CHECK CONVERSION: THE IMPLICATIONS
OF AN INNOVATIVE PAYMENT SYSTEM

I. INTRODUCTION

If you are a consumer you have likely done the following: In preparation for a social event you are hosting, you decide you need a few things from the store. After collecting what you need, you proceed to the checkout line. As the clerk scans the items in your shopping cart, you realize that you do not have enough cash to satisfy the amount owed. However, as a participant in today’s economy, you know that cash is not always necessary. In short, you know you can leave the store with all that you need, because you still have a couple of payment options at your disposal. One option is to write a check, while another option, one upon which many Americans rely, is to use a credit card.

Many consumers opt for the second method of payment.1 If a consumer decides to pay with a credit card, the charged outlay shows up in the credit card’s next billing cycle. It is upon the receipt of the credit card bill that a consumer pays for the items purchased previously. Most consumers remit their check to the address listed on the statement without reading the fine print.

Most consumers do not know how that check will make its way through the banking system; however, a close read of the billing statement provides the consumer with valuable information as to how the process works. If the consumer’s credit card company is interested in saving on collection costs, as most are, the consumer may find that the check is being converted into an Automated Clearing House transfer. Because this type of conversion benefits companies, more and more companies will employ this technology. This Comment explains the implications of that conversion and the laws that govern Automated Clearing House payments.

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1. For the twelve-month period ending December 31, 2004, Visa reported over six billion credit card transactions. Visa Quarterly Report, at http://usa.visa.com/download/about_visa/newsroom/statistics/Q42004.pdf (last visited Mar. 22, 2003). The amounts associated with these transactions exceeded $600 billion. Id. It should be noted that while Visa is the dominant force in credit card transactions, the addition of other competitors would make these volumes even higher.
II. WHAT IS ACH?

ACH, which stands for Automated Clearing House, is a type of electronic payment system called an electronic fund transfer (EFT). An EFT is "any transfer of funds that is initiated . . . electronic[ally] . . . for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account." The ACH network allows consumers and businesses to transfer funds electronically.

The ACH Network is a batch processing, store-and-forward system. Transactions received by the financial institution during the day are stored and processed later in a batch mode. Rather than sending each payment separately, ACH transactions are accumulated and sorted by destination for transmission during a predetermined time period.

"Like a giant web, the ACH network is composed of financial institutions that either send or receive checking account-based transactions for payment."

ACH transactions can take the form of a credit or a debit depending on the flow of the funds. Most consumers are familiar with ACH credits, because direct deposit of payroll is a type of ACH credit. Instead of receiving a check from an employer, an employee directs her employer to deposit her wages directly into a checking account. ACH transfers can also flow in the opposite direction, meaning that transfers can also deduct money from an account. A common form of ACH debit is online bill payment. For instance, rather than mailing a check to a local utility company, consumers can make the payment online. In some instances consumers initiate the transfers while in other instances the consumers authorize the utility company to initiate the transfer.

ACH is growing at an impressive pace. In the third quarter of 2003 there were close to two billion ACH network transactions. This repre-

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2. Id. § 11.01.
3. Payment systems have evolved over time. In early civilizations barter was the only viable payment system. PAUL S. TURNER, LAW OF PAYMENT SYSTEMS AND EFT §§ 1.01-03. (Supp. 2001). Then precious metals, in the form of coins, began to be the preferred payment system. Id. However, due to the difficulty of exchanging metal coins, paper money became the system of choice. Id. Paper money took the form of both currency and what we call "drafts" in today's parlance. Id. Today, in addition to paper money, electronic payment systems exist.
4. Regulation E, 12 C.F.R. § 205.3(b) (2004).
6. Id.
9. VARTANIAN ET AL., supra note 5, at 52.
sented a 13.34% growth over the volume recorded in the third quarter of 2002. In contrast, the Federal Reserve reported that it processed 16.59 billion checks in 2002, a 1.9% decline from the 2001 volumes. This marked the third straight year in which the Federal Reserve reported a decline. Judging from these volume trends, it appears that, while checks are still a prevalent form of payment, more and more consumers and businesses favor using the ACH network to make and collect payments. Because the ACH network provides an inexpensive way of settling business and consumer payments, the ACH network will undoubtedly play a significant role in the payment systems arena in the years to come. New products—like eCheck—which take advantage of the efficient ACH network, are part of the reason ACH volumes have grown at such an impressive pace.

III. WHAT IS ECHECK?

There are several ways in which eCheck works. This paper addresses two of the subsets of eCheck in which a consumer physically writes a check, because it is under these circumstances that the consumer likely has the impression that the check travels through the banking system. First, there is accounts receivable truncation (also called “accounts receivable conversion” and abbreviated “ARC”) used in conjunction with a lockbox. Second, there is check conversion at the point of purchase (POP). These two banking products are described below.

A. Accounts Receivable Check Conversion in Conjunction with Lockbox

In order to appreciate fully the process behind accounts receivable truncation in conjunction with a lockbox, it is helpful to understand how pay-
ments were processed prior to the advent of this new technology. The history of the lockbox can be traced to the 1930s.\textsuperscript{17} Beginning in the 1960s, companies began to outsource their collection efforts to large banks and third parties who promised to collect funds and process their payments in an expeditious manner.\textsuperscript{18} Banks and third parties offered services called retail and wholesale lockboxes to facilitate their collection efforts.\textsuperscript{19} Under the lockbox model, consumers and businesses remit their payments to a specific post office box instead of the company’s street address.\textsuperscript{20} All the mail delivered to the post office box is periodically gathered by the party offering the lockbox service and deposited to the customer’s account.\textsuperscript{21}

A lockbox is beneficial to a company for many reasons. For one, funds are deposited to their accounts more quickly than they would be if the payments were processed in-house.\textsuperscript{22} Funds are deposited into the customer’s account more quickly because the time it takes to clear through the banking system—also called “processing float”—is reduced.\textsuperscript{23} Another benefit of a lockbox is that a company can concentrate on its core competencies rather than concern itself with the important, but labor-intensive, check collection process. While lockbox processing can be expensive, a significant reduction in float can make a lockbox cost effective.\textsuperscript{24}

Companies utilize retail lockboxes to collect payments made by consumers.\textsuperscript{25} For example, when a consumer pays a utility bill, the consumer

\begin{quote}
\textsuperscript{17} Banks processed remittances in the 1930s so that they could stake their claim on payments made to companies that owed the bank money. In 1947, RCA Corporation asked its banks to handle its collection process, a process RCA considered to be quite cumbersome. Richard J. Poje, \textit{The Death and Birth of Wholesale Lockbox,} AFP EXCHANGE, Mar. 1, 2003, \textit{available at} \url{http://www.poje.com/wholesale%20LB.pdf} (last visited Mar. 10, 2005).
\end{quote}

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\textsuperscript{18} During this time, business schools began discussing “management science.” \textit{Id.} at 2. As a result of this, bankers began discussing the value of float to their customers. \textit{Id.} Because of the interest rate environment at the time, savings in float translated into material savings for a company. \textit{Id.}
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\begin{quote}
\textsuperscript{19} \textit{Id.}
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\textsuperscript{21} \textit{Id.}
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\textsuperscript{22} \textit{Id.}
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\textsuperscript{23} It should be noted that processing float for checks has been greatly reduced due to the passage of the Check Clearing for the 21st Century Act, or “Check 21.” Check 21 allows for the collection of checks using an electronic image rather than the physical check. 12 U.S.C. § 5001 (2003). By passing images, the time it takes for a check to clear will be greatly reduced. \textit{Id.}
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\textsuperscript{24} While there are complex ways to calculate the cost benefit of a lockbox, a simple example illustrates the financial analysis. To determine the cost, a company looks at the number of items processed and calculates the per item and fixed costs the lockbox provider charges. This cost is measured against the potential benefit. To determine the benefit, the company looks at the daily volume flowing through the lockbox and the applicable daily interest rate. (This number could be substantial if a company has debt that carries with it a high interest rate.) The company calculates the daily interest that would be earned. Then, that interest number is multiplied by the float reduction, which is measured in days. In addition, the labor associated with this aspect of the collection process should be calculated and factored as a benefit, for this aspect of the collection process will be eliminated by the implementation of a lockbox. These benefits, measured against the costs, determine whether a lockbox is economically justified.
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remits the payment to a post office box. In addition to the check, a consumer usually detaches part of the bill, called a remittance document, and sends both the check and the detached document to the post office box.\footnote{Id.} This remittance document, sometimes referred to as a scannable coupon, is usually machine-readable.\footnote{See Poje, supra note 17, at 2 (highlighting the general attributes of wholesale and retail lockboxes).} Retail lockboxes employ technology that read this scannable coupon as part of the lockbox process.\footnote{Id. at 60.} Companies that want to collect payments from other companies use wholesale lockboxes. While the payments between companies are accompanied with remittance documents, these remittance documents are not machine-readable.\footnote{Id.}

Accounts receivable truncation takes basic lockbox principles and incorporates the ACH network. ARC is a process "whereby paper checks are converted into electronic funds transfers at the end of the business day and originated through the ACH network."\footnote{Lacefield v. Elec. Fin. Group, 35 S.W.3d 755, 758 (Tex. Ct. App. 2000).} In short, with accounts receivable truncation, the person remitting payment continues to send a check to the lockbox.\footnote{Herb, supra note 25, at 6.} Technically, this process "lets the lockbox operator scan the paper checks and use the information from the magnetic ink character recognition line to create an automated clearing house transaction."\footnote{Will Wade, ARC Seen Hastening the Decline of Paper Checks, AM. BANKER, May 22, 2003, at 12.} By employing this technology, a company processes the payment similarly to the way a company pays its employees through direct deposit of payroll.\footnote{Herb, supra note 25, at 6.} This method of processing is valuable to companies because it takes less time to process and costs less. As evidenced by statistics, ARC is growing at an impressive rate. In the third quarter of 2003, close to 44 million checks were converted into ACH payments.\footnote{Nat'l Automated Clearing House Ass'n, Electronic Payments Ass'n, Third Quarter 2003 ACH Statistics (Oct. 7, 2003), available at http://www.nacha.org/news/stats/StatsQ32003rld001.htm (last visited Mar. 8, 2005).} This represented a 718% increase over the third quarter of 2002.\footnote{Id.} As more companies learn about the benefits of ARC, these volumes will likely continue to climb at a high rate.

B. eCheck at the Point of Purchase

Check conversion can also occur at the point of purchase. For instance, if a local retailer, at its checkout line, converts the paper check to an ACH, the retailer would be employing eCheck POP. In this type of transaction, the cashier runs the check through "a check reader that captures the routing number,\footnote{The Routing Transit Number identifies the bank with which a consumer maintains his or her} account number, and check number."\footnote{Id. at 60.} After this data from the
line is captured, the cashier manually keys in the amount of purchase. The check reader then "prints an authorization for the transaction, and the authorization is given to the consumer to sign." Once signed, an ACH transfer can be generated that will withdraw funds from the consumer's account. The consumer's check is then voided and returned to the consumer.

IV. WHY ARE COMPANIES EMPLOYING CONVERSION?

As mentioned above, ARC is growing at an impressive rate. As the number of companies employing eCheck continues to rise, the number of checks clearing through the banking system will decline. This conversion will occur for several reasons.

A. Cost

"Businesses of all sizes crave efficiency and seek ways to lower operating expenses." Businesses can achieve the aforementioned goal, because the cost of clearing ACH transfers through the ACH network is cheaper than the cost of processing checks, resulting in lower banking service charges incurred due to a company's cash management operation. In 2002, the Federal Reserve released statistics showing the cost for processing a check was 4.5 cents per item while the cost to process an ACH was 1.5 cents per item. In terms of actual cost savings to companies, "[i]t has been estimated that merchants who convert a paper check into an ACH debit entry can save up to one third of the cost of processing the check." In addition, service charges should be reduced because banks will no longer have to deliver checks to other banks in order to clear them. This delivery cost

account. Preceded and followed by a symbol, it is the first nine number sequence under the "for" line on a check. See, e.g., SunTrust Banks, Inc., Routing Transit Information, at https://www.suntrust.com/personal/Checking_Savings/routing_transit.asp (last visited Mar. 9, 2005).
37. TURNER, supra note 2, ¶ 10.03[A].
38. MICR stands for "Magnetic Ink Character Recognition." The MICR line is the first sequence of numbers appearing on the bottom line of the check.
39. TURNER, supra note 2, ¶ 10.03[A]. Other information like "a driver's license number or telephone number," id., can be keyed in also.
40. Id.
41. Id.
42. Id.
43. Gary Cawthorne, a vice president for global payments with Unisys Corporation, stated: "All the numbers we've been seeing show checks declining at about 2% to 4% per year, but with arc that could become 6% to 8%." Wade, supra note 32, at 12.
44. Poe, supra note 17, at 58.
45. Banks charge corporate customers check clearing fees as well as other banking fees, which are associated with processing payments.
47. TURNER, supra note 2, ¶ 10.03[A].
is included in the bank service charges a company presently pays for a lockbox.\textsuperscript{49} As far as intangible savings, a company's treasury staff will be free to do other tasks, because the deposit reconciliation process will take less time.\textsuperscript{50} This could allow a company's treasury staff to focus on more strategic initiatives.

B. Extended Deadlines

A company also gets the benefit of extended deadlines. With check processing, the checks must be received by a time established by the bank to get same-day credit. For deposits made at a branch, the time is usually 2:00 p.m. That time is normally extended when a company deposits via a lockbox. Article 4 of the Uniform Commercial Code governs aspects of the check-collection process, including this deadline.\textsuperscript{51} Section 4-108(a) states that a bank may establish an afternoon hour, not earlier than 2:00 p.m., as the cutoff hour for processing checks presented that day.\textsuperscript{52} In fact, the official comment to Section 4-108 explains that "[e]ach of the huge volume of checks processed each day must go through a series of accounting procedures that consume time. Many banks have found it necessary to establish a cutoff hour to allow time for these procedures to be completed . . . ."\textsuperscript{53} The Code further provides that all items not received before the deadline will be treated as if they were received at the beginning of the next business day.\textsuperscript{54}

However, Article 4 does not govern ACH payments, and the deadline for credit is later in the day. For example, the Federal Reserve's deadline may be as late as 2:15 a.m.\textsuperscript{55} This means that a third party providing lockbox services has more time to process payments for credit. More processing time translates to the bottom line for a company, because more payments will get expedited credit than they would with a traditional lockbox. A merchant relying on eCheck POP benefits since the clerks at checkout lines can continue converting checks up until the bank's deadline. This deadline will undoubtedly be much later than the deadline associated with a physical deposit at the branch or operations center.

C. ACH Priority

Further, ACH payments take priority over paper checks.\textsuperscript{56} To highlight the importance of this benefit, consider the following hypothetical. An indi-

\begin{itemize}
\item \textsuperscript{49} See \textit{id}.
\item \textsuperscript{50} \textit{Turner}, \textit{supra} note 2, § 10.03[A].
\item \textsuperscript{51} \textit{U.C.C.} § 4-101 (2004).
\item \textsuperscript{52} § 4-108(a).
\item \textsuperscript{53} § 4-108 cmt. 1.
\item \textsuperscript{54} § 4-108(b).
\item \textsuperscript{56} Wade, \textit{supra} note 32, at 12.
\end{itemize}
vidual has $100 in a checking account. That individual has written a check in the amount of $100 to the order of a local grocery store that is to be processed as a check and, in addition, has written a check to the order of a local department store in the amount of $80 that has been converted into an ACH. Further, assume both the check and the ACH are presented on the same day. Since ACHs are typically given priority for handling by banks, the converted check will be debited against the individual’s account before the check. Because of this, logically, the merchant that converted the check will receive the funds, while the merchant who does not convert the check has in its possession a check drawn against an account with insufficient funds. Even though the check being processed as a check may have been written earlier than the converted check, the ACH in the above hypothetical will still take priority since ACH payments usually clear in less time than checks, assuming both are presented to the individual’s bank at the same time.

D. Notification of Returns

Finally, and very importantly, the merchant will be notified of returned ACHs earlier than it would receive notification of a returned paper check. This earlier notification should make the collection process operate more smoothly for merchants. In addition, “[t]he merchant may also recover the cost of returned debits by way of a separate ACH debit transaction if the consumer has authorized the separate debit and the available funds in the account are sufficient.” The ability to see returned items earlier should not be understated, for it allows a company to spot fraudulent payments much earlier.

V. LAWS THAT GOVERN CHECKS

UCC Articles 3 and 4 and Regulation CC govern checks. First, Article 3 of the UCC applies to negotiable instruments. A negotiable instrument is “an unconditional promise or order to pay a fixed amount of money.” Negotiable instruments can be classified in one of two groups: notes or drafts. A negotiable instrument that takes the form of a promise is a note, while a negotiable instrument that takes the form of an order is a draft.

57. Id.
58. A company will be notified within “approximately three to six days in the case of a returned ACH debit entry, as opposed to about 8 to 12 days for a paper check.” TURNER, supra note 2, § 10.03[A].
59. Id.
60. Id.
61. Wade, supra note 32, at 12.
63. § 3-104(a).
64. § 3-104(e).
65. § 3-104(e); MARK BUDNITZ, CONSUMER BANKING AND PAYMENTS LAW: CREDIT, DEBIT, ATM
Since a check is considered a draft, the term “negotiable instrument” includes checks.66 Furthermore, Article 3 also provides a definition of ordinary care,67 which applies equally to Article 4.68

Article 4 governs bank deposits and the processing of checks.69 In fact, the official comment to Section 4-101 states that “[t]he great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections . . . . This Article meets that need.”70 Part 2 of Article 4 governs the collection of items and focuses on depositary and collecting banks while Part 3 of Article 4 governs the collection of items but focuses on payor banks.

Checks are also governed by Regulation CC. “The Regulation CC rules supplement the check collection and return rules in UCC Article 4.”71 In fact, the purpose of Regulation CC is “to implement the Expedited Funds Availability Act.”72 Regulation CC outlines the “Availability Policies” and also governs the “Collection of Checks.”73 For example, Regulation CC states that “[a] depositary bank shall make funds deposited in an account by check available for withdrawal not later than the business day after the banking day on which the funds are deposited.”74 In addition, Regulation CC clearly outlines the obligations of banks when dealing with returned checks.75 Finally, Regulation CC has a section regarding liability of financial institutions.76

VI. LAWS THAT GOVERN ACH

While the Uniform Commercial Code governs the processing of paper checks, ACH entries are governed by the National Automated Clearing House Association (NACHA) and Regulation E.77 Regulation E applies to a transfer where a consumer has authorized a bank or financial institution to credit or debit an account.78 Regulation E “establishes the basic rights, li-
abilities, and responsibilities of consumers who use electronic fund transfer services and of financial institutions that offer these services.\textsuperscript{79}

NACHA establishes the rules governing ACH transfers.\textsuperscript{80} NACHA is comprised of many regional associations which collectively represent over 13,000 financial institutions.\textsuperscript{81} In essence, NACHA facilitates the exchange of electronic debits and credits among financial institutions.\textsuperscript{82} NACHA establishes operating rules which provide the legal requirements for ACH participants.\textsuperscript{83} So, NACHA provides the legal framework for member institutions by contract while Regulation E outlines the rights of consumers who utilize this payment method.\textsuperscript{84}

\textbf{VII. IMPLICATIONS FOR CONVERTED CHECKS}

Thus far, this Comment has focused on the reasons why a local retailer would be inclined to utilize the ACH network. As mentioned above, the gains in efficiency and cost considerations are quite compelling. These reasons alone explain why a retailer, focused on improving profit margins, would like to take advantage of this technology. However, the employment of such technology does have an effect on both consumer and corporate check writers. Depending on the specific situation, our sympathy for the check writer varies with the circumstances.

\textbf{A. The Implications of Reduced Float for Corporate Check Writers}

Just like consumers, corporations must reconcile their bank accounts. However, the stakes are much higher with corporations. Corporations that write thousands of checks each month find it necessary to reconcile their bank accounts on a daily basis. Daily reconciliation allows a company to properly gauge its cash position. This knowledge, especially if learned early in the day, enables a company to benefit from more attractive short-term interest rates.

To aid this important reconciliation process, companies often receive an electronic data transmission from their banks. This data transmission, consisting of all the paid checks, can be set up to feed directly to a company's accounting software. This paid list is compared to the list of checks the company has issued. If checks are converted into ACHs, the data transmission feed will not be as complete as it would have been had a check not been converted. This means that more time will need to be spent on reconciling accounts thereby delaying the time at which a customer becomes

\textsuperscript{79} § 205.1.
\textsuperscript{80} Turner, supra note 2, § 11.01.
\textsuperscript{81} Id.
\textsuperscript{82} Id.
\textsuperscript{84} See id.
aware of its cash position. In short, the reconciliation process becomes more complicated if checks are converted into ACH debits.\textsuperscript{85}

Furthermore, check fraud is a serious concern for large companies.\textsuperscript{86} To combat this issue, many companies rely on a banking product called "Positive Pay."\textsuperscript{87} With Positive Pay, a company provides a list of the checks issued to its bank.\textsuperscript{88} In turn, the bank will only pay the presented checks that appear on the list provided to them by the bank.\textsuperscript{89} "However, a check that is converted into an electronic ACH transaction bypasses this list."\textsuperscript{90} In addition to circumventing fraud, Positive Pay is often used in conjunction with the account reconciliation process described above.\textsuperscript{91} This is because a company using Positive Pay must have a way to create an issue file from its accounting software, which is sent to the bank via a data transmission. If a company can generate the required issue file out of its accounting software, the accounting software will likely be able to accept a paid list data transmission from the bank. As mentioned above, this paid list greatly facilitates the account reconciliation process.

Finally, the use of such technology is obviously favored by companies who are in the collection business. After all, companies that collect a lot of money want the money credited to their accounts as quickly as possible. However, as illustrated above, businesses that disburse a large quantity of funds may not appreciate a process that complicates the reconciliation process. Furthermore, a company interested in bottom-line profits may not appreciate a service that effectively reduces float. In short, while a collector likely wants to collect funds as quickly as possible, a disbursing organization would like to delay payment for as long as possible.\textsuperscript{92} "A payer makes a conscious decision. There are various reasons to pay by check, and if they wanted to pay electronically, they would. There are still advantages to paying by check, but this scenario takes control away from the payer."\textsuperscript{93}

B. The Implications of Reduced Float for Consumer Check Writers

As outlined above, retailers would likely want to utilize products and services that can expedite the collection of money. Because eCheck reduces

\textsuperscript{85} Will Wade, Treasurers Blast Nacha Plan to Convert Corporate Checks, AM. BANKER, Feb. 7, 2003, at 18 [hereinafter Treasurers Blast].

\textsuperscript{86} "Check fraud costs companies an estimated $10 billion a year and is increasing at an annual rate of 15 percent to 20 percent. According to federal agencies, more than 2 million fraudulent checks are written in the United States each day . . . ." Anne Bond Emrich, Financial Community Sees Rise in Check Fraud, GRAND RAPIDS BUS. J., May 12, 2003, at 1.

\textsuperscript{87} Treasurers Blast, supra note 85, at 18.

\textsuperscript{88} Id.

\textsuperscript{89} Id.

\textsuperscript{90} Id.

\textsuperscript{91} Id.

\textsuperscript{92} In this situation, the disbursing organization would like to extend the float. This means that funds stay in its accounts longer, earning interest for the company.

\textsuperscript{93} Treasurers Blast, supra note 85, at 18 (quoting G.M. Stettner, former chairman of the Association for Financial Professionals).
the processing float, the implementation of this technology will help a neighborhood retailer achieve this goal. Furthermore, as outlined above, this reduced processing float means increased bottom-line profits. It has been observed that "[t]he purpose of electronic check conversion is to reduce the cost of handling paper checks and transfer funds faster from [the consumer's] account into the merchant's account."94 In fact, "using ARC means that transactions are processed as ACH payments and clear within two days, versus the four to five days sometimes required to clear paper checks."95 Undoubtedly, this will have an impact on consumers who play the float. Consumers playing the float "take the chance that their deposit will beat the check to their financial institution."96 While consumers take a substantial risk when engaging in such financial shenanigans, they may still question why something that would not have resulted in overdraft fees in the past now results in such fees. Even in cases where a consumer is told that a check will be converted into an ACH, there will likely be many consumers that do not understand the implications.97

In addition, in many cases where ARC is employed, a customer may not even know that a check will be converted into an ACH. "It is a reality that not all consumers review their billing statements, and therefore there may be a portion of consumers who do not read the notifications from billing companies that authorize the ARC transactions."98 This is not an issue with eCheck at the point of purchase since a customer is given back the actual check.99 However, where the conversion is taking place at the lockbox, a customer may not know of the conversion ahead of time if the customer does not read his or her entire bill.100 Since Regulation E has a notice requirement, it is possible that a consumer could contend that there was not adequate notice of the conversion, in the event that the conversion resulted in harm to the consumer.

94.  McCluskey, supra note 8, at 25.
95.  Wade, supra note 32, at 12.
96.  Sam Davis & Stanley D. Mabbitt, Checking Account Bounce Protection Programs, CONSUMER FIN. LAW Q. REP, Winter 2003, at 34.
97.  It is unreasonable to think checkout clerks at the point of sale will have knowledge sufficient to explain the intricacies of the ACH network. Further, assuming arguendo that the clerks do, in fact, possess such knowledge, it is unreasonable to think a clerk will take the time to explain the implications to the consumer. See McCluskey, supra note 8, at 28.
98.  Herd, supra note 25, at 3.
99.  Id.
100.  For example, on the back of the first page of an American Express bill, the following language appears: "We reserve the right to process checks electronically, at first presentment and any re-presentments, by transmitting the amount of the check, routing number, account number and check serial number to your financial institution. Your checking account may be debited as soon as the same day we receive your payment." (on file with author).
C. Consumer Liability for Unauthorized Transfer

The liability of a consumer for unauthorized transfers is dependent on several factors, including whether basic disclosures were provided to the customer by the financial institution. The regulation lists what information should be provided to the consumer in such disclosures. However, currently there are no universal notice requirements for ACH payments. Regulation E provides that the financial institution must give basic notice when the consumer contracts for electronic fund transfer services or prior to the time that the first transfer involving the consumer’s account is made. For example, in the case of preauthorized transfers, before such a transaction can take place, a consumer may only authorize the transaction by signing a writing.

Assuming there has been basic notice, the consumer’s liability is largely dependent on the amount of time that has expired between the consumer becoming aware of the unauthorized entry and the consumer’s contact with the financial institution. If the financial institution sends a monthly statement which shows an unauthorized transaction, and if the consumer fails to notify the financial institution within sixty days of the transmittal date of the statement, the consumer’s liability for subsequent unauthorized transfers is the amount of the transfers. However, Regulation E defers to an agreement made between a bank and its customer, or to state law, in the event either of the two limit liability to less than that allowed under § 205.6.

Under Article 4, which governs physical checks, a financial institution is required to provide a customer with a statement which would “allow the customer reasonably to identify the items paid.” If the actual checks are not returned to the customer, the financial institution is to maintain legible copies of the checks for seven years. Article 4 contains risk allocation rules for unauthorized checks that differ from the rule of Regulation E. Un-
nder Article 4, upon receiving a statement of return of items, "the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized."112 This duty includes inspecting the statement for alterations of an item and inspecting the statement for items that were not authorized.113 If the bank proves that the customer did not exercise care in inspecting a statement, a bank customer can not assert a claim against the bank.114 In addition, a financial institution is not liable to a customer if

the customer fails to report an unauthorized signature or alteration with respect to an item in breach of the subsection (c) duty . . . and the bank subsequently pays other items of the customer with respect to which there is an alteration or unauthorized signature of the customer and the same wrongdoer is involved.115

In this instance, a bank customer is still afforded reasonable time to examine the statement, but the customer cannot take more than thirty days.116 However, if a customer does not discover and report to the bank an unauthorized signature or alteration within one year, the customer is entirely precluded from asserting a claim against the bank.117

The above analysis suggests that under either Regulation E or Article 4 of the Uniform Commercial Code, the customer faces liability if reasonable steps to notify the financial institution of an incorrect debit are not taken. While it appears a customer does have more time to discover an error in the event of an unauthorized signature on a check, Regulation E still provides for a generous sixty-day window. This window is ample time for a customer to discover an unauthorized debit.

D. Error Resolution

Regulation E defines "error" to include, among other things, an unauthorized fund transfer, a fund transfer for an incorrect amount, and failure to include a fund transfer on a periodic statement.118 The regulation sets forth the time limits and extent of a financial institution's investigation.119 "A financial institution shall investigate promptly and . . . shall determine whether an error occurred within 10 business days of receiving a notice of error."120 If the financial institution finds an error, it is required to correct

112. § 4-406(c).
113. § 4-406(c).
114. § 4-406(d).
115. § 4-406(d) advisory committee's note.
116. § 4-406(d)(2).
117. § 4-406(f).
119. § 205.11(c).
120. § 203.11(c).
the error within one business day.\textsuperscript{121} The regulation does, however, provide for time extensions in certain circumstances.\textsuperscript{122} There are also procedures that must be followed in the event the financial institution determines that there was not an error.\textsuperscript{123} Most notably, the regulation provides that a financial institution must provide a written explanation of its findings.\textsuperscript{124} If the consumer requests it, the financial institution must forward to the consumer the documents that aided the financial institution’s determination.

As noted earlier, the procedures banks must follow when dealing with physical checks are explained in Article 4 as supplemented by Regulation CC. The customer has a duty to inspect a bank statement. Failure to do so can preclude the customer from asserting a claim against the financial institution. However, if the customer can show that the bank failed to exercise good faith\textsuperscript{125} or failed to exercise ordinary care,\textsuperscript{126} the customer is not precluded from asserting a claim against the bank.\textsuperscript{127}

This analysis shows that a customer is not losing much in terms of recredit rights when a check is converted to an ACH. In fact, Regulation E more clearly delineates the responsibilities of the banks and the customers.

\textbf{E. Information Received from Financial Institutions}

Consumers also rely on information from banks concerning payments that have been made. Consumers have three main concerns about bank information. First, consumers want enough information on their bank statements to balance their checkbooks.\textsuperscript{128} In addition, it is imperative that consumers have enough information to establish that a particular payment was made.\textsuperscript{129} Furthermore, as discussed above, information is important because customers must notify banks in the event the customer believes the account was wrongly debited. For these reasons it is critical for customers to have detailed bank account information.

If a customer’s check is converted into an ACH, the customer may get confused reading the bank statement. To illustrate the possible confusion, consider the following hypothetical. A consumer visits a music store with the intention of buying a compact disc. The consumer decides to pay with a

\begin{itemize}
  \item \textsuperscript{121} § 205.11(c).
  \item \textsuperscript{122} Exceptions of when the time period may be extended include: when the transfer was initiated outside of the state, when it was the result of a point of sale debit card transaction, and when the transfer was within thirty days of the first deposit to the account. §§ 205.11(c)(3).
  \item \textsuperscript{123} § 205.11(d).
  \item \textsuperscript{124} § 205.11(d).
  \item \textsuperscript{125} Good faith is defined as meaning “honesty in fact and the observance of reasonable commercial standards of fair dealing.” U.C.C. § 1-201(b)(20) (2002).
  \item \textsuperscript{126} “Ordinary care” is defined as the “observance of reasonable commercial standards.” U.C.C. § 3-103(a)(9) (2002). However, in the case of banks, as long as a bank’s procedures are roughly equivalent to the practices generally used in the banking industry, the fact that a bank does not individually examine each instrument, does not render the bank’s process unreasonable. § 3-103(a)(9).
  \item \textsuperscript{127} U.C.C. § 4-406(e) (2002).
  \item \textsuperscript{128} Herd, supra note 25, at 2.
  \item \textsuperscript{129} Id.
check. The consumer makes check number 123 payable to the music store and notates the transaction in his check register. At the end of the month, the consumer accesses his bank’s online account statement. Since the check has been converted into an ACH, the consumer will not be able to find check number 123. While this problem could lead to confusion, the customer will still be able to reconcile the account because the bank account statement will list the name of the merchant and the amount. While the process will be a bit more confusing, the customer still has a way to balance the bank account. Furthermore, customers will become more accustomed to the process of check conversion over time.

F. Ability to Place Stop Payment Orders

The conversion of a check to an ACH may also create a practical problem relating to the placing of stop payment orders. Under Article 4, a customer has a right to place a stop payment order. While a customer does have the ability to place a stop payment on an ACH item, the customer must notify the financial institution at least three business days before the transfer. Obviously, when a check is converted into an ACH, a customer’s ability to effectively stop payment on that item is virtually eliminated. In the event of a dispute with a retailer, the customer cannot as easily stop payment on an ACH as would be the case with a check.

G. Fees Associated with Insufficient Funds

State law governs the amount a merchant can charge a customer who writes a check that is subsequently not paid or dishonored. Specifically, the Alabama code states:

A merchant making a sale of merchandise, goods, or services . . . who receives a check, draft, negotiable order of withdrawal, or like instrument drawn on a bank or other depository institution given by any person . . . [in exchange for] merchandise, goods, or services may, if the instrument is not paid or is dishonored by the institution, charge and collect . . . from whom the instrument was received, a bad check charge of not more than the greater of either twenty-five dollars ($25) or an amount equal to the actual charge by the depository institution . . . .

Section b, however, increases the maximum amount that can be charged to thirty dollars. It is important to note that the code governs only instru-

130. § 4-403(a).
131. Regulation E, 12 C.F.R. § 205.10(c) (2001).
132. ALA. CODE § 8-8-15(a) (1975).
133. ALA. CODE § 8-8-15(b) (1975). This increase occurred gradually and took final effect in 2003.
ments. In short, the statute does not cover the fees that can be charged if an ACH transfer is returned for insufficient funds.

If an ACH transfer is returned, NACHA rules govern. Specifically, as the ACH rules state, a "[Receiving Depository Financial Institution] may return entries for any reason, provided it uses an appropriate Return Reason Code as specified." Examples of Return Reason Codes include: insufficient funds, account closed, and invalid account number. While a financial institution has the right to return an ACH transfer, a more interesting question is how a merchant can collect a fee in the event the account does not have sufficient funds to cover the transfer. In fact,

[a]n Originator desiring to use the ACH Network to collect a service fee must originate a separate . . . entry to the consumer's account and must follow all rules governing the specific transaction used, including having first obtained the consumer's authorization for such an entry in the manner specified by the NACHA Operating Rules.

Some merchants may want to place that authorization on the actual check in a point of purchase scenario. According to NACHA rules, a merchant must affirmatively procure the customer's approval in the form of a signature to collect a fee associated with a transfer drawn on an account with insufficient funds. The following conditions must be met: the authorization must be in the form of a signature (initials are not sufficient), the language on the check must specifically state that the signature authorizes an ACH debit, the authorization must state how a customer can revoke the authorization, the customer must receive a copy, and the originator must retain a copy for two years. Therefore, this is more than what would be required had the check not been converted. For this reason, the conversion to an ACH does not result in any more harm to consumers than if the check was not converted. In fact, because some merchants may not want to slow down the checkout process by procuring a signature, the conversion to an ACH may actually serve to prevent those fees from being deducted at all.

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134. McCluskey, supra note 8, at 28.
136. id.
137. id. at 160.
138. id.
139. id. at 160-61.
140. McCluskey, supra note 8, at 28. "Moreover, since only about 1 check in 1,000 goes bad, the merchant is getting 999 signed statements to collect one service fee. In most cases, this additional paperwork and checkout counter hassle is not worth it to them." id.
VIII. CONCLUSION

Payment systems have changed with the needs and advancements of society. For example, it is axiomatic that the barter system would not efficiently address the complex financial needs of a global society. As payment systems evolve to accommodate society, it is easy to see why companies would want to embrace a technology that makes it easier and more cost effective to collect payments.

However, as has been illustrated, check conversion impacts both corporate and consumer check writers. Given the complexity of corporate check writing, perhaps we should be more sympathetic to corporate opposition to eCheck services. However, as we analyze the affects of eCheck on consumers, it is clear that consumers are not losing much leverage as Regulation E has mechanisms built in that serve to protect consumers to an acceptable degree.

Consumers should be aware of what may happen when a check is written to the order of a local retailer. However, consumers should take comfort in knowing that such check conversions are not to a consumer’s detriment. In short, as long as consumers are adequately protected, and if eCheck yields tangible benefits to companies, society should embrace these and future payment systems.

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