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IN A CASHLESS SOCIETY: WHAT HAPPENS WHEN THERE IS A MISTAKE?

*Respectfully Submitted
by Ryan Mattson*

Introduction	1
I. Background	6
A. Electronic Funds Transfer	7
1. Funds Transfers in General	7
2. The Specifics of Direct Deposits	11
B. Laws Regulating Direct Deposits	13
1. Federal Electronic Funds Transfer Act	13
2. Uniform Commercial Code Article 4A	17
II. Analysis	19
A. Inter-Financial Institution Direct Deposits	20
B. Intra-Financial Institution Direct Deposits	24
III. Conclusion	26

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INTRODUCTION

As corporate counsel for Widget Inc., you have been informed that John Smith's, one of Widget Inc.'s factory employees, \$942.31 pay check was accidentally direct deposited into the wrong account. It seems that Mr. Smith when completing the direct deposit sign-up form, mistakenly gave his bank account number as 14504698 instead of the correct number of 14504689. As a result, Mr. Smith's next check was deposited into account 14504698, an account belonging to an unknown person. To complicate matters this unknown person withdrew the \$942 before the mistake was discovered and refused to return the money despite receiving notice of the error from the bank. Additionally, the bank refused to release the identity of this unintended beneficiary and took the position that this is a loss situation for Widget Inc.

So as corporate counsel for Widget Inc. what course of action do you take? Considering the small amount of money at stake, this problem likely will not make it to the top of your priority list. In fact, you may be content with advising the

payroll department to reissue the employee's pay and to write the loss off. Although on the other hand, you might realize the importance of understanding the company's rights and obligations in this type situation. After all, a similar mistake may happen in the future, and what if next time the CEO's pay, versus a factor worker's pay, is deposited in the wrong account? Such a mistake could involve \$20,000 to \$30,000, certainly an amount of money worth considering. So you decide to look into the matter, surely the law on this issue is relatively straight forward, right?

To your surprise you discover there is no comprehensive body of law defining the rights and obligations that arise from consumer related electronic funds transfer such as a direct deposit. While some aspects of consumer related electronic funds transfers are governed by the federal Electronic Fund Transfer Act and Regulation E,¹ this particular issue is not. States often have their own EFT legislation, although this legislation also fails to address the current issue.² The Uniform Commercial Code's newly formulated Article 4A is a comprehensive body of law regulating funds transfers; however,

¹ See 15 U.S.C. § 1693 and 12 C.F.R. § 205.

² See, e.g., Michigan Electronic Fund Transfer Act, Mich. Comp. Laws Ann. § 488.1 (West 1998).

Article 4A does not apply to consumer related transactions such as direct deposits.³ Case law is also of little help. Although there are a few funds transfer cases addressing liability issues that arise when a payment order misdescribes the beneficiary, there is a problem with these cases in that they deal with wholesale wire transfers versus consumer electronic funds transfers such as direct deposits.⁴ This distinction is crucial because the issue of a misdescribed beneficiary in a wholesale wire transfer is clearly resolved by the newly formulated Article 4A⁵ and, as such, the pre-Article 4A wholesale wire cases now represent outdated law. This leaves you with the question what law does apply?

a analogy?

Logically from an employer's or a financial institution's planning perspective it makes sense to consider the liability issue as between the parties with the deepest pockets - i.e., the employer and the employer's financial institution. It is probably safe to assume that the employer will issue another payroll deposit to the employee but this time to the correct

³ See U.C.C. Funds Transfers Art. 4A Prefatory Note. ("If any part of a funds transfer is covered by EFTA, the entire funds transfer is excluded from Article 4A.").

⁴ See *infra* Part II.B.

⁵ See § 4A-207 U.C.C.

account.⁶ If this assumption is correct, the employer will have incurred damages for the extra payroll. And thus, the question from the employer's point of view is who, if anyone, is liable to the employer for these damages? It is relatively clear that the unintended beneficiary would be primarily liable to the employer.⁷ However, it is important to consider whether the employer's financial institution would be secondarily liable because problems could arise with collection. For starters the identity of the unintended beneficiary is unknown to the employer and there is a strong likelihood that the financial institution will for privacy reasons refuse to release the

⁶ This assumption is based on common sense reasoning. If the employer is attempting to encourage its employees to sign up for direct deposit, the employer will want to avoid a perception among its employees that direct deposits are unsafe. As such, to avoid having direct deposit horror stories floating around, the employer will have a strong incentive to quickly resolve the mistake in favor of the employee. The issues raised if the employer does not reissue the employees pay are outside of the scope of this paper.

⁷ See, e.g., *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Arcturus Builders Inc.*, 552 N.Y.S.2d 287 (1990).

identity of the unintended beneficiary.⁸ Even if the employer obtains the identity of the unintended beneficiary, collection could be hindered by other factors such as bankruptcy. Therefore, it is important for the employer to understand its rights and obligations against the financial institution and it is this issue that this paper addressed by this paper.

Specifically, this paper discusses the following issue: as between the employer's financial institution and the employer, who should bear the risk of loss for the misdescription of beneficiary mistake? This issue is framed in the context of the hypothetical set forth in the introductory paragraph of this paper and assumes there is no governing contractual provision.

The paper consists of three sections. The first section reviews some background information by explaining how an electronic funds transfer works in general and specifically how a direct deposit works. Additionally, the background introduces the current laws regulating direct deposits. Next the Analysis section explains the legal issues raised and predicts how a

⁸ See, e.g., *Taylor v. Nationsbank N.A.*, 738 A.2d 893 (Md. Ct. Spec. App.1999), cert. Granted, 745 A.2d 426 (Md. Feb. 9, 2000) (charging a bank with invasion of privacy for releasing the name and phone number of a depositor in order to resolve an errant transfer).

court might decide those issue under current law. The comment concludes by suggesting some recommendations for how contractual agreements and/or legislation can clarify the uncertainty of this area of the law.

I. BACKGROUND

There are many ways that payment can be achieved. In a primitive society payment is likely to be accomplished through bartering or trading. Other more efficient forms of payment use cash, checks, or credit cards. Over the last couple of decades businesses, consumers and even certain government agencies have increasingly recognized the benefit of transacting business through another type of payment method - electronic funds transfers ("EFTs"). Funds transfers are similar to checks in that both methods of payment result in the transfer of money from one depository account to another, although funds transfers are distinguished because they do not require the presentment of a check.⁹ Accordingly, EFTs are a faster and less expensive form of payment. Additionally, funds transfers and checks are governed by different laws. Checks by Articles 3 and 4 of the Uniform Commercial Code and funds transfers are governed by

⁹ See UCC §§ 4-101, 4-102(2).

different laws depending on various factors such as what transfer system was used.¹⁰

To give legal advice on a particular transaction it is helpful, if not necessary, for an attorney to understand exactly how the transaction in issue works. For this reason, the background section of this paper begins by discussing what an electronic funds transfer is and how it is carried out. Next, a summary of the different laws regulating direct deposits is given.

A. Electronic Funds Transfer

1. Funds Transfers in General

Conceptually the process of a funds transfer is not difficult to understand. A "funds transfer" is a transfer of a bank credit pursuant to a payment order.¹¹ And, an electronic funds transfer is a funds transfer where the payment

¹⁰ See *infra* I.B.

¹¹ See MODEL ELECTRONIC PAYMENTS AGREEMENT AND COMMENTARY (FOR DOMESTIC CREDIT TRANSFERS) 2 (Prepared by the EDI and Information Technology Division of the Section of Science and Technology of the American Bar Association, 1996).

instructions are electronically communicated.¹² The EFT transaction begins when then "originator" of the transfer communicates payment instructions to her financial institution.¹³ In the payment instructions the originator tells her financial institution how much money to transfer from her account, to what account she wants the money transferred to, and when the transfer should take place.¹⁴ The originator's financial institution then takes the necessary steps to accomplish the transfer in accordance with the payment instructions.¹⁵ What steps the financial institution takes depend on various factors. For instances, in the case of an intra-institution transfer the

¹² See *id.*

¹³ See *id.*

¹⁴ See *id.* Note there are two fundamental categories of EFT transactions - credit transfers and debit transfers. See *id.* "A credit transfer is one in which the originator instructs its bank (via a payment order) to transfer funds belonging to the originator for credit to the beneficiary's account." *Id.* A direct deposit is a credit transfer. See *id.* "A debit transfer is one in which the originator instructs its bank (via a payment order) to collect funds on behalf of the originator by debiting another party's account at the other party's bank." *Id.*

¹⁵ See *id.* at 8.

financial institution can accomplish the transfer with a mere bookkeeping entry by debiting the originator's account and crediting the beneficiary's account.¹⁶ If the originator instructs her financial institution to transfer funds to an account located in a different financial institution, then the originator's financial institution will generally use a funds-transfer system to communicate the payment instructions to the beneficiary's financial institution.¹⁷

In the United States there are several different funds-transfer systems.¹⁸ The Automated Clearing House ("ACH") network is the transfer system that is ordinarily used to carry out consumer related EFTs such as direct deposits, point-of-sale transactions, automated teller machine transaction, etc.¹⁹ The ACH network system was designed to reduce the use of paper checks for making routine payments such as payroll checks, mortgage payments, etc.²⁰ ACH payments are governed by rules promulgated by the National Automated Clearing House Association

¹⁶ See *id.*

¹⁷ See *id.*

¹⁸ See *id.* at 9.

¹⁹ See NATIONAL AUTOMATED CLEARING HOUSE ASSOC., ACH RULES CORP. ED., Operating Guidelines, Section 1 (2000).

²⁰ See *id.*

("NACHA").²¹ NACHA's membership consists of representatives from each of the forty regional ACH associations in the United States.²² All of the institutions in the ACH associations must be depository institutions which include: commercial banks, savings banks, savings and loan associations, U.S. branches of foreign banks, Edge Act corporations, and credit unions.²³ Currently there are over 25,000 financial institutions participating in the ACH network.²⁴

In addition to the ACH system there are several other funds transfer systems used in the United States.²⁵ The two systems that transfer the largest amount of funds are Fedwire and the Clearing House Interbank Payment System ("CHIPS"). These systems generally do not involve consumer transfers, rather they typically process commercially related transfers between

²¹ See *id.*

²² See *id.*

²³ See *id.*

²⁴ See MODEL ELECTRONIC PAYMENTS AGREEMENT AND COMMENTARY (FOR DOMESTIC CREDIT TRANSFERS) 8 n. 29 (Prepared by the EDI and Information Technology Division of the Section of Science and Technology of the American Bar Association, 1996).

²⁵ See *id.* at 8-9.

businesses or financial institutions.²⁶ Fedwire is the funds transfer system developed and maintained by the Federal Reserve System.²⁷ The system is made up of federal reserve banks and branches, the Treasury and other government agencies, and more than 9,000 on-line and off-line depository institutions.²⁸ CHIPS is the world's largest private-sector electronic funds transfer network, processing almost \$1 trillion in transfers per day.²⁹ Most CHIPS transfers result from international transactions.³⁰

2. The Specifics of Direct Deposits

An employer using a direct deposit payment system typically creates a computer file of payment instructions for each payroll period.³¹ The payment instructions include the employees' names, routing and account information, amount to be credited to their

²⁶ See *id.*

²⁷ See *id.*

²⁸ See *id.*

²⁹ See *id.*

³⁰ See *id.*

³¹ See NATIONAL AUTOMATED CLEARING HOUSE ASSOC., ACH RULES CORP. ED., *Operating Guidelines*, Section 1 (2000).

account, and the date the transfer is to take place.³² The employer delivers the file to its financial institution, and the financial institution, in turn, credits the local accounts of the employees within the financial institution.³³ The employer's financial institution then creates a new computer file with the payment instructions for all of the employees who have accounts at different financial institutions and delivers this file to its ACH association.³⁴ The ACH sorts the payment instructions received from all of its customers, including the employer's financial institution, and then creates a separate output file for each financial institution within its association, and delivers the output files to the depository institutions electronically.³⁵ The ACH then posts the net amount for each of the financial institutions to its account.³⁶ Each respective financial institution processes the file and posts the

³² See *id.*

³³ See *id.*

³⁴ See *id.*

³⁵ See *id.* The computer file sent to the ACH association would likely contain direct deposit payment instructions for all of the financial institution's customers not just the instructions for the one employer.

³⁶ See *id.*

individual entries to the accounts of its customers.³⁷ The end result is that the employer's account is debited for the amount of the payroll and each of the employees' accounts are credited for the amount of their respective pay.

B. Laws Regulating Direct Deposits

1. *Federal Electronic Funds Transfer Act & Regulation E*

The Electronic Fund Transfer Act ("EFTA") was enacted for the purpose of "provid[ing] a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems," and its primary objective "is the provision of individual consumer rights."³⁸ The Act's purposes are carried out by Regulation E which is promulgated by the Board of Governors of the Federal Reserve System.³⁹

The EFTA sets forth error resolution procedures designed to protect consumers from errors that occur during the process of an electronic funds transfer.⁴⁰ While direct deposits come

³⁷ See *id.*

³⁸ Electronic Fund Transfers Act, 15 U.S.C. § 1693(b) (1997).

³⁹ See *id.* § 1693b; see also 12 C.F.R. § 205.1.

⁴⁰ See *id.* § 1693f.

within the scope of the Act's error resolution procedures,⁴¹ the type of mistake in the current misdescription of beneficiary issue is not covered by the Act for two reasons. First, the liability question as between the employer and the employer's financial institution does not involve a consumer.⁴² The EFTA's error resolution procedures only apply to consumers which are defined as "a natural person[s]."⁴³ Since the employer as described in the introductory hypothetical of this paper is a

⁴¹ See, e.g., *id.* § 1693e (requiring that consumers give written authorization for direct deposits); *id.* § 1693a(6) (explicitly including direct deposits in the definition of EFTs). The EFTA defines "electronic fund transfer" as follows:

(6) the term "electronic fund transfer" means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but is not limited to, point-of-sale transfers, automated teller machine transactions, *direct deposits* or withdrawals of funds, and transfers initiated by telephone. *Id.* (emphasis supplied).

⁴² See, e.g., *Shawmut Worcester County Bank v. First Am. Bank*, 731 F. Supp. 57, 61 (D. Mass. 1990) (holding that the EFTA's error resolution procedures only protect consumers not corporations).

⁴³ 15 U.S.C. § 1693a(5).

What about subrogation?

corporation, it is not entitled to invoke the error resolution procedures set forth in the EFTA.⁴⁴ However, even if a consumer was involved, as would be the case if considering the liability issue from the employee's point of view, the EFTA would still be of no help for the current issue. To illustrate, first consider what would happen if the employee invoked the error resolution procedure in the current situation.

To invoke the error resolution procedure the employee would need to give its financial institution oral or written notice of the fact that he did not receive his directly deposited paycheck.⁴⁵ The notice would have to be given within 60 days after he received his bank statement which revealed the fact that he did not receive his paycheck.⁴⁶ After receiving notice, the consumer's financial institution would be required to investigate the alleged error, determine if an error has in fact occurred, and report or mail the results of the investigation and its determination to the employee within 10 business days.⁴⁷ If the financial institution determines that an error did occur, it must promptly, but in no event more than one business day

⁴⁴ See *id.* § 1693(f).

⁴⁵ See *id.*

⁴⁶ See *id.*

⁴⁷ See *id.*

after the determination, correct the error.⁴⁸ However, there is an exception. The financial institution could in lieu of the above-described procedures, provisionally recredit the employee's account for the amount alleged to be in error.⁴⁹ The provisional credit would have to be done within 10 business days after receiving notice of the alleged error.⁵⁰ The financial institution would then have 45 days from the time of the employee's notice to complete its investigation and its determination if an error has occurred.⁵¹ Where the financial institution determines that an error did not occur, it must deliver or mail to the employee an explanation of its findings within 3 business days after the conclusion of its investigation.⁵²

Consider how this procedure would apply to the facts set forth in the introductory hypothetical of this paper. After conducting the investigation the employee's financial would come to the conclusion that the mistake resulting in the errant transfer was not due to the financial institution's fault. The

⁴⁸ See *id.*

⁴⁹ See *id.*

⁵⁰ See *id.*

⁵¹ See *id.*

⁵² See *id.*

financial institution will correctly claim that it completed its duty of processing the payment order received from its customer, the employer.⁵³ When looking to the legislative history of the EFTA it is clear that Congress did not intend for the Act to deal with this type of problem.⁵⁴

2. *Uniform Commercial Code Article 4A*

Article 4A is the first comprehensive body of law designed to regulate funds transfers.⁵⁵ Article 4A was approved in 1989 by the National Conference of Commissioners on Uniform State Laws and the American Law Institute, and as of July 1994 Article 4A had been enacted by forty-nine states and the District of

⁵³ See e.g., *Shawmut Worcester*, 731 F. Supp. at 61.

⁵⁴ See generally EFT AND THE PUBLIC INTEREST, A REPORT OF THE NATIONAL COMMISSION ON ELECTRONIC FUND TRANSFERS (1979).

⁵⁵ See U.C.C. Art. 4A (1997). Article 4A was approved in 1989 by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. See MODEL FUNDS TRANSFER SERVICES AGREEMENT AND COMMENTARY 1 (Prepared by the Business Law Section of the American Bar Association, 1994). As of July 1994, UCC 4A had been enacted by forty-nine states and the District of Columbia. See *Id.*

Columbia.⁵⁶ Prior to Article 4A the laws that governed wire transfers were non-uniform and incomplete. This drafters of Article 4A noted that:

There is no comprehensive body of law that defines the rights and obligations that arise from wire transfers. Some aspects of wire transfers are governed by the rules of the principal transfer systems. . . . But the funds-transfer system rules apply to only limited aspects of wire transfers. The resolution of the many issues that are not covered by the funds-transfer system rules depends on contracts of the parties, to the extent they exist, or principles of law applicable to other payment mechanisms that might be applied by analogy.⁵⁷

Article 4A is comprehensive and it establishes default rules for situations that are not governed by contracts, transfer system rules, or other federal or state laws.⁵⁸ While Article 4A is a very sophisticated and impressive body of law, it leaves the door open on some EFT issues such as consumer related EFTs and it does not cover debit EFTs.⁵⁹ Article 4A does not cover an EFT "[i]f any part of a funds transfer is covered by EFTA, the entire funds transfer is excluded from Article

⁵⁶ See MODEL FUNDS TRANSFER SERVICES AGREEMENT AND COMMENTARY 1 (Prepared by the Business Law Section of the American Bar Association, 1994).

⁵⁷ U.C.C. Art. 4A Prefatory Note.

⁵⁸ See *id.*

⁵⁹ See *id.*

4A."⁶⁰ The primary focus of Article 4A is on what it calls "wholesale wire transfers."⁶¹ The drafters of Article 4A explain that wholesale wire transfers are almost always between businesses or financial institutions and such transfers involve large amounts of money.⁶² The wire transfers that come within Article 4A's scope are generally carried out through Fedwire or the New York Clearing House Interbank Payments Systems ("CHIPS").⁶³

II. ANALYSIS

As between the employer's financial institution and the employer who should bear the risk of loss for the misdescription of the beneficiary mistake?⁶⁴ To answer this issue the threshold question is whether the employer and the employee belong to the same financial institution. If the employer and the employee belong to separate financial institutions, then the employer's financial institution would use an ACH association to accomplish

⁶⁰ See *id.*

⁶¹ See *id.*

⁶² See *id.*

⁶³ See *id.*

⁶⁴ See *supra* p. 2.

the direct deposit. As such, the National Automated Clearing House Association ("NACHA") Operating Rules would govern the transaction - this analysis is discussed under section A below. However, if the direct deposit only required a transfer from the employer's account to an account within the same financial institution, the question of what law would apply is more difficult to determine - this analysis is discussed under section B below.

A. Inter-Financial Institution Direct Deposits

The National Automated Clearing House Association has established uniform rules governing, among other things, direct deposits processed through the ACH network.⁶⁵ Section 2.1.1 of the NACHA Operating Rules requires that before an originator initiates its first direct deposit through the ACH network, the originator must enter into a contractual agreement with its financial institution under which the originator agrees to be bound by the NACHA Operating Rules.⁶⁶ For direct deposits the originator is the employer who is directing the transfer of

⁶⁵ NATIONAL AUTOMATED CLEARING HOUSE ASSOC., ACH RULES CORP. ED., OPERATING RULES Art. 2 § 2.1.1 (2000).

⁶⁶ See *id.*

funds to the employee's account.⁶⁷ Thus, before the employer begins its direct deposit program, it must enter into an contractual agreement with its financial institution which would, among other things, bind the employer to the NACHA Operating Rules.⁶⁸ The NACHA has published a sample contractual agreement intended to serve as the basis for the required contract between the employer who wants to set up a direct deposit program and the employer's financial institution.⁶⁹

Section 15 of the NACHA's sample agreement would govern the present issue, if adopted. This provision is entitled "Inconsistency of Name And Account Number" and reads as follows:

Company acknowledges and agrees that, if an Entry describes the Receiver inconsistently by name and account number, payment of the Entry transmitted by Financial Institution to the Receiving Depository Financial Institution may be made by the Receiving Depository Financial Institution (or by Financial Institution in the case of an On-Us Entry) on the basis of the account number supplied by the Company, even if it identifies a person different from the named Receiver, and that Company's obligation to pay

⁶⁷ See *id.* § 13.1.30 (defining the term "Originator").

⁶⁸ Since the NACHA Operating Rules only govern interbank transfers, this requirement would not apply to intrabank direct deposits.

⁶⁹ See NATIONAL AUTOMATED CLEARING HOUSE ASSOC., ACH RULES CORP. ED. Operating Guidelines, Section II - Participant Relationships, Ch. 1 -- Originators.

the amount of the Entry to the Financial Institution is not excused in such circumstances.⁷⁰

For purposes of an analysis, consider how this rule would apply to Widget Inc.'s scenario as explained in the introductory hypothetical of this paper. First, assume that Widget Inc. and its financial institution adopted section 15 and that Widget's employee did not belong to Widget's financial institution. Applying section 15 it is clear on the face of the contract that Widget has no claim against its financial institution for the direct deposit error. And taking this analysis one step further, the NACHA Operating Rules provide that Widget would have no claim against the ACH association that processed the transfer nor would Widget have a claim against the receiving financial institution.⁷¹ Under the NACHA Operating Rules, however, Widget as the originator of the direct deposit could seek a reversal of the erroneously deposited pay.⁷² However,

⁷⁰ See *id.*

⁷¹ See *id.*

⁷² See generally NATIONAL AUTOMATED CLEARING HOUSE ASSOC., ACH RULES CORP. ED. Art. 2 § 2.5. "The reversing entry must be transmitted to the Receiving ACH Operator in such time as to be transmitted or made available to the [Receiving Depository Financial Institution] by midnight of the fifth banking day following the Settlement Date of the erroneous entry." *Id.* § 2.5.1.

this remedy will only work if the mistake is discovered within five days of the settlement date of the erroneous deposit,⁷³ and assuming that the unintended beneficiary did not withdraw the money or, if the money was withdrawn, nonetheless still has sufficient funds in his or her account to initiate the reversal. If a reversal action is not possible, as is the case in the introductory hypothetical of this paper, then Widget's only remedy would be against the unintended beneficiary of the transfer.

Of course the employer and its financial institution would not be required to adopt section 15 as provided in the NACHA's sample agreement. The only requirement is that the contract bind the employer to the NACHA Operating Rules for transactions using the ACH network originated by the employer.⁷⁴ It is unlikely though that section 15 would be a provision that the financial institution and the company instituting the direct deposit would want to omit or alter. The financial institution should be allowed to rely on the account number stated in the payment instructions within the direct deposit file generated by the employer. The simple reason for this is that the employer's financial institution would have no easy way of verifying that

⁷³ See *id.*

⁷⁴ See *id.* § 2.1.1.

the names and account numbers match when for the employees are not depositors within its institution. Thus, it is likely that section 15 or a substantially similar provision will find its way into the ACH agreements between employers using direct deposits and the employers' financial institutions.

B. Intra-Financial Institution Direct Deposits

What happens if the errant direct deposit did not use the ACH network because the employer and the unintended beneficiary had accounts within the same financial institution? With respect to occupational credit unions it is very common for an employer and its employees to do business with the same credit union. There would be a good chance that the employer and its financial institution would have a contractual agreement providing for who should bear the risk of the type of mistake discussed in the introductory hypothetical of this paper. However, if there is no contractual agreement, the issue of controlling law raises some interesting questions.

As explained in the Background section of this paper the Electronic Fund Transfer Act would not apply to the misdescription of beneficiary error.⁷⁵ Article 4A of the Uniform

⁷⁵ See *infra* I.B.

Commercial Code does not control consumer direct deposit transactions.⁷⁶ There are a few pre-Article 4A wire transfers cases that are somewhat analogous to the present issue. Note that these cases have been superceded by Article 4A. Nonetheless if the current issue were to come in front of a court today, the logic used in the analogous pre-Article 4A cases would likely serve as a starting point in the court's analysis. It is important to observe that the pre-Article 4A cases that will be discussed involved wholesale wire transfers which are distinguishable from the present issue involving a direct deposit.⁷⁷ While wholesale wire transfers and direct deposits are carried out in the same way,⁷⁸ distinguishing between the two is important because wholesale wire transfers are specifically governed by Article 4A but direct deposit transaction are not.⁷⁹

Despite the fact that the case law deals with wholesale wire transfer, they are still relevant for two reasons. First, both the cases and the present scenario involve funds transfers. They are analogous in that they both involve transferring money

⁷⁶ cite, quote and *see infra*

⁷⁷ See prefatory notes of U.C.C. Art. 4A.

⁷⁸ See *id.*

⁷⁹ See *supra* I.B.

from one depository account to another pursuant to a payment order. Secondly, the courts in these earlier cases were faced with a similar scenario that a court today deciding the present issue would be in. Prior to the adoption of Article 4A, when these earlier cases were decided, there was no comprehensive body of law governing funds transfers. Those courts were divided on how to resolve the misdescription of beneficiary errors. Several courts resolved the error by applying traditional common law principles negligence. And other courts opined that common law principles were inappropriate and thus applied by analogy the laws relating to check collection.

III. CONCLUSION

From a planning perspective it is very important for a company to understand all of its rights and obligations that it has when entering into a direct deposit system. Since currently there is not an established comprehensive legal framework governing direct deposits, contractual provisions become very important. Companies should use the sample contract issued by the NACHA as a starting point for developing a contract with its financial institution that provides for certain outcomes for errors that could occur in the direct deposit context.