

CHECKS AND BALANCES

By: Amos Goodall

A graduate of Franklin and Marshall (BA), Fordham Law School (JD), and Stetson College of Law (LLM), Amos Goodall began the practice of law in Centre County in 1976 following a clerkship with the Chief Judge of the Middle District of Pennsylvania. In 1987, he began his own firm, which became Goodall & Yurchak. This firm was acquired by Steinbacher Law in Williamsport and became part of Steinbacher, Goodall & Yurchak. Amos Goodall continues to practice in the State College office.

For nearly thirty years he has been rated a preeminent attorney by Martindale Hubbell, the national legal rating service. In 2000, he was certified as an Elder Law Attorney by the National Elder Law Foundation. Amos Goodall has been ranked as a Super Lawyer in the category of Elder Law by Thompson-Reuters every year since that category was established, and he was named by Best Lawyers in America as Lawyer of the Year in Elder Law in 2016 and in Trusts and Estates in 2017.

He is a co-author with Professor Morgan and others of the LexisNexis Treatise, Tax, Estate and Financial Planning for the Elderly, as well as its accompanying Forms publication.

This year he completed a term as President of the National Elder Law Foundation. He is a fellow of the American College of Trust and Estate Counsel, and was a member of the board of the National Academy of Elder Law Attorneys, where, as public relations chair, he worked with Congressman G. C. Thompson on the Special Needs Trust Fairness Act, which was ultimately adopted as part of the Twenty-First Century Cures Act in 2016.

This fall, the Legal Intelligencer announced that Amos Goodall has been given a Lifetime Achievement Award for 2020 as part of the Legal Intelligencer's 2020 Professional Excellence Awards series. These awards recognize the achievements of Pennsylvania lawyers "who have made a significant, positive impact on the legal profession and who have left an imprint on the legal history of the state."

Amos Goodall is solicitor to the Centre County United Way. During his career, he has been chair of the Board of Directors of Foxdale Village, the Centre Foundation, the Centre County Youth Service Bureau, the Centre County Child Development Council, and has given pro bono advice in establishing or operating dozens of other local organizations.

He lives in State College with Casey, his wife. Their daughter, Hawley, and family live in Lake Como, NJ, and their son, Christian, is deceased.

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Introduction¹

From the time a cave dweller traded a rock that could be used as a weapon for a recently harvested fruit that could be eaten, commerce has involved increasingly efficient means of financial exchanges. Some of us tendered a check from our parents' checking account to pay our law school tuition. That check traveled from our parents' home to our dorm mail box; it was tendered to the bursar's office where it was deposited in the school's checking account. The same piece of paper passed through the banking system and was physically included in the mailing containing our parents' monthly account statement, a similar process that has prevailed for hundreds of years.

According to Wikipedia, there is early evidence of using checks in India during the Mauryan period (from 321 to 185 BC). A commercial instrument called the adesha was in use, which was an order on a banker desiring him to pay the money of the note to a third person. Some experts think the Romans may have invented the check about 352 B.C. But, according to most history texts, it probably wasn't until the early 1500s, in Amsterdam, Holland that people who had accumulated cash began depositing it with Dutch "cashiers," for a fee, as a safer alternative to keeping the money at home, then the cashiers agreed to pay the debts out of the money in each account, based on the depositor's written order or "note" to do so.²

To be sure, there have been technological advances, such as magnetic ink character recognition (MICR) that allowed automated sorting and routing of checks

¹As can be deduced from the citations below, a seminal work in this area is Benjamin Geva, Law of Electronic Funds Transfers (Matthew Bender & Co. 2020) (Hereafter "Electronic Funds Transfers").

²<https://checkkeeper.com/blog/history-of-checks/> (Last visited 8/29/20). For more information see Ram Naresh Chaudhary, Law Relating to Cheques (Deep & Deep Publications, 2009).

between banks and led to automated central clearing facilities, but the process continued to involve a piece of paper that was passed from station to station through a system.

Certain safeguards are obvious. If our check was improperly read or altered after leaving our hands and anywhere along its voyage through the system, we would be able to tell when we received it in the envelope containing the statement.

Check Clearing for the 21st Century Act

This law³ eliminates the requirement of transferring checks in paper form by authorizing a process for checks to be “truncated”.

(18) Truncate. The term “truncate” means to remove an original paper check from the check collection or return process and send to a recipient, in lieu of such original paper check, a substitute check or, by agreement, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check), whether with or without subsequent delivery of the original paper check.⁴

Under this law, a substitute check may used without the original paper check. A substitute check is the legal equivalent of the original check for all purposes, including any provision of any Federal or State law, and for all persons, if the substitute check accurately represents all of the information on the front and back of the original check as of the time the original check was truncated, provided it bears the legend “This is a legal copy of your check. You can use it the same way you would use the original check.”⁵

The warranty made in connection with a check which has been truncated, in part, is that the substitute check accurately represents all of the information on the front and

³12 U.S.C. §§5001-5006

⁴12 USCS § 5002 (18).

⁵12 USCS § 5003(b).

back of the original check as of the time the original check was truncated.⁶

Any attorney who has ever considered litigating a matter in which the authenticity of a document has been in issue can imagine the difficulties inherent in attacking or establishing the validity of an instrument that has been truncated unless the party who originally wrote the check has retained the original instrument from the time of truncation.

ACH TRANSFERS

The banking industry has a network that coordinates electronic payments and automated money transfers through automated clearing houses.⁷ This transfer system moves money (in its broad sense) between banks without using paper checks, wire transfers, credit card networks or cash.

Payments through ACH are processed in batches at the end of each day by one of two central clearing houses, The Federal Reserve or the Clearing House. Typically wages are withdrawn directly from an employer's account deposited directly into the wageearner's account and recurring bills are withdrawn directly from the consumer's account and deposited directly into the creditor's account. For all users, one problem is that there is a direct link into the paying person's bank account. The Electronic Fund Transfer Act protects electronic fund transfers from consumer bank accounts, but this does not cover business accounts. A "consumer" means a natural person.⁸

⁶12 USCS § 5003(b)(1).

⁷ Justin Pritchard, "What Does ACH Stand For", *The Balance* (May 14, 2020) <https://www.thebalance.com/what-does-ach-stand-for-315226> (Last visited 9/8/20).

⁸"Definitions" Regulation E §1005.2, 12 CFR §1005.2.

For consumers, is a withdrawal is “unauthorized” if “initiated by someone other than the consumer without actual authority to initiate a transfer, the consumer received no benefit from it, and the consumer did not furnish such person with the card, code, or other means of access to his account.”⁹ The burden of proof is on the consumer to prove that a transaction was not authorized. But if the consumer alleges an unauthorized transfer and puts forward d put forward some evidence supporting it. At that point, the burden of proof shifts to the financial institution, which must prove that the transfer was authorized.¹⁰

The consumer has no liability for an unauthorized transfer unless the bank proves

1. (I) the access device used for the transfer must have been accepted by the consumer and
 - (ii) the financial institution must have provided a means to identify the consumer to whom the access device was issued, such as a signature, photograph, fingerprint, or electronic or mechanical confirmation like a PIN; and
2. the financial institution must have provided to the consumer written information pertaining to
 - (I) the consumer’s liability for unauthorized transfers,
 - (ii) a telephone number and an address for notifying the financial institution of an unauthorized transfer, and
 - (iii) the financial institution’s business days.¹¹

“Access device” means a card, code, or other means of access to a consumer's account, or any combination thereof,¹² that may be used by the consumer to initiate electronic fund transfers. A protected deposit relationship is a “demand deposit (checking), savings, or

⁹Ognibene v. Citibank, N. A., 112 Misc. 2d 219, 219, 446 N.Y.S.2d 845, 846, 1981 N.Y. Misc. LEXIS 3417 (New York Cirt Civil Court, NY County, 1981)..

¹⁰The Law of Electronic Funds Transfers § 6.05 (2019)

¹¹Liability of consumer for unauthorized transfers, Regulation E §1005.6, 12 CFR §1005.6.

¹²“Definitions” Regulation E §1005.2, 12 CFR §1005.2.

other consumer asset account . . . held directly or indirectly by a financial institution and established primarily for personal, family, or household purposes.”¹³

Incidentally, there are companies dealing with the consumer that make it difficult to terminate electronic funds transfer process once started. However, the regulations make it clear such a transfer is unauthorized if the consumer has notified the financial institution that transfers by that person are no longer authorized.¹⁴

Finally, automated funds transfers, once authorized, recur spontaneously until terminated, whether or not there are funds in the transferring account, which can result in charge backs to the creditor and bad check fees to the consumer, even if the transfer is authorized.

For non-consumer accounts, under applicable rules, the payor (sometimes called the recipient of the debit order), must issue a “stop payment” order before a preauthorized transaction was completed.¹⁵

WIRE TRANSFERS

While ACH transfers are handled in batches generally at the end of the day, wire payments are handled by banks individually. In the author’s practice, wire transfers have tended to be large-value payments. Theoretically, the transfer is instantaneous going from the sender’s account into the receiver’s, but as a matter of practice, typically recipients want funds to be wired in the morning so that they are lodged in the recipient’s

¹³Id.

¹⁴Id.

¹⁵“RDFI Obligation to Stop”, National Automated Clearing House Association (NACHA) Operating Rules § 3.7.2

account before the end of the day.¹⁶

There are two types of networks through which wire payments are transmitted, either a communication system or a communication and settlement system. While a communication system transmits only instructions and other data, a communication and settlement system also transfers value.

In a communication system, interbank settlement is carried out outside the framework of the system. SWIFT is such a communication system without a settlement facility. In an international SWIFT transfer, the sending and receiving banks settle bilaterally in a correspondent account the one holds for the other, or through some other mechanism.¹⁷

The more frequent process is the communication and settlement system. Here, settlement can be carried out either multilaterally on a “net net” basis or individually on a gross basis.

Net net settlement takes place among participants in a clearinghouse arrangement. In this context, payment obligations among participants are amalgamated and the resulting amounts (owed between each and all other participants) are settled periodically (e.g., at the end of the day) by one payment from each net net debtor to the clearinghouse, or to a settlement account owned jointly by the participants, followed by the clearing house’s payment to each net net creditor. One agency offering this process is the

¹⁶This also gives the parties flexibility in satisfying transmitting bank requirements. For example, some banks will honor wire transfer instructions given remotely, others will require the sender’s authorized representative to be personally present at the branch to authorize the transfer, especially for larger transfers.

¹⁷The Law of Electronic Funds Transfers § 3.01 (2019)

National Settlement Service which is offered by Federal Reserve Banks. Under this service, a clearing house may send a settlement file that lists the net net debit or credit position of each participant. Debits are made to the Federal Reserve master accounts of each net net debit participant and corresponding credits made to a settlement account on the books of a Federal Reserve Bank, which temporarily holds funds for the settlement arrangement. Once all debits have been made and credited to the settlement account, credits are then made to the Federal Reserve master accounts of each net net credit participant.¹⁸

Individual gross basis settlement takes place through wire transfer systems. Two generally used in the United States are the Clearing House Interbank Payments System (“CHIPS”®) and the Fedwire® Funds Service. CHIPS® is a private clearing house, while Fedwire® is created by the Federal Reserve Banks. Each agency is authorized to issue rules that supercede Article 4A of the Uniform Commercial Code.¹⁹ In this context, each funds transfer is settled individually on the books of the common correspondent or the common ledger of the payment system as the funds transfer is carried out between the sending and receiving banks.

In an on-line wire-transfer system, communication can be either through a central switch or via gateways. In a central switch system, interbank communication is intermediated through a central switch. In a gateway system, interbank communication is facilitated by means of a direct computer-to-computer communication between the participants.

¹⁸The Law of Electronic Funds Transfers § 3.01 (2019)

¹⁹E.g., UCC §4A-107.

Fedwire® Funds Service

This funds transfer system known as Fedwire® Funds Service is operated by the federal Reserve Banks. Roughly 7,300 banks throughout the United States participate in the transfer of trillions of dollars each day.²⁰

In a simple Fedwire® funds transfer between an originator and a beneficiary where Reserve Banks are the only intermediary banks, the originator's bank and the beneficiary's bank communicate through the Reserve Banks, and settle by means of a debit to the account of the sender (originator's bank) at a Reserve Bank and a corresponding credit to the account of the receiving bank (beneficiary's bank) at a Reserve Bank.²¹

In practice, Fedwire® transfers are not posted directly to the accounting system of the Reserve Banks, known as the Integrated Accounting System (or IAS), which keeps track of changes in a bank's master account. Rather, Fedwire® transfers are posted to a "working balance" maintained for each bank. Each transfer generates a debit to the sender's working balance and a credit to the receiving bank's working balance. Where the debit would result in an overdraft to the sending bank's working balance which exceeds the permissible overdraft under the Federal Reserve Policy on Payment System Risk and the account is monitored on a real-time basis, the funds transfer is not carried out. In this case, neither the debit to the sender nor the credit to the receiving bank is posted to their respective working balances. Working balances are adjusted instantaneously, with each

²⁰Board of Governors of the Federal Reserve System, "Fedwire Funds Services", http://www.federalreserve.gov/paymentsystems/fedfunds_about.htm (Last visited 9/8/20).

²¹12 CFR §210.26.

transfer as it occurs, so as to be updated continuously throughout the day. At the end of the day, the final working balance of each bank is integrated into its master account.

Together with other transactions, such as check, ACH, and securities settlements, this sets the final closing balance of the bank's master account. This closing balance becomes the opening working balance for the next day.²²

As summarized in The Law of Electronic Transfers, this is generally the process for a wire transfer:

1. When a payment message is originated by the sending bank, the system first carries out security checks. If the sending bank is authorized and the message conforms to protocol edits and sequence number checking, it is logged on to the data base and the following additional editing is performed before the message is processed:
 - Are the sending and receiving banks authorized to use the Fedwire® system?
 - Is the message for today's cycle and is it being originated within wire transfer operating hours?
 - Does the message text conform to standards?If the message fails any of the above edits, the message is rejected and returned to the sending bank with a description of the error. The sending bank may correct the message and re-enter it as a new message, but must use a new sequence number.
2. If the message passes the authorization and validation process, the system determines if the sending bank's account is being monitored under the Federal Reserve Payment System Risk Policy. There are two main possibilities.
 - If the sending bank's account is not being monitored, the payment may proceed. The sending bank's account is debited and the sending bank is notified. If the debit exceeds the bank's balance, then a daylight overdraft occurs, that is, the sending bank's balance goes negative. A credit is then posted to the receiving bank's account.
 - If the sending bank's account is being monitored, the system checks to see if the sending bank has sufficient balances to cover the transfer. If the sending bank has sufficient balances, processing continues as described above. It is possible that a monitored bank would be allowed to incur a daylight overdraft

²²1 The Law of Electronic Funds Transfers § 3.04 (2019)

- so long as it does not exceed the bank's net debit cap and posted collateral.
- If the sending bank does not have sufficient balances (and is on the monitor), the system determines if the message should be placed in a pending queue or rejected back to the sending bank. If the message is rejected, the message is returned to the sending bank with an error message indicating insufficient balances (NSF).²³

Generally funds are transferred in a Fedwire® transaction on the same day, although this is not guaranteed.²⁴ Once a transfer is properly initiated, it is irrevocable.²⁵

. . . [I]n the enactment of Article 4-A, "[e]stablishing finality in electronic fund transfers was considered a singularly important policy goal. Payments made by electronic funds transfers . . . are to be the equivalent of cash payments, irrevocable except to the extent provided for in article 4A." (*Banque Worms v BankAmerica Intl.*, 77 NY2d 362, 372, 570 N.E.2d 189, 568 N.Y.S.2d 541 [1991] [internal citations omitted].)²⁶

Notice of a credit to the receiving bank's account from the Federal Reserve constitutes acceptance of the transfer.²⁷ The receiving bank is obligated to pay the

²³The Law of Electronic Funds Transfers § 3.04, quoting D.L. Mengle, J.K. Severson, and C. Vital, *A Comparison of Fedwire and Swiss Interbank Clearing*, Discussion Paper, Fed. Res. Bank of Richmond (May 1989). (2019)

²⁴Federal Reserve Banks, "Funds Transfers Through Fedwire Funds Service", Operating Circular No. 6, ¶8.6
<https://www.frbservices.org/assets/resources/rules-regulations/122019-operating-circular-6.pdf> (last visited 9/8/20).

²⁵*Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 609 F.2d 1047, 1051, 1979 U.S. App. LEXIS 10708 (2 Cir. 1979).

²⁶*Bayerische Hypo-Und Vereinsbank AG v HSBC Bank USA, N.A.*, 2015 N.Y. Misc. LEXIS 2602, *12, 2015 NY Slip Op 31270, 7-8 (NY Co. Supreme Court 2015).

²⁷UCC §4A-209(b)(2).

recipient on the day of acceptance, unless notice was received after the close of the funds-transfer business day of the receiving bank.²⁸ Since the Reserve Banks are standing behind each payment, a credit from a Fedwire® transfer is the equivalent to cash.

Practice Pointer

Here are some considerations for Wire Transfers:

- Was the transmittal memorandum forged by the Sender?
- Was the transmittal memorandum completed accurately by the Sender?
- Were funds in the Sender's account attached by a creditor of the Sender before the transmittal and processing of the memorandum?
- Was the transmittal memorandum actually transmitted and accepted by the Sender?
- Is the Sender's bank is a member of the applicable Wire Transfer network?
- Did the Sender's Bank accurately key in the transmittal information?
- Is the Sender's bank sufficiently solvent to cover the transfer or does the Wire Transfer network's guidelines allow overdrawing the account?
- Has the Sender stopped payment after authorizing the transfer?
- Has your bank received the funds?
- Have the funds been properly credited to your account?

If you receive formal written notification from your bank that funds have been received, you should be safe in spending the money!!

²⁸The Law of Electronic Funds Transfers § 2.11 (2019)

In conclusion, while there are obviously challenges to the use of wire transfer technology, a number of potential drawbacks are eliminated by its use. In particular, opinions cited above seem to stand for the proposition that, subject to analysis on a case by case basis, once a wire transfer is properly initiated, the Sender no longer has an ownership interest in the underlying funds, and the Recipient may look to the Federal Reserve to complete the transaction notwithstanding events subsequent to the transaction.