranty liability, see note 245 supra.
271. U.C.C. § 4-401.
272. U.C.C. § 4-403.
273. U.C.C. § 4-402.
before it is presented for payment, and assuming a credit union operating a share draft plan is a "bank," that option is available to a credit union customer as well.\textsuperscript{274} Indeed, the ordinary credit union share draft agreement usually includes a stop order option as a contractual customer right, albeit sometimes only if the stop order is in writing and accompanied by payment of a prescribed fee. Should a stop order be ignored, a credit union presumably will incur liability to its customer for the amount of damages the customer is able to show.\textsuperscript{275}

Should a credit union dishonor a share draft improperly, it will incur liability to its customer for damages caused by the dishonor,\textsuperscript{276} perhaps including damage to the customer's good credit.\textsuperscript{277} Given, again, that a credit union offering a share draft program is a "bank" for Article 4 purposes, there appears to be no reason to excuse such a credit union from the operation of the "properly payable" rule and its related duties.

Section 4-407 provides a payor bank, which a credit union is now assumed to be, with certain procedural protections against customer damage claims that a paid item was properly stop ordered or otherwise not properly payable.\textsuperscript{278} Under this section, sometimes referred to as the "double subrogation rule," a bank that has paid such an item may place itself in the position of an intermediate holder or holder in due course. If the customer would have been liable to that intermediate party were they still holding the instrument, his claim against his bank is defeated. Alternatively, the section provides that should the bank choose to honor the customer's demand that it recredit, it may assume the customer's position with regard to claims he has against the payee or other intermediate holder, and recover on those claims. Again, there appear to be no practical or conceptual reasons for not allowing a credit union operating a share draft plan the benefits of this section. Similarly, other provisions that round out the bank-customer relationship ought properly to govern credit union share draft programs.\textsuperscript{279}

\textsuperscript{274} The National Credit Union Administration requires federally chartered credit unions offering share draft services to allow a contractual stop order right. 12 C.F.R. § 701.34 (c)(5)(c) (1979). There is a strong argument that the stop order provisions of § 4-403 accord stop order privileges to customers as a matter of right, and therefore a separate customer agreement to pay a stop order charge is unenforceable. U.C.C. § 4-403, Comment 2 provides:

The position taken by this section is that stopping payment is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop should be borne by the banks as a cost of the business of banking.

\textsuperscript{275} U.C.C. § 4-403 (3).

\textsuperscript{276} U.C.C. § 4-402.

\textsuperscript{277} Liability might be incurred if the dishonor is intentional, rather than mistaken. \textit{Id.}

\textsuperscript{278} \textit{E.g.,} a post-dated share draft.

\textsuperscript{279} U.C.C. § 4-405 (2) allows a bank to pay the checks of a deceased customer up to 10 days after death. A credit union would probably find applicability of this section to its advantage; in the absence of such a provision, there probably
B. Other Thrift Institution "New Check" Services

1. Negotiability

"Checking-like" services have in the recent past been marketed under a confusing welter of names.\(^{280}\) The current standard denomination of a mutual savings bank or savings and loan institution third party payment instrument\(^{281}\) used to access a deposit is a negotiable order of withdrawal (NOW).\(^{282}\) NOW accounts are offered by both mutuals and savings and loans. The only significant difference between a mutual NOW draft and that of a savings and loan is that the former, like a credit union share draft, is sometimes a "payable through" item,\(^{283}\) while a savings and loan association NOW draft is customarily one drawn on the savings and loan association itself.\(^{284}\)

A mutual savings bank NOW draft carrying a "payable through" bank is susceptible to the same analysis given a credit union share draft. Issued in the same form and relevant particulars as a share draft, it meets the applicable provisions of part 1 of Article 3 of the Code, and qualifies as a negotiable demand draft. A savings and loan association NOW draft drawn on a "payable though" bank is of course subject to that same analysis. A NOW draft drawn on a mutual savings bank or savings and

would be a question as to the authority of a credit union to pay any deceased customer's share drafts even were it without notice of death.

Both §§ 4-405 and 4-404, relating to a bank's optional payment of checks over six months old, alone in Article 4, use the term "check," rather than "item." Because the conclusion has been reached that a share draft fits the Code's definition of a "check"—a draft drawn on a bank and payable on demand—the two sections also would apply to credit unions.

280. The marketing names include at least the following: NOWs (negotiable orders of withdrawal, usually on an interest-bearing account); WOWs (written orders of withdrawal, non-transferable, drawn on a non-interest-bearing account, offered by some thrifts in the early 1970s but now rare); POWs (payment orders of withdrawal, on a non-interest-bearing account); and NINOWs (non-interest-bearing negotiable orders of withdrawal).

281. Recall that some thrift institutions have been offering ordinary demand deposit accounts since before the turn of the century. See note 119 and accompanying text supra.

282. A "NOW account" was itself initially a trademarked marketing name of Consumers Savings Bank, Worchester, Massachusetts. Probably because it was both the first and most widely publicized denomination given a negotiable instrument used to access an interest-bearing account, the name has gained widespread trade, public, and even judicial recognition.

283. See note 8 supra. For a period of time in 1978 a number of New York mutual savings banks that were members of the Federal Reserve System, see note 9 supra, offered automatic fund transfer accounts (AFT) authorized for commercial banks by a 1978 amendment to Regulation Q, 12 C.F.R. § 217.5 (c) (2) (1979). Apparently, the service was authorized under the rationale that Regulation Q governs not just commercial banks, but all federal reserve "member" banks, a category which might include a mutual. Most of these thrifts withdrew the offering in favor of the more direct NOW accounts when 12 U.S.C. § 1832 (1976) was amended November 10, 1978, to permit NOW accounts in New York. National Association of Mutual Savings Banks, Mutual Savings Banking: May 1979 Annual Report of the President 18 (1979).

284. See note 8 and accompanying text supra.
loan association is even more manifestly a negotiable demand item. In all respects, save that it is drawn on a thrift institution, such an instrument appears identical to a standard commercial bank check. As is the case with a share draft account, NOW accounts customarily are subject by statute or bylaw to the right of the thrift institution to impose a notice of withdrawal, usually thirty or sixty days. But as with share drafts, while the subjection of the account to that notice of withdrawal requirement may mean that the account is not a demand deposit account, the requirement does not affect the character of the instrument itself.285

There exists an exception to the standard thrift institution check-like instrument. In 1977, the Pennsylvania Department of Banking issued regulations allowing state chartered savings banks to offer NOW accounts, provided each draft bore a legend reserving to the bank the right to require fourteen days advance notice of withdrawal.286 The regulations were challenged by a state association of commercial bankers, and subsequently upheld by the Pennsylvania Supreme Court as within the delegated authority of the State Secretary of Banking.287 In language that was arguably dicta, the court characterized the legend-bearing instrument as a "time" rather than a "demand" instrument.288 This characterization is probably incorrect. It is true that the holder of such an instrument (or of any other thrift institution instrument subject by separate agreement to an advance notice of withdrawal requirement) might have to wait a period of time if the institution exercised its notice of withdrawal right and the holder chooses to seek payment from that institution. That holder, however, immediately upon dishonor could demand payment of the drawer, as if the instrument had been dishonored because of insufficient funds or a stop order. A time instrument is defined by the Code as one payable at a definite time;289 a demand instrument is one payable on demand or in which no time for payment is stated.290 The Pennsylvania court's incorrect characterization has apparently caused some administrative problems affecting the clearing of thrift check-like instruments.291

285. See note 213 supra.
287. Id. at 336-37, 392 A.2d at 1321.
288. Id. at 338, 392 A.2d at 1322. The apparent reasoning behind that conclusion, although not made explicit in the opinion, was one of disclosure: Should a depository institution demand of its customers advance notice of withdrawal, holders of outstanding instruments should know that the instrument would not be payable by the institution until the notice period runs.
290. U.C.C. § 3-108.
291. On April 18, 1979, the Federal Reserve Board requested comment on Federal Reserve System handling of NINOWs, and other "check-like payment instruments." Participation by the federal reserve in the collection of thrift institution check-like instruments is pivotal to thrift institutions' continuing to offer checkable deposit services to their customers. The problem the Pennsylvania court's opinion poses is that if a Pennsylvania NINOW instrument is a time
2. Collection

The Code's definition of a "bank" was subjected to extended scrutiny earlier in the context of whether a credit union offering share draft accounts fit that definition for the purposes of Articles 3 and 4. The conclusion, expressed with limited misgivings, was that a credit union fits that definition. A thrift institution offering a NOW account satisfies that definition even more completely. Not only do mutual savings banks and savings associations meet the formal definition of the word "bank" as derived from the usual approaches to statutory construction, but the practical reasons for so denoting them under the Code are even more compelling. These institutions are substantially larger than credit unions, and are uniformly operated by professionals. Many have offered checking services for years, and the panoply of other banking services offered easily exceeds that of credit unions.

If a mutual savings bank or savings and loan association is a "bank" as that term is defined in the Code, and if it is a payor of negotiable drafts drawn on it, then it follows that it qualifies as a "payor bank" as that phrase is used throughout Article 4. Similarly, if such a thrift institution qualifies as a "bank," and the NOW draft drawn on it is a demand draft, then that draft is a "check."

VI. Conclusion

This article does not purport to be an exhaustive analysis of the Code's applicability to innovative withdrawal schemes. Sophisticated technological advances, coupled with increasing consumer demand for less expensive and more liberal account access, have produced a variety of diverse new "checkable deposit" plans. The advent of electronic funds transfer and truncation of the collection process has effectively revolutionized the types of services customarily available in the banking industry.

New developments in the area are not limited to new account accessing schemes made practical by more sophisticated electronic technology. Other financial intermediaries are beginning to offer services that allow

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instrument, it is probably not eligible for federal "cash item" treatment under Regulation J. "Cash items"—checks and other items payable on demand and collectible at par, see 12 C.F.R. § 210.2(i) (1979)—are handled and processed within the Federal Reserve System by computer. "Non-cash items" are items that by definition require special handling, see 12 C.F.R. § 210.2(j) (1979), a practical impossibility given the volume of thrift institution "check-like" instruments.

292. U.C.C. § 1-201 (4) ("any person engaged in the business of banking").

293. See text accompanying notes 220-238 supra.

294. Seven percent of the mutual savings banks in this country have deposits in excess of $1 billion; 25% have deposits in excess of $300 million. National Association of Mutual Savings Banks, 1979 National Fact Book of Mutual Savings Banks, Table 8 at 15 (1979).

295. "A bank by which an item is payable as drawn or accepted." U.C.C. § 4-105 (b).

296. This conclusion has been concurred in by at least one authority. See H. Bailey, supra note 7, § 1.17.
customers access to funds with check-like instruments. Two major investment brokerage firms now provide customers with a "checking-like" service using "payable through" commercial banks quite similar to the credit union share draft service. Whether such an investment firm thus embarks on the "business of banking" for Code purposes presents an obvious question which shall not be essayed here.

The principal inquiry in this article has been into the character, for purposes of negotiable instruments law, of the major new account accessing methods developed by financial intermediaries in the last decade: credit union share drafts and other thrift institution NOW instruments. Both have fairly burst upon the market place within the last few years. Widespread use of the instruments has made their precise character of major importance, affecting the rights of persons who issue or accept them as well as financial institutions on which they are drawn. A careful analysis of these instruments under Articles 3 and 4 of the Uniform Commercial Code has led to the conclusion that they satisfy the requirements for negotiable demand items and are in fact checks as that term is used in the Code. That conclusion is based upon a determination that thrift institutions offering these particular withdrawal modes are "engaged in the business of banking" for Articles 3 and 4 purposes.

Certain problems attending the conclusion that thrift institution "check-like" instruments are in fact checks have been examined, perhaps most importantly the application of section 4-406, the "bank statement rule," to credit union share drafts. With truncated collection, the paid

297. The investment firm Merrill Lynch, Pierce, Fenner & Smith has undertaken a customer offering marketed under the name "Ready Assets Trust." A feature of the offering is a procedure whereby:

[A shareholder] may redeem shares by check in an amount not less than $500. At the shareholder's request, the Bank of New York, the Transfer Agent, will provide the shareholder with checks drawn on the custody account of the Trust with its Custodian. These checks can be made payable to the order of any person in any amount not less than $500. The payee of the check may cash or deposit it like any check drawn on a bank. When such a check is presented to the Transfer Agent for payment, the Transfer Agent will present the check to the Trust as authority to redeem a sufficient number of full and fractional shares in the shareholder's account to cover the amount of the check.

MERRILL, LYNCH, PIERCE, FENNER & SMITH, READY ASSETS TRUST PROSPECTUS 15-16 (May 29, 1979). E. F. Hutton has developed a similar offering, marketed under the name "Cash Reserve Management." As with the Merrill Lynch offering, shareholders are permitted to draw checks against shares in an amount not less than $500, using New England Merchants Bank as a collaborating commercial bank. E. F. HUTTON, CASH RESERVE MANAGEMENT PROGRAM PROSPECTUS 12 (March 29, 1978). In both cases the instruments utilized are "payable at," rather than "payable through" the participating commercial bank, but in both form and substance the investment firm itself appears to be the drawee, with the commercial bank serving the function of assisting in the collection of the instrument and presenting it to the investment firm for payment. The instruments used are similar to credit union share drafts, and may well be subject to the same analysis. But see U.C.C. § 3-121.
share draft is not returned to the customer, as section 4-406 contemplates a check will be. The Code provides in section 4-103 for variation by agreement of the parties in the effect of provisions of Article 4. The benefit to a customer in receiving paid checks, so that he might examine them for wrongdoing and retain them for proof of payment or other purposes, is not inconsequential, however, and the question of whether such a customer has "agreed" to waive return of checks by signing a multiple provision boiler contract on a "take-it-or-leave-it" basis is problematic. On the other hand, credit union share draft truncation may be precursive of collection developments in the entire banking community, and it does bring with it certain cost savings which are passed on to customers.

A single overriding consideration compels the conclusions reached. The Uniform Commercial Code, perhaps one of the most tightly knit and carefully drafted of the various uniform laws, was designed to be a flexible system of rules that were accommodating to new developments in the commercial or banking market place. To view thrift institution "check-like" instruments as falling without the Code would be to view it as a strait jacket requiring or inviting amendment on the occasion of each market innovation, perhaps on a disorganized state-by-state basis. Such a result surely was not contemplated by the Code's drafters.