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Harold W. Bangert

BANK CHECK TRANSACTIONS IN NORTH DAKOTA CUSTOM V. LAW

HAROLD W. BANGERT *

INTRODUCTION

A word of explanation should introduce this article. It is written in almost elementary terms. Certain common daily acts of business *are* explained in detail. Various kinds of banks are defined. A bank check is defined, as are the parties to a bank check transaction. But how many readers of this article have available in their minds a working knowledge of the nature of the legal relationships created by the drawing and collecting of a bank check, of the fact that by statute there is no privity of contract between the holder of a check and the bank upon which it is drawn? How many realize that in practice this latter relationship, or lack of it, has resulted in involved state and national legislative battles intended to curb nefarious business practices stemming from it? How many understand that this rule of law has resulted in the great majority of North Dakota banks adopting and following customs which seem to be quite in conflict with their legal obligations?

Almost daily association with bankers over a period of two years has led me to believe that neither bankers nor their customers generally understand our laws governing the use of bank checks, and if lawyers do know what the law is, their banker clients have not sought their advice. Surely it is not to be assumed (a) that bankers as a class knowingly avoid their legal responsibilities, or (b) that business men as a class willingly accept less than the face value of checks given to them in discharge of just obligations due them.

What business man or lawyer has not heard, in response to his question about the nature of bank checking account charges, "Well, this is the way it is done," or "All banks do it this way," or "Banking is pretty complicated and this is the way we have to do it"? These vague and meaningless answers are the product, not of an unwillingness to explain on the part of the bankers, but of the adoption by the banking fraternity of custom upon custom until the final custom, expressed in bank charges, is actually quite unexplainable, and in most cases en-

* Attorney-at-law, Fargo, N. D.

tirely un-understandable. I am sure that the confusion surrounding the handling of bank checks lies in a blind adherence to *custom,* the result of a lack of knowledge of the *law.* This article is intended only to state the laws and customs with a minimum of argument and thus a minimum of supporting citation. It is hoped that it will prove to be a useful working tool for North Dakota lawyers and their business men and banker clients.

DEFINITIONS

We should first set down certain limited definitions of the terms to be used in this article. If the definitions prove to be of general usefulness, that will be by chance and not by design.

Bank: A chartered corporation (12 USCA 21; 6-02 NDRC) expressly and impliedly empowered to accept money for deposit from the general public and to authorize depositors to draw "checks" thereon (12 USCA 24; 6-0302 (8) NDRC).

National Bank: A bank chartered under Federal law (12 USCA 21). There are 41 national banks in North Dakota, reasonably well distributed over the state, located in towns as small as Binford (pop. 311), and in our largest cities.

State Bank: A bank chartered under state law. There are 109 state chartered banks in operation in North Dakota today. For the most part state banks are located outside of our larger cities, although there is one in Williston and another in Minot.

Federal Reserve Bank: A specially chartered bank (of which there are but 12 in the United States) empowered to accept money for deposit only from other banks which are its "members", or which are "non-member clearing banks." Since Federal Reserve Banks do not accept public deposits, they of course do not have "checks" drawn on them. They are "bankers' banks" with a peculiar and significant statutory power to collect checks from their members "at par", of which much more lafer! (12 USCA 342). The Federal Reserve Bank serving this area is located in Minneapolis. All national banks in North Dakota, 41, are by statute members of the Federal Reserve Bank. One state bank, the Bank of Rhame, has voluntarily subscribed to membership, and the Bank of North Dakota is the single "non-member clearing bank." The Federal Reserve Bank is empowered by statute to operate a "clearing house." (12 USCA 248 (0)).

Bank of North Dakota: A unique institution created by statute in 1919 (6-0901 NDRC) with a single place of business at Bismarck. It is by many authorities considered to be the State of North Dakota "doing business as a bank." It is empowered to operate a checking business just as is our defined "bank." It has the additional power of collecting "at par" from North Dakota chartered state banks (6-0913 NDRC) just as does the Federal Reserve Bank from its member banks. It is also empowered to operate a "clearing house" (6-0911 NDRC).

Correspondent Bank: A correspondent bank is a "bank," either state or national, which in addition to accepting deposits from the general public, also accepts deposits from other banks. A bank becomes a correspondent bank by the simple act of accepting another bank's money. The account thus accepted becomes known as a "country bank account." Usually correspondent banks are located only in larger centers. All Fargo banks are correspondent banks for certain country banks. Several banks in other larger North Dakota communities are correspondents of neighboring country banks. All North Dakota banks, whether large or small, carry accounts in one or more of the Minneapolis-St. Paul banks, thus the Minneapolis-St. Paul "correspondent banks" carry "country bank accounts" of all North Dakota banks. The relationship between a correspondent bank and a country bank is that of debtor and creditor. (Zollman, Sec. 4971; Mercantile State Bank of Minneapolis v. Farmers Home Bank of Lilly, South Dakota (Minn.) 199 N. W. 575).

Check: "A check is a bill of exchange drawn on a bank payable on demand ...." (41-1702 NDRC). "A check itself does not operate as an assignment of any part of funds to the credit of the drawer with the bank, and the bank is not liable to the holder unless and until it accepts or certifies the check." (41-1706 NDRC).

Maker: As used in this article "maker" is a word of art meaning a person who makes and gives a check for the purpose of discharging some lawful obligation.

Payee-depositor: Again a word of art, meaning the person who receives the maker's check and deposits it for collection in a bank other than the one on which it is drawn.

Exchange: "Exchange charges are charges which some banks deduct in paying checks drawn upon themselves when they are presented through the mails from out of town points for the alleged service of remitting the proceeds to these distant points." Par Collection and Absorption of Exchange Controversies, Melvin C. Miller, American Bankers Association, New York, New York, 1947, P. 4.

Service Charge: "A service charge is a fee for service rendered by a bank to the drawer of a check for the service to him of paying the amount of his check to someone else. In the language of the trade, a service charge is imposed against a depositor with notice and with his consent and becomes a part of the contract between a bank and the depositor." Par collection and Absorption of Exchange Controversies, Melvin C. Miller, American Bankers Association, New York, New York, 1947, P. 4.

Par: "Par" in banking terminology denotes payment of checks to payees or their agents at their face value—without deductions for the benefit of the drawee bank or any intervening bank. Thus, a check is or is not "par."

THE PROBLEM

And now without intending any similarity to persons living or et cetera, let us assume that Mr. John Lawyer of Tuttle,

North Dakota, at the conclusion of a successful and entertaining Bar Association meeting at Grand Forks, cheerily pays his bill at the Federick Hotel with a check for $10.00 drawn on the First State Bank of Tuttle. He goes home and notes that in due course the check was presented and was paid. The check, cancelled, was returned to him by his bank and Mr. Lawyer slept easily with the knowledge that again he had come through and discharged his obligation.

But it didn't work that way at all! The Federick Hotel only got $9.90 for the check, and the next time that Mr. Lawyer comes to town with a "country bank check", the chances are that there will be a demand that he "add exchange".

This is what happened: The Frederick Hotel, now the payee-depositor, deposited the check in the Second National Bank of Grand Forks. The hotel paid the bank a service charge of 2c for handling the item for it. The Second National Bank, having no account with the First State Bank of Tuttle, as was its custom sent the check by mail to the Fourth National Bank of Minneapolis, in which it knew that the Tuttle bank deposited money. The Fourth National Bank of Minneapolis, in accordance with a previously made agreement *between itself and the bank at Tuttle,* sent the check by mail to Tuttle. The First State Bank of Tuttle took $10.00 out of Mr. Lawyer's account, put 10c in its own corporate pocket, and remitted $9.90 to the Fourth National Bank of Minneapolis, no objection being heard from Minneapolis! The Fourth National Bank in turn credited the Second National Bank of Grand Forks with $9.90, which upon learning of this credit, charged back to the Frederick Hotel at the end of the month as part of the regular item "Exchange Charged by Other Banks" the amount held out by the First State Bank of Tuttle. This is the substance of a *customary* "exchange" transaction. Actual bookkeeping practice may vary from bank to bank.

The manager of the hotel now comes to the reader as an attorney and says, "Now, I don't mind giving a break to one of your brother lawyers—if he really needs the dime. I appreciate his business and I hope he comes back again, but there were 75 lawyers who stayed with me during your convention and they all paid by check. On 50 of these checks I got all my money but on 25 I lost amounts from 10c to $1.00 a piece. This isn't peculiar to lawyers. My total "exchange" bill averages

about $50.00 a month—more than $500.00 a year. This has been going on ever since I can remember. What I would like to know is, why I have to lose money on some checks and not on others? I would like to know who gets the money, and finally, I want to know if there is any way that I can get full value for all checks that people give to me for my rooms!"

You will of course first determine the relationship that existed between your client, the Frederick Hotel, and your brother-in-the-bar, Mr. John Lawyer. Upon cursory examination you will conclude that a debitor-creditor relationship existed which it was the *debitor's obligation to discharge.* You will determine that the creditor, the hotel, was not obligated to accept anything except "legal tender" and that in accepting a check from the debitor, he accepted it purely as a convenience to the debtor (31 USCA 451 et seq; 40 Am Jur 740). You will also determine that the obligation has not been discharged inasmuch as there is still due from the debtor to the hotel the sum of 10c. (41-1709 NDRC). (But consider the suggestion that it is the hotel's obligation to Lawyer to insist that the check be paid in full.)

Inasmuch as by statute checks are not assignments (supra), you will advise the hotel that there is no privity of contract between it and the First State Bank of Tuttle. In any event, for all practical purposes, the hotel can neither afford to attempt recovery of the dime from Mr. Lawyer nor from his bank.

Your next inquiry will be directed to another party in the transaction, the Second National Bank of Grand Forks, and to yet another party, the Fourth National Bank of Minneapolis. What is the relationship between the hotel payee-depositor on the one hand and its bank in Grand Forks and the Fourth National Bank of Minneapolis on the other? Here, in all probability, lies the answer to your client's questions!

Two Systems of Check Collection

There are two systems of law in North Dakota pertaining to the collection of bank checks. Federal statutes govern banks which are members of the Federal Reserve System. A Federal statute (12 USCA 342) requires that all banks which are members of the Federal Reserve System remit without deduction of any amount from the face of the check to the Federal Reserve Bank. *It is to be noted and remembered that the mem-*

ber banks of the Federal Reserve System are not required by Federal statute to remit in full to each other, or to any other bank. (Pascagoula National Bank v. Federal Reserve Bank 70 L. Ed. 400, 269 U. S. 537).

A second system of check collection has been in existence in North Dakota since 1919 with the establishment of the Bank of North Dakota. Paralleling the Federal statute, the Bank of North Dakota Act (6-0913 NDRC) requires that all state chartered banks remit in full or "at par" to the Bank of North Dakota. *It is to be noted and remembered that state chartered banks are not required to remit at par to each other, or to any other bank.*

§ 6-0913. Collection Items Must Be Paid to Bank of North Dakota at Par; Violation a Misdemeanor. All checks and other instruments and items of exchange payable on demand sent by the bank of North Dakota to any state bank or banking association in North Dakota, for collection, shall be remitted for at par by such state bank or banking association to the Bank of North Dakota. Any person or corporation who shall violate any of the provisions of this section shall be guilty of a misdemeanor.

From a standpoint of practicality, each member bank of the Federal Reserve System, knowing that its checks can be collected at par through the Federal Reserve Bank in Minneapolis, (to focus the problem locally) remits *directly* at par to other member banks when occasions arise. In Grand Forks, for instance, where all are national banks, as a matter of convenience to each other the banks exchange items between themselves "at par", i.e., without the deduction of any amount for their own respective benefits. They do this because the law *permits* them, on behalf of their depositors, to collect items drawn on each other through the Federal Reserve Bank of Minneapolis. This process of direct collection is the product of *custom.* The custom of course has grown out of a fundamental requirement of *law* that an agent, the depository bank, fully discharges his obligation to his principal, the payee-depositor.

However, in so far as the Bank of North Dakota par collection statute is concerned, it has been the general practice of North Dakota banks to disregard the law. This practice probably stems from the fact that in the banking fraternity national banks are *customarily* regarded as "par banks", though, as has been pointed out, they are *par* only in that they must pay at par to the Federal Reserve Bank; whereas, state

chartered banks have *customarily* been thought of in the banking fraternity as "non-par banks", since not being members of the Federal Reserve System, except by voluntary association, they are not required by statute to pay at par to the Federal Reserve banks. Inasmuch as it was not the *custom* to collect state bank checks at par, *banks have generally elected to ignore the mandate of the North Dakota statute,* to their sometimes mutual interest, but apparently almost always to the disinterest of the payee-depositor of a check.

THE PRINCIPAL-AGENT RELATIONSHIP

There can be no question but that the relationship between the payeee-depositor and his own banker is that of principal and agent. (7 Am Jur 475; McGoldrick Lumber Company v. Farmers Lumber Company, 64 N. D. 544, 254 N. W. 281). Since, however, an understanding of this relationship is fundamental to a point intended to be made in this paper, it may be worth-while to briefly review the applicable statutes.

Many states have so-called "check collection statutes" setting forth certain presumptions governing the relationships of parties to a check, the maker and the payee (McGoldrick Lumber Company v. Farmers Lumber Company, supra) and spelling out some of the obligations of the bank handling checks. Such a statute appears at Section 6-0368 of the North Dakota Revised Code, and it may be worth the reader's while to carefully examine it at this time. It is important that the reader remember the language of the statute that "the bank and every other agency through whose hands such instrument or the proceeds thereof shall pass shall be charged with ordinary business care and shall be liable for any loss thereof . . . and the owner or depositor of such instrument shall have a cause of action directly against such bank, or other agency, for his damage or loss on account of its default or lack of ordinary business care."

Section 6-0368 of the North Dakota Revised Code provides that the bank "shall not be liable to the owner or depositor until actual final payment is received by the collection" of a check and "the depositor, endorser, guarantor or surety of any check, draft, or other instrument so received, endorsed, cashed or credited shall be liable to the bank to the extent of any money paid out or given by it on account of such instrument."

Consistent with the obligations thus spelled out, banks in North Dakota require that their depositors enter into certain "deposit agreements." These agreements often make reference to this statutory provision and not unusually they are incorporated in the "signature card" or in some other writing concerned with establishment relationships between the depositor and his bank. Some typical agreements follow:

"In receiving items for deposit or collection, this bank acts only as depositors' collecting agent and assumes no responsibility beyond the exercise of due care. All items are credited subject to final payment in cash or solvent credits. This bank will not be liable for default or negligence of its duly selected correspondents nor for losses in transit, and each correspondent so selected shall not be liable except for its own negligence. This bank or its correspondents may send items, directly or indirectly, to any bank, including the payor, and accept its draft or credit as conditional payment in lieu of cash; it may charge back any item at any time before final payment, whether returned or not, also any item drawn on this bank not good at close of business on day deposited." or,

"Any item cashed, received for application on an obligation, or for collection or deposit and credit will be accepted by this bank subject to the provisions of Chapter 92, 1927 Session Laws of North Dakota. (6-0368 NDRC) This bank may also charge back any item drawn on this bank not good at close of business of day deposited."

This obligation of an agent to his principal is set forth in detail in Title 3 of the North Dakota Revised Code.

"Agency is the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control and consent by the other so to act." Restatement, Agency, Section 1.

"In the exercise of good faith and diligency it is the duty of the agent to use reasonable effort to keep his principal informed of all facts that may come to the agent's knowledge concerning matters that have been intrusted to him which affect the principal's business, his rights, or his interests, or which he would desire to know and which can be communicated without violating a superior duty owing to a third person." 2 AM Jur, Sec. 269.

As an agent a bank becomes the trustee of its principal.

"Everyone who voluntarily assumes a relation of personal confidence with another is deemed a trustee within the meaning of this chapter not only as to the person who reposes such confidence, but as to all persons of whose affairs he thus acquires information which was given to such persons in the like con-

fidence, or over whose affairs he, by such confidence, obtains any control." 59-0108 NDRC.

"In all matters connected with his trust, a trustee is bound to act in the highest good faith toward his beneficiary and may not obtain any advantage therein over the latter by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind." 59-0109 NDRC.

"Neither a trustee nor any of his agents may take part in any transaction concerning the trust in which he or anyone for whom he acts as agent has an interest, present or contingent, adverse to that of his beneficiary except as follows:

1. "When the beneficiary, having capacity to contract, with a full knowledge of the motives of the trustee and of all other facts concerning the transaction which might affect his own decision and without the use of any influence on the part of the trustee, permits him to do so;
2. "When the beneficiary, not having power to contract, the district court upon the like information of the facts, grants the like permission; or
3. "When some of the beneficiaries having capacity to contract and some not having it, the former grant permission for themselves and the district court for the latter in the manner above prescribed." 59-0111 NDRC.

"An agent, in dealing with the principal on his own account in regard to a subject matter as to which he is employed, is subject to a duty to deal fairly with the principal and to communicate to him all material facts in connection with the transaction of which he has notice, unless the principal has manifested that he knows such facts or that he does not care to know of them." Restatement Agency, Sec. 390.

"An agent who acts for adverse principals in a transaction is subject to a duty to act with fairness to each, and to disclose to each all facts which he knows or should know would reasonably affect the judgment of each in permitting such dual agency, except as to a principal who has manifested that he knows of such facts or that he does not care to know of them." Restatement, Agency, Sec. 392.

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It is now apparent that the Second National Bank of Grand Forks and the Fourth National Bank of Minneapolis are the agents of the Frederick Hotel. It is apparent that they are obligated as banks to use at least "ordinary business care," and as trustees to conduct themselves with utmost good faith in the discharge of their obligations to the Frederick Hotel, their beneficiary.

It is also apparent now that the bank-agent-trustees have

failed to discharge their obligations. They had within their knowledge a means of collecting Mr. John Lawyer's check according to its tenor by the use of the Bank of North Dakota. They elected, because of *custom,* not to use that means. They elected to disregard their obligations established by *law* in favor of the *custom* established in banking.

Customs, no matter how well established in the banking world, are not binding on persons doing business with banks without specific knowledge of the customs, unless they are "so general and well known in the community as to give rise to a presumption of such knowledge." (Smith v. National Bank of D. O. Mills & Co. (CCA) 191 F. 226.)

The face of the transaction would seem to indicate that the bank owed "ordinary business care" to its payee-depositor. That care would call for the collection of the *face amount of the check* in the most expenditious manner possible. (Federal Reserve Bank of Atlanta v. Malloy, 68 L. Ed. 617, 264 U. S. 160). The bank-agent could not without notice to the hotel arbitrarily elect to accept less than the face amount of the check from the drawee bank, even if it was impelled to do so by reasons it thought to be in the interest of the Frederick Hotel. But if we find that, so that it might benefit, the bank elected to collect less than the face amount of the check, it is held not to the use of the "ordinary business care" of the check collection statute but to the high duty of a trustee to its beneficiary. But the relationship of the Second National Bank of Grand Forks with the Fourth National Bank of Minneapolis does not need to be considered in the solution of our hypothetical case, for we have already observed that, without regard to the accrual of any direct benefits to itself, the Grand Forks bank had at its disposal an established method of check collection through which it could have realized "par" for its principal and which it failed to utilize, the statutory collection facilities of the Bank of North Dakota.

The reader will at this point be curious as to the legal implications that would have arisen had the Second National Bank of Grand Forks actually been the "correspondent" of the First State Bank of Tuttle. Suppose that at the time the Frederick Hotel deposited the check, unbeknownst to it the Second National Bank of Grand Forks had in its coffer a substantial sum of money which it was holding on deposit for

the First State Bank of Tuttle. A question immediately arises as to whether there is any "adverse interest" inherent in such a deposit which should be disclosed to the Frederick Hotel.

By statute national banks and other members of the Federal Reserve System are prohibited from paying interest on "demand deposits" of other banks. (12 USCA 371a). However, if the Second National Bank of Grand Forks could find a reason for it, it might be able to induce the First State Bank of Tuttle to deposit with the Second National Bank a substantial sum of money, say, $100,000, without paying any interest on it. There are many reasons advanced by correspondent banks for such deposits but the one pertinent to this paper which is inherent in banking *custom,* even if not expressed between bankers, has to do with the collection of checks drawn on the country bank.

It would certainly be to the interest of the First State Bank of Tuttle to place its reserve funds, i.e., funds which must be kept available at all times, in some place where they might produce at least some income. Quite without regard to the interest of the Frederick Hotel or other of its potential payee-depositors it would seem to be to the interest of the First State Bank of Tuttle to leave $100,000 with a neighboring correspondent bank if it was understood *between the banks* that as a matter of *custom* checks which came into the hands of the correspondent bank for collection would be sent, *not to the Bank of North Dakota through which payment would have to be in full or "at par," but rather directly to Tuttle.* If such an arrangement were to exist, it would seem that the Second National Bank of Grand Forks had not discharged its statutory obligation to its principal when it failed to notify the Frederick Hotel that, for its own benefit, i.e., the use of $100,000 of interest free funds, it would be unable to collect from the State Bank of Tuttle the full amount given to the principal by the debtor, Mr. John Lawyer!

CONCLUSION

In conclusion it should be said with emphasis that many North Dakota banks have broken the bonds of custom and in the collection of checks are serving their depositors to their fullest ability. Other North Dakota banks have expressed an unwillingness to depart from the *customary* method of check collection unless they are presented with written or oral de-

mands by their deposits. Still other North Dakota banks, apparently without knowledge of their legal obligations to their depositors, refuse to respect specific instructions that items drawn on so-called non-par banks in North Dakota be collected at par.

Lest the reader think that this article is intended to present a controversial question under the guise of self-serving arguments, it should be kept in mind that of the more than 14,000 banks in the United States, only about 2,000 still "charge exchange" by one device or another. Of those 2,000 banks, more than 650 are located in the Ninth Federal Reserve District centering on Minneapolis. The balance are generally in the "Deep South," Alabama, Florida, Georgia, Louisiana, Missouri, North Carolina, South Carolina, Tennessee, and Texas.

In testifying before the Committee on Banking and Currency of the United States Senate, R. E. Gormley, a southern banker of national reputation, when questioned by Senator Taft, said, "That has been the custom in the past. We were not responsible for it." (Senate Hearings, P. 15).* SENATOR TAFT: "Why don't your customers who keep money in your bank pay the exchange charges themselves?" MR. GORMLEY: "It is simply because it has been the custom that has existed with us for fifty years to do it the other way. That is our answer." (Senate Hearings, P. 17).

The practice of charging "exchange" which the Supreme Court of Nebraska has termed "an unjust exaction" (Placek v. Edtrom, 26 N. W. 2nd 489, which see for a full discussion of "exchange") is used by some 90 banks in North Dakota only because they along with other banks in the state do not fully understand their legal obligation to their depositors to collect "at par" *if they know how.* Bankers are often bound by custom and when approached on the subject they seem inclined to say with Mr. Gormley, "It is simply because it has been the *custom* that has existed with us for fifty years to do it the other way. That is our answer!"

* Hearing before Committees on Banking and Currency, House of Representatives and United States Senate, 78th Congress, on HR 3956 and S 1642 hereafter referred to as Senate Hearings and House Hearings, United States Government Printing Office, Washington, 1945.