The Revision of U.C.C. Articles Three and Four: A Process Which Excluded Consumer Protection Requires Federal Action

Mark E. Budnitz

Follow this and additional works at: https://digitalcommons.law.mercer.edu/jour_mlr

Part of the Consumer Protection Law Commons

Recommended Citation

This Article is brought to you for free and open access by the Journals at Mercer Law School Digital Commons. It has been accepted for inclusion in Mercer Law Review by an authorized editor of Mercer Law School Digital Commons. For more information, please contact repository@law.mercer.edu.
The Revision of U.C.C. Articles Three and Four: A Process Which Excluded Consumer Protection Requires Federal Action

by Mark E. Budnitz*

I. INTRODUCTION

The 1990 official revision to Articles 3 and 4 of the Uniform Commercial Code ("U.C.C.") represents a major failure in process. A crying need exists for a comprehensive national reevaluation of the law of payment systems as it affects all consumers. Instead, the sponsors of the revisions, the American Law Institute and the National Conference of Commissioners on Uniform State Laws, chose to exclude entirely issues of concern to consumers.¹ The failure of process, however, goes beyond this omission. Recent developments in the provision of government benefits to those without bank accounts raise the question whether the uniform state laws approach is a viable method for future legislative action in regard to payment systems law that affects consumers.

The extent of the failure of process is illustrated by the plight of those consumers who have the greatest need for legal protection, but who have very little: The twenty million recipients of government benefits who cannot afford checking accounts.² Because these recipients lack checking ac-

* Associate Professor of Law, Georgia State University College of Law. Dartmouth College (B.A., 1966); Harvard Law School (J.D., 1969). Member, State Bar of Georgia. Member, Ad Hoc Committee on Payment Systems, Section of Business Law, American Bar Association. The Author gratefully acknowledges the research assistance of Scott P. Hilsen.

¹ U.C.C. § 4-101 cmt. 3 (1990). For purposes of this Article, references to the former version of the UCC are to the 1989 Official Text of the UCC. References to the most recent revision of Articles 3 and 4 are to the 1990 Official Text.

² DEPARTMENT OF THE TREASURY FINANCIAL MANAGEMENT SERVICE, FROM PAPER TO PLASTIC: THE ELECTRONIC BENEFIT TRANSFER REVOLUTION 9 (1990) [hereinafter EBT REVOLUTION].

827
counts, they must use cash and money orders, both of which lack many advantages of checking accounts (legal and otherwise). Meanwhile, the federal and many state governments are planning to stop sending checks to these consumers, instead transferring benefits to them under an electronic system that may be devoid of any statutory protection whatsoever. This system is known as Electronic Benefits Transfer ("EBT"). It is not clear that EBT is the optimum system for transferring government benefits. If a law of consumer payment systems was enacted on the federal level, proposed new national programs such as EBT could be evaluated within that framework. If necessary, federal law could be adjusted to accommodate EBT. In the alternative, other systems could be considered, such as one accompanied by a federal law providing all recipients with bank accounts in which benefits would be transferred through direct deposit. If a federal law of consumer payment systems was adopted, no need would exist to compromise national projects so they conform to state payment law drafted without regard to consumer needs, or to enact federal legislation preempting state law to the extent necessary to facilitate every new national development.

The drafters of the new Articles 3 and 4 adopted a process that excludes consumer interests and suggests that individual state legislatures are to decide whether more needs to be done for consumers. Exactly the opposite process is needed: A comprehensive national examination of consumer payment systems.

II. THE PAYMENT TRANSFER SYSTEMS OF UNBANKED GOVERNMENT BENEFITS RECIPIENTS

Millions of government benefits recipients who do not have bank accounts currently receive their benefits checks in the mail. These checks often are lost or stolen. If the recipient is fortunate enough to escape this misfortune, then the recipient must find someone to cash the check. Check cashing services are happy to oblige, because these largely unregu-

3. Id. at 1.
5. For purposes of this Article, the 1989 Official Text of the U.C.C. is referred to as the "old" U.C.C. or "old" Articles 3 and 4, and the 1990 Official Text is referred to as the "new" U.C.C. or "new" Articles 3 and 4.
7. EBT REVOLUTION, supra note 2, at 25. Millions also receive food stamps.
8. Id. at 28, 30.
lated companies often charge exorbitant fees. Converting a government benefits check to cash presents the recipient with many problems. For example, cash can be easily lost or stolen, and recipients are ill-advised to pay bills by sending cash through the mail. Therefore, recipients must either convert the cash into something else or go to each creditor or vendor of goods and services individually to pay their bills. This process may necessitate the further expense of transportation to each obligor. In addition, by using cash, recipients cannot take advantage of safeguards available to those using checks.

Rather than walking around with cash that must last for an entire month and paying rent, utilities, and other bills in cash, many recipients buy money orders. The cost of money orders is high in many instances, and the recipient using them loses many of the advantages associated with using checks.

The recipient can purchase several money orders in one stop soon after the benefits check arrives to pay for recurring bills of the same amount, such as rent. However, unanticipated bills, and bills whose exact amount depends on usage (such as utilities) require additional trips to the store that sells money orders. This results in further expense and considerable hardship for many recipients, including those who live in rural areas and those who are disabled.

The plight of unbanked recipients contrasts sharply with persons who have checking accounts. Those persons with checking accounts are able to have their government benefits checks transferred electronically by direct deposit into their accounts, or they can receive their checks through the mail and deposit them at their financial institution. Furthermore, they can pay their bills by writing checks from the comfort and safety of their homes. By using the banking system, they receive various benefits and have the advantage of many safeguards. For example, their money is in a safe place, the bank is liable in most instances for forgeries, and consumers can stop payment if goods or services are unsatisfactory, and they receive monthly statements. The bank must follow standards of good faith and must exercise ordinary care in its handling of customer accounts. Numerous federal protections also apply.

9. Id. at 9.
10. See infra text accompanying notes 28-32.
12. EBT Revolution, supra note 2, at 29.
14. Id. § 4-403.
15. Id. § 4-406.
16. See id. § 3-103(4).
17. See id. § 3-103(7).
The fact that the poorest, most vulnerable people in the country, the ones who need the safest payment system, lack a system with even minimal legal safeguards, has caused many to advocate "basic banking," or "lifeline banking," in which financial institutions would be required to offer banking services to all. This policy issue is national in scope and beyond the purview of the U.C.C. Therefore, Congress is currently considering it. However, it cannot be divorced from consideration of Articles 3 and 4. For if basic banking is adopted by Congress and signed into law, the decision by the U.C.C.'s sponsors to entirely exclude consumer issues becomes even more questionable. In addition, the uniform state law approach becomes more problematic if the national government enacts laws such as basic banking that so profoundly affect the payment system. Because of the cost to the government of mailing benefits checks to recipients and the disadvantages to recipients, state governments and the federal government are planning to establish a new electronic delivery system, EBT. EBT also raises questions about the uniform state law process.

III. ELECTRONIC BENEFITS SYSTEMS (EBT)

The federal and state governments have conducted various pilot EBT projects in order to experiment with different approaches to electronic delivery of benefits. The federal government currently is developing plans to implement EBT nationwide. In an EBT system, recipients of certain government benefits such as Aid to Families With Dependent Children and Supplemental Security Income (which includes disability benefits) are issued a card which accesses automated teller machines ("ATM") and point-of-sale ("POS") terminals at retail establishments. When the recipient wishes to obtain cash, he or she may use the card at either an ATM or POS terminal to receive it. Recipients of food stamp benefits use their cards at grocery stores much the way they use credit and debit cards to buy goods.

The government intends to implement EBT to save money and better serve recipients. The present system of mailing checks is very expensive. The government expects EBT to be far less expensive if adequate volume is achieved because transferring payments electronically eliminates the

21. See EBT REVOLUTION, supra note 2, at 43-51.
22. See id. at 25-27.
expense of envelopes, postage, printing, and storage. In addition, the
government hopes EBT will result in better service because checks could
no longer be lost or stolen.

Some EBT programs are voluntary, while others are mandatory. The
federal government has not yet decided whether its permanent program
will be compulsory. Moreover, it remains unclear whether recipients in
voluntary programs are provided with information sufficient to make a
knowing and intelligent decision whether or not to switch to EBT. In
some programs, the government owns the account that holds the govern-
ment benefits; in others, each recipient has an individual account. The
difference is crucial. If the government owns the account, the recipient
has no statutory rights. If the recipient owns the account, the many safe-
guards of the Electronic Funds Transfer Act apply. The federal govern-
ment has not yet decided which type of account to use in its permanent
system.

Only by evaluating the decisions the government has made on many
fundamental issues and comparing EBT to other systems including the
old and new U.C.C. may one determine whether EBT is truly a superior
system such that the government should require or encourage recipients
to participate in it.

IV. CONSUMER RIGHTS AND OBLIGATIONS UNDER THE OLD AND NEW
ARTICLES 3 AND 4

Neither the old nor the new U.C.C. Articles 3 and 4 drafters had the
consumer customer in mind, and in fact these articles are heavily
weighted in favor of the banks. Articles 3 and 4 and the payment system
they regulate, however, contain features that make the system attractive
for many consumers. Focusing on the plight of unbanked government
benefits recipients who may be shunted into an electronic system illus-

23. Id. at 26.
24. Id. at 19-20.
25. The advertising brochure for one of the pilot programs boasts that EBT is quick,
easy to use, and safe. None of the disadvantages are mentioned. Brochure for the Secure
Card offered by the First National Bank of Maryland (available in the office of Mercer Law
Review.)
26. EBT REVOLUTION, supra note 2, at 43.
27. 15 U.S.C. §§ 1693-1700 (1988). The EFTA applies only to consumer accounts. 15
U.S.C. § 1693a(2) (1988); EBT REVOLUTION, supra note 2, at 50.
Adopted, 61 YALE L.J. 334, 361-62 (1952); Grant Gilmore, The Uniform Commercial Code:
A Reply to Professor Beutel, 61 YALE L.J. 364, 374-75 (1952); Edward Rubin, Efficiency,
Equity and the Proposed Revision of Articles 3 and 4, 42 ALA. L. REV. 551, 589-90, 592-93
(1991); Gail K. Hillebrand, Revised Articles 3 and 4 of the Uniform Commercial Code: A
brates the differences among payment systems and the laws which govern them.

Checks provide consumers with an excellent vehicle for transferring funds. Consumers can carry checks wherever they go and use them to buy goods and services, or keep them at home and pay bills from there. In addition to convenience, the legal system contains several safeguards regarding the use of checks. If vendors fail to provide satisfactory goods or services, consumers can stop payment on their checks if they act promptly. Further, checks provide consumers with the opportunity to achieve an accord and satisfaction when they claim to owe a smaller amount than that claimed by the vendor. If checks are lost or stolen, consumers are protected against forgeries and alteration unless by their own negligence consumers substantially contribute to the forgery or alteration or fail to notify the bank of forgeries and alterations after receiving a statement of account.

Consumers can keep track of the balance in their account by recording deposits, withdrawals, and transfers by check. Periodic bank statements provide an opportunity for consumers to verify their calculations and provide consumers with information from which they can ascertain that checks have been stolen or altered.

Many flaws exist in this system from the consumer’s perspective, however. In a few instances the new Articles 3 and 4 somewhat improve the consumer’s position, but on the whole the consumer is probably worse off.

A. General Duties of Financial Institutions to Depositors

When consumers deposit money in banks, they become creditors with respect to that money, and the banks are debtors. In addition, the U.C.C. imposes general duties that put some teeth into this debtor-creditor relationship. A general duty to act in good faith bound banks subject to the old Articles 3 and 4. Although ostensibly providing a meaningful albeit vague standard, the U.C.C. then eviscerated the standard by defining it as “honesty in fact.” This is a subjective test, allowing banks to engage in unacceptable conduct as long as they are not dishonest. The dramatically different standard of good faith that applies to merchants

32. Id. § 4-406.
33. 5A Michie on Banks and Banking ch. 9, § 1 (1983).
34. U.C.C. § 1-203 (1962).
35. Id. § 1-201 (19).
under Article 2, which governs the sale of goods, illustrates the weakness of this standard. For merchants, good faith "means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." The old U.C.C. offered no explanation to justify holding merchants to a substantially higher standard than banks. New Article 3 corrects this anomaly by defining good faith for banks handling checks in essentially the same terms as the old U.C.C.'s definition for merchants. While the new definition clearly imposes a greater duty upon banks, the meaning of "observance of reasonable commercial standards of fair dealing" is not apparent. The comment seeks to clarify this by explaining that fair dealing "must be defined in context," and that fair dealing "is concerned with the fairness of conduct rather than the care with which an act is performed." Finally, one must determine fair dealing "in the light of reasonable commercial standards." The drafters provide no guidance for interpreting the fairness of conduct or what might constitute reasonable commercial standards. Nonetheless, the thrust of the change is to impose a higher duty upon banks.

Under the old U.C.C., banks are subject to the duty to exercise ordinary care. While the old U.C.C. provides no general definition of ordinary care, the obligation is explicitly imposed upon banks in certain provisions. The comment to section 4-103 states that ordinary care is "used with its normal tort meaning and not in any special sense relating to bank collections." This language is subject to criticism. The new Article 3 defines ordinary care as the "observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged." On its face the provision seems to encourage a "race to the bottom," for it could be read to allow minimally acceptable conduct as long as everyone else is behaving the same way in the prevailing area. The definition does require the standard to be reasonable, however, and the comment gives the standard

36. Id. § 2-103(1)(b).
37. Id.
38. Id. § 3-103(a)(4) (1990).
39. Id.
40. Id. § 3-103 cmt. 4 (1990).
41. Id.
42. Id. § 4-103 cmt. 4 (1990).
44. Id. § 4-103 cmt. 4.
some bite by stating that the customer can show lack of ordinary care by proving the bank’s procedures are “unreasonable, arbitrary, or unfair.” A comment also points out the difference between the fair dealing standard contained in the definition of good faith and the standard of ordinary care. The former focuses on the fairness of conduct, whereas the latter is concerned with the “care with which an act is performed.”

The definitions of good faith and ordinary care in the new Articles 3 and 4 are vague. Defining a duty essentially as an obligation to be fair and reasonable begs the question. Nevertheless, greater precision may be impossible since these general duties must apply in many different situations. In addition, those definitions at least impose standards upon banks. As discussed above, under one EBT mode, banks would not be subject to any general duties towards recipients.

B. Accord and Satisfaction

Few consumers can afford to hire a lawyer and, if necessary, file a lawsuit when they dispute the amount charged for goods and services. Even if consumers have the funds, ordinarily the amount in dispute is not large enough to justify the cost of legal services. Payment by check or money order provides a possible means of resolving the controversy. The consumer can pay the amount he or she believes is appropriate. Under pre-U.C.C. law, if the payee cashed the check or money order, courts considered the consumer’s obligation to be satisfied. Under the old U.C.C. the courts split on this issue. Some courts held that the debt was not discharged if the payee indicated he or she took the instrument under protest, and others held that the pre-U.C.C. law still governed. The new U.C.C. essentially codifies pre-U.C.C. law. Consumers in states adopting the new U.C.C. can take advantage of this important self-help device free of the confusion and doubt which reigned under the old U.C.C. The new Article 3, however, does contain one requirement that may eviscerate the accord and satisfaction remedy for some consumers. If an organization notifies the consumer that an offer of full payment must be sent to a specific place or person, the consumer loses the remedy if he or she sends

47. Id. § 3-103 cmt. 5.
48. Id. § 3-103 cmt. 4.
49. Id.
50. See supra text accompanying notes 26-27.
it to another office, or person, in that organization. This may cause problems for consumers who move frequently or live in areas with unreliable mail delivery. In addition, if the consumer does not have a dispute with the company at the time he or she receives notice of the proper person or place to send full satisfaction checks, the consumer is unlikely to pay sufficient attention to the notice or to remember it months later when the consumer decides to send such a check.

Accord and satisfaction can be a two-edged sword for consumers, because it can be used to their detriment. For example, insurance companies in particular seek to satisfy claims by sending consumers checks which act as an accord and satisfaction. The new U.C.C. provides a safeguard for consumers based on the assumption that consumers, who believe the insurance company owes them a greater amount, cash these checks without realizing the effect on their legal rights. The new U.C.C. permits the consumer who cashed such a check to revoke the accord and satisfaction within ninety days by paying the amount of the check. One problem with this provision is the failure of the U.C.C. to require disclosure of the right to revoke to the payee. Consumer protection statutes typically require companies to disclose to consumers the rights these statutes provide. This disclosure requirement is the legislators' acknowledgement that it is meaningless to grant rights to consumers unless steps are taken to ensure that consumers are made aware of those rights. The drafters of the new U.C.C. did not have to consider whether to require disclosure, however, because they decided not to include provisions designed specifically to protect consumers. Commercial law statutes do not require disclosure apparently on the theory that the parties to the transaction know the law or have the money to hire a lawyer or otherwise obtain the information necessary to understand their legal rights and obligations. Thus we have the anomalous situation of a provision in the new U.C.C. that is of particular benefit to consumers, but of which many consumers will not be able to take advantage due to the lack of disclosure.

54. Id. § 3-311(c)(1). If the organization is aware of the consumer's dispute and tender of a check in full satisfaction, the accord and satisfaction is still effective. Id. § 3-311(d).
55. See Hillebrand, supra note 28, at 694.
58. Miller, supra note 6, at 412-15.
C. Stop Payment

The U.C.C. gives consumers the right to stop payment on their checks. Although the right is subject to important restrictions, the ability to stop payment allows consumers a "cooling off" period in which to reconsider their purchasing decisions. This right is particularly important for low income consumers who may be more likely to be misled and for whom an unwise decision may have a devastating impact. Even though the consumer who stops payment is still liable to the payee or a subsequent holder of the check, the consumer who successfully stops payment has the upper hand. If the merchant wants to be paid, the merchant has to take the time and spend the money to act affirmatively, and the consumer can raise defenses against the merchant.

Many consumers use personal money orders rather than checks, because they do not have bank accounts. Case law under the old U.C.C. is split on whether buyers of personal money orders can stop payment. Most cases hold that buyers of bank money orders cannot stop payment. Moreover, it is not clear whether the consumer can stop payment when he or she loses the money order before the consumer designates the payee.

The new U.C.C. distinguishes between types of money orders sold by banks. If the form of the money order allows it to be considered "an ordinary check drawn by the purchaser except that the amount is machine impressed," the buyer of the money order can stop payment. However, if the money order is in a form that falls within the definition of a "teller's check," the buyer has no right to stop payment.

The primary limitation on a consumer's right to stop payment is that he or she has to notify the bank before the bank decides to pay the check. Problems may arise when the bank fails promptly to recredit the consumer's account and when the bank pays the check despite the consumer's instruction to stop payment. Neither the old nor the new U.C.C.

63. Id.
64. BAILEY & HAGEDORN, supra note 52, at ¶ 23.15, note 169; see JOHN F. DOLAN, UNIFORM COMMERCIAL CODE, TERMS AND TRANSACTIONS IN COMMERCIAL LAW 358 (1991).
66. Id.
67. Id.; Id. § 4-403 cmt. 4.
68. Id. § 4-303(1).
requires the bank to recredit the account within a certain period of
time. If forced to sue over the bank's failure to recredit, the consumer
has the burden of proving that he or she suffered a loss as a result of that
failure, as well as the amount of the loss.

D. Postdated Checks

Consumers who live from paycheck to paycheck and do not have credit
cards sometimes are able to obtain needed goods and services despite
having an insufficient amount in their checking accounts. They write
postdated checks and both the vendor and the customer hope that by the
date on the check the consumer will have the funds in the account. In
effect, the consumer is using the check as a credit instrument, and the
vendor does not even charge interest. The old U.C.C. regarded the
postdated check as a valid negotiable instrument. A bank paying a
postdated check before the date on the instrument was liable for resulting
injury to the consumer.

The new U.C.C. provides that the bank can pay a postdated check
before its date unless the consumer files an order notifying the bank that
the check is postdated and should not be paid prematurely. This provi-
sion extinguishes the effectiveness of a postdated check for consumers
and may actually harm them. Postdating will no longer be useful for con-
sumers because the new U.C.C. does not require disclosure of the need to
file an order with the bank. The revision may harm consumers because,
ignorant of the change in the law, they will assume the funds in their
account can be used for other purposes and the bank will dishonor these
checks when the bank pays the postdated check early. Requiring cus-
tomers to file an order probably was inevitable. Automated check process-
ing systems cannot handle postdated checks and several states have
passed nonuniform amendments protecting banks from liability when
they pay these checks early. It is unfortunate, however, that the new
U.C.C. allows banks to require the order without notifying consumers of
this new condition placed on postdated checks.

69. Hillebrand, supra note 28, at 706-07; Rubin, supra note 28, at 578.
70. U.C.C. § 4-403(3) (1990).
71. See Bailey & Hagedorn, supra note 52, ¶ 2.10.
73. Bailey & Hagedorn, supra note 52, ¶ 16.16.
74. U.C.C. § 4-401(c) (1990).
75. Id.
76. See generally Hillebrand, supra note 28, at 704-05.
77. Bailey & Hagedorn, supra note 52, ¶ 16.16.
78. U.C.C. § 4-401(c) (1990).
E. Lost, Forged, and Altered Checks

Sometimes consumer checks are forged or altered, particularly when these checks are stolen. Under the old U.C.C., as between the consumer and the bank, if the bank pays the check, the bank is liable for any loss unless the consumer engaged in negligent conduct that substantially contributed to a material alteration or unauthorized signature. The U.C.C. drafters decided not to define negligence. It is a fact question for the judge or jury. The U.C.C. and comments provide some comfort for the consumer. For example, with regard to alterations, the comment states that the consumer is not required to take “unusual precautions.” In addition, consumers do not bear the loss unless their conduct “substantially contributes” to the forgery or alteration. Although courts have disagreed about the meaning of that phrase, courts do agree that it is not sufficient for the bank merely to point to some careless conduct. Finally, even if the consumer did engage in the type of negligence that makes him or her liable for the loss, the loss shifts to the bank unless it paid the check “in good faith and in accordance with the reasonable commercial standards” of the bank’s business.

These provisions are important to persons such as recipients of government benefits, who live and work in high crime areas with an increased likelihood their checks may be stolen. Bearing the loss can be especially devastating for people of limited means. It is reasonable to assume that when a theft occurs, the case often will be settled prior to an action being filed in court when the consumer can point to bank conduct that arguably does not comport with reasonable commercial practices.

The new U.C.C. contains essentially the same language except for a provision that makes it infeasible in most situations for consumers to be able to assert their rights. Under the new section 3-406, if the negligent consumer proves that the bank failed to exercise ordinary care and that failure substantially contributed to loss, a comparative negligence scheme operates. Under this scheme, banks are far less likely to settle since they

80. Id. § 3-406 cmt. 3.
81. Id. § 3-406 cmt. 7.
82. Id. § 3-406 cmt. 3.
83. Id. § 3-406(a), (b) (1990).
87. Id. § 3-406(b) cmt. 4 (1980).
have little to lose. The bank has paid the check and removed the amount of the check from the consumer’s account. It need not do anything to protect itself. Therefore, the consumer must take the initiative. Under the old U.C.C., the bank knew that if the consumer could show lack of ordinary care, the bank lost the case. Under the new U.C.C., the consumer must not only show lack of ordinary care, but also damages under the comparative negligence standard. It will not make financial sense for consumers to litigate in most cases because the comparative negligence standard forces the consumer into a trial that likely will be an expensive one in which the consumer has to show exactly how negligent the bank was as compared to the consumer. At best, consumers will obtain settlements far less favorable than under the old U.C.C.

Another potential stumbling block for consumers occurs when they fail to report a problem promptly to their bank because they do not realize that their checks have been stolen, forged, or altered even after the bank sends them a statement and their cancelled checks. The old U.C.C. provides that if a wrongdoer forges the consumer’s signature or alters more than one of the consumer’s checks, and the consumer fails to report this to the bank within a reasonable period after receiving the first forged or altered check and the statement, then the bank is required to recredit the consumer’s account only for the amount of the first check. If the consumer can show the bank failed to exercise ordinary care, however, the bank must recredit the amount of all forged or altered checks regardless of the consumer’s failure to report promptly.

The new U.C.C. severely weakens the consumer’s position because it provides that if the bank failed to exercise ordinary care and substantially contributed to a loss, a comparative negligence scheme operates. As discussed previously, comparative negligence makes settlement less likely and makes litigation infeasible in most situations.

Finally, the new U.C.C. offers banks an escape from liability in its definition of ordinary care. Banks use high speed automated equipment to process checks. To accommodate this technology, the new Article 3 provides that if a bank uses automated equipment, “reasonable commercial

---

89. *Id.* § 3-406(a), (b) (1990).
91. The reasonable period cannot be more than fourteen calendar days. U.C.C. § 4-406(2)(b) (1962) (amended 1990).
94. *Id.* § 4-406(e) (1990).
95. *See supra* text accompanying notes 87-90.
standards do not require the bank to examine the instrument if the failure to examine does not violate the bank’s prescribed procedures and the bank’s procedures do not vary unreasonably from general banking usage not disapproved by this Article or Article 4.”

The provision undermines the consumer’s ability to prove that the bank failed to exercise ordinary care.

F. The Periodic Bank Statement

Although neither the old nor the new Article 4 explicitly requires banks to send consumers a statement of account, the bank cannot impose a duty on the consumer to report forgeries and alterations promptly if the bank fails to provide the statement. In other words, as between the consumer and the bank, the bank bears the loss for forgeries and alteration if it does not provide the statement.

Increasingly, banks offer consumers accounts that do not return cancelled checks. This system, known as check truncation or check safekeeping, often is offered at a lower cost than regular checking because it is less expensive for the bank. The bank saves money by not mailing the cancelled checks. Often, because the checks are stored by someone else, the bank saves the cost of sending the checks back to the consumer’s bank. The new U.C.C. provides that if the bank does not return the consumer’s cancelled checks, the statement of account must provide sufficient information. “The statement of account provides sufficient information if the item is described by item number, amount, and date of payment.” This provision accommodates check truncation. As the comment to this provision notes, information that consumers need—the date of the check and the payee’s name—is not required. Consumers must depend on their own records to monitor their truncated checks.

Banks should develop new technologies such as truncation. The consumers’ problem is that the new U.C.C. does not require the bank to alert consumers of significant deficiencies in their statements and to alert consumers of the need to maintain careful records. Lacking this notice, consumers may not realize the importance of keeping more careful records than is necessary for regular checking accounts until lack of these records contributes to their failure to discover and promptly report forged or altered checks and they suffer a loss. Low income consumers, unsophistica-

97. U.C.C. § 3-103(a)(7) (1990); see id. § 4-406 cmt. 4.
98. See generally Budnitz, supra note 45, at 777-80.
100. Id. § 4-406(a).
101. Id.
102. Id. § 4-406 cmt. 1.
V. CONSUMER RIGHTS AND OBLIGATIONS UNDER THE ELECTRONIC FUND TRANSFERS ACT

Consumers increasingly are involved in electronic transfers of funds. Examples include direct deposit of paychecks and government benefits checks, automated teller machine transactions, electronic bill paying, preauthorized transfers, and debit cards used to purchase goods at stores. These transactions are subject to the Electronic Fund Transfers Act ("EFTA"), which offers a striking contrast to the U.C.C. The EFTA is also crucially important to EBT recipients. The EFTA applies if the government decides accounts will be owned by each recipient. However, the EFTA does not apply if the government decides to use government owned accounts.

Professor Rubin identified several areas in which the EFTA is more favorable to consumers. Both the new and old U.C.C. contain no specific requirements as to the contents of bank statements when consumers receive their cancelled checks and the revised U.C.C. requires information which is inadequate in the truncation context. In contrast, the EFTA requires banks to provide written documentation with information that consumers need, including the name of the person to whom the funds were transferred and the date the transfer was initiated. The new U.C.C. does not require this information in the truncated environment.

As discussed below, the government should determine whether to drop its plans for EBT and instead urge Congress to enact a basic banking law. The administration should consider whether recipients will be accorded the benefits of the EFTA, and, if so, whether they would be better off with the EFTA’s safeguards or those of the U.C.C. Regarding the monthly statement, recipients would benefit from the EFTA’s provisions.

Recipients may not receive the EFTA’s required statements in a permanent EBT system. In one EBT pilot project, the Federal Reserve

103. Hillebrand, supra note 28, at 687, 702.
106. Id. § 1693a(6).
107. Id.
109. See supra text accompanying notes 101-02.
111. See infra text accompanying note 156.
Board ("FRB") exempted banks from providing account statements even though benefits were transferred into recipient owned accounts. Whether the FRB will apply the exemption to permanent EBT systems is unclear. Without a monthly statement, EBT recipients cannot determine what adjustments have been made to their account. When consumers withdraw money from an ATM, the EFTA merely requires documentation relating to the specific transfer they initiated. This documentation need not include the balance in the account. Consequently, EBT recipients must receive complete account statements. Their benefits may vary considerably. For example, they need to know whether they are getting cost of living increases, or whether the government has made deductions from their benefits due to dependents reaching the age of majority, the recipient getting a part-time job, or the government changing the benefits formula. Because many can barely make ends meet, recipients need to know the balance in their account so they can calculate how much to spend until the next benefits check.

The EFTA provides rules for unauthorized transfers which provide consumers with a loss allocation scheme superior to that in the U.C.C. Under the EFTA, if the bank has complied with certain requirements, the consumer is liable for a maximum of $50. If the consumer fails to notify the bank within two business days after learning of the loss or theft of his card used in an electronic fund transfer, the consumer is liable for up to $500. If he does not inform the bank of an unauthorized transfer within 60 days of receiving a statement the consumer faces unlimited liability. This loss allocation scheme allows consumers and banks to apply clear-cut rules to resolve disputes without going to court. Thus, the parties avoid the confusion of the U.C.C. rules and the consumer also avoids the insurmountable barrier of the U.C.C.'s comparative negligence standard.

The EFTA also benefits consumers through its error resolution procedure. If consumers believe the bank is in error, and they notify the bank within a certain amount of time, the bank is required to investigate and inform the consumer of the investigation's results within ten days. A bank wanting additional time to comply must recredit the consumer's account so the consumer can use the disputed funds in the interim. If the

112. EBT Revolution, supra note 2, at 50.
114. Id. § 1693(a)(11) (definition of "unauthorized electronic transfer").
115. Id. § 1693g(a)(1).
117. Id.
118. Rubin, supra note 28, at 583-84.
120. Id. § 205.11(c).
bank decides the consumer is wrong, it must send the consumer a written explanation.\textsuperscript{121}

The EFTA's error resolution procedure and the FRB's regulations have many problems.\textsuperscript{122} Nevertheless, the EFTA's approach marks a significant departure from both the new and old U.C.C. which provide no incentives or mandated procedure for prelitigation settlement of disputes.\textsuperscript{123}

In another departure from the U.C.C., the EFTA requires banks to notify consumers of their rights and how to exercise them.\textsuperscript{124} As noted above,\textsuperscript{125} the U.C.C.'s failure to require notification is a major flaw, especially because many consumer rules changed under the new U.C.C. with no mechanism for informing consumers of these rules.

Finally, the EFTA makes consumer litigation feasible by providing for actual damages, statutory damages, costs, and attorney fees.\textsuperscript{126} This provision corrects the severe imbalance of resources and bargaining power that exists between a consumer and a bank.

Despite these advantages of electronic fund transfers ("EFT"), in some respects consumers are better off transferring funds via check or money order. Whereas EFT results in an immediate withdrawal of the consumer's funds, consumers can delay that withdrawal if they use postdated checks.\textsuperscript{127} EFT users also cannot stop payment when sold unsatisfactory goods and services.\textsuperscript{128} Consumers who pay using credit cards have a viable alternative to postdated checks because they defer payment by using such cards. Those who cannot qualify for credit cards, including many EBT recipients, do not have an adequate option. Finally, consumers paying by check can use their check to obtain an accord and satisfaction, an advantage not shared by those who use EFT alone.\textsuperscript{129}

\textbf{VI. EBT AND THE BASIC BANKING ALTERNATIVE}

Congress is considering federal legislation requiring banks to offer a basic banking service.\textsuperscript{130} Although the details vary from one bill to another, the legislation generally would mandate a bank account with no required

\textsuperscript{121} Id. \S 205.11(f).
\textsuperscript{123} See Rubin, supra note 28, at 585.
\textsuperscript{124} Budnitz, supra note 122, at 46-61 (analysis of notification requirements of EFTA).
\textsuperscript{125} See supra text accompanying notes 56-58, 71-76, 103.
\textsuperscript{126} 15 U.S.C. \S 1693m (1989).
\textsuperscript{127} Id. \S\S 1693a-1693d.
\textsuperscript{128} Id.
\textsuperscript{129} Compare U.C.C. \S\S 1-207 and 2-209 with 15 U.S.C. \S 1693a(6) (1989).
balance or a low minimum required balance and a small number of free checks per month.\textsuperscript{131} The General Accounting Office reported that twenty percent of American families do not have a bank account.\textsuperscript{132} A 1983 study sponsored by the Federal Reserve Board and other government agencies found that families without bank accounts were disproportionately low income, high school dropouts, headed by a female, and nonwhite.\textsuperscript{133} Consumer groups contend that many of these families do not have checking accounts because they cannot afford the service charges levied on accounts with low balances.\textsuperscript{134} The survey evidence is mixed. One consumer group survey found that fifty-three percent of those interviewed did not have checking accounts because they were "too costly."\textsuperscript{135} An American Bankers Association Survey produced contrary findings.\textsuperscript{136} A recent study by the Financial Management Service of the Department of the Treasury identified seven reasons why people do not have checking accounts.\textsuperscript{137}

Most bankers oppose basic banking.\textsuperscript{138} In addition to the banks' concerns about the profitability of such accounts and to the details of the legislation,\textsuperscript{139} basic banking represents substantial government interference with the free market system. It is a step toward turning the bank into an institution like a public utility.\textsuperscript{140} Nevertheless, the problematic features of EBT lead to the conclusion that basic banking may be a more attractive alternative.

Through EBT, the government hopes to switch to a system that is less expensive than the present system.\textsuperscript{141} Whether EBT will be less expensive

\begin{flushleft}
\textsuperscript{131} See generally id.
\textsuperscript{132} Hillebrand, supra note 28, at 711.
\textsuperscript{134} AM. BANKERS ASSOC., ANALYSIS OF UNIDEX SURVEY OF LOW INCOME HOUSEHOLDS WITHOUT CHECKING ACCOUNTS, reprinted in Rubin & Cooter, supra note 133, at 148.
\textsuperscript{135} CONSUMER ACTION, CONSUMER BANKING SERVICE (1985), reprinted in Rubin & Cooter, supra note 133, at 150.
\textsuperscript{136} ANALYSIS OF UNIDEX SURVEY, supra note 134, at 148.
\textsuperscript{137} EBT REVOLUTION, supra note 2, at 7. The seven reasons households did not have bank accounts included: 1) inaccessibility to and inconvenient hours of banks; 2) distance to, or lack of familiarity with banks; 3) previous negative experience with banks; 4) preferring to use cash; 5) lacking funds to meet minimum balance requirement or justify maintaining an account; 6) illiteracy; and, 7) inadequate math and reading skills. Id.
\textsuperscript{138} Garson, supra note 130, at 1.
\textsuperscript{139} Examples of serious concerns include: whether the accounts would be interest-bearing, whether the bank could charge fees for checking accounts and stop payment orders, whether the bank could refuse to accept certain persons as customers, whether the bank could terminate its relationship to certain customers, and whether basic banking will result in long teller lines.
\textsuperscript{140} Canner & Maland, supra note 133, at 154.
\textsuperscript{141} EBT REVOLUTION, supra note 2, at 25-27.
\end{flushleft}
to the government is, however, unclear, because much depends upon who bears certain costs of EBT. For example, the federal government acknowledges that training programs that teach recipients how to use EBT are "absolutely critical." The government has not determined, however, who will pay to train the trainers, or who will train the recipients. The cost may be considerable because of the nature of the project. Training will be an ongoing need because of the turnover of trainers and because of the steady influx of newcomers to the recipient population. Special training programs must also be devised for the disabled and the non-English speaking recipients.

The total cost of training and other system components cannot be known until the government decides whether to make EBT universal, mandatory, or both. If the government chooses to make EBT universal and mandatory, every recipient of designated benefits programs will be required to participate in EBT even if, for example, they are disabled or non-English speaking or live in rural areas far from current EBT facilities such as ATMs and POS terminals. Mandatory non-universal EBT would exempt certain categories of people from EBT, such as blind persons, but would be mandatory for all others. A third alternative is for the program to be totally voluntary. If totally voluntary, EBT may not achieve the volume needed for economies of scale to operate and be cost feasible. Universal and mandatory EBT saves the administrative cost of having dual EBT and non-EBT systems but would necessitate increased expenses such as training the disabled to use ATMs, and training non-English speaking or illiterate recipients to use EBT.

In addition to the cost of training, EBT may require substantial capital outlays for equipment. Who will pay for this is unclear. For example, universal EBT requires placing ATMs or POS terminals in areas where they currently are few and far between, for example, rural areas and the inner city. It would appear that universal EBT would require equipment accessible to the disabled. Although the recent Americans with Disabilities Act ("ADA") requires banks to provide "auxiliary aids and services" enabling the disabled to use bank services such as ATMs, banks may lower the costs of compliance by showing that complete adherence

142. Id. at 46.
144. ELECTRONIC BENEFITS TRANSFER (EBT) POLICY PAPER, supra note 4.
creates an "undue burden." Banks participating in EBT face, however, more stringent demands than those imposed by the ADA. The Supplemental Security Income program ("SSI"), which includes aid for the disabled, is one benefit program the government wants to include in EBT. To meet the needs of disabled SSI recipients in an EBT program, the government may impose on banks requirements beyond those required under the ADA. Whether banks or the government will pay the cost of buying new equipment for the disabled that exceed the requirements of the ADA, and for those in rural communities and the inner city, is unclear.

EBT is costly in other respects. It is undecided who will pay the cost of issuing EBT access cards and personal identification numbers or who will pay for implementing error resolution procedures. Banks fear that they will be liable if EBT recipients are mugged at ATMs. According to a government report, banks should "insure safety" for EBT recipients. EBT may prove costly to banks if they are required to keep the funds in interest bearing accounts. In addition, retailers would like the government to provide cash advances since they will have to maintain far more liquidity as EBT recipients demand cash at the check-out aisle.

Some cost issues depend upon whether the government or the recipient owns the account. If the recipient owns the account, the EFTA applies and, absent revisions to the EFTA, the bank must supply ATM recipients with notices and periodic statements. Also, the bank is liable for losses due to unauthorized use beyond the amount for which the consumer is liable. If the government owns the account, the bank's obligations and costs are limited to those in the contract between the bank and the government.

Electronic systems fail. Sometimes they fail because of natural disasters or technological reasons; at other times they fail because wrongdoers

146. Id. See Adam S. Levy, New ATMs Designed to Break Down Less, AM. BANKER, Dec. 19, 1991, at 13A, col. 1 (NCR ATMs designed to meet ADA requirements cost from $18,000 to $38,000); Matt Barthel, Citibank Faces Big Job Refitting ATMs for Disabled, AM. BANKER, Dec. 2, 1991, at 8, col. 1 (Citibank's unique ATMs will require expensive changes to comply with the ADA, but bank's huge financial losses may provide justification for arguing "undue burden" excuse).

147. EBT Revolution, supra note 2, at 73-74.

148. Id. at 49. Matt Barthel, Tight Security Sought at N.Y. ATMs, AM. BANKER, Dec. 18, 1991, at 3, col. 1 (New York City council member proposes law to mandate security measures at ATM sites); Jeanne Iida, ATM Security at Sites in New York Held Lax, AM. BANKER, Dec. 10, 1991, at 17, col. 1 (New York City police reported 630 crimes at ATM locations in a 21 month period; New York City council study found security inadequate).

149. Hearings, supra note 144, at 145.


151. Id. § 1699g.
sneak into the system and steal or foul things up.\textsuperscript{152} Whatever the cause, system breakdowns cost money to fix and cause recipients distress when they cannot gain access to their funds. If they own their accounts, recipients will flock to the bank offices where their accounts are located. If the government owns the accounts, recipients will not know where to go for relief. Presumably, recipients should go to the welfare office. It is unclear how well that office will be able to respond since the system failure is beyond the welfare department’s control.

Finally, EBT’s fundamental problem is that it provides the recipient with cash. The government has not yet decided how many free withdrawals per month recipients will be allowed. If few are permitted, recipients must walk around with cash representing a considerable amount of their total monthly benefit. In that case, recipients are susceptible to mugging or losing their money. In the alternative they may hide it in their often burglarized residences. To pay bills such as rent and utilities, they must take the money from the ATM to a store that sells money orders. Alternatively, recipients are saved this inconvenience if they can make withdrawals from a retailer’s POS terminals and buy money orders from that retailer. Cash users cannot take advantage of the features available to check users (for example, stop payment, accord and satisfaction, and a convenient place from which to pay bills.)

Although containing some of the features of a check, a money order is a far more expensive and less convenient device than a check. Unless a person knows the exact price of goods in advance, he or she must go the retailer, choose the item desired, go to an ATM, withdraw the money needed, go to a store and buy a money order, and, finally, go back to the retailer to pay for the item. In addition, in most states nonbank money orders are issued by unregulated companies, putting purchasers of money orders at risk.\textsuperscript{153} For example, in 1977, USN Company and its affiliate, Universal Money Order Company, filed for bankruptcy. Consumers faced utility cut-offs, evictions, and repossessions because the companies did not have the funds to honor the money orders.\textsuperscript{154}

Given the enormity of the issues confronted, the uncertainty of the ultimate cost of implementing EBT, and the problems associated with suc-
cessfully linking the diverse recipient population to the most technologically (and perhaps most vulnerable) advanced payment system, the government must consider alternative systems that may be less problem-atic. The checking account is the alternative solution. The government's EBT planners should investigate the possibility of providing banks with incentives to offer basic banking accounts. The government should conduct a cost-benefit study to determine if it would be less costly to provide some form of subsidy to make basic banking more attractive to banks so that all government benefits payments could be transferred electronically through direct deposit.

VII. THE NEED FOR A FEDERAL CONSUMER PAYMENTS LAW

The administration's plan to implement EBT illustrates the inade-quacy of enacting a uniform payments law on a state by state basis with the objective of not addressing consumer concerns. As discussed in Part VI of this Article, EBT is not necessarily the best route. A national basic banking policy that encourages recipients to receive their benefits through direct deposit may be more efficient. The problem with the basic banking approach is that either old or new Articles 3 and 4 will govern the recipient's check transactions. These laws do not take consumer needs into account. If the government decides to implement EBT, Article 3 and 4 still govern money orders. In addition, if government owned accounts are used, the consumer is deprived of the safeguards of the EFTA.

The government can only rationally deal with consumer needs in pay-ment systems by enacting a federal consumer payments law responsive to those needs. Much of that legislation is already in place: The EFTA (governing electronic transfers when the consumer owns the account),

---

155. The House Banking Committee voted in favor of reducing deposit insurance in half for banks that offer basic banking. Robert Garsson, Panel Backs Incentives For Serving Poor, AM. BANKER, June 26, 1991, at 1. Tom Leander & Ellen Braitman, In Selling Service to Poor, Banks Badly Lag Rivals, AM. BANKER, Nov. 8, 1991, at 1, col. 1, 8 (American Bankers Association survey found that 60% of banks lost money or broke even on basic banking). The major problem with ensuring basic banking as a means of transferring benefits instead of developing EBT is the inability of basic banking to relieve inefficiencies associated with the paper-based food stamp program. See generally Food Stamp Program: Standards for Approval and Operation of Food Stamp Electronic Benefit Transfer Systems, 56 Fed. Reg. 65,114 (1991) (to be codified at 7 C.F.R. pts. 274, 276-78 (proposed Dec. 13, 1991)). Federal Deposit Insurance Corporation Improvement Act, § 232, Pub. L. No. 102-242, 105 Stat. 2308 (1991) (to be codified at 12 U.S.C. 1834) (this law providing incentives to banks offering basic banking does not take effect until appropriations are provided and no such appropriations have been approved).

156. See text accompanying supra notes 130-55.

Truth in Lending (regulating payment through credit instruments), and the Expedited Funds Availability Act (guaranteeing the prompt availability of funds deposited in an account by check). Consumers now need a law that safeguards negotiable instruments like checks and money orders.

As far as possible, the proposed federal legislation should be consistent with new Articles 3 and 4 to avoid costly disruption of bank operations. For example, the federal legislation should retain the new U.C.C.’s definitions of good faith and ordinary care. Consumers should retain new Article 3 rights to revoke accord and satisfaction checks. However, federal legislation should reconsider new Article 3’s loophole for organizations that notify consumers of where full payment checks must be sent.

The proposed federal law should require banks to inform consumers of their rights and duties. For example, if banks will no longer be liable for paying a postdated check prematurely unless consumers file an order, the bank must notify consumers of that fact. If consumers use truncated checks, the bank should be required to alert them of the need to keep careful records if the bank’s statements omit crucial information the consumer will need if checks are forged or altered.

The new federal law should change new Articles 3 and 4 in several respects. First, Congress should require banks to promptly recredit consumer accounts if they pay checks despite the consumer’s timely stop payment instruction. Second, Congress should reject the new U.C.C.’s comparative negligence scheme in favor of the old U.C.C.’s loss allocation schemes.

Third, banks should be required to maintain some procedure for reviewing checks for forgeries, or at least notify consumers that they use automated processing methods which preclude any meaningful review for forgeries. If consumers have this information they may take better measures to safeguard their checks. Fourth, Congress should examine the law relating to money orders to determine whether federal law is needed to safeguard the rights of consumers using those instruments. Fifth, Congress should establish a mandated error resolution procedure for consumer disputes involving checks and money orders. In addition, successful consumers should also be entitled to attorney fees if they have to litigate. While such a provision is typical of consumer protection statutes, even the U.C.C.’s Article 2A provision on unconscionable leases contains an attorney fee provision, although it applies to commercial

160. See supra notes 39-41, 46-49.
162. See supra text accompanying notes 89-90, 94-96.
leases as well as consumer leases. Finally, in conjunction with EBT, if the system will employ government-owned accounts, Congress should enact legislation to extend the protections of the EFTA to recipients. Passage of the proposed federal consumer payments law is vital for EBT recipients as well as EFTA's safeguards, since EBT users will need to use money orders.

VIII. Conclusion

The drafters of new Articles 3 and 4 adopted a process that affects all consumers using checking accounts and money orders, but which intentionally excludes consumer concerns. The drafters suggested that individual state legislatures should enact their own laws to protect consumers if they believe consumers needed further safeguards. This process is flawed in several respects. As the Prefatory Note to new Article 3 states, "the law for payments through checks . . . should be uniform . . . . Otherwise, checks as a viable payment system . . . will be severely hampered . . . ." It is more likely that uniformity will be lost if individual states change Articles 3 and 4 to meet consumer needs as perceived in each state. Uniformity will not be lost, however, because political realities preclude the enactment of consumer protection provisions. Well-organized and well financed banks and their lobbyists likely will oppose proposed consumer legislation. Well-connected and sophisticated, they can influence the political process. Consumer groups, where they exist at all, lack the organization and resources of the banks. Moreover, a bill modifying the law of negotiable instruments is unlikely to inspire the enthusiasm needed for consumer activism, regardless of the importance of the bill to consumers. In contrast, when legislation is proposed in Congress, national consumer groups will be more effective.

The drafters' ad hoc state-by-state process is flawed for a fundamental reason. Consumer payment system concerns are national in scope, and Congress has acknowledged this by enacting legislation such as the EFTA and the Expedited Funds Availability Act. Consumers throughout the country need laws requiring banks to promptly recredit checks paid in violation of stop payment instructions. Comparative negligence renders litigation too problematic and too costly for consumers whether they live in Nevada or New Jersey. In addition, Congress is considering basic banking and EBT at the national level. States would frustrate national policy if Congress enacts basic banking to promote consumer well-being, while

164. U.C.C. § 2A-108(4) (1990). If lessee brought an action he or she knew was groundless, attorney fees shall be awarded to the defendant. Id.
165. Id. Prefatory Note to Revised Article 3 (reprinted in 2 U.L.A. 8 (1991)).
166. See Rubin, supra note 28, at 588-89.
at the same time states are adopting a new U.C.C. which, in some respects, detracts from their well-being. Congress should not establish a national EBT program, assuring recipients necessary safeguards through coverage under the EFTA or otherwise, and, at the same time, put those recipients at the mercy of the states that pass laws governing money orders. Consumer concerns are national in scope and require national solutions.