The Continuing Controversy Surrounding Delayed Funds Availability

Nan S. Ellis

Follow this and additional works at: https://via.library.depaul.edu/law-review

Recommended Citation
Available at: https://via.library.depaul.edu/law-review/vol36/iss2/3

This Article is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Law Review by an authorized editor of Via Sapientiae. For more information, please contact digitalservices@depaul.edu.
THE CONTINUING CONTROVERSY SURROUNDING DELAYED FUNDS AVAILABILITY

Nan S. Ellis*

I. INTRODUCTION

When a customer deposits a paycheck into a bank account, at what point does that customer have a right to access those funds? This question encompasses a situation where customers rely on those funds for cash withdrawal as well as where customers rely on those funds to cover a check drawn upon an account. Contrary to the popular perception of immediate availability, the answer to this question is not as simple as one might presume. To a large extent, the best answer is "whenever his bank will let him." The customer's bank generally gains provisional access to those funds within two days. However, banks commonly put a "hold" on checks in the collection process anywhere from five to twenty days. This creates a daily float available to banks which has been estimated to produce approximately $290

* Associate Professor of Law, Sellinger School of Business and Management, Loyola College, Maryland; B.A., 1974, Ohio State University; J.D., 1977, Ohio State University.

1. The term "bank" is used in this Article to encompass all forms of financial institutions that accept items for deposit, including savings and loan and thrift institutions. For the Uniform Commercial Code definition of the term "bank," see U.C.C. § 1-201(4) (1976).

2. This should not be confused with the question of when banks might allow customers to draw on those funds as a matter of accommodation to a valued customer. Despite standard hold periods, it is common for banks to make exceptions and allow customers access to deposited funds before expiration of the hold period. See, e.g., Cooper, Checks Held Hostage-The Funds Availability Controversy, 102 BANKING L.J. 532 (1985); Jordan, Ending the Floating Check Game: The Policy Arguments for Delayed Availability Reform, 36 HASTINGS L.J. 515 (1985). This created problems for at least one bank. In Fidelity & Deposit Co. v. Bank of Bladenboro, 596 F.2d 632 (4th Cir. 1979), the court found that the bank was contributorily negligent for failing to observe the established hold period. For a discussion of this case, see infra note 136.

3. This is termed provisional credit or provisional settlement. For a discussion of the bank collection process, see infra notes 39-68 and accompanying text. Banks make provisional settlements in no more than two days when they process checks through the Federal Reserve System. The Federal Reserve System has availability schedules by which banks operate. Baxter & Patrikis, The Check Hold Revolution, 18 U.C.C. L.J. 99, 116 (1985); Jordan, supra note 2, at 527-28.


5. The daily float has been estimated at $3.2 billion per year. Jordan, supra note 2, at 529.
This delay has been the subject of increasing debate. Advocates of reform assert that hold periods are attempts by banks to get interest-free use of their customers' funds. Banks, on the other hand, attribute the need for hold periods to the risks associated with dishonored checks and loss by fraud. The disagreement has been the source of public outcry against imposition of hold periods. A study conducted for the Federal Reserve System revealed that eleven per cent of bank customers have problems with availability of funds. Consumer groups have raised complaints, lawsuits have been initiated, and administrative and legislative reform has been proposed.

7. See infra notes 81-87 and accompanying text (discussion of the hardships imposed on depositors by delayed hold periods).
8. Miller, Ballen & Scott, Commercial Paper, Bank Deposits and Collections and Commercial Electronic Funds Transfers, 39 BUS. LAW. 1333, 1360-64 (1984); Jordan, supra note 2, at 516; Cooper, The Banker's Float That Sinks Depositors, 43 SOC. SERV. REV. 42 (1982). Federal Reserve figures show that depositary institutions earn approximately $290 million each year through this practice. Cooper, supra note 2, at 534.
9. There is little disagreement that banks face some risk of loss that can be minimized by imposing substantial hold periods. See, e.g., Baxter & Patrikis, supra note 3, at 100; Cooper, supra note 2, at 533; Jordan, supra note 2, at 516; Wechsler, supra note 4, at 1121. One author categorizes two types of risks: credit-risk loss and fraud-risk loss. Credit-risk loss entails the danger that the deposited item will eventually be returned because of insufficient funds, no account, or because of a stop payment order. Fraud-risk loss includes the risk of forged endorsements, forged drawer's signatures, material alteration, and check kiting schemes. Cooper, supra note 2, at 533.
11. Should Government Say When You Make Funds Available?, 76 A.B.A. BANKING J. 140 (1984). This refers to a survey conducted through the research center of the University of Michigan. There is disagreement as to the significance of this figure. Some commentators believe this represents significant dissatisfaction, while others assert that it represents an insignificant degree of complaint. The study also revealed that 43% of complainants blamed their problems arose because they were unaware of the bank's policies. A number of studies have produced similar results. See, e.g., Cooper, supra note 2, at 536-37. More recent studies reveal that the number of consumer complaints has risen slightly. H.R. REP. No. 404, 99th Cong., 1st Sess. 15 (1985).
12. Regulation J was amended, in part, to speak to the problem of delayed funds availability. See 12 C.F.R. § 210.2(c) (1986); 50 Fed. Reg. 5734 (1985); infra notes 247-53 and accompanying text. In addition, it has been urged that the Federal Reserve Board implement reform of the check collection return process. See infra notes 185-88, 219-21 and accompanying text.
13. In addition to a plethora of state statutes, several federal statutes have been introduced. See infra notes 142, 147 and accompanying text.
This Article examines the debate surrounding delayed funds availability. The Article first examines the workings of the check collection process because the rationale for the imposition of any availability hold is intricately tied to that process. The Article then examines the delays typically imposed, as well as the problems encountered by bank customers caused by such delays. After concluding that these delays are unreasonable and unfair to bank customers, the Article discusses recently proposed solutions.

II. THE REGULATORY ENVIRONMENT

The banks' primary justification for hold periods is that they are needed to minimize the risk of loss from returned checks. To understand this rationale, one must first understand how a check is presented for collection. The mechanism for check collection is regulated both by the Uniform Commercial Code (U.C.C.) and by Federal Reserve Board Regulation J. 14

When a drawer15 draws and delivers a check16 to a payee,17 the payee typically wishes to obtain payment on the item.18 The payee might present19 the check directly to the drawee bank20 for payment.21 If the payee chooses this method, the time period within which the drawee bank must act22 on the item is clearly set forth in the U.C.C. section 3-506(2). That section provides that the drawee bank must, in this situation, pay or return the item by the close of business on the day of presentment.23 No substantial delay in availability is presented by this situation.

---

15. Although not defined in the U.C.C., the “drawer” of a check is generally the owner of the account on which the check is drawn and from which the check will be paid. The drawer is typically the person who wrote and signed the check. See R. BRAUCHER & R. RIEGERT, INTRODUCTION TO COMMERCIAL TRANSACTION 64 (1977); E. COMPTON, PRINCIPLES OF BANKING 62 (1983); D. WHALEY, PROBLEMS & MATERIALS ON NEGOTIABLE INSTRUMENTS 3-4, 23 (1981); Dow & Ellis, The Proposed Uniform New Payments Code: Allocation of Losses Resulting From Forged Drawer's Signatures, 2 HARV. J. ON LEGIS. 399, 402 n.12 (1985).
16. A check is “a draft drawn on a bank and payable on demand.” U.C.C. § 3-104(2)(b) (1977). It is a written order by a drawer to the drawee to pay a sum of money to a third party. R. BRAUCHER & R. RIEGERT, supra note 15, at 402 n.12.
17. The “payee” is the person to whom the drawee bank is ordered to effect payment of a draft. U.C.C. § 3-104(2)(b); R. BRAUCHER & R. RIEGERT, supra note 15, at 64.
18. In the context of bank collections, the check is alternatively referred to as an “item.” U.C.C. § 4-104(1)(g) (1977).
19. “Presentment” is a demand for payment made upon the drawee bank. Id. § 3-504(1).
20. The drawee is the entity on which the check or draft is drawn. U.C.C. § 3-503(2) (1977). R. BRAUCHER & R. RIEGERT, supra note 15, at 64; D. WHALEY, supra note 15, at 3-4.
21. Few checks are actually presented in this manner. E. COMPTON, supra note 15, at 152; Wechsler, supra note 4, at 1125 n.23.
22. The term “pay” is used throughout this paper to connote final payment. See U.C.C. § 4-213 (1977). For a discussion of what constitutes final payment, see infra note 54 and accompanying text.
More commonly, however, the payee will use its own bank as a collecting agent rather than presenting the check directly to the drawee bank.\(^4\) Thus, the relevant inquiry involves the interaction between the payee and its bank. It is clear that if one deposits \textit{money}\(^5\) in an account the money is available as of the opening of the banking day\(^6\) following the banking day of deposit.\(^7\)

On the other hand, if the payee deposits a check into an account when does the payee have the right to access those funds? The U.C.C. clearly sets forth the timetable for availability in the former situation. Where the depositary bank\(^8\) is also the payor bank,\(^9\) the bank must make the funds available for withdrawal at the opening of the bank's second banking day following deposit.\(^10\) For example, if a check drawn on the First National Bank is deposited into an account with the First National Bank on Monday, the funds become available as of right on Wednesday morning. During this time, the First National Bank ascertains whether the item is properly payable,\(^11\) whether or not there are sufficient funds in the drawer's account, and then it posts\(^12\) the item to the drawer's account. Generally, this delay is not considered to cause a significant hardship on depositors. These checks, termed "on-us" items, represent one-half of the checks written in this country.\(^13\)

The delay becomes more lengthy when the depositary bank is not the same bank as the payor bank. Here, the U.C.C. gives very little guidance, pro-

---

\(24\). Obviously, if the drawer draws the item on a New York bank and mails the check to a payee in California, it is unlikely that the California payee would journey to New York to collect the check.

\(25\). In this context, money refers to cash.

\(26\). The U.C.C. defines "banking day" as "that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions." U.C.C. § 4-104(1)(c) (1978).

\(27\). \textit{Id.} § 4-213(5). The average bank customer might be surprised to know that such funds are not immediately available. The bank is given time to credit the funds to the customer's account. Presumably, the bank could accomplish this task in much less time. Regardless, this delay is not the subject of the debate surrounding delayed funds availability.

\(28\). The U.C.C. defines the "depositary bank" as the "first collecting bank to which an item is transferred for collection even though it is also the payor bank." \textit{Id.} § 4-105(a).

\(29\). The U.C.C. defines the "payor bank" as "a bank by which an item is payable as drawn or accepted." \textit{Id.} § 4-105(b). The payor bank is also referred to as the drawee bank. \textit{See id.} § 3-102 comment 3.

\(30\). \textit{Id.} § 4-213(4)(b).

\(31\). Under U.C.C. section 4-401(1), a bank is permitted to charge its customer's account for properly payable items. By implication, it cannot charge its customer's account for items that are not properly payable. Although the U.C.C. does not expressly provide, it is clear that items containing forged drawer's signatures and forged endorsements are not properly payable. \textit{See, e.g.,} Fireman's Fund Ins. Co. v. Security Pac. Nat'l Bank, 85 Cal. App. 3d 797, 831, 149 Cal. Rptr. 883, 905 (1978); B. CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS § 6.4[21, at 6-36 (rev. ed. 1986).

\(32\). The U.C.C. defines the process of posting in section 4-109 as "the usual procedure followed by a payor bank in determining to pay an item and in recording the payment." U.C.C. § 4-109 (1978).

\(33\). Jordan, \textit{supra} note 2, at 521.
viding only that the depositary bank must make the deposited funds available to its customer as of right when final payment occurs and the bank has had a reasonable time to learn that the settlement is final. In order to understand this provision, one must first examine the concept of final payment. To do so requires a more complete understanding of how the bank collection process works. Because the depositary bank generally has no way of knowing when final payment has occurred, substantial delays are often routinely imposed before the bank will allow its customer to withdraw funds.

III. THE BANK COLLECTION PROCESS

To understand the reasoning behind the imposition of such delayed availability schedules it is necessary to understand more fully the process through which checks are collected. The bank collection process is the method by which the payee, or person to whom the item was transferred, is able to obtain payment. Collection begins when such person deposits the item in a depositary bank. The collection process is essentially one of transferring the item from the depositary bank to the payor bank and remitting the proceeds back to the depositary bank and eventually to the customer. The primary responsibility of collecting banks, including the depositary bank, is to forward the item to the payor bank using a reasonably prompt method with the exercise of ordinary care. The complexity of the actual process varies with the number of banks handling the item. The time period necessary to collect the item varies, depending upon the number of intermediary banks

---

34. For a discussion of what constitutes final payment, see infra note 54 and accompanying text.
35. "'Settle' means to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A settlement may be either provisional or final." U.C.C. § 4-104(1)(J) (1977).
36. Id. § 4-213(4)(a). The problem, of course, is that the depositary bank will never learn when payment is final. It will only learn if the item has been dishonored. See infra notes 54-58 and accompanying text. It is this lack of knowledge that creates the risk of loss that banks attempt to avoid by imposing availability delays.
37. The depositary bank must assume that final payment has occurred when sufficient time has elapsed for notice of dishonor to be given. This is due to the nature of the bank collection process. See infra notes 60-68 and accompanying text.
38. What follows is a brief overview of the check collection process. It is not intended to be a complete treatment of the topic. See also Dow & Ellis, supra note 15, at 402-09; Malcolm, How Bank Collection Works Article 4 of the Uniform Commercial Code, 11 How. L.J. 71 (1965) (further discussion on this topic).
39. The U.C.C. defines "collecting bank" as "any bank handling the item for collection except the payor bank." U.C.C. § 4-105(d) (1977).
40. Id. § 4-204(1).
41. Id. § 4-202(1). A collecting bank is deemed to have acted "seasonably" if it forwards the item on or before midnight of the banking day following receipt of the item. Id. § 4-202(2).
42. The U.C.C. defines "intermediary bank" as "any bank to which an item is transferred in the course of collection except the depositary or payor bank." Id. § 4-105(c). The depositary and all intermediary banks are also termed collecting banks because they handle the item for collection. See id. § 4-105(d).
and the distance between the depositary and payor bank. Whether the check will be processed through an intermediary bank, and, if so, the number of intermediary banks, depends almost entirely upon the distance between the depositary and payor bank, as well as upon whether or not either bank is a member of the Federal Reserve System.

When the payee deposits the check into his account with the depositary bank, the depositary bank will credit the payee's account for the amount of the item. The credit is provisional at this point, subject to reversal should the item subsequently be dishonored by the payor bank. In addition to provisionally crediting the account of the depositor, the depositary bank debits the account of the bank to which the item is next forwarded. If the depositary bank is not a member of the Federal Reserve System, it might forward the check to a correspondent bank which is a Federal Reserve member. Corresponding debits and credits accompany the physical transfer of the item at each step.

Ultimately, the item is presented to the payor bank for payment. At this point, the payor bank determines whether the item should be paid or dishonored. While it is making this determination the payor bank typically makes provisional settlement for the item by crediting the account of the presenting bank. The provisional credit must be given by midnight of the banking day of receipt of the item.

The process by which the item moves toward the payor bank works primarily by computer. The information required to process the item is

---

43. See id. § 4-213 comment 10.
45. This right of reversal, called chargeback, is set forth in U.C.C. section 4-212 (1978). This right may be exercised by the depositary bank against its customer (the payee) even if the bank has allowed the customer to draw on those funds. See id. § 4-212(4). The ease with which chargeback can be exercised is, of course, affected by allowing the customer use of this provisional credit. The right of chargeback expires upon final settlement. Id. § 4-212(1).
46. See id. §§ 3-507, 3-510 and the accompanying comments.
47. If there are no intermediary banks involved, this is the payor bank. If the depositary bank and the payor bank are located in the same city they will most likely meet to exchange checks, often through a local clearing house. See R. Braucher & R. Riegert, supra note 15, at 102-04. In addition, a depositary bank can send the check directly to the payor bank. This method of bank collection, is termed "direct send." Id. at 107-08.
49. Id. § 4-302(a).
magnetically encoded on the check using Magnetic Ink Character Recognition (MICR). The item is then electronically processed by the use of reader/sorters. Little, if any, manual processing of the item occurs. The trip to the payor bank is, therefore, relatively quick. Provisional credit is generally received within two to three days.

If the payor bank decides to pay the item, it will debit the account of the drawer and remit payment to the presenting bank. In reality, no money typically will change hands. All is accomplished by way of bookkeeping entries. Final payment can be accomplished in one of several ways, the most common of which occurs when the payor bank, after making a provisional settlement, fails to revoke the settlement within the time permitted by statute or clearing house rule. The U.C.C. provides that this applicable time limit is the midnight deadline. Thus, final payment typically is made when the payor bank fails to dishonor the item by its midnight deadline.


52. It has been suggested that the speed of the forward process of a check is due to each bank's financial incentive. As each bank forwards the item it receives a provisional credit that may be used for investment and reserve requirements. See Wechsler, supra note 4, at 1128.

53. 1985 Hearing, supra note 50, at 47 (statement of Sen. Alfonse D'Amato); Cooper, supra note 8, at 42. In fact, by the provisions of the availability schedules of the Federal Reserve, the provisional credit will be available in a maximum of 2 days. Baxter & Patrikis, supra note 3, at 116-17; Jordan, supra note 2, at 527-28. The average time for collection is 1.9 days with approximately 80% of checks presented one day after deposit. Wechsler, supra note 4, at 1130 (citing AMERICAN BANKERS ASSOCIATION, BANK ADMINISTRATION INSTITUTE & FEDERAL RESERVE SYSTEM, A QUANTITATIVE DESCRIPTION OF THE CHECK COLLECTION SYSTEM 161 (1981)).

54. U.C.C. § 4-213 provides:

(1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:

(a) paid the item in cash; or
(b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or
(c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or
(d) made provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon a final payment under subparagraph (b), (c), or (d) the payor bank shall be accountable for the amount of the item. U.C.C. § 4-213(1)(1978). See id. § 4-302.

55. See U.C.C. § 4-302(a) (1978). The payor bank is accountable for any item that it has not paid or returned before the bank’s midnight deadline, regardless of whether it has made a provisional settlement for the item. This is termed the undue retention doctrine. For the history of the undue retention doctrine, see Blake v. Woodford Bank & Trust Co., 555 S.W.2d 589, 598-99 (Ky. Ct. App. 1977). See generally Note, Retention of Check: Payor Bank’s Liability Under Section 4-302, 10 B.C. INDUS. & COM. L. REV. 116 (1968) (tracing the derivation of section 4-302 and analyzing its effectiveness).

56. The U.C.C. defines the “midnight deadline” as “midnight on its next banking day following the banking day on which it receives the relevant item . . . .” Id. § 4-104(h).

57. Member banks of a clearing house can allow themselves additional time. Id. § 4-103(2). See id. § 4-213 comment 4.
The event of final payment operates as the turn-around point in the bank collection process. At this point all provisional settlements become final and the right of reversal or chargeback is lost.58 The process differs, however, when the payor bank decides to dishonor the item and revoke the provisional settlements. Upon receipt of the check and notice of dishonor, the intermediary and depositary banks similarly revoke all provisional settlements given.61 In contrast to the swift, computerized route to the payor bank, the return trip of a dishonored check is accomplished manually in an extremely time consuming fashion.62 At each stage, bank clerks physically handle the item. Banks do not use electronic equipment to speed the process.63 Each bank in the chain need only pass the check up the chain by its midnight deadline to avoid liability. Although the use of couriers is common to transfer a check toward the payor bank, the United States mail is the most commonly used means for the return trip.65 Although the actual length of the trip varies, it is estimated that the return trip takes, at a minimum, twice as long as the forward trip. It is not common for the return trip to take three or four times as long as the forward trip.

The delay by the depositary bank in making collected funds available to its customer is caused by a reluctance on the part of the depositary bank to allow the customer to draw upon deposited funds until it is certain that final payment has occurred, that all provisional settlements have become final, and that there is no danger of chargeback by the intermediary or payor banks. Unfortunately, the depositary bank typically has no way of knowing when final payment has occurred. Only if the payor bank actually dishonors the item will the collecting banks receive any notice.67 No notice is sent to

58. Id. § 4-212(1).
59. Most checks are dishonored due to insufficient funds, stop payment order, closed account, missing indorsement, irregular signature, or because the check was drawn on uncollected funds. BANK ADMINISTRATION INSTITUTE, THE IMPACT OF EXCEPTION ITEMS ON THE CHECK COLLECTION SYSTEM 24 (1974).
60. The payor bank may send written notice of the dishonor only if unable to physically return the check. U.C.C. § 4-301(1) (1978). See, e.g., Blake v. Woodford Bank & Trust Co., 555 S.W.2d 589, 599 (Ky. Ct. App. 1977); Northwestern Nat'l Ins. Co. v. Midland Nat'l Bank, 96 Wis. 2d 155, 163, 292 N.W.2d 591, 596 (1980). This is important when considering proposals to shorten the period of delayed availability. See infra notes 257-59 and accompanying text.
62. 1985 Hearing, supra note 50, at 159 (statement of C.T. Conover, Comptroller of the Currency). It has been suggested that, in contrast to financial incentives that encourage speed in the forward trip, there is no incentive encouraging speed in the return trip. See supra note 52; Wechsler, supra note 4, at 1133.
63. See generally BANK ADMINISTRATION INSTITUTE, supra note 59; see also Jordan, supra note 2, at 532; Wechsler, supra note 4, at 1133-35.
64. U.C.C. § 4-212(1) (1977).
65. Jordan, supra note 2, at 519, 527; Wechsler, supra note 4, at 1134.
66. Wechsler, supra note 4, at 1137.
67. It has been said in this regard: "No news is good news." Id. at 1140.
verify final payment. Therefore, the depositary bank typically assumes that final payment has occurred when sufficient time has passed within which notice of dishonor would have been received. Because of delays inherent in the bank collection process, in particular the return of dishonored items, this period of time can be substantial.

IV. THE DEBATE

A. Arguments in Favor of Existing Hold Periods

Those who favor existing hold periods frequently assert that they are necessary to prevent a loss to the depositary bank in the event that the deposited check is subsequently dishonored. A potential for loss arises from the nature of the bank collection process, in particular from the method by which dishonored checks are returned. The fear, of course, is that the depositary bank will allow its customer to withdraw the deposited funds, the deposited check will be dishonored, and the bank will be unable to recover the funds from its customer. In addition to the very real fear of loss from typical returned checks, banks cite losses from fraud or check

68. Considering the sheer number of checks cleared annually, compared with the number of checks dishonored annually, it makes more sense to send notice only when the unusual occurs and the check is not paid.

69. There is evidence to suggest that a large number of items are returned after the expiration of the hold period despite the rather substantial hold periods imposed by most banks. Wechsler, supra note 4, at 1178-79.

70. Those in favor of the existing hold periods are primarily banking institutions and federal regulators. That the position taken by bank regulators consistently mirrors that of the industry is seen as curious by at least one commentator. See Wechsler, supra note 4, at 1160. Bank regulators clearly are unsympathetic to consumer complaints to the extent that it has been suggested “that the relationship is akin to ‘putting the arsonist in charge of the fire department.’” Id. at 1161 n.258 (citing Fair Deposit Availability Act: Hearing on S.573 Before the Subcom. on Consumer Affairs of the Senate Comm. on Banking, Housing and Urban Affairs, 98th Cong., 1st Sess. 137 (1983) (testimony of G. Essary, People Inc., Flushing, N.Y.).

71. See supra notes 60-68 and accompanying text.

72. See supra notes 66-69 and accompanying text.

73. It has been asserted that “the criminal world understands the vulnerability of the check collection system and is prepared to exploit that vulnerability.” Baxter & Patrikis, supra note 3, at 120. (Both Mr. Baxter and Mr. Patrikis are counsel for the Federal Reserve Bank of New York). There have been a number of fraud cases involving intentional alteration of the MICR encoding on a check to delay the check’s progress in the check collection system. See, e.g., United States Fidelity & Guaranty Co. v. Federal Reserve Bank, 590 F. Supp. 486 (S.D.N.Y. 1984), reh'g denied, 620 F. Supp. 261 (S.D.N.Y. 1985). In this case a customer deposited a check with a MICR number that did not match the routing symbol. This resulted in the check being routed aimlessly from bank to bank in search of the payor. After expiration of the ten day hold period, the depositary bank allowed the customer to withdraw $755,000 against the check. It was only after the withdrawal that the notice of dishonor was received. See also
kiting which might result without hold periods as a major justification for the such periods. While these are very real concerns, substantial delayed funds availability is an inappropriate response. The merits of this contention will be evaluated below.

Proponents of hold periods also assert that any unfairness which might result from holds is mitigated because many banks credit interest to customers who hold interest bearing accounts from the time of the deposit rather than from the time of the availability of the funds. This argument is flawed in several respects. First, not all consumers have interest-bearing accounts. When the account is not interest-bearing, the depositary bank has absolutely interest-free use of the funds during the availability delay. Second, even when the account is interest bearing, the amount of interest typically paid is substantially less than the interest rate at which the bank is able to invest those funds. The result is low-interest use of the funds. The distinction is meaningful when one considers that customers do not consent to the use of their funds by the bank.

B. Arguments Against Existing Hold Periods

Opponents of hold periods assert that lengthy hold periods adversely affect bank customers. Numerous "horror stories" of consumer hardship caused


74. Check kiting is a crime by which perpetrators in effect "play the float" to "create" money. They open two bank accounts in distant locations. Then they write a worthless check drawn on the bank at Point A and deposit it in a bank at Point B. They similarly write a check drawn on the bank at Point B and deposit it in the bank at Point A. This will be used to "cover" the first check written. They continue in this fashion making a series of deposits that create the impression of substantial balances. When one bank allows withdrawal of the funds, the kite has been successful and "when the smoke clears" the bank that allowed the withdrawal will be left "holding the bag." See generally Jordan, supra note 2, at 544 (description of how kiting schemes operate).

75. The fear of loss from check fraud is cited most frequently as a justification for substantial hold periods. Jordan, supra note 2, at 544; Wechsler, supra note 4, at 1141 nn.123-32 and accompanying text.

76. See infra notes 97-127 and accompanying text.
77. See infra notes 81-91 and accompanying text.
78. See infra notes 93-95 and accompanying text.
79. Wechsler, supra note 4, at 1159.
80. The depositor might be said to have consented to the use of his funds in this manner. Notice of the hold periods on signature cards or deposit slips or notice posted in the bank can be construed to constitute an agreement to those terms on the part of the customer. Such agreements will be enforced under the terms of U.C.C. section 4-103(1). This includes Federal Reserve regulations, operating letters, and clearing house rules, even without customer assent. In addition, section 1-201(3) includes common banking practices within the definition of an agreement even without express customer assent. One case partly relied on this rationale to deny customers' objections to excessive hold periods. Rapp v. Dime Savings Bank, 64 A.D.2d 964, 408 N.Y.S.2d 540 (1978), aff'd, 48 N.Y.2d 658, 396 N.E.2d 740 (1979). See infra notes 130-33 and accompanying text.
by delayed availability have been recounted.\footnote{81} Consumers often need immediate access to their funds to pay their bills. Delayed access to funds has been cited as a common cause of dishonored checks.\footnote{82} This might occur where a consumer deposits his tax refund check into his account on Monday. Although the consumer may not be informed of a delay, the depositary bank routinely imposes a seven day hold on all deposited checks. On Tuesday, the consumer writes a check making his mortgage payment relying upon the funds deposited the day before. The mortgage payment is presented for payment on Thursday and dishonored for insufficient funds.\footnote{83} The consumer is outraged, he has suffered embarrassment,\footnote{84} his credit rating has been adversely affected,\footnote{85} and his bank probably will assess his account a charge for the "bounced" check.\footnote{86} He may even be forced to pay his mortgage company an extra fee, either for the dishonored check or for a late charge.

The hardship imposed by hold periods impacts disproportionately on small businesses\footnote{87} and consumers. Large businesses are much more likely to use wholesale electronic funds transfers without delayed availability problems.\footnote{88} Individuals and small businesses have not shown the same enthusiasm for

\footnote{81. Reports of so called horror stories abound. They include stories of customers who have holds imposed on social security checks and reports of 15 day hold periods imposed upon cashier checks. H.R. REP. No. 404, 99th Cong., 1st Sess. 13-14 (1985). Even more alarming stories have been recounted. Mrs. Lucy Cody of Boston deposited $1,413.45 into her account. All but about $400 of the deposit was in cash. The depositary bank imposed a two week hold on the entire deposit, including the cash portion. Mrs. Cody did not discover this until the checks she had written upon the deposit were dishonored. Id. at 13. Even more persuasive is the story of a man who deposited a check for $5000 into his account. After a $50 withdrawal was refused, the customer discovered that the bank not only had placed a ten day hold upon the deposited check, but had imposed the hold upon the entire account. Id.}

\footnote{82. See supra note 59.}

\footnote{83. It is not considered wrongful dishonor under U.C.C. section 4-402 for a bank to dishonor a check drawn on credits that were not yet available. See, e.g., Merchant v. Worley, 79 N.M. 771, 449 P.2d 787 (1969); Dow, Damages and Proof in Cases of Wrongful Dishonor: The Unsettled Issues Under UCC Section 4-402, 63 WASH. U.L.Q. 237, 237 n.4 (1985).}

\footnote{84. 1985 Hearing, supra note 50, at 32 (statement by Rep. Carper).}

\footnote{85. Id. at 33.}

\footnote{86. It is estimated that approximately $3.4 billion per year is assessed in service charges for returned checks. H.R. REP. No. 404, 99th Cong., 1st Sess. 12 (1985). Typical fees imposed for dishonor due to insufficient funds vary from $2 to $6 with a $4 charge average. BANK ADMINISTRATION INSTITUTE, supra note 59, at 28. Overdraft charges have been reported as high as $30 per check. H.R. REP. No. 404, 99th Cong., 1st Sess. 12 (1985).}

\footnote{87. In addition to the hardship stemming from delayed availability described in the text, small businesses also face problems stemming from the delay in check collection. A business accepting checks (as payee) might suffer loss where it relinquishes possession of merchandise in exchange for a check. Before the business receives notice of the dishonor, the purchaser has received and used the merchandise.}

\footnote{88. Jordan, supra note 2, at 517. See also Scott, Corporate Wire Transfers and the Uniform New Payments Code, 83 COLUM. L. REV. 1664 (1983) (average wire transfer is $2 million compared with the average check in the amount of $570).}
electronic funds transfers. Further, the depositor who maintains a large balance in his account typically suffers less from the imposition of hold periods. This is true both because the bank is more likely to waive hold periods for wealthy depositors, and because one who maintains a large balance is less likely to rely on the last deposit made for the checks written.

Consumers' complaints are aggravated by the fact that banks typically have access to deposited funds before expiration of the hold periods. Often banks gain access to the funds in accordance with the Federal Reserve availability schedules. Under these timetables, the longest wait for access to funds is two days. When a bank is given a provisional credit before final payment, it is, in effect, given an interest-free loan by the Federal Reserve financed at the government's expense. Further, after collection, the interest-free loan continues at the customer's expense until the funds are available for use. This creates a financial incentive for the collecting bank to delay availability. Consumers argue that collecting banks are able to make substantial profits by using this float.

In addition, the depositary bank is able to count funds provisionally credited to its account by the Federal Reserve towards its reserve accounts, even though the funds have not yet been made available to its customer. This might provide additional incentive to delay availability.

89. BANK ADMINISTRATION INSTITUTE, CHECKING ACCOUNT USAGE IN THE UNITED STATES xiii, 137-38 (1979). See also Fox, Another Step Toward the Cashless Society? The 1978 Federal Electronic Fund Transfer Act, 18 AM. BUS. L.J. 209 (1980). Part of this might be due to the fact that electronic funds transfers might be unavailable to the consumer. For example, if one's employer does not offer the option of direct deposit of the payroll check (a form of electronic funds transfer (EFT)), then the consumer can hardly be faulted for not embracing EFTs. In fact, the major electronic fund transfer systems currently in use are not available for use by individual depositors. This would include Fed Wire (inter-bank transfers within the Federal Reserve System), Bank Wire (service for private-sector banks), and Clearing House Interbank Payment System (available to participating New York City banks). See generally N. PENNY & D. BAKER, supra note 51, §§ 9.01-9.04, at 9-1 to 9-14 (thorough discussion of electronic fund systems).

90. It is quite common for hold periods to be waived. See supra note 2 and accompanying text.

91. The depositary bank might waive its hold periods where the risk to be incurred in the event of dishonor is minimal. Because the depositary bank always has the right to chargeback its customer's account in the event of dishonor, the bank might feel more comfortable allowing early access to funds where it reasonably believes that the depositor has the ability to reimburse the bank for the funds in the event chargeback becomes necessary. See supra note 45 and accompanying text.

92. See supra note 3 and accompanying text.

93. Baxter & Patrikis, supra note 3, at 116-17. This loan might no longer be considered interest-free because the Federal Reserve now charges a fee for collection of checks through the system. This was established by the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat 132 (codified in scattered sections of 12 U.S.C. (1982)). E. COMPTON, supra note 15, at 38.

94. Baxter & Patrikis, supra note 3, at 117.

95. See supra note 8 and accompanying text.

96. Cooper, supra note 2, at 534.
While advocates of change recognize that banks have a legitimate interest in protecting themselves from the risk of loss from returned checks, the actual risk of bank loss is minimal. Although a significant number of checks are returned daily, returned checks account for less than one percent of the checks deposited for collection. In addition, one-half of these returned items are paid upon second presentment. Perhaps more relevant to a discussion of the risk of loss from such checks is a consideration of the dollar value involved in return items. Sixty-three percent of those checks returned are for amounts of less than $100. While checks in amounts greater than $2,500 account for only two percent of all returned checks, they account for fifty percent of the dollar value of all returned checks.

The depositary bank does not suffer a loss every time a check is returned. The depositary bank is permitted by law to recover the amount of any returned check from its customer. It can do this either under the contract of deposit with its customer, or under U.C.C. provisions for indorser's contract, warranty, or chargeback. The depositary bank's rights in this regard are not diminished if the bank allows its customer to draw on the deposited, uncollected funds. Therefore, the fear of the depositary bank is twofold: 1) the bank fears that the item will ultimately be dishonored; and 2) the bank fears that it will be unable to recover the amount of the item from its customer through chargeback. Only when both situations exist will the depositary bank suffer any loss. The availability of recovery from

97. Id. at 536.
98. The risk of loss for returned items is estimated at $0.02 per check. Bank Administration Institute, supra note 59; Cooper, supra note 2, at 537. Total bank loss from returned checks totalled only $5 million in 1974. Bank Administration Institute, supra note 59, at 25.
99. While complete statistics are unavailable, the Federal Reserve estimates that 360 million checks were returned through the Federal Reserve in 1981. This represents one percent of the checks collected through the Federal Reserve. Cooper, supra note 2, at 535. This can represent a significant amount of checks for any given bank. Approximately 4,000 checks are returned daily to Citibank. Baxter & Patrikis, supra note 3, at 120 n.123.
100. 1985 Hearing, supra note 50, at 159 (statement of C.T. Conover, Comptroller of the Currency); Id. at 213 (Joint Policy Statement on Delayed Availability of Funds (citing 1981 Bank Administration Institute Survey and the Federal Reserve System)); Cooper, supra note 2, at 535. The actual return rate is estimated to be approximately 0.67% of the checks processed. Bank Administration Institute, supra note 59, at 23-29; Jordan, supra note 2, at 532 n.87.
101. Cooper, supra note 2, at 537.
102. Id. at 537.
103. Cooper, supra note 2, at 536.
105. See id. § 4-207.
106. See id. § 4-212.
107. While statistics can be found listing the number of items dishonored annually, see supra note 99, no statistics have been found that describe what percentage of this is not recoverable through chargeback from the customer. It has been stated without support that the vast majority of dishonored checks are recovered from the customer either through subsequent deposit or chargeback. Cooper, supra note 2, at 537.
its customer minimizes the potential for loss from an already unlikely dishonor and is rarely addressed in established hold periods.

Further, while lengthy hold periods are likely to minimize the risk of certain types of losses, they will have little or no effect on other types of potential losses. The depositary bank fears that the item will be dishonored, either due to credit considerations such as insufficient funds, no account, or stop payment orders, or due to fraud such as forged endorsements, forged drawer’s signature, material alteration, or check kiting. Imposition of lengthy hold periods are unlikely to reduce losses due to certain instances of fraud. Many instances of fraud, such as material alteration or forged endorsements, are generally discovered long after final payment. Hold periods will not offer the depositary bank any protection. In such situations, following expiration of established hold periods, the depositary bank will allow its customer access to the deposited funds. Following discovery by the payor bank of the fraud, the payor bank is able to pass the loss up the chain, under breach of warranty, to the depositary bank. Thus, even after final payment the depositary bank will ultimately bear the loss in spite of delayed hold periods.

Moreover, while hold periods are of some value in the prevention of check kiting and losses due to forged drawer’s signature, the depositary bank is

108. This has been termed the credit-risk loss. See Cooper, supra note 2, at 533. Credit-risk loss is discussed supra note 9.
109. This has been termed the fraud-risk loss. Cooper, supra note 2, at 533.
110. Id. at 538. One study suggests that current hold periods are, in fact, inadequate to provide depositary banks with maximum protection. Id. at 538 n.23.
112. For example, assume that Frank Forger forged his indorsement on a check made out to Pete Payee and deposited it in his account with the Depositary National Bank. The check was forwarded for collection and subsequently paid by the Payor National Bank. When Pete discovered that the check had been stolen, he contacted Dan Drawer, who subsequently contacted the Payor National Bank. Payor National is able to pass the loss up the chain under breach of warranty principles. See id. § 4-207. The Depositary Bank clearly breached the warranty of good title, and the warranty of genuine signatures. Id. at § 4-207(2)(a)-(b). Under such principles, the loss generally rests upon the first party who dealt with the forger, in this case the Depositary National Bank. See, e.g., Payroll Check Cashing v. New Palestine Bank, 401 N.E.2d 752 (Ind. App. 1980); North Carolina Nat’l Bank v. Hammond, 298 N.C. 703, 260 S.E.2d 617 (1979); Bank of the West v. Wes-Con Dev. Co., 15 Wash. App. 238, 548 P.2d 563 (1976); see Note, Allocation of Liability for Checks Bearing Unauthorized Endorsements and Unauthorized Drawer’s Signatures, 24 WAYNE L. REV. 1077 (1978) [hereinafter Note, Allocation]. Thus, unless the customer is the person who dealt with the forger, rather than the forger himself, the depositary bank will bear the loss in spite of the availability delay.
113. Hold periods would only work to reduce loss in the event of forged drawer’s signature where the payor bank discovered the forgery before final payment and dishonored the item. Where the payor bank paid the item in spite of the forgery, the payor bank would bear the loss under the rule of Price v. Neal, 3 Burr. 1354, 97 Eng. Rep. 871 (K.B. 1762) (codified at U.C.C. § 3-418). See, e.g., Payroll Check Cashing v. New Palestine Bank, 401 N.E.2d 752, 754-55 (Ind. App. 1980); see also Dow & Ellis, supra note 15, at 406; Note, Allocation, supra note 112, at 1079, 1081.
better situated to prevent loss due to such frauds.\textsuperscript{114} Such loss might be prevented by careful verification. The bank is in an excellent position to examine the item\textsuperscript{115} and the customer.\textsuperscript{116}

On the other hand, hold periods are an ineffective way of preventing losses due to credit inadequacies. If the drawer's account has insufficient funds or a stop payment order has been issued, the item will be dishonored before the funds have been made available to the customer with no resulting loss to the depositary bank. This is of particular significance because eighty-one percent of all items dishonored are dishonored as a result of credit inadequacies.\textsuperscript{117} Furthermore, unlike the above situation involving fraud, the depositary bank cannot determine in advance whether any given check might be returned because of credit inadequacies through item verification.\textsuperscript{118}

Nevertheless, the blanket holds imposed by many banks do not legitimately address this concern. First, there are several categories of checks upon which holds are routinely placed\textsuperscript{119} where there is little or no risk of credit inadequacy. For example, government checks (state, federal, or local),\textsuperscript{120} certified checks,\textsuperscript{121} cashier checks,\textsuperscript{122} and, to a lesser extent, payroll or dividend checks impose virtually no risk of dishonor due to credit inadequacies. Second, even where the depositary bank cannot examine a given item and determine its likelihood of dishonor due to credit inadequacies, it can make some determination with respect to the creditworthiness of its customer, the depositor.\textsuperscript{123} In fact, banks typically recognize this factor, at least in practice.

\textsuperscript{114} Those who favor delayed availability frequently cite the fear of check kiting as a major justification for hold periods. It is clear that the potential loss for a bank from just one major check kiting scheme is enormous; larger than the capital reserves of many banks. Jordan, \textit{supra} note 2, at 552. However, this argument overlooks two important points. First, banks are insured against losses from check kiting schemes. Thus, a loss would merely increase the cost of doing business by the cost of the additional premiums to cover the insurance. These costs are passed on to the customers. Second, and perhaps more important, better methods are currently available to prevent check kiting schemes. Banks commonly utilize basic security measures to screen suspected accounts and to detect kiting. B. \textit{Clark}, \textit{supra} note 31, § 4.12, at 4-18-20 (Cum. Supp. 1983); Jordan, \textit{supra} note 2, at 544.

\textsuperscript{115} The bank could examine the item to determine the validity of the endorsements or obvious material alterations.

\textsuperscript{116} This is particularly useful when the customer is the perpetrator of the fraud. However, where the customer is the victim of the fraud, the bank is usually in an ideal position to pass the loss to the customer. Cooper, \textit{supra} note 2, at 545.

\textsuperscript{117} Cooper, \textit{supra} note 2, at 542. See \textit{Bank Administration Institute}, \textit{supra} note 59, at 25.

\textsuperscript{118} Cooper, \textit{supra} note 2, at 542.

\textsuperscript{119} Wechsler, \textit{supra} note 4, at 1153-54.

\textsuperscript{120} There are numerous reports of holds placed upon IRS tax refund checks and social security checks.

\textsuperscript{121} A certified check is a check that has been accepted by the payor. This makes the payor the primary obligor. See \textit{U.C.C.} §§ 3-411, 3-413. Therefore, dishonor is unlikely.

\textsuperscript{122} A cashier's check is drawn by a bank on itself, the bank is both drawer and drawee. E. \textit{Compton}, \textit{supra} note 15, at 66.

\textsuperscript{123} This is relevant because it is only when the check is dishonored and the bank cannot
It is common for banks to waive the availability hold periods\textsuperscript{124} where the bank is confident that the customer will be able to reimburse the depositary bank for any loss in the event of dishonor.\textsuperscript{125} Rather than mitigating the harshness of lengthy hold periods, frequent waivers add to the confusion and the inequity. Hold periods should be limited to those situations where holds would legitimately further the interests meant to be protected, rather than imposing blanket hold periods with frequent\textsuperscript{126} waivers.\textsuperscript{127}

There is no doubt that dishonor of an item after funds have been made available to a depositor poses very real risks that legitimately concern bankers. Admittedly these risks can be addressed, to some extent, by delayed availability of funds. However, the lengthy blanket hold periods routinely imposed by many banks\textsuperscript{128} are an inappropriate way of minimizing these risks. The imposition of lengthy hold periods attempts to address these risks at the expense of consumers and small businesses. Furthermore, delaying availability of funds on items where there is either very little risk of dishonor, little risk of loss due to the availability of the right to chargeback, or a more effective way to reduce the risk of loss is overbroad in its application.

V. Proposed Solutions

A. Case Law

If one accepts the premise that the current practice of delayed availability of funds is unfair and should be either abolished or modified, the next question to be addressed is how this goal should be accomplished. One of the first approaches customers took to force banks to shorten the hold

\textsuperscript{124} Cooper, supra note 2, at 541-44; Jordan, supra note 2, at 534. \textit{But see} Wechsler, supra note 4, at 1146-47 n.162.

\textsuperscript{125} Sometimes this can be dangerous also. Consistent waiver of the availability periods by bank officials allowed E.F. Hutton to perpetrate a massive check kiting scheme. Wall St. J., May 6, 1985, at 3, col.2. \textit{See also} Jordan, supra note 2, at 545 n.158.

\textsuperscript{126} While hold periods are frequently waived, the basis upon which any decision to waive hold periods is made is unclear and largely a question of business judgment. This makes it very difficult to predict whether or not holds will be placed upon a particular deposit.

\textsuperscript{127} One commentator suggests that hold periods are justified in very limited circumstances:

1. Where there is an identifiable credit risk that the bank cannot reasonably assume the customer will be able or available to reabsorb; or

2. Where there is a fraud risk that the bank, in its dealings with the item, cannot determine prior to deposit \textit{and} that the bank cannot reasonably assume that the customer will be able or available to absorb the loss.

Cooper, supra note 2, at 546.

\textsuperscript{128} Not all banks routinely impose the blanket holds that are the subject of this paper. In fact, studies have shown that blanket holds are uncommon in small cities where banks are likely to know their customers. Cooper, supra note 2, at 541.
periods was to turn to the courts for help. The cases focus on the question of the "reasonableness" of the hold period imposed. In Rapp v. Dime Savings Bank, the plaintiff asserted that a hold period of six days on local checks and fifteen days on out-of-town checks was unreasonable. The court disagreed, holding that the period was part of an agreement between the bank and its customer which was enforceable under U.C.C. section 4-103(1). In finding the agreement enforceable, the court found that it was neither manifestly unreasonable nor inconsistent with the exercise of ordinary care. Further, it appears likely that courts might approve hold periods without evidence of an agreement. In fact, the court in Discount Auto Mart v. Bank of North Carolina found that a depositary bank's right to impose hold periods exists without regard to an agreement creating the hold period.

Depositor court challenges to hold periods have usually been unsuccessful. However, alternative solutions have been proposed to alleviate the adverse consequences suffered by consumer depositors.

129. Recall that the bank must make a depositor's funds available for a "reasonable" period of time after final payment occurs. U.C.C. § 4-213(4)(a) (1977). The drafters' comments to the section make clear that a determination of what constitutes a reasonable amount of time will depend upon the distance the item has to travel, the number of intermediary banks, the successive midnight deadlines of each bank and other pertinent facts. Id. § 4-213 comment 10; See supra note 44 and accompanying text.


131. The bank's availability policies were printed on the back of deposit slips and posted in each branch. The court found that the customer impliedly consented to the terms of the agreement by opening an account and depositing his check. It has been asserted that this analysis overlooks the fact that the agreement referred to in the case is, at best, a contract of adhesion in which the bank customer has little or no actual choice or opportunity to agree to the terms. Jordan, supra note 2, at 549 n.178. This argument is recognized if not sanctioned in Baxter & Patrikis, supra note 3, at 124 n.147.


133. Id. § 4-213(1). These are the only two grounds under which an agreement by the bank will not be enforced. In enforcing the agreement the court noted that the terms of the hold period were printed on the back of the deposit slip as well as posted in the bank office. Further, the court noted that the basic purpose of check holds is to "protect the bank and, indirectly, the bank's depositors, against making payments, via withdrawals, on deposited checks which prove to be uncollectible." Rapp v. Dime Savings Bank, 64 A.D.2d 964, 408 N.Y.S.2d 540, 543 (1978), aff'd, 48 N.Y.2d 658, 396 N.E.2d 740, 421 N.Y.S.2d 347 (1979).

134. Wechsler, supra note 4, at 1147. The court in Discount Auto Mart v. Bank of North Carolina, 45 N.C. App. 543, 263 S.E.2d 41 (1980), while faced with a slightly different question, upheld the bank's right to impose hold periods without the necessity of an agreement.


136. No reported case can be found in which a plaintiff successfully convinced a court to shorten or abolish the hold periods. However, there have been several cases in which banks entered into settlements with the plaintiff customers. In Chadwick v. Crocker Nat'l Bank, Civ. No. 792521 (San Francisco Super. Ct. 1983), class action plaintiffs alleged that defendant placed an unreasonably long hold on deposited checks and failed to adequately disclose its policy. Although Chadwick contended that the plaintiffs could not have prevailed on the merits,
B. Disclosure

One of the first suggested solutions, and the solution advocated by bankers and the Federal Reserve Board, is disclosure of the delay period. Studies have demonstrated that the majority of consumer complaints cite lack of disclosure as a major source of problem. Therefore, early in the debate surrounding delayed availability of funds, bankers advocated voluntary programs of disclosure as a solution to the problem. They also argued that disclosure would minimize any hardship occasioned by delay periods and would encourage banking institutions to work toward ultimate voluntary solutions. With disclosure, it was thought, an institution's hold policies could form the basis of an informed consumer's choice among institutions. Market competition itself would assert pressure for change. A number of states, agreeing with the validity of these arguments, have adopted statutes man-

Crocker not only agreed to shorten its delay period, see Jordan, supra note 2, at 546 n.162, but also awarded plaintiffs attorney's fees of $140,000. Uncollected Funds— A Costly Quagmire, BANKERS NEWS WEEKLY (Jan. 10, 1984).

A settlement was also reached in Ricketts v. Lloys Bank of Cal., No. 343769 (L.A. Super. Ct. 1983). The parties agreed to a one day reduction in the hold period and specified more complete disclosure. Jordan, supra note 2, at 546 n.162. See Wechsler, supra note 4, at 1148 n.172.

The confusion in the courts' treatment of this issue is aggravated by a surprising decision from the Fourth Circuit in Fidelity & Deposit Co. v. Bank of Bladenboro, 596 F.2d 632 (4th Cir. 1979). Concerned about the overdraft condition of its depositor's account, the depositary bank imposed a ten day hold period. The hold period was never observed and the depositary bank continued to pay against uncollected items until it received notice of dishonor. Upon dishonor, the insurer of the depositary bank sued various collecting banks alleging negligence in the collection process and in advising the depositary bank of the dishonor. The court found the depositary bank to be contributorily negligent as a matter of law for allowing its customer to draw on deposited funds before the hold period expired. In this case the depositary bank failed to observe an established hold period. The effect of this decision on shortening or eliminating hold periods is unclear.


138. See, e.g., 1985 Hearing, supra note 50, at 320, 337 (ARCB Special Report); Id. at 157 (statement of C.T. Conover, Comptroller of the Currency); Lieberman, Fed Requests Disclosure of Float Policies, 149 AM. BANKER 1 (Feb. 16, 1984); Moyer, Tell Customers Why Checks Aren't Instant Cash, 75 A.B.A. BANKING J. 240 (May 1983); Regulating Policies on Funds Availability Unnecessary, 3 BANKERS NEWS WEEKLY 4 (Oct. 9, 1984); Sample Statements Offered on Delayed Availability, 2 BANKERS NEWS WEEKLY 1, col. 2 (Aug. 16, 1983).

139. See supra note 11 and accompanying text.

140. Ballen, There Are No Easy Solutions to the Delayed Availability Problem, 6 NAT'L L.J. 15 (1984); Olson, Procedures for Float Disclosure Need Uniformity, 149 AM. BANKER 4 (Aug. 16, 1984); Wechsler, supra note 4, at 1165-66; How to Avoid Customer Confusion Over Funds Availability, 13 BANK OPERATIONS REP. 1 (Jan. 15, 1984); Sample Statements Offered on Delayed Availability, 2 BANKERS NEWS WEEKLY 1, col. 2 (Aug. 16, 1983).

DELAYED FUNDS AVAILABILITY

dating the disclosure of delayed availability schedules.\footnote{142} In addition, statutorily mandated disclosure is an important component of every legislative proposal.\footnote{143}

There are several problems with embracing disclosure as the panacea to the problem of delayed availability of funds. Banks have increasingly disclosed delayed availability policies, but consumer dissatisfaction has actually risen slightly.\footnote{144} Thus, if disclosure is meant to alleviate consumer complaints, it has not been successful. More importantly, if delayed availability is unfair to the consumer-depositor, disclosure of the unfairness does not make it any less unfair.\footnote{145} While advance notice of bank policies might eliminate some of the inconveniences associated with hold periods, there is no escaping the inequities stemming from bank use of customer funds with virtually no alternative for the customer.\footnote{146}

C. Legislated Availability Schedules

An alternative approach to the problem of delayed access to funds is the establishment of fixed availability schedules. Legislation establishing such schedules generally places specific limits on the number of days that the depository institution can hold an item for various categories of checks. New York and California were among the first states to adopt statutes mandating availability.\footnote{147} While it is not the intent of this Article to describe the specifics of all statutes concerning delayed availability, a discussion of some common provisions in these two statutes will prove useful. Both states amended U.C.C. section 4-213(4)(a) and required that regulators specify what is a “reasonable” amount of time to delay availability as of right.\footnote{148} The specifics

143. See infra notes 147 & 157 and accompanying text.
145. For an excellent discussion of the inadequacies of disclosure as a solution, see Wechsler, supra note 4, at 1164-67.
146. In most communities there is little difference among banks with respect to delayed availability schedules. Wechsler, supra note 4, at 1167.
148. Miller, Ballen & Scott, supra note 8, at 1361.
of these regulations are of interest. First, the regulations provide that funds from deposited checks must be made available within one business day for the following items: checks of $100 or less, items drawn on the depositary bank, first-endorsed items drawn on the United States Treasury or on the respective state or local governments.\textsuperscript{149} Funds from deposited local checks (same city) must be made available\textsuperscript{150} within two business days.\textsuperscript{151} Depositary banks have three to four business days to make funds available for intrastate checks.\textsuperscript{152} There is a slight variation between the states. For example, New York regulations give depositary banks six business days to make funds available on out-of-state checks, while California sets the deadline at eight business days.\textsuperscript{153}

Second, each state provides certain situations to which the above periods do not apply. In each of these situations depositary banks are free to set their own availability schedules:

1. When checks are drawn for more than $2500;
2. When an item is deposited within 30 days of the opening of the depositor’s account;
3. Where the depositor’s account has been overdrawn on 3 separate occasions within the previous 6 months;
4. Where the depositary bank in good faith doubts the collectability of the item; and
5. Where the item is drawn on a bank located outside the United States.\textsuperscript{154}

In addition, both states clearly provide that the time limits do not apply if the delay in making funds available is caused by circumstances beyond the control of the depositary bank. This would include circumstances such as interruption of communication facilities, war or emergency conditions.\textsuperscript{155}

Further, California regulations provide that the time limits are inapplicable


\textsuperscript{150} The maximum periods listed apply to commercial banks. Slightly different periods are provided for savings banks, and savings and loan institutions. Wechsler, \textit{supra} note 4, at 1170.

\textsuperscript{151} Section 10.190405(a)(2) of the California Administrative Code; section 34.3(a)(1) of the New York Code.

\textsuperscript{152} Section 10.190405(a)(3)-(4) of the California Administrative Code; section 34.4(a)(2) of the New York Code. California requires availability of funds in three business days on items drawn on in-state banks, located in a different city but using the same clearing facility as the depositary bank. On other in-state checks the depositary bank has four business days to make the funds available.

\textsuperscript{153} Section 10.190405(a)(5) of the California Administrative Code; section 34.3(a)(3) of the New York Code.

\textsuperscript{154} Section 10.190407(a) of the California Administrative Code; sections 34.4(a)-(e) of the New York Code.

\textsuperscript{155} Section 10.190407(c) of the California Administrative Code; section 34.4(g) of the New York Code.
where there is a processing delay as in the case of an improperly encoded item.\textsuperscript{156}

The major provisions of these statutes will be evaluated because they form the basis for legislation introduced at the federal level.\textsuperscript{157} Any statute dealing with the problem of delayed availability of funds must balance the risk of loss to banking institutions caused by relatively immediate availability against the hardship on the customer imposed by delayed availability periods.\textsuperscript{158} The question is how well these statutes achieve this balance. At first glance, this balance appears to have been maintained by accelerating availability while attempting to limit the risk of loss to banking institutions. However, a closer examination is warranted.

The first question to be considered is whether the availability of deposits will be improved to a significant degree. It has been asserted that the improved availability is largely illusory.\textsuperscript{159} This statement is supported by an examination of the mandated availability schedules. The statutes mandate availability in business days rather than calendar days. Further, the day of deposit is not included in the necessary calculations.\textsuperscript{160} Thus, although the statutory scheme appears to provide great improvement, when one compares pre-statutory practice with the mandated schedules, there has been little change.\textsuperscript{161} For example, conversion of the New York\textsuperscript{162} mandated availability

\textsuperscript{156} Section 10.190407(a)(5) of the California Administrative Code. This presumably would exempt deposited checks where an error in encoding makes manual processing necessary. Its effect upon delays caused by fraudulent encoding is doubtful. In such a situation the depositary bank would be unable to determine that there was an encoding inconsistency at the time of deposit. \textit{See, e.g.}, United States Fidelity & Guaranty Co. v. Federal Reserve Bank, 590 F. Supp. 486 (S.D.N.Y. 1984), reh'g denied, 620 F. Supp. 361 (S.D.N.Y. 1985); Northpark v. Bankers Trust, 572 F. Supp. 524 (S.D.N.Y. 1983).


\textsuperscript{158} It has been said that any legislative solution must address only the following problem areas: 1) the customer's need to know the general hold policy of the institution, 2) the customer's need to know the hold placed upon a specific item, 3) the need to set maximum hold periods to prevent unreasonable hold periods, 4) the need to restrict the opportunity to vary the new law by agreement as the court found in \textit{Rapp v. Dime Savings}, 5) the problem of check returns, 6) the question of interest during the availability delay, and 7) appropriate penalties for violation. \textit{See} Jordan, \textit{supra} note 2, at 549-50. There is, however, no question that any legislation must not unreasonably increase the risk of loss from dishonored checks or fraudulent schemes.

\textsuperscript{159} Wechsler, \textit{supra} note 4, at 1175.

\textsuperscript{160} \textit{Cal. Admin. Code} tit. 10, ch. 10(1) art. 30(5) §§ 10.190402, 10.190405; State of New York, General Regulations of the Banking Board, pt. 34, § 34.3.

\textsuperscript{161} Wechsler, \textit{supra} note 4, at 1175-78.

\textsuperscript{162} A similar conversion could be accomplished for the California schedules.
schedules into calendar days reveals that commercial bank funds from local checks must be available in five calendar days, and for out-of-state checks the funds must be made available in ten calendar days. This compares with the pre-statutory practice of median availability of four days for local checks and nine days for out-of-state checks. The maximum hold periods almost mirror the median hold periods described. The claim of little actual improvement has been made in reliance upon these statistics.

However, this contention fails to consider the extent to which improvement exists. While the median hold periods mirror the statutory maximums, studies reveal substantial deviation from the pre-statutory median. The longest hold period imposed was eight days for local checks, fifteen days for intrastate checks, and twenty-two days for out-of-state checks. The results are even more disparate when the hold periods of savings and loan institutions are examined. Here, statutes impose maximum hold periods of five calendar days for local checks, compared with a pre-statutory median of eight days and a high of thirty-nine days; the statute imposes a maximum hold period of eight business days for in-state checks, compared with a pre-statutory median of eleven days and a high of forty-six days; the statute imposes a maximum hold period of twelve business days for out-of-state checks, compared with a pre-statutory median of seventeen days and a high of forty-six days. While little difference exists between the maximum mandated hold periods and the median hold periods found at New York commercial banks, there is a substantial improvement between the mandated maximums and the longest hold periods imposed, particularly in the savings and loan institutions. In light of this, statutes can effectively eliminate the extremes in treatment.

To a great extent, the improvement in aggregate fund availability has been achieved without substantial increase of risk of loss to the depositary banks. First, prior to enactment of the statute the majority of banks imposed hold periods similar to the maximum hold periods mandated by the statute without substantial loss from dishonored checks. Furthermore, placing checks into various categories and establishing different availability schedules for checks in each category improved availability with minimally increased risk of loss to the depositary institution. A good example of improved availability is the requirement that checks of less than one hundred dollars be available by the day after the deposit. Improved availability can be achieved for a large number of checks without significant increased risk. Similarly, next

163. Wechsler, supra note 4, at 1176 (citing a survey of New York banks conducted by the State of New York Banking Department in 1983.)
164. Wechsler, supra note 4, at 1176.
165. It has, however, been asserted that the $100 figure might actually be too low to be effective. Wechsler, supra note 4, at 1173 n.348. Because consumers need to obtain cash from their payroll checks through their checking accounts, and most paychecks presumably are greater
day availability of checks drawn upon governmental units poses little risk of loss to depositary institutions.\(^{166}\)

Moreover, the statutes attempt to exempt from the maximum hold periods situations where there is a greater than usual risk of loss to the depositary bank. Although there are slight differences, both California and New York generally exempt three types of checks from the maximum hold periods: large deposits, deposits into new accounts,\(^{169}\) deposits drawn outside the United States,\(^{170}\) and deposits into accounts where there have been repeated overdrafts.\(^{171}\) Additionally, depositary banks are permitted to utilize their own availability schedules if there are good faith doubts with respect to the collectability of items or where certain specified emergency conditions exist. The statutes appear to have successfully balanced the need for rapid availability of funds with the need to protect the depositary banks from unnecessary risk of loss. A recent study of the New York banks revealed virtually no additional losses reported since enactment of the statute.\(^{172}\)

Despite the improvements made by these statutes, there is a fundamental problem with the concept of state regulation.\(^{173}\) State regulation, by its very nature, is limited to state boundaries. More importantly, states address the problem in varying ways, but the vast majority ignore it. Thus, the problem of delayed availability is being addressed in a very piecemeal fashion. State regulation can never address the source of the delayed availability problem — the nature of the check return process.\(^{174}\) Legislatures can impose maximum hold periods only on banks chartered in their own states; they cannot regulate the nature of the national check collection system.

However, it has been suggested that imposition of hold periods without revising the check collection process, could induce banks to implement the

\(^{166}\) Seventy-two percent of the total volume of all checks written are for under $100. Bank Administration Institute, \textit{supra} note 89, at 65.

\(^{167}\) See \textit{supra} note 120 and accompanying text.

\(^{168}\) Checks drawn upon new accounts have an increased risk of being dishonored. Wechsler, \textit{supra} note 4, at 1212 n.540. In addition, a large majority of fraud cases were perpetrated by holders of new accounts. Baxter & Patrikis, \textit{supra} note 3, at 124-25; Serpico, \textit{Don't Get Stung by New-Accounts Fraud}, A.B.A. Banking J. 184 (May 1984).

\(^{170}\) See \textit{supra} note 154 and accompanying text.

\(^{171}\) "Repeated overdrafts" is considered to be three overdrafts within a six month period. See \textit{infra} notes 242-81 and accompanying text.

\(^{172}\) The only true solution to the problem of delayed availability is to change the check return process. See \textit{infra} notes 242-81 and accompanying text.
required changes without further regulation.\textsuperscript{175} If the currently adopted method of check collection becomes infeasible, because of either technological change or increased risk imposed by legislative initiative, banks can seek alternative means of check collection. This suggestion has some merit with respect to state regulation.\textsuperscript{176} However, it does not account for the fact that banks within a small number of states have little power to change the national bank collection process.\textsuperscript{177}

\textbf{D. Proposed Federal Legislation}

Because state legislation is inadequate to solve this problem, federal legislation has been proposed during the past several congressional sessions.\textsuperscript{178} During the 99th Congress, the House passed the Expedited Funds Availability Act.\textsuperscript{179} The Fair Deposit Availability Act of 1986 was introduced in the Senate as part of the Deposit Insurance Reform and Competitive Enhancement Act.\textsuperscript{180} These two bills have significant differences. This Article will examine the salient features of each proposal. It will then evaluate the proposals and offer a recommendation.\textsuperscript{181}

\textbf{1. The Expedited Funds Availability Act}

The Expedited Funds Availability Act (the Act) adopts a three-part approach to the problem of delayed funds availability. First, the statute directs

\begin{itemize}
\item Wechsler, \textit{supra} note 4, at 1198 n.474, attributing such a general statement to Federal Reserve Board of Governors member Nancy Teeters.
\item The author cannot help but be persuaded by this argument when considering proposed federal legislation. \textit{See infra} notes 181-241 and accompanying text.
\end{itemize}

Uniform nationwide application of mandated availability schedules may well be unnecessary to deal with what is an essentially localized problem that can be effectively dealt with at the state level. Several states have already taken the initiative to adopt such schedules and in view of the local variations of this problem, state action is probably the most appropriate vehicle for dealing with it.

\begin{itemize}
\item See \textit{supra} note 157 (partial listing of past and presently proposed federal statutes).
\item H.R. 2443, 99th Cong., 2d Sess. (1986).
\item H.R. 2443, 99th Cong., 2d Sess. § 2 (1986). House Bill 2443 (the Act) begins with a set of findings and a statement of its purpose that are, in many ways, a summary of the issue of delayed funds availability. The drafters find that: 1) the writing and deposit of checks is an important element in the efficient operation of the American economy; 2) many people rely on the rapid availability of funds for the basic necessities of life; 3) notwithstanding the fact that depository institutions receive provisional credit from the Federal Reserve for deposited checks within one to two business days after such checks are deposited, many depository institutions have imposed inordinate delays on availability; 4) the incidence of returned checks amounts to approximately one percent of all checks written and a substantial portion of these returned checks are paid on second presentment; 5) with few exceptions, efforts by state government, federal agencies, and the financial industry have been unsuccessful in curbing the found abuses; and 6) a coordinated federal response is the most reasonable way to assure that depositors are treated fairly in gaining access to the funds in their accounts.
\end{itemize}
the Federal Reserve Board to develop a plan to speed up the check collection process.182 Second, the statute adopts maximum availability schedules.183 Third, the statute requires disclosure of a bank's availability policy.184 In perhaps its most important section, the Act directs the Board of Governors of the Federal Reserve to immediately develop "an expedited availability schedule"185 designed to meet certain availability goals. This process is to be implemented no later than three years from the effective date of section 4 of the Act.186 In order to achieve this goal, the Board of Governors of the Federal Reserve would be directed to consider certain specified alternatives including, but not limited to, the following:187

1) automated check return;
2) uniform indorsement standards;
3) direct notification of dishonor, within specified time limits;
4) permitting return of all checks through the Federal Reserve System; and
5) allowing the payor bank to directly return dishonored checks to the depositary bank.188

The feasibility of each of these alternatives will be discussed below.189

The statute would also create a two-stage process for imposing mandated maximum hold periods. Permanent hold period limitations would become effective upon implementation of the new system of check collection discussed above. The check collection process would be revised to provide for availability of local checks on the start of the business day following the business day of deposit.190 Thus, Tuesday morning availability is required of

182. Id. § 3(a). See also infra notes 185-88 and accompanying text.
183. Id. §§ 3(b), 4, 5. See infra notes 190-205 and accompanying text for a discussion of the availability scheme.
184. Id. §§ 9, 10.
185. Id. § 3(a)(1).
186. Section 4, providing for interim hold periods, would become effective 90 days after enactment of the statute. Id. § 16(b). Therefore, the Federal Reserve process would have to be in place within 3 years and 90 days from enactment of the Act.
187. Id. § 3(g)(1)-(5).
188. Curiously, the statute adopts language to identify the parties in the bank collection process which is inconsistent with U.C.C. language. The statute begins by defining "depository institution" as including all institutions covered in section 19(b)(1)(A) of the Federal Reserve Act. Id. § 15(11). It then further differentiates between "originating depository institutions" (as meaning "the branch of a depository institution on which a check is drawn"), id. § 15(14), and the "receiving depository institutions" (as meaning "the branch of a depository institution in which a check is first deposited"), id. § 15(15). To avoid confusion, this Article will employ U.C.C. terminology, referring to the "originating depository institution" as the payor bank, and the "receiving depository institution" as the depositary bank.
189. See infra notes 242-81 and accompanying text.
190. Much like the New York and California legislation discussed supra in notes 147-77 and accompanying text, the statute mandates availability in business days, rather than utilizing the U.C.C. terminology of "banking day." The statute defines a "business day" as "any day other than a Saturday, Sunday, or legal holiday." H.R. 2443, 99th Cong., 2d Sess. § 15(3) (1986).
checks deposited on Monday. The bill would also require that no more than three business days intervene\(^\text{192}\) between the business day of deposit and the business day of availability of nonlocal\(^\text{193}\) checks.\(^\text{194}\) Thus, Friday availability is required of checks deposited Monday. Furthermore, the statute provides for an interim availability schedule. Under the interim availability schedule, cash deposits and wire transfer deposits would be available no later than the business day after the business day of deposit or transfer.\(^\text{195}\) Next business day availability also would be required for checks of less than $100, checks drawn on a branch of the depositary institution if both branches are located in the same check processing region, or in the same state, a first-indorsed check drawn on the United States, state, or local Treasury, and a first-indorsed cashier's check, certified check, teller's check, or bank check. The timetable for availability for other categories of checks is to be phased in over a three year period with a schedule applicable to the first year and more stringent schedules to take effect in the second and third years. In the first year, not more than two business days could intervene between the business day of deposit and the business day of availability for local checks.\(^\text{196}\) Thus, Thursday availability is required for funds deposited on Monday.\(^\text{197}\) During this same year, no more than six business days could intervene between the business day of deposit and the business day of availability for nonlocal checks.\(^\text{198}\) For a deposit on Monday, availability would be required a week from the following Wednesday.\(^\text{199}\) For the second and third years of applicability, no more than one business day would intervene between the business day of deposit and the business day of availability for local checks,\(^\text{200}\) and no more than six business days could intervene for nonlocal checks.\(^\text{201}\)

To minimize the risk of loss to the depositary institutions, exceptions to the scheduled availability are provided in certain situations. Depositary institutions are generally free to follow their own availability policy with respect to several types of deposits:

1) funds deposited into new accounts;\(^\text{202}\)
2) funds totalling more than $5000 deposited into an account on any given

\(^\text{192}\). The statute is confusing, specifying the maximum number of business days that can "intervene" between the day of deposit and the day of availability.

\(^\text{193}\). There will be no distinction between in-state and out-of-state checks, as is common in current state legislation. See supra notes 151-53 and accompanying text.


\(^\text{195}\). Id. § 4(a).

\(^\text{196}\). Id. § 4(c)(2).

\(^\text{197}\). This of course presumes that no holiday intervenes between the day of deposit and the day of scheduled availability.

\(^\text{198}\). The length of the period is due to the intervention of the weekend between the time of deposit and the time of availability. There will always be a weekend when the mandated time period is six business days.


\(^\text{200}\). Id. § 4(d)(3).

\(^\text{201}\). Id. § 4(d)(4).

\(^\text{202}\). Id. § 5(a) (new accounts are defined as accounts no older than 30 days). In the
business day;\textsuperscript{203}
3) checks redeposited after an initial dishonor;\textsuperscript{204}
4) items deposited into accounts that have been the subject of repeated overdrafts;\textsuperscript{205} and
5) checks drawn on institutions located outside the United States.\textsuperscript{206}

In addition, mandatory hold periods would not apply when:

6) emergency conditions existed that might affect the speed with which the deposited item could be processed through the collection system;\textsuperscript{207}
7) the Board of Governors of the Federal Reserve suspended the applicability of the Act after determining that banking institutions were experiencing an unacceptable level of losses due to check related fraud;\textsuperscript{208} and
8) a depositary institution has reason to doubt the collectability of funds deposited.\textsuperscript{209}

The statute also would require written disclosure of availability policies. Notice would be made by pre-printed deposit slips, mailed notice, and posting
the notice in a conspicuous place at each depositary institution. The Federal Reserve Board is given the authority to publish model disclosure forms to facilitate compliance with the disclosure requirements.

There are several additional statutory provisions. The statute would require that funds deposited into an interest-bearing account accrue interest no later than the business day upon which the depositary institution receives provisional credit for the item. The Act would require the Board of Governors of the Federal Reserve to establish a Payments System Advisory Council to advise the Board in the exercise of its function under the Act.

Finally, provision is made for both administrative enforcement and civil liability. The Act adopts a two-part damage scheme similar to the damage provisions of other federal consumer protection statutes. Under the provisions of the Act, any institution that fails to comply with a requirement imposed is liable to any person injured by that failure for actual damages and statutory damages. Under the actual damage provision the offending institution is liable for any actual damage sustained as a result of its failure to comply. In addition to actual damages, a plaintiff could recover additional amounts limited to no less than $100 and no more than $1,000. Plaintiffs could also recover costs and reasonable attorney's fees. However, there would be no liability for unintentional violations resulting from a bona fide error, notwithstanding "the maintenance of procedures reasonably adopted to avoid any such error."

2. The Fair Deposit Availability Act of 1986

The Fair Deposit Availability Act of 1986 (the Bill) differs markedly from the House Act discussed above. The Bill adopts a two-part approach to the problem of delayed availability. First, it would require disclosure of the availability policies. Second, it would direct the Board of Governors of the Federal Reserve to improve the check clearing system to meet specified goals.

210. H.R. 2443, 99th Cong., 2d Sess. § 8. It is not uncommon for banks to begin to accrue interest from the date of deposit notwithstanding delayed availability schedules. Wechsler, supra note 4, at 1159.

211. Id. § 11(a).

212. Id. In general, each administrative agency is given the power to enforce the Act with respect to the institutions it regulates.


214. H.R. 2443, 99th Cong., 2d Sess. § 14(a) (1986). In class action suits, the statutory recovery would have no minimum recovery but would be limited to no more than the lesser of $500,000 or one percent of the net worth of the defendant institution. Id. § 14(a)(2)(B).

215. Id. § 14(c)(1). Bona fide errors include clerical, calculation, computer malfunction and programming, and printing errors. Id. § 14(c)(2).

Under the first part, every banking institution\textsuperscript{217} would be required to provide written disclosure of its general availability policy. In addition, the institution would be required to post at each location a clear and conspicuous notice setting forth this general policy, and mail an annual reminder to each depositor.\textsuperscript{218} The Federal Reserve Board would be authorized to publish model disclosure forms to facilitate compliance with the disclosure requirements. The Federal Reserve Board also would be directed to prepare a regulation for the purpose of improving the check clearing system. Improvements in the check clearing process should allow funds deposited by local checks to be available upon expiration of one business day after deposit and funds deposited by all other checks to be available upon expiration of three business days after deposit.\textsuperscript{219} The regulation should be published for comment no later than eighteen months after enactment\textsuperscript{220} and should be effective no later than thirty-six months after enactment.\textsuperscript{221} The Federal Reserve Board also would be instructed to consider thirteen methods of improving funds availability.\textsuperscript{222}

The Bill would mandate availability schedules for only one category of checks: those where the deposited check is a first-endorsed check drawn on the Treasury of the United States. In those instances, the funds would be available no later than the date upon which the depositary institution is given

\textsuperscript{217} The statute is not written in language consistent with the U.C.C. For the purposes of this Article, U.C.C. terminology will be employed.

\textsuperscript{218} Id. § 1003(a)-(b).

\textsuperscript{219} Id. § 1005(a)(1)-(2). It is not clear what the statutory language “upon expiration of” means. Where availability is required “upon expiration of one business day after deposit” presumably this requires availability on close of business on Tuesday for Monday deposits.

\textsuperscript{220} Id. § 1005(a).

\textsuperscript{221} Id. § 1005(c).

\textsuperscript{222} S. 2592, 99th Cong., 2d Sess. § 1005(b)(1)-(13) (1986) lists these methods:
1) adopting a uniform endorsement standard;
2) providing for direct notification of returned checks;
3) providing for direct return of checks;
4) providing for return of all checks through the Federal Reserve;
5) extending time limits for returns (this is often proposed because it is thought that the current midnight deadline encourages the use of the United States Mail to return checks rather than the use of more efficient couriers. It has been suggested that by extension of the midnight deadline to the following morning less banks would return items by use of the slow and inefficient means of the United States Mail);
6) establishing schedules for the availability of funds;
7) prescribing the availability of funds based on the nature of the account to which the deposit was made or the nature of the account holder;
8) the use of electronic means of collecting and returning checks;
9) providing for check truncation;
10) the establishment of an automated return system;
11) charging based upon notification that a check will be presented for payment;
12) creating incentives for payor banks to return unpaid items promptly to the depositary institution; and
13) keeping the costs of any improvements to be implemented to a minimum.
provisional credit for the item. The Bill also contains several miscellaneous provisions. Where funds are deposited into interest-bearing accounts, depository institutions would be required to compute interest on deposited funds no later than the date upon which the institution receives provisional credit for the item. The bank would be permitted to delay the accrual of interest only if the computation of interest began at a later date for all deposits, including cash deposits. The Bill would create an Expedited Funds Availability Council to advise and consult with the Board of Governors of the Federal Reserve. The Bill also would provide for both administrative enforcement and civil liability. With respect to civil liability, a depository institution which failed to comply with disclosure, interest, or availability provisions would be liable to an injured party for both actual damages and statutory damages, except where such failure resulted from a bona fide error.

E. Evaluation of Proposed Federal Legislation

In many respects the proposed federal statutes are substantially similar. Both proposed statutes mandate disclosure which is an important, but not sufficient, component of any solution. Both recognize that the only long-term actual solution to the delayed availability problem lies in revision of the check collection process. The major substantive difference between the two bills is that the Senate Bill does not contain maximum availability schedules. Instead, the Federal Reserve Board would be directed to promulgate a regulation to improve the check collection system with the view toward reaching certain specified availability goals. The plan would be prepared within eighteen months and implemented within three years. There would be no maximum hold periods imposed during this three year planning period. This approach is flawed in several respects. First, consumers would

---

See generally N. Penney & D. Baker, supra note 51, § 2.01, at 2-1 to 2-4 (explanation of the various forms of check truncation). See infra notes 247-48 and accompanying text.

223. S.2592, 99th Cong., 2d Sess. § 1006. If the date upon which provisional credit is given is not a business day, the funds should be made available on the next business day.

224. Id. § 1004. Where the accrual of interest is delayed, the depository bank must provide a written disclosure of that fact. Id. § 1003(g).

225. Id. § 1005(d).

226. Id. § 1007. The administrative enforcement scheme is substantially similar to the administrative enforcement scheme contained in H.R. 2443 outlined above. See supra note 212 and accompanying text.

227. S. 2592, 99th Cong., 2d Sess. § 1008 (1986). Again, this is substantially similar to H.R. 2443 outlined above. See supra notes 213-15 and accompanying text. With respect to statutory damages, the court may allow damages of not less than $50 nor more than $500. S. 2592, 99th Cong., 2d Sess. § 1008(a)(2)(A) (1986).


229. See supra notes 144-45 and accompanying text for a discussion of the inadequacies of disclosure as the sole remedy.
wait at least three years before the hope of any relief. Second, even after the expiration of the three year period, there would be no guarantee of relief. The Federal Reserve would be directed only to promulgate a regulation to improve the check collection system with the intent of meeting specified availability goals. Thus, while the Senate Bill provides a goal of availability it does not mandate achievement of the goal even after expiration of the three year period. This is intended to provide the Federal Reserve Board with flexibility to deal with availability issues.\textsuperscript{230} However, leaving sole discretion with the Federal Reserve Board might very well defeat the intent of the Senate Bill. There is no guarantee that after initiation of any Federal Reserve Board regulation that improvement in availability would be achieved. In fact, history suggests otherwise. The Federal Reserve Board has been extremely reluctant to do anything about availability. It has opposed mandated availability schedules and has consistently maintained that proposed schedules (much like the goals set forth in the Senate Bill) are unrealistic and unobtainable. Therefore, to expect the Federal Reserve to implement a plan to achieve those goals is unrealistic and will prove to be unobtainable.

The approach taken in the House Act is more sound. The House Act would achieve the goal which fairness dictates — more rapid availability with little risk of additional loss to the banking community. It also provides for the achievement of an ultimate solution — revision of the bank collection process. The House Act does not require, however, that depositors wait for their funds while the banking community argues over how best to achieve that revision. Mandating maximum availability schedules provides incentives for banks to change the process to meet these schedules. The bank collection process is, after all, the method banks have chosen to implement check collection.\textsuperscript{231} If the present process becomes economically unsound, an alternative process may be sought.

Accepting the importance of maximum availability schedules in any legislation does not end the analysis. One must examine the specific schedules proposed to determine whether they are feasible. In analyzing the efficacy of the maximum availability schedules imposed by the House Act, one must consider the benefits to be achieved to consumers weighed against the potential for loss to depositary banks.\textsuperscript{232} In this regard, two questions must


\textsuperscript{231} It should, however, be remembered that banks must operate within the parameters of the U.C.C. and Regulation J. The current requirement of the physical return of the item through each step in the collection chain by a series of midnight deadlines contributes to the problem. See supra notes 60-66 and accompanying text. The “3-4-8” Committee of the Permanent Editorial Board of the UCC is currently drafting a proposed revision of Articles 3 and 4 of the U.C.C. However, this issue may not be addressed. See Miller, Report on the New Payments Code, 41 Bus. Law. 1007, 1010 (1986).

\textsuperscript{232} In fact, if the adopted plan creates additional losses, these losses surely will be passed
be answered. First, are the hold periods themselves reasonable, including both the interim and the permanent availability timetables? Second, is the period of time within which the Federal Reserve Board must implement change in the bank collection process and within which the permanent availability schedule must be met, reasonable?

The first question is made more difficult by the fact that there are two availability schedules that should be examined. The proposed interim availability schedules would achieve the desired balance between speed of availability and risk of loss. These hold periods are no more stringent than the periods currently being complied with under state statutes. In fact, the maximum hold periods specified, particularly during the first year, would not be substantially different from the average hold periods commonly imposed at the present time. As with similar state legislation, the major advantage of the House Act is the elimination of unusually high hold periods. Moreover, as with similar state legislation, the House Act provides sufficient exceptions to the availability schedules to allow depositary banks to protect themselves in situations where an increased risk of loss is likely. Thus, hold periods can be limited to the extent provided by the interim hold periods without significant increased losses.

Reaching a similar conclusion with respect to the permanent availability schedules is more difficult because a great deal of speculation is required. Whether banks could comply with the mandated availability schedules without a significant increased risk of loss depends upon whether the method on to depositors in the form of increased service charges or higher interest rates. It is therefore clearly to the benefit of all to avoid imposition of unreasonable risk of loss to the depositary banks.

233. For example, under New York legislation, banks are given two business days to make local checks available, three business days to make in-state checks available, and six business days to make out-of-state checks available. See supra notes 150-56 and accompanying text. By comparison, H.R. 2443 would require that local checks be made available in three business days (no more than two business days can intervene between the day of deposit and the day of availability) and that nonlocal checks be available in seven business days for the first year; that local checks be made available in two business days and that nonlocal checks be available in seven business days for the second and third years. See supra notes 192-95 and accompanying text. Under the provisions of H.R. 2443, local checks are only those checks drawn on the depositary institution in the same check processing region or in the same state as the depositary bank. H.R. 2443, 99th Cong., 2d Sess. §§ 3(b)(1), 15(12) (1986). Nonlocal checks would include checks referred to in the state legislation as out-of-state checks.

234. See supra notes 161-64 and accompanying text for a comparison of the New York and California legislation with pre-statutory practice; see also Iovacchini, Laws to Limit Checks' Hold Periods Have Minimal Effect on Processing, BANK SYSTEMS & EQUIPMENT 49 (Apr. 1985) (state legislation required little change in most banks' holding practices).

235. See supra notes 161-64 and accompanying text for a discussion of this factor with respect to state legislation.

236. See supra notes 165-72 and accompanying text.

237. The experience at the state level supports this conclusion. Compliance with state statute has not caused a significant increase in bank loss. See supra note 172 and accompanying text.
chosen by the Federal Reserve Board to speed up the bank collection process can meet the required schedule. It is not entirely clear that this will be possible. The permanent availability schedules would require next day availability for local checks and availability within four business days for nonlocal checks. Because processing of the check toward the payor bank is already highly automated, improvements are unlikely. Any decrease in check clearing times would, therefore, have to be achieved by improvement in the return process. Whether or not this can be achieved to provide for the payment availability schedule is unclear. Given the uncertainty, it seems unwise to mandate the permanent availability schedules discussed. A more sensible approach might be to allow the Federal Reserve Board, in conjunction with the Payment Systems Advisory Council, to create availability schedules upon implementation of the improved check clearing system. These schedules should in no event delay availability beyond the times specified in the second and third years of the interim availability schedules. The Federal Reserve Board could assess the effectiveness of the improved system and determine to what extent speed of processing has been increased, and in turn, determine a reasonable availability schedule. Any such evaluations could be in the progress reports the House Act requires the Federal Reserve Board to make to Congress.

The second question concerns whether or not the Federal Reserve Board can reasonably be expected to implement improvements in the check clearing process with the three year period specified. Again, the answer is sheer speculation. It does, however, appear likely that the three year timetable is sufficient.

F. Improvement in the Check Clearing System

The ultimate answer to the problem of delayed funds availability is to improve the check clearing system. Because depositary banks are never given notice of final payment, they are reluctant to give depositors access to their funds until they are reasonably sure that final payment has been made. Depositary banks can only hope that final payment has been made when sufficient time has elapsed for notice of a dishonored check to reach them. The waiting time can be substantial. While checks are cleared by swift computerized means on their way to the payor bank, the return process is slow and time-consuming. The solution, therefore, is to address the very

---

238. No more than three business days could intervene between the day of deposit and the day of availability.
239. See supra notes 190-93 and accompanying text.
241. One commentator concluded that the corollary five year period in previously proposed H.R. 5301 was far too long and that the three year period in S. 2851 was realistic. Wechsler, supra note 4, at 1187, 1191.
nature of the problem: the check collection system. The banking community recognizes the need for reform in the check return process. Processing costs of return items represent a disproportionate share of total processing costs and are growing rapidly.

Suggestions for reform focus either on speeding up the return process or speeding up the process by which depositary banks receive notice of dishonor.

G. Electronic Fund Transfers

Some suggest that adoption of a completely electronic fund transfer system would eliminate any problems of funds availability. Arguably all problems would be avoided if consumers utilized existing electronic fund transfers alternatives. However, consumers have been unwilling to abandon checks in favor of electronic fund transfers. A somewhat related alternative would be the adoption of check truncation. However, neither a full scale electronic fund transfer system, nor a more limited check truncation alternative, is

243. Bank Administration Institute, supra note 59, at 2, 23. In 1973, the cost of processing return items totaled $125 million. This represented 11% of total processing costs. Banks incurred these costs despite the fact that return items accounted for only two thirds of one percent of all checks processed. Id. at 23.

244. Id. at 1. It is thought that return processing costs will increase unless corrective action takes place to streamline processing. Id. at 7. The Bank Administration Institute recommends that: "It might be well for banks to assume more risks or to work toward modification of the current legal requirements in an effort to reduce processing costs." Id. at 5.


246. Bank Administration Institute, supra note 89, at 1-4, 137-139; Dow, supra note 213, at 1; Fox, supra note 89.

247. There are two types of check truncation: drawee bank check retention and depositary bank check retention. In drawee bank check retention, the check is processed as it is presented, but instead of being returned to the customer with his monthly bank statement, it is retained at the payor/drawee bank. In depositary bank check retention, on the other hand, the depositary bank retains the check and makes presentment to the payor bank by electronic communications. See generally N. Penney & D. Baker, supra note 51, at § 2.01 (explaining the various forms of check truncation). For the purposes of this Article the term check truncation will be used to refer solely to depositary bank check retention.

available currently nor are they likely to be available in the near future.\textsuperscript{249} This suggestion should be rejected because it fails to address directly the issues surrounding existing delays.

H. Direct Notification of Dishonor

Under direct notification, payor banks that dishonor items would be required to notify depositary banks of the dishonor within a specified period of time. Checks would be handled as before but delays would be substantially reduced because depositary banks would be free to release funds without fear of loss after the expiration of the time period. A limited version of direct notification is currently in use for checks in amounts of $2500 or more collected through the Federal Reserve System.\textsuperscript{250} This requirement is part of a recent amendment to Regulation J, intended by the Federal Reserve Board to reduce the need for substantial hold periods.\textsuperscript{251}

Regulation J, as amended,\textsuperscript{252} requires a payor bank that dishonors an item to provide notice of nonpayment so that such notice is received by the depositary bank by midnight of the second banking day following the day on which the payor bank is required to dishonor the item.\textsuperscript{253} For example, if a check is presented for payment on Monday, the payor bank would have until midnight Tuesday to dishonor the item and would be required to notify the depositary bank of the dishonor by Thursday. The payor bank could provide the required notification by any means,\textsuperscript{254} such as telephone, certified mail, or electronic wire. The payor bank would be required to include with the notification certain information specified in the regulation, provided that

\textsuperscript{249} Wechsler, supra note 4, at 1197-98. A study by Trans Data Corporation found that approximately 25\% of all financial institutions truncate checking services. Garsson, Truncation Losing Ground as Banks Concentrate on Other Matters, AM. BANKER 15 (Apr. 18, 1984).

\textsuperscript{250} Amendments to Federal Reserve Board Regulation J, 50 Fed. Reg. 5734 (1985) (codified at 12 C.F.R. § 210.12(c)). For a brief overview of the Amendment, see Miller & Ballen, supra note 248, at 1400-02. At first glance, limiting the requirement of direct notice might seem curious. It is exactly these large figures that are excluded from coverage of state and proposed statutes mandating shorter hold periods. However, the intent of both legislative and administrative action is to limit the risk to the depositary bank.

\textsuperscript{251} For a discussion of the wire notice requirement, see Mulford, The Federal Reserve's Wire Notice of Nonpayment, 100 BANKING L.J. 622 (1983).

\textsuperscript{252} Prior provisions of Regulation J and operating circulars required notification of nonpayment to the presenting bank. There were several problems with the previous approach. First, notification was not required to be made to the depositary bank. Second, it was unclear who had to give notice, when notice was to be given, and what information had to be included in the notice. Third, because no sanctions were imposed for noncompliance, the notification requirements were often ignored. See Jordan, supra note 2, at 538-42. Each of these problems has been addressed in the amended provisions. See infra notes 253-56 and accompanying text.

\textsuperscript{253} Amendments to Regulation J, 50 Fed. Reg. 5734, 5740 (codified at 12 C.F.R. § 210.12(c)(2)).

\textsuperscript{254} Id. § 210.12(c)(2).
it is able to determine the information from the face of the item. Substantial penalties are included for noncompliance. A payor institution that fails to exercise ordinary care in complying with the requirement is liable to the depositary bank for losses incurred by the depositary bank, up to the amount of the item, if the loss would have been avoided by the exercise of ordinary care by the payor bank. In addition, a payor bank that fails to act in good faith may be liable for consequential damages.

At first glance, direct notification for all dishonored checks in the clearing system appears to be an attractive alternative to shortening the hold periods. The forward process of check clearing is already rapid. This alternative eliminates delays while waiting for the return without extensive and costly changes in the check clearing system. However, this alternative imposes costs of its own. No matter which method of notification is chosen, it is likely that the notice procedure would be labor intensive. Bank employees would have the tasks of wiring or telephoning individual depositary banks. This would require determining which bank is the depositary bank, as well as communicating with thousands of foreign banks. Given the immense volume of checks returned each year, this additional burden would be staggering, and totally impracticable if imposed on a general level. Moreover, this labor burden would be imposed in addition to the present labor intensive method of returning checks, because the present method of returning checks through each level of intermediary banks with manual handling at each stage would be retained.

I. Standard Indorsement

The procedure by which endorsements are affixed to checks contributes to the delay in returning dishonored checks. A cursory glance at the back of a canceled check will illustrate the haphazard manner in which collecting banks indorse checks in no apparent order. A payor or collecting bank

---

255. *Id.* § 210.12(3). The information sent to the depositary bank must include the name of the payor bank, the name of the payee, the amount of the item, the reason for return, the date of the indorsement of the depositary bank, the account number of the depositor, the branch at which the item was first deposited, and the trace number on the item of the depositary bank. Further, the Federal Reserve Board has encouraged payor banks to include additional information in the notification such as the drawer of the check, the number of the check, the date of the check, the presenting institution, and any other useful information. *See id.* §210.12(c)(2).

256. *Id.* § 210.12(c)(6).

257. This is not an easy task given the haphazard manner in which endorsements are placed upon checks. *See infra* note 260 and accompanying text.

258. It is now common for banks to maintain correspondent relationships with a small number of banks. This added communication burden could be eliminated because the Federal Reserve will provide notification services.

259. Three hundred and sixty million checks were returned through the Federal Reserve in 1981. Cooper, *supra* note 2, at 535. It is estimated that two percent of all returned checks are in amounts greater than $2,500. *See supra* notes 102-03 and accompanying text. Even this percentage represents a substantial number of direct notifications required.
attempting to return a check spends considerable time and effort deciphering to whom the check should next be sent. This adds to the return time required for processing and virtually requires manual processing of the item.

As a partial solution to the availability issue, standard endorsements have been proposed. Such an indorsement standard was developed in 1981 by the American National Standards Institute. (ANSI). This would require a standardized placement of indorsement on the back of checks so that the depositary bank and each collecting bank would have specific places for indorsement. This, it has been suggested, would greatly simplify the manual return routing process and make automated return of checks more feasible. The substantial cost entailed in purchasing the necessary check processing equipment is purportedly a major impediment to adoption of the standard indorsement. More importantly, it is doubtful whether adoption of a uniform indorsement standard could increase the speed of processing enough to significantly effect availability schedules. Adoption of a uniform indorsement standard would merely speed up a basically flawed system, and then only to a very small degree. It would do nothing to change the basic problem of repeated manual handling of the item. However, a modified form of standard endorsements might prove useful. Any indorsement form which provides ease of identifying the depositary bank is essential to the successful implementation of either direct notification or direct return.

J. Methods to Allow Electronic Processing of Return Items

It has been suggested that any reform of the check collection process should address the problem of check returns by allowing electronic processing of return items. One way to accomplish this is by the use of carrier envelopes with pre-printed MICR strips bearing the routing symbols of the depositary bank. This would allow electronic processing of return items.

260. The standard is referred to as ANSI x9.3-1981. Copies of the standard are available from the Order Department of the American National Standards Institute, 1430 Broadway, New York, N.Y. 10018. The cost is $4.00.

261. See 1985 Hearing, supra note 50, at 201-02 (statement of P. Martin, Member, Board of Governors of the Federal Reserve System).

262. See supra notes 250-59 and accompanying text.

263. See infra notes 273-81 and accompanying text.

264. See generally Leary, A Proposal for the Automation of Returns of Cash Items, 19 U.C.C. L.J. 47 (1986). Leary further stipulates that any plan for automated processing should comply with the following specifications:

1) it should not require new equipment or new procedures applicable to all items;
2) it should enable return items to be included in outgoing cash letters of the payor bank;
3) it must preserve the item for later machine processing if the item is represented following dishonor.

Id. at 48-49.

265. The Federal Reserve and the American Bankers Association have been conducting an experiment using return-item carrier envelopes. Miller & Ballen, supra note 248, at 1402. Another carrier experiment is also being conducted through Continental Illinois Bank in Chicago. Leary, supra note 264, at 57 n.32. Apparently, the program has not been enthusiastically accepted by banks. Id.
similar to the processing that is now common for the forward trip.266 A related suggestion advocates that a MICR identification of the depositary bank be placed upon the item either by the depositary bank or the payor bank.267

The major objections to these proposals focus on the current technology available268 and the cost of any additional processing. These objections are without merit. Banks that currently possess automated check processing systems already have several ways of initiating MICR processing for returns. These range from the paste-over method,269 to the use of a full-length MICR strip with the depositary bank's routing symbols.270 In addition, the cost of such processing would be minimal.271 Furthermore, new equipment expenditures would be required.

K. Direct Return of Items

Another proposal to improve the check collection process is direct return of dishonored items. Under the present system, dishonored items are returned to the depositary institution via the same route traveled toward the payor bank, only the return trip is conducted manually rather than by automation.272 Direct return of items entails returning dishonored items directly to the depositary institution rather than through collecting banks. Direct return is authorized by optional U.C.C. section 4-212(2).273 If a returning bank opts to directly return an item to the depositary bank, it then recovers the amount

266. This apparently has been used in Canada with some success. Jordan, supra note 2, at 560.
267. For an excellent discussion of suggestions relevant to electronic processing of this sort, see Leary, supra note 264, at 58-65. Leary discusses the type of MICR strip utilized and the placement of such strip.
268. Objections have focused on the question of where to imprint the necessary MICR information. It is asserted that there is no room on the standard check for an additional MICR line, and that enlargement of the standard check is not favored. See Wechsler, supra note 4, at 1209 n.527.
269. The white-tape, paste-over method is currently used where an encoding error is detected. The properly encoded information is simply pasted over the error. This method could be employed for return item processing by pasting over the payor bank's routing numbers with the depositary bank's routing information. See Leary, supra note 264, at 58 (where the author rejects this method because of its limitations upon representment).
270. Leary favors this approach over the paste-over method because of the ease with which the added MICR strip could be removed to facilitate representment. See Leary, supra note 264, at 59.
271. The cost of the full-length MICR strip has been estimated to be $0.009 per check. The cost of carrier envelopes has been placed at $0.014 per carrier. Neither of these costs represent a significant expense considering that these costs would not be imposed upon all checks collected but only upon the return items. Processing of return checks already represents a disproportionate share of the total processing costs. See supra note 243-44 and accompanying text.
272. See supra notes 62-66 and accompanying text.
of the check directly from the depositary bank, allowing all provisional settlements to become final.\textsuperscript{274}

Since 1983 the Federal Reserve Bank of Dallas has been experimenting with a pilot program on direct return (the Dallas pilot project).\textsuperscript{275} In order to return a check through this project, the payor returns the item to the Dallas Federal Reserve Bank, which, in turn, returns the item to the depositary bank.\textsuperscript{276} The results of the experiment have been promising. Return time for checks has been considerably reduced\textsuperscript{277} at minimal cost.\textsuperscript{278} However, in order to have a favorable effect on funds availability, the program must be mandatory and instituted nationwide.

Alternatively, if some items are returned directly and quickly but others are not, the depositary bank would have no way of knowing in advance whether the dishonored checks will be returned directly or through the time-consuming method presently used. This would result in the need for hold periods presently asserted. One major obstacle to adopting direct return on a national level is state law. Several states\textsuperscript{279} have not yet adopted U.C.C. section 4-212(2)\textsuperscript{280} which authorizes direct return. The Federal Reserve Board is urging those states to change their law to accommodate direct return.\textsuperscript{281}

VI. CONCLUSION

The present policy of delayed funds availability is unfair to depositors and is not justified by legitimate banking concerns. In the typical situation, banks are permitted access to deposited funds, both in terms of income and reserve account requirements, long before the depositors are given access to the same funds. This is commonplace, despite the fact that little risk of

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{274} Id. § 4-212 comment 4.
\item\textsuperscript{275} The experiment is being conducted in a series of phases. Ultimately, the pilot project will offer direct return even for checks originally collected outside the Federal Reserve System for payers located in the Dallas District. This would extend to situations where the depositary bank was located outside of the district. See Wechsler, supra note 4, at 1203-05.
\item\textsuperscript{276} For a general description of how the pilot program works, see Dallas Fed Implements Check Returns, Saves Time for District Institutions, \textit{Bank Systems & Equipment} 51 (Apr. 1985).
\item\textsuperscript{277} Early in Phase II of the three phase project, return time was reduced by about two days. 1985 Hearing, supra note 50, (statement of P. Martin, Member Board of Governors Federal Reserve); Wechsler, supra note 4, at 1205 n.506.
\item\textsuperscript{278} The charge imposed by the Federal Reserve for return items is $0.50 per item. This charge is reduced to $0.25 per item if the items are capable of being machine processed. Wechsler, supra note 4, at 1205 n.509. It should be noted that return item processing costs already account for a disproportionate percentage of total check processing costs. It has been estimated that the average cost of return item processing in 1974 was $0.75 per item. \textit{Bank Administration Institute}, supra note 59, at 25.
\item\textsuperscript{279} The District of Columbia, Louisiana, Nevada, New Jersey, Oregon, and Wisconsin do not permit the direct return of items. Leary, supra note 264, at 55 n.23.
\item\textsuperscript{280} Section 4-212(2) of the U.C.C. is optional. \textit{See} U.C.C. § 4-212(2) comment 4 (1978).
\item\textsuperscript{281} 1985 Hearing, supra note 50, at 198-99 (statement of P. Martin, Member, Board of Governors of the Federal Reserve System).
\end{enumerate}
\end{footnotesize}
dishonor and subsequent depositary bank loss exists. Customers, for the most part, are given no opportunity to object to this treatment.

A. Necessary Components to a Viable Solution

There are no easy solutions to the delayed availability problem. Any solution must be cost-efficient and balance the need for fairness to depositors with the need to minimize risk of loss to depositary banks. Any viable solution must include several components — disclosure, maximum hold periods, and improvement in the check collection process. None of these components would be adequate without the others.

Bank disclosure of hold periods imposed on deposited checks is essential. As long as public opinion is such that the average depositor is unfamiliar with the policy of delayed availability, and as long as bank practices vary, disclosure will be required. In addition, it should be remembered that most consumer complaints regarding delayed availability stem from lack of knowledge of the depositary bank’s policies. However, disclosure alone is insufficient because it does not address the basic unfairness of allowing depositary banks unlimited access to customer funds without adequate justification.

The second major component necessary to any solution to the problem of delayed funds availability is legislated maximum availability schedules. Without maximum availability schedules, banks are free to continue the unfair policy of imposing delayed availability. The policy of allowing banks to determine their own reasonable availability schedules is unworkable. Allowing the Federal Reserve Board flexibility to develop schedules would be equally fruitless given past Federal Reserve reluctance to regulate availability.

The last major component, and the ultimate solution to the problem of delayed availability, is improvement in the check clearing process. Only by changing the process by which checks are cleared through the check collection process, in particular the check return process, can a long-term solution be achieved. Without this change any mandated availability solution will be at the expense of additional risk of loss to the depositary banks.

B. Need for a Federal Statute

The delayed availability solution will best be achieved by adoption of federal legislation. Legislation adopted at the state level can only address the problem in a piecemeal fashion because most states will ignore the issue and those states that address the issue will adopt different solutions. More importantly, state legislation is unable to mandate any reform of the check clearing system. A federal statute must be adopted. Such a federal statute should be similar to the House Act discussed above. Any successful legislation must include the necessary components outlined above.

A successful statute must require depositary institutions to disclose availability policies when an account is opened, periodically as a reminder, and by posting the policies in the bank.Disclosure would eliminate many prob-
lems caused by delayed availability by allowing customers to plan more efficiently.

Second, a successful statute must direct the Federal Reserve Board to take action to improve the method by which the check collection system operates, and specify a reasonable timetable for the implementation of the change. A three year period appears to be reasonable. Furthermore, a successful statute must provide for maximum availability schedules. Interim schedules should be created to impose availability limits during the check collection revision process. The interim schedules must reasonably balance the need for availability with consideration of the risk of loss to depositary institutions stemming from returned checks. The schedules set forth in the House Act appear to achieve this goal. Checks are placed in various categories depending upon the risk of loss to the depositary bank. Checks in categories in which there is perceived to be little danger of return, such as cashier's checks or checks drawn upon the United States government, should be made available shortly after deposit. The timetable imposed for general availability must be reasonable. The timetable selected in the House Act appears to be adequate. Exception must be made for categories of checks in which a greater than average risk of loss is perceived. The House Act adequately protects depositary institutions in this regard.

In addition, some attention should be paid to permanent availability guidelines. Imposing permanent availability schedules at this time is premature. The schedules specified in the House Act might be feasible if improvements can be made in check clearing. Determination of reasonable availability timetables in light of improvements in the check clearing system which are neither developed nor implemented is sheer speculation. Such speculation is inappropriate in a statute of this nature. Instead, the Federal Reserve should be given the power to impose permanent availability schedules after implementation of the improvements mandated. This would provide flexibility without speculating about improvements in the collection process. General guidelines could be prepared so that permanent availability schedules would not delay availability beyond the time periods set forth in the interim availability schedules.

C. Improvements in the Check Collection Process

The root of the delayed availability problem lies in the means by which checks are presently collected, in particular the means by which dishonored checks are returned. Therefore, the ultimate solution lies in changing this process. Several possible alternatives have been discussed. Improvement can best be achieved through provisions for automated return of checks. Either a workable method of affixing the MICR encoding symbols of the depositary bank to the item can be achieved, or encoded carrier envelopes can be used. There are virtually no persuasive arguments against the use of automated return.

However, it will take some time to implement the change advocated. Other improvements might be adopted to speed the process in the interim. Direct
send of the items from the depositary bank to the payor bank should be encouraged in all instances, and a standard indorsement for the depositary bank is desirable. Direct return, as is now available through the Dallas pilot project, should be expanded. Direct notice of dishonor, however, should be rejected as an alternative applicable to all checks. Such notice is effective to reduce the risk of loss to the depositary bank when applied to checks in amounts greater than $2,500. Checks in such amounts account for a substantial percentage of the loss from dishonored checks, but only a small percentage of returned checks. Therefore, reductions in the risk of loss are achieved without imposing inordinate burdens in terms of notification requirements upon payor banks. This would not be the case if the direct notice requirement were extended to cover all checks. In such a case, the burden of notice would outweigh the benefits to be achieved.

Although the problem of delayed availability is complex, it can be solved. This Article has presented the reader with one proposal for minimizing hardship to the depositor without imposing unreasonable risks upon the depositary institutions.