Banking Setoff--A Study in Commercial Obsolescence

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BANKING SETOFF:
A STUDY IN COMMERCIAL OBSCOLENCE

If a depositor with any bank also uses a credit card of the bank, the bank has the right to debit his account for any indebtedness incurred on the credit card account without prior warning and whether or not the depositor agreed thereto in advance. Under existing law, this right is known as a banker's right of setoff. Although the principle is derived from equitable and statutory setoff doctrines under which the mutual demands or obligations are deemed compensated insofar as they equal each other, banking setoff is different in that it involves the special relationship of bank and depositor and the practice of debiting the latter's demand deposit without his consent.

Because of a recent and notable increase in consumer legislation and the expanding protection of procedural due process, the banking setoff procedure is ripe for re-evaluation. For example, The Consumer Credit Protection Act of 1968 is designed to require forewarning before setoff. Similarly, principles of prior notice and a hearing based on Snedach v Family Finance Corp. are designed to prevent the deprivation of a significant property interest without compliance with constitutional safeguards.

This note will illustrate how the equitable principle upon which setoff is based has been lost in the inequitable practice by examining the growth and present status of banking setoff, including current abuses of the practice. It will conclude with an analysis of the setoff practice in light of consumer legislation and the constitutional protection afforded by the due process clause of the Fourteenth Amendment as interpreted in Snedach and later related decisions.

2. See note 45 & accompanying text infra.
3. "Nothing before has quite equaled this rush to respond to the needs, desires and grievances of the buying public. In federal agencies alone, there are an estimated 400 different consumer programs."
4. In just the last three years, Congress has passed a dozen major consumer laws. Pending in the House and Senate are some 150 similar bills, some of them sure to be voted into law this year." U.S. NEWS & WORLD REPORT, Feb. 2, 1970, at 44.
5. See notes 96-154 & accompanying text infra.
Banking Setoff in General

Banking setoff is an offshoot of the venerable banker's lien which arose as part of the law merchant and was absorbed into English common law. The general rule has evolved that a banker has a lien on all property in his possession that belongs to a customer for the balance due the bank from such customer in the ordinary course of business. The doctrine enjoys wide acceptance, with a majority of jurisdictions perpetuating it by judicial decision and a minority by statute. A


common example is the lien on commercial paper left with a bank by its customer for purposes of collection.\textsuperscript{10}

When the doctrine is applied to a general bank deposit, however, the lien is not a lien at all but what is termed "a right of setoff" based on general principles of equity. When a depositor opens a general account (demand deposit) with a bank, a debtor-creditor relationship is created. The bank has legal title to any money deposited and becomes indebted to the depositor in the amount of the deposit; the latter has a chose in action.\textsuperscript{11} That one cannot have a lien on his own property is self-evident.\textsuperscript{12} This syllogism is correct as far as it goes. At this point courts have determined that the bank has no security interest in the account because the requirements of a lien are not met. Instead of limiting banks to statutory setoff, the courts chose to allow the bank a right of setoff as part of the concept of the banker's lien. Thus, while the bank is the debtor of its customer, should the customer become similarly indebted to the bank, the latter has the right under this hybrid lien to debit the customer's account in satisfaction of his indebtedness to the bank. This procedure is accomplished without resort to formal judicial proceedings, legal or equitable.\textsuperscript{13} Moreover, the right exists apart from any setoff statute\textsuperscript{14} and operates automatically.

\begin{itemize}
\item § 45-808 (1948).
\item South Dakota: S.D. Compiled Laws Ann. § 44-11-11 (1967).
\item The Uniform Commercial Code includes a provision embodying the concept of the banker's lien as applied to the bank collection process. However, the official comment makes it clear that the section does not abrogate nor supplant the banker's lien, but merely extends its application. Uniform Commercial Code § 4-208, Comment 1.
\item 12. An ingenious, if not ingenuous, argument has been made that one can have a lien on his debt to another. 9 Harv. L. Rev. 146 (1895). However, the contention is based on the false premise that the genuine lien and a right of setoff have the same substantive effect. Yet it is clearly impossible, short of casuistic distinctions, to have a lien on one's own property. See generally 2 T. Michie, Banks and Banking § 136 (1913).
\item 14. Gonsalves v. Bank of America, 16 Cal. 2d 169, 173, 105 P.2d 118, 121 (1940). One authority offers this rationale for the rule: "[The right of set-off] is independent of the statute of set-off, because it is an equitable right of set-off arising
in those cases where it is applicable. Finally, by the majority view the right is exercisable unless the depositor objects prior to exercise. The depositor's prior consent is unnecessary.

Thus, banking setoff allows a bank in the position of creditor to rely on a security interest of which the customer is unaware. The practice of peremptorily debiting the customer's account before proof of his indebtedness to the bank is only one example of how banking setoff has diverged from the equitable principles on which it was ostensibly founded.

from the mutual dealings or transactions of the bank and the other party. Since it has been the custom for banks to deal with depositors and customers with the understanding and on the faith and expectation that a set-off shall be allowed, and since such dealings are generally understood to be part of the business of banking, courts of equity may the more readily find an implied contract when a bank is involved, than in other cases. After the implied contract is found, set-off will be allowed." Clark, Set-off in Cases of Immature Claims in Insolvency and Receivership, 34 HARY. L. REV. 178, 194 (1921). However, none of the California decisions make any reference to the rationale of an implied contract. But see Allen v. Bank of America, 58 Cal. App. 2d 124, 127, 136 P.2d 345, 347 (1943).

One court has noted that banking setoff also exists apart from any statutory banker's lien. Kasparek v. Liberty Nat'l Bank, 170 Okla. 207, 209, 39 P.2d 127, 129 (1935).


In an odd approach, the court in Gardner v. First Nat'l Bank, 10 Mont. 149, 25 P. 29 (1890) ignored the banker's lien entirely and held that the death of the depositor revoked the bank's power to setoff the depositor's indebtedness against his account, drawing an analogy between a bank's right of setoff and a power in trust.

18. There are an estimated 3.2 million BankAmericards in use in California, representing almost two million accounts. Approximately 44 percent of the card holders pay their monthly bill with Bank of America checks and another 15 percent pay in person at one of the bank's 997 branches. It is possible, therefore, that some 59 percent or almost 1.2 million holders of the BankAmericard also maintain general accounts with Bank of America. These accounts serve as additional collateral for the customer's indebtedness on the credit card and are subject to banking setoff upon default. Information courtesy of BankAmericard Administration Center, 1 So. Van Ness Ave., San Francisco, California.

For an interesting look at the charge account banker see 36 CONSUMER REPORTS 49 (1971).

19. There are, however, some restrictions imposed on the exercise of setoff. Since the indebtedness between the bank and depositor must be mutual, setoff will not be allowed where the account was opened for a special or limited purpose. Reynes v. Dumont, 130 U.S. 354 (1889); Smith v. Security Bank & Trust Co., 196 Ark. 685,
Illustrations of the Substantive Evil

The setoff of a customer's indebtedness without notice or regard to his protests, is probably the most common example of the inequity of the bank's right. There are, in addition, certain other benefits which accrue to the bank along with this right which are detrimental not only to its customer but to certain of the customer's other creditors. The following are a few examples.

Under the Federal Bankruptcy Act

Under the Bankruptcy Act the trustee of the bankrupt may avoid certain transfers by the bankrupt to a creditor if the transfer would give the creditor a preference over other creditors of the same class. A "preferential transfer" is defined as

[A] transfer . . . of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

Therefore, when an insolvent debtor deposits money in a bank within four months prior to the filing of a petition in bankruptcy, and the bank sets off the amount of the deposit in satisfaction of an antecedent obligation due the bank by the debtor, the bank should be considered as having a preference. Accordingly, it should be compelled to turn over the amount of the deposit and file a claim along with the other creditors of the depositor for its own pro rata dividend out of the estate assets. To allow setoff in such an instance will allow the bank

119 S.W.2d 556 (1938); Powell v. Bank of America, 53 Cal. App. 2d 458, 128 P.2d 123 (1942). But cf. Continental & Commercial Trust & Sav. Bank v. Chicago Title & Trust Co., 229 U.S. 435 (1913) (where small balance from a special deposit remained, bank was allowed setoff). Setoff will also be disallowed if the deposit is a trust account of which the bank had actual or constructive knowledge. Purdy v. Bank of America, 2 Cal. 2d 298, 40 P.2d 481 (1935). In addition, if the debt to the bank is yet unmatured, no setoff is allowed, American Sur. Co. v. Bank of Italy, 63 Cal. App. 149, 218 P. 466 (1923); Zollinger v. First Nat'l Bank, 126 Okla. 182, 259 P. 141 (1926), unless the indebted depositor is also insolvent. Norris v. Commercial Nat'l Bank, 231 Ala. 204, 163 So. 798 (1935); Barrios & Co. v. Indemnity Ins. Co., 101 Cal. App. 675, 282 P. 386 (1929); Parker v. First Nat'l Bank, 96 Okla. 70, 220 P. 39 (1923). An agreement by the depositor that the bank may setoff against an unmatured debt is binding. Brown v. Maguire's Real Estate Agency, 343 Mo. 336, 121 S.W.2d 754, (1938). 

22. Id. § 60(a)(1), 11 U.S.C. § 96(a)(1).
to obtain a greater percentage of its debts to the detriment of the insolvent depositor’s other creditors.

Nevertheless, the Bankruptcy Act does recognize and allow set-off under certain conditions. Setoff will be disallowed only if the transfer to the creditor claiming setoff was made within four months before filing of the petition and the creditor had knowledge that the bankrupt was insolvent. Thus, setoff by a bank should be disallowed if the deposit was made within four months of the filing and the bank had knowledge or notice that the depositor was insolvent. The result, however, has been just the opposite. Setoff has been allowed, giving the bank a preference over the other creditors, unless the transfer was made expressly to give the bank a preference. In New York County National Bank v. Massey the United States Supreme Court allowed setoff where the bank knew of its depositor’s insolvency. The Court said that there was no “transfer” and the provision against preferential transfers did not apply. The theory propounded was that a deposit cannot be a transfer of part of the debtor’s estate because the debtor has the right to withdraw it at any time. The Court also found that there could be no transfer without a “diminution of the estate” of the debtor. The section defining “transfer”, however, was amended in 1952 to include every possible means of “parting with property.” Whether such a broad definition is now sufficient to cover a bank deposit remains undecided. Further litigation should be anticipated to clarify the issue.

At present, however, setoff is subject to criticism as clearly contrary to the intent of the Bankruptcy Act. Decisions reiterate that the purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt’s estate. While “equitable” does not necessarily mean “equal,” if a creditor is to be preferred over others it should be

26. In re Wright-Dana Hardware Co., 212 F. 397 (2d Cir. 1914); Gates v. First Nat’l Bank, 1 F.2d 820 (E.D. Va. 1924). But mere knowledge by the bank that its depositor is in a financial bind will not render a subsequent setoff a preferential transfer. Drugan v. Crabtree, 299 F. 115 (4th Cir. 1924); Fourth Nat’l Bank v. Smith, 240 F. 19 (8th Cir. 1916).
28. 192 U.S. at 147.
clear from the statute.\textsuperscript{32} No part of the Act says that a bank should enjoy a preferential position and the happenstance of its status as a depositary for its customers' funds is certainly not a rational reason for giving it a preference.\textsuperscript{33}

\textit{As a Preference against Decedents' Estates}

Preferences by way of banking setoff are not limited to the Bankruptcy Act. Notwithstanding statutory provisions governing the order and manner of the payment of claims against a decedent's estate, banking setoff again works a preference in favor of the bank in such cases.

California Probate Code section 950 specifies that all liens, debts and charges against a decedent's estate be discharged in a particular order.\textsuperscript{34} Liens take priority over nonlien judgments and all other demands against the estate not ranked higher than liens.\textsuperscript{35} Should a bank have notes and securities in its possession belonging to an indebted customer when the latter dies, the bank has a true statutory lien. After filing its claim against the estate,\textsuperscript{36} the bank should be paid from estate assets according to its lien priority.

If the indebted customer had been maintaining only a general demand deposit with the creditor bank, the bank could only have a right of setoff since a true lien under such circumstances is impossible.\textsuperscript{37} Under present law, that bank account would pass to the estate administrator \textit{subject to} any right of setoff in the bank. In Ainsworth v. Bank of California\textsuperscript{38} counsel for the estate argued that to allow the bank a right of setoff would allow it to satisfy all its claims against the estate to the prejudice of other creditors. The court responded that the general rule \cite{508} stated to be that the administrator can only maintain such claims as the testator or intestate might have successfully asserted if living. \ldots We do not think the case before us would be an exception to the general rule \ldots or that the creditors of the estate would stand in any better position than the testator would himself have stood had he lived and had drawn his check after his note was due, and had been refused payment.\textsuperscript{39}

\begin{footnotes}
\item[32.] Nathanson v. NLRB, 344 U.S. 25, 29 (1952).
\item[33.] A proposed amendment in the Chandler bill which would have limited banking setoff under conditions where other transfers would be voidable preferences never appeared in the Chandler Act of 1952. Banker opposition caused the amendment to be stricken. J. Maclachlan, Law of Bankruptcy § 292, at 343 (1956).
\item[35.] Expenses of administration, of the funeral, of the last illness, a family allowance, debts having a preference by the laws of the United States and certain wages up to $900 are all ranked above liens in priority of payment. \textit{Id.}
\item[36.] Cal. Prob. Code §§ 701 (1956); Id. § 707 (West Supp. 1971).
\item[37.] See notes 11-12 & accompanying text \textit{supra.}
\item[38.] 119 Cal. 470, 51 P. 952 (1897).
\item[39.] Id. at 476, 51 P. at 954.
\end{footnotes}
Since Ainsworth, section 950 of the Probate Code, referred to above, was enacted governing the order of payment. This code provision does not make it clear whether Ainsworth is still viable. Thus far, the decision has gone unchallenged, although it has not been cited in this regard in any subsequent rulings since 1922.

Irrespective of its current validity, however, the Ainsworth doctrine of banking setoff was only the beginning. Later decisions broadened the doctrine as against decedent's estates. In Pendleton v. Hellman Commercial Trust & Savings Bank the court held that the defendant did not have to first file a claim as required by the Probate Code before exercising setoff. Yet, in Reveal v. Stell, decided a few months earlier by the same court, an individual creditor was not allowed the defense of setoff because he failed to first file a claim against the estate. The facts of both cases make it clear that the decedent owed money to both creditors. However, because the creditor in one case was a bank exercising setoff, the court reasoned that there was no need to meet the filing requirement. Since the filing statute appears to apply to all claims against an estate sounding in contract, it is anomalous to require an individual creditor to file a claim against the estate but not to require the same of a creditor bank. Two possible answers for this inconsistent result are either that (1) the bank acquired a more advantageous position because of its status as a bank, or (2) the court erred in requiring the individual creditor to file a claim where mutual demands existed between the creditor and decedent at the time of the latter's death.

Since the statutory setoff provided in section 440 of the Code of Civil Procedure operates automatically, one writer has suggested that the mutual claims of two debtors are extinguished without their prior knowledge or agreement. If this is correct then requiring a claim to be filed before automatic setoff is a useless act. But if other creditors

42. 58 Cal. App. 448, 208 P. 702 (1922).
43. 56 Cal. App. 463, 205 P. 875 (1922).
44. CAL. PROB. CODE § 707 (West Supp. 1971).
45. CAL. CODE CIV. PROC. § 440 (West 1954) provides:
   "When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counterclaim could have been set up, the two demands shall be deemed compensated, so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other."
are involved and the debtor is insolvent, an inequitable result ensues. For example, assume an insolvent decedent owed $50,000 to each of six creditors, including the bank where he maintained a general demand deposit. At his death, the account had a balance of $50,000 which represented the entire assets of the estate. Notwithstanding that section 950 of the Probate Code requires that all claims be paid in a particular order, Ainsworth dictates that the bank be allowed setoff of the decedent’s indebtedness against the full balance of his account. The result is a fully compensated bank and nothing for the other five creditors or for expenses of the funeral or last illness.

The same writer recognizing the automatic extinction of cross-demands under section 440 notes that there may be a waiver of the right since setoff will not be forced on a party against his will. Similarly, waiver of banking setoff should occur under like circumstances since setoff is not imposed on a bank against its will. But the circumstances giving rise to a waiver of banking setoff are unclear. Ainsworth and Pendleton indicate that the bank can declare setoff by making a book entry as late as when the estate administrator seeks to recover the deposit. This is apparently true even though the bank allowed the decedent to withdraw funds while the bank had the right to exercise setoff. This result is no doubt due to the construction of setoff as a “right” not a “duty.” For if the bank had the “duty” to exercise setoff, a delay or failure to do so should effect a waiver the same as it would under section 440.

Thus, banking setoff in this instance may be summarized as follows: it may be exercised against an estate account without first filing a claim. Accordingly, depending on the amount of the account and the

47. A waiver may occur if, for example, X owes Y store $500 and an employee of Y store negligently injures X, inflicting the same amount of damages. X may refuse to pay the bill and consider the two demands as extinguished. If Y store sues to collect the $500, X may answer by way of a counter-claim. Alternatively, X could choose to sue Y store in court in order to protect his credit rating and thereby waive his right to offset. X would then be obligated to pay the $500 bill to Y store. See id. at 224, 268. See, e.g., Franck v. J.J. Sugarman-Rudolph Co., 40 Cal. 2d 81, 90, 251 P.2d 949, 954 (1952).

48. In Walters v. Bank of America, 9 Cal. 2d 46, 55, 69 P.2d 839, 843 (1937), where a garnishee bank claimed a debt due it from the debtor as a setoff, the court held that the bank had to actually apply such debt against the amount in the depositor’s account. If, instead, it paid the amount in the account to the debtor, the payment would be deemed an admission that there was no debt due the bank and its claim of setoff would be denied. The decision is of doubtful validity today on the subject of attachment of bank accounts because of Randone v. Superior Court, 5 Cal. 3d 536, 488 P.2d 13, 96 Cal. Rptr. 709 (1971), but is still notable in that it never mentions a waiver by the bank of its right to setoff.

of the bank's claim, the bank may be fully compensated while the estate's other creditors are left with only their copies of notarized claims—filed but to no avail.

Setoff Against the Estate for Indebtedness Incurred by the Administrator in Continuing the Business of the Decedent

A perplexing problem is raised when the estate administrator seeks to carry on the decedent's former business for the welfare of the estate.\(^{50}\) The right of setoff again may work an injustice best illustrated by a hypothetical situation: Decedent had owned a financially troubled enterprise which the estate administrator is authorized to continue. The administrator obtains a loan from the bank of $10,000 and opens a general account with the lender in which to keep receipts from the business. The business—the sole asset of the estate—ends in insolvency and the account has a balance of $9,000. May the bank setoff and thereby be 90% compensated on its loan to the estate? In Estate of Smith\(^{51}\) the general factual situation above occurred, except the administrator did not open an account with the bank. The court had little trouble reaching the conclusion that the loan did not give the bank a preferential claim as "expenses of administration" or a lien on the assets of the estate, but was a mere debt owing the bank from the assets of the estate (in effect, holding the bank was but a lowest ranked general creditor). The court felt that to allow the bank a preference would "defeat the very spirit and purpose of the probate law which seeks to distribute the property of an estate to the heirs, legatees and creditors of the decedent as speedily and in as unimpaired a condition as possible."\(^{52}\) But under present law, if the administrator had opened an account with the bank which loaned the funds, setoff would be allowed and the "spirit and purpose" of probate ostensibly defeated.\(^{53}\)

In Estate of Allen\(^{54}\) the lender was not even a bank and the court again refused to allow preferential payment to the lender. The court felt that the legislature did not intend to give those loaning money to the estate preferential status.\(^{55}\) That was a worthy conclusion, of

\(^{50}\) Cal. Prob. Code § 572 (West 1956) allows the administrator to carry on the decedent's business during administration for benefit of the estate. Section 830 permits the administrator to borrow money for this purpose.

\(^{51}\) 16 Cal. App. 2d 239, 60 P.2d 574 (1936).

\(^{52}\) Id. at 243, 60 P.2d at 576.

\(^{53}\) While the account may be held in trust for the benefit of the estate, such facts are not chargeable to the bank if it had no knowledge of this purpose. See note 19 supra.


\(^{55}\) Id. at 352, 108 P.2d at 976-77.
course, but again illustrates the injustice of the banking setoff where the interests of other creditors or heirs are involved.

The *Smith* decision emphasizes the irony of the situation. To avoid setoff in the foregoing hypothetical situation, the estate administrator could simply keep the receipts from the business in a different bank or not open an account at all.

**Avenues of Assault on Banking Setoff**

The foregoing discussion dealt with the abuses coexistent with banking setoff. The purpose of this section is to analyze the potential of consumer legislation to curb these abuses and of constitutional safeguards to eliminate them entirely.

The Consumer Credit Protection Act\(^{56}\) and Uniform Consumer Credit Code\(^{57}\) are the legislative controls to be examined. Their truth-in-lending provisions may be made directly applicable to security interests such as banking setoff. Unfortunately, the net effect of both will only be disclosure of the right of setoff prior to its exercise.

On the other hand, procedural due process as interpreted and broadened in *Sniadach v. Family Finance Corp.*\(^{58}\) is aimed at preventing the very exercise itself. If the Fourteenth Amendment is applicable, the banking setoff will be subject to the prerequisites of prior notice and hearing before being exercisable.\(^{59}\) The thesis of this note is that banking setoff stands in no better position than the attachment and garnishment statutes which have recently been held unconstitutional.\(^{60}\)

Finally, the reader should note that neither consumer legislation nor the Fourteenth Amendment is designed to destroy the exercise of banking setoff completely. However, if the major or sole advantage to the practice is the abuse which it allows, removal of the abuses should emasculate the practice and render it an obsolete commercial practice.

**The Consumer Credit Protection Act**

In 1968 Congress enacted the Consumer Credit Protection Act\(^{61}\) [CCPA] which purpose was to reform the consumer credit industry.

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57. See text accompanying notes 80-95 infra.
59. Id.
Its most familiar provisions relate to truth-in-lending under which a creditor must make certain disclosures prior to the extension of any credit. One such disclosure is the possible retention or acquisition of a security interest by the creditor in the borrower's property. The requirements are three-fold: (1) disclosure must be made prior to the extension of credit; (2) the disclosure must set forth how the security interest will be either retained or acquired; and (3) the disclosure must include a description of the interests retained or acquired. To these three requirements should be added the one specifically mentioned in the statute itself:

a *meaningful* disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and *avoid the uninformed use of credit.*

Banking setoff has yet to be construed in light of the CCPA but prior California decisions shed light on the nature of the bank's right. While not a technical lien, "it is in the nature of a lien or security interest in the funds, similar to and enforceable in the same way as the lien against commercial paper." Regulation Z, promulgated by the Federal Reserve System and intended to be interpretative of the CCPA, defines a security interest as

*any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and*

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62. Id. §§ 1601-65.
63. Id. § 1637(a) (7), which reads in pertinent part:

"Before opening any account under an open end consumer credit plan, the creditor shall disclose to the person to whom credit is to be extended each of the following items, to the extent applicable:

... (7) The conditions under which the creditor may retain or acquire any security interest in any property to secure the payment of any credit extended under the plan, and a description of the interest or interests which may be so retained or acquired."

An open end credit plan is defined as a "plan prescribing the terms of credit transactions which may be made thereunder from time to time and under the terms of which a finance charge may be computed on the outstanding unpaid balance from time to time thereunder." Id. § 1602(i). This definition includes the revolving charge account. See generally Brandel, *Open End Credit Disclosure, 26 BUS. LAW. 815 (1971); Buerger, Revolving Credit and Credit Cards, 33 L. & CONTEMP. PROB. 707 (1968)*.

67. Courts must take judicial notice of the regulation, 44 U.S.C. § 1507 (1970). It is also prima facie evidence of the contents of the statute; id. § 1510(e).
other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

As a security interest, therefore, any right of setoff must be disclosed prior to the extension of credit. How the right is retained or acquired and a description of the interests against which setoff may be used must also be disclosed. These requirements, according to one authority, should already have been complied with by banking institutions. Yet, another writer notes that disclosure after credit is extended may be insufficient. Clearly, however, prior disclosure of banking setoff is not being made by banks under their credit card arrangements. Regulation Z makes it mandatory that

68. This particular phrase may include the true banker's lien, CAL. CIV. CODE § 3054 (West 1954), in that it is similar to the mechanic's lien, id. § 3059, and materialman's lien, id. § 3051, by virtue of being automatic and nonconsensual.


70. FRB REG. Z, 12 C.F.R. § 226.2(z) (Supp. 1971) (emphasis added).

71. "Both with respect to advertising and the actual loan documentation, it seems . . . that banks should have by now reviewed every bank form, leaflet, brochure, mailing enclosure which was being used to determine whether it is in compliance with the truth-in-lending requirements." Reuben, Truth-in-Lending: Its Impact on Banks, 87 BANKING L.J. 3, 24 (1970).

72. "A creditor might not be in compliance by giving a disclosure statement after the credit was approved." Frank, Preparation of Bank Forms for Regulation Z, 87 BANKING L.J. 307, 322 (1970).

73. Until recently, the following appeared on the BankAmericard application form: "Regardless of any other agreement existing at the time your BankAmericard account is opened, your BankAmericard balance is not secured by any contractual lien. However, the balance may be secured by a Banker's lien, arising under California Civil Code, section 3054, upon any property while it is in the Bank's possession." FORM TPL 850 SF 4-71 (REV). This is a misleading summary of the bank's security interest because the banker's lien does not apply to a general demand deposit, such as a checking account, since one cannot have a lien on his own property, i.e., a banker cannot have a lien on money deposited which now belongs to him. See notes 11-12 & accompanying text supra.

The Master Charge application forms may vary with the issuing bank. The following statement is taken from the disclosure statement of Crocker National Bank and is probably representative: "To secure payment of any credit extended on the Account, Bank may retain or acquire a lien on any property coming into its possession, and if so agreed in writing as to other property, a security interest in such other property." 71-024 (REV. 5-71). Under this statement, Crocker Bank would clearly violate the CCPA if it setoff the account of a customer against his credit card account, without the prior consent of the customer. Because the bank cannot have a lien on general demand accounts, such accounts must be "other property" which requires a written agreement. The statement makes no disclosure of any right of setoff, which is unnecessary if the bank must have prior written agreement before its exercise.
If the underlying agreement provides for the granting of a security interest in or lien upon all property of the customer now or thereafter in the creditor's possession, the customer must be informed of these facts. 74

Finally, one author notes that the interest secured must be designated with a certain specificity. 75 In light of the foregoing interpretation of the requirements imposed by the CCPA regarding disclosure of security interests, the following statement is suggested as complying with the minimum standard. The statement discloses information as to setoff only and is not intended to cover similar requirements as to interest rates, periodic charges, minimum payments, etc., which are also subject to the CCPA: 76

Notwithstanding any other agreement, oral or written, to the contrary, between you and [name of bank], any amount due or outstanding on your [name of credit card] account is not secured by any contractual or consensual lien. However, the balance due on the amount may be secured by a lien on any of your property in the possession of [name of bank] by virtue of the Banker's Lien statute contained in California Civil Code section 3054. However, the Banker's Lien statute does not apply to checking accounts and other similar general demand deposits which you now maintain or plan to open and maintain in the future with [name of bank]. Nevertheless, any such accounts and deposits may be taken (debited) and applied to any outstanding balance due on your [name of credit card] account under [name of bank]'s "right of setoff." Such accounts include account no.—which you are now maintaining with [name of branch] of [name of bank]. [Name of bank] may debit any of these accounts and apply the funds contained therein to your [name of credit card] balance without prior notice. If you do not desire [name of bank] to have such a right in any

In its most recent mailing enclosure, BankAmericard added the following disclosure to the statement earlier in this note: "If you breach your BankAmericard agreement, the Bank may, without notice, under its 'right of offset,' debit any deposit account you may have with the Bank and credit the proceeds to your BankAmericard balance." Form TPL 880 8/71 (REV). This additional disclosure was received more than a year after initial credit was extended by BankAmericard. If disclosure must be made prior to the extension of credit, setoff should be disallowed on any credit card balance incurred prior to disclosure of the security interest.


75. "If you [the bank] have a security interest in an automobile, you must identify the vehicle. . . . If your security is a passbook or securities, you must do the same." Id. at 327.

76. See text accompanying note 62 supra.
accounts you are now or will be maintaining with it, written notice to that effect must be received by [name of bank] prior to the use of your [name of credit card].

While somewhat lengthy, the above statement discloses all the bank's security interests with the specificity and detail envisioned by the CCPA. Anything less may be insufficient.

BankAmericard, Master Charge and other such bank-cardholder arrangements are assuming a position of convenient buying power in this credit-oriented society. Thus, from a practical viewpoint, disclosure would work no injustice on the bank as the average applicant will not be dissuaded from applying merely because of a statement as to the bank's rights. What credit card applicant believes that the time will come where his checking account will be used to pay off his credit card balance? Notwithstanding the evident widespread use and abuse of all forms of credit, the applicant surely entertains the notion that the heavily indebted is a class to which he will never belong.

The Uniform Consumer Credit Code

The CCPA is federal legislation covering the entire credit industry. The Uniform Consumer Credit Code [UCCC], on the other hand, is designed for enactment by the states to complement the CCPA. The two acts are not mutually exclusive. The CCPA specifically provides that a state may impose substantially similar requirements, in

77. "Bank credit cards, which require payment of interest, represent one of the fastest growing sectors of the credit industry today." Caplovitz, Consumer Credit in the Affluent Society, 33 L. & CONTEMP. PROB. 641, 645 (1968) [hereinafter cited as Caplovitz]. One report notes that Master Charge can be used to hire an attorney, employ a caterer, get an electrolysis treatment, pay taxes and are honored in many major hospitals. LaRiviere, Credit Cards Lift Lid on Holiday Spending, L.A. Times, Dec. 23, 1971, pt. IV (View) at 8, col. 2.

"To prove the effectiveness of its credit card, the Bank of America hired a San Francisco secretary to use its card in place of money for one month; she encountered difficulties only with tolls, taxis, and vending machines." Comment, Bank Credit Plans: Innovations in Consumer Financing, 1 LOYOLA L. REV. (Los Angeles) 49, 50-51 n.10 (1968).

78. Caplovitz, supra note 77, at 642.

79. "According to [one] view, credit stimulates impulse buying and irrational expenditures by making it easier for families to make expensive purchases. The accusation of families living beyond their means is frequently heard in the credit society, and the suspicion is that such families are just as apt to be found in the middle class suburbs as in the ghetto. Obviously, research is needed on this point to find out the frequency of each outcome and the kinds of families that benefit from, or are hurt by, the ready availability of credit." Id. at 646.

80. For a comparative study of the CCPA and the UCCC, see a symposium contained in 33 L. & CONTEMP. PROB. 639 (1968).
which case the CCPA will acquiesce,\textsuperscript{81} or possibly stricter requirements, in which case compliance with the CCPA will not exempt the creditor from the stricter state laws.\textsuperscript{82}

According to a recent report, the UCCC has enjoyed only limited acceptance in the two years since the final draft was issued.\textsuperscript{83} Because this code is due to be considered by the California legislature in the 1972 session, banking setoff should be examined in light of the UCCC.

The UCCC is intended to supplant virtually every existing state law regulating the credit industry.\textsuperscript{84} In their place, the UCCC will provide a uniform system of disclosure requirements applicable to all areas of credit transactions, including conditional sales contracts, mortgages and credit cards.

While the CCPA’s disclosure requirements apply to credit in all forms, the UCCC distinguishes between credit extended under a revolving charge account (e.g., a department store credit card arrangement) and credit amounting to a tripartite loan arrangement (e.g., the BankAmericard plan).\textsuperscript{85} However, the UCCC disclosure requirements applicable to either arrangement are strikingly similar to each other\textsuperscript{86} and to the CCPA disclosure provision.\textsuperscript{87} The language of the CCPA's “security interest” disclosure provision, for example, is almost identical with that of the UCCC’s which states:

Before making a consumer loan pursuant to a revolving loan account, the lender shall give the debtor the following information:

\[
\ldots
\]

\textsuperscript{82} Id. § 111(a), 15 U.S.C. § 1610(a).
\textsuperscript{83} San Francisco Chronicle, Oct. 9, 1971, at 9, col. 1 (enacted in Oregon and four other states).
\textsuperscript{84} See UNIFORM COMMERCIAL CREDIT CODE [hereinafter cited as UCCC] § 9.103 (1)-(2) (note re Repealer and Amendatory Provisions). This would mean the repeal of CAL. CIV. CODE §§ 1912-16 (West 1954) (usury laws) and id. § 2982 (West Supp. 1971) (motor vehicle conditional sales contracts). The recent Song-Beverly Credit Card Act would also have to be included in this group. Cal. Stat. 1971, ch. 1019, § 1747.50 at 2152. See generally Moo, Legislative Control of Consumer Credit Transactions, 33 L. & CONTEMP. PROB. 656, 663 (1968) [hereinafter cited as Moo].
\textsuperscript{85} Compare UCCC § 1.301(16) (defining seller credit card) with id. § 1.301 (9) (defining lender credit card) and id. § 3.108 (defining revolving loan account).

The code makes it clear that it desires to “treat the single-merchant credit card as being under the regulatory provisions of the sales article but to treat transactions under the multiple-purpose credit card as being within the regulatory provisions of the loan article.” Moo, supra note 84, at 664.

\textsuperscript{86} Compare UCCC § 2.310 (disclosure under merchant credit card plan) with id. § 3.309 (disclosure under a bank credit card plan).

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(g) conditions under which the lender may retain or acquire a security interest in property to secure the balances resulting from loans made pursuant to the revolving loan account, and a description of the interest or interests which may be retained or acquired. 88

The official comment makes it clear that disclosure must be made by the lender at or prior to the time the buyer receives a credit card or is otherwise enabled to use the account. 89 For failure to comply with the requirements of the code, a variety of civil actions are authorized including restraining orders, class actions, actions for damages and civil penalties for willful violations by a creditor or his representative. 90

Under the Uniform Commercial Code [UCC], a security interest agreement must be signed by the debtor before it is enforceable. 91 If banking setoff is subject to the requirement of a prior written agreement, then it is useless, as one writer has noted, 92 to also requires creditors to disclose their security interests. However, banking setoff as a security interest is not among those types of interests whose enforceability must be founded on a prior written agreement. No such agreement is required by the UCC where the collateral subject to the interest (demand deposit) is already in the possession of the secured party (bank). 93 As the money in a customer's demand deposit account is the collateral and is in the possession of the bank, the need to comply with this requirement of the UCC is obviated. Furthermore, the UCC's basic provision requiring a prior written agreement is expressly subject to another section which gives a collecting bank a security interest similar to the common law banker's lien. 94 Because the courts interpret banking setoff as an integral part of the banker's lien, no prior written agreement is necessary for setoff to be validly exercisable by a bank.

No present state law acts to curtail the practice of banking setoff. The UCC section on the banker's lien is presently interpreted to

89. UCC § 2.310, Comment 1.
90. Id. §§ 6.110-113(2).
91. UNIFORM COMMERCIAL CODE § 9-203(1)(b); CAL. COMM. CODE § 9203 (1)(b) (West 1964); cf. UNIFORM COMMERCIAL CODE § 9-302 (financing statement must be filed to perfect the security interest); id. § 9-402 (filed financial statement must be signed by debtor).
93. UNIFORM COMMERCIAL CODE § 9-203(1)(a); CAL. COMM. CODE § 9203 (1)(a) (West 1964).
94. UNIFORM COMMERCIAL CODE § 4-208, Comment 1; CAL. COMM. CODE § 4208 (West 1964) Comment 1.
be subject to the banker's lien statute. The enactment of the UCCC, therefore, would fill the void to the extent that more strict enforcement procedures are available under the UCCC than under the CCPA.

Procedural Due Process

Under present practice, a bank may debit its customer's general demand deposit account and credit that amount toward diminution or extinguishment of the customer's indebtedness to the bank. The "transfer" of the funds, represented by the account, from that account to another is accomplished without prior notice or hearing as to the validity of the bank's claim against its depositor.

The third and final thesis of this note is that the practice of set-off previously illustrated is subject to the due process clause of the Fourteenth Amendment. Due process requires that before a state can deprive any person of life, liberty or property, prior notice and a hearing must be afforded. Since Sniadach v. Family Finance Corp., the due process clause has been undergoing an expanding interpretation and many state procedures of long standing are now facing constitutional challenges. Such deficient procedures include prejudgment garnishment of wages, bank accounts, accounts receivable and moneys on deposit with a hospital. Old and venerable lien statutes have been struck down. In addition, the termination of welfare benefits and unemployment compensation benefits without

95. See authorities cited in note 94 supra.
prior notice and hearing have been held to fall within the constitutional mandate of the due process clause. Statutes permitting sales of property in distress for rent and the issuance of writs of repossessions without also requiring compliance with fundamental due process requirements have likewise been held invalid.

Against this background of growth in the realm of due process stands the ancient but well-established practice of banking setoff. Two distinct problems are raised by the practice itself and the law which has developed around it: first, whether the requisite state action is present; second, whether there has been the deprivation of a property interest. The balance of this note will attempt to answer both problems in the affirmative and to illustrate how a reasonable interpretation of Sniadach and subsequent decisions does include banking setoff in that group of now defunct state practices.

**The Requisite State Action**

The Supreme Court was early to recognize that the "[i]ndividual invasion of individual rights is not the subject-matter of the [Fourteenth] amendment." The Court must find some semblance of state action involved in the deprivation before the amendment is applicable.

When a bank exercises setoff against a customer's account, it is generally acting under color of one of two California statutes. The first is the codified banker's lien. Although setoff is different from the true lien, apparently banks rely partially on the statutory lien. The second is the statute governing setoff of cross demands. When

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108. United States v. Cruikshank, 92 U.S. 542 (1875). "The fourteenth amendment prohibits a State from depriving any person of life, liberty, or property, without due process of law; but this adds nothing to the rights of one citizen as against another." *Id.* at 554.
110. Gonsalves v. Bank of America, 16 Cal. 2d 169, 173, 105 P.2d 118, 121 (1940) (the banker's lien applies to demand deposits but is more correctly called a right of setoff). See note 73 *supra*.
a state statute is involved, sufficient state action is generally found by the courts. 112

However, the bank need not rely on state statutes in all cases. A defense against finding state action is that banking setoff is not governed by either the statutory lien or statutory setoff but instead by general equitable principles and the mutual dealings of the bank and depositor. 113 Such a contention could be based on the facts that the banker's lien is a part of the English common law and that setoff itself is a nonstatutory right in a majority of jurisdictions. 114 In California, however, the English common law is codified and state action can again be found in statutory involvement. 115 In those jurisdictions where such is not the case, an alternative ground must be found.

The "public function" doctrine may be applicable to find state action in cases involving an institution such as a bank which performs a public function in an individual capacity. The limitations of this doctrine, first espoused in Marsh v. Alabama, 116 are unclear, 117 but company towns, 118 shopping centers, 119 and private parks controlled by the municipality 120 have been deemed so involved in a public function that regulation by the state was sufficient state action. State control and regulation of banking and financial institutions clearly exists. 121

Still another alternate basis for finding state action is the "judicial
involvement" of the state, a doctrine which the Court assumed as already recognized by all.\textsuperscript{122} Under this doctrine, merely because banking setoff is enforced in the state courts is sufficient state action. Because the contours of this doctrine are in a state of flux, however, it is best relied on only as a last resort.

\textit{Deprivation of Property}

The law has developed that only a debtor-creditor relationship is established between a bank and its customer, although at least one writer has suggested that the bank should be held to a fiduciary standard.\textsuperscript{123} Accordingly, the law has established that money deposited with a bank becomes its property.\textsuperscript{124} Clearly, then, there cannot be a deprivation of any money belonging to the depositor. The relationship of the parties and the practice of setoff itself requires the resolution of anomalous ideas: by exercising setoff, the bank is clearly depriving its customer of the right to draw out money and yet that same money already belongs to the bank. Therefore, a distinction must be made between the physical cash dollar and the bank account representing the same. The depositor does have a chose in action against the bank which is a recognized property right.\textsuperscript{125} By setoff, the bank is depriving him of the use of his right to withdraw funds.\textsuperscript{126} Thus, while the bank is not depriving him of his technical chose in action since the customer may sue to recover the amount set off by the bank, if the chose in action is viewed as the customer's right to withdraw deposited funds on demand, then use of the chose in action is impaired by banking setoff. In interpreting California law, the United States Supreme Court noted that:

[t]he relationship of bank and depositor is that of debtor and creditor, founded upon contract. The bank has the right \textit{and duty} under that contract to honor checks of its depositor . . . \textsuperscript{127}

\begin{itemize}
  \item \textsuperscript{122} Shelley v. Kraemer, 334 U.S. 1 (1948). "That the action of state courts and judicial officers in their official capacities is to be regarded as action of the State within the meaning of the Fourteenth Amendment, is a proposition which has long been established by decisions of this Court." \textit{Id.} at 14; cf. Bell v. Maryland, 378 U.S. 226, 255-57 (1964) (Douglas, J., concurring opinion); Barrows v. Jackson, 346 U.S. 249, 254 (1953).
  \item \textsuperscript{123} 10 ILL. L. REV. 602, 607-08 (1916).
  \item \textsuperscript{124} See cases cited note 11 & accompanying text \textit{supra}.
  \item \textsuperscript{125} CAL. CIV. CODE § 14 (West 1954).
  \item \textsuperscript{126} "The 'property' of which petitioner has been deprived is the \textit{use} of the garnished portion of her wages during the interim period between the garnishment and the culmination of the main suit." Snidach v. Family Fin. Corp., 395 U.S. 337, 342 (1969) (Harlan, J., concurring); \textit{accord}, Randone v. Superior Court, 5 Cal. 3d 536, 552, 488 P.2d 13, 23, 96 Cal. Rptr. 709, 719 (1971); cf. United States v. Causby, 328 U.S. 256, 262 (1946).
\end{itemize}
If the right to withdraw funds, therefore, is the true property right to be protected, then a breach of the duty to honor checks, by setoff without prior notice to or consent of the customer, is sufficient deprivation to merit Fourteenth Amendment relief.

A customer's right of withdrawal is not absolute, however. The UCC recognizes that it is subject to any right in the bank to apply the deposit to a customer's obligations.\textsuperscript{128} The UCC does not mention whether an underlying contract is needed to support the bank's right or whether prior notice or consent of the customer is required. However, that the Commissioners on Uniform State Laws intended to contravene the due process clause is doubtful.

Finally, it should be noted that setoff is a permanent deprivation unless the customer wishes to expend the time and money in court to recover the amount set off. In this way setoff differs from the wage garnishment statutes, which limited the length of time that property could be garnished.\textsuperscript{129}

\textit{Banking Setoff in Light of Sniadach}\textsuperscript{130}

Assuming that the requisite state action and deprivation of a significant property interest are both present, the final issue presented in this section is that all setoffs, at least as to bank accounts, should be forbidden by the due process clause unless prior notice and hearing is granted.

The impact of \textit{Sniadach v. Family Finance Corp.}\textsuperscript{131} has been pervasive and has yet to be reconstrued by the Supreme Court. In addition to decisions already noted,\textsuperscript{132} prior notice and hearing have been held required before seizure of beds, stoves, mattresses, dishes, and tables in a replevin action,\textsuperscript{133} and before sale of stored property in an unlawful de-

\textsuperscript{128}\textit{Uniform Commercial Code} § 4-213(5).
\textsuperscript{130}The \textit{Sniadach} decision has prompted a rash of literature on its ramifications. See generally Note, Some Implications of \textit{Sniadach}, 70 \textit{Colum. L. Rev.} 942 (1970); Note, Attachment and Garnishment: The \textit{Sniadach} Case and its Implications for Related Areas of the Law, 68 \textit{Mich. L. Rev.} 986 (1970); Comment, The Constitu-
\textsuperscript{131}395 U.S. 337 (1969).
\textsuperscript{132}See cases cited in notes 98-106 supra.
tainer action.\(^{134}\) On the other hand, the decision has been held not controlling where the defendant’s debtors are attached,\(^{135}\) or his prune crop,\(^{136}\) or real property\(^{137}\)—especially under a writ of foreign attachment.\(^{138}\)

In *Randone v. Superior Court*\(^{139}\) the California Supreme Court ruled that attachment of bank accounts without prior notice and a hearing on the validity of the attaching creditor’s claim was invalid as a violation of procedural due process. In a unanimous opinion, the court concluded that section 537(1) of the Code of Civil Procedure, allowing attachment of the defendant's property in unsecured contract actions could not withstand constitutional scrutiny. The court interpreted *Sniadach* as returning the entire domain of prejudgment remedies to the long-standing procedural due process principle which dictates that, *except in extraordinary circumstances*, an individual may not be deprived of his life, liberty or property without notice and hearing.\(^{140}\)

The court further noted that a bank account is not unlike wages in that both represent the “necessities of life” protected in *Sniadach*.\(^{141}\) Thus, whether the absence of prior notice and hearing will be decisive appears to depend on whether the property being taken represents the “necessities of life.” Under banking setoff bank accounts are affected in the same way that they would be under garnishment or attachment. In both the right of the customer to reach the funds represented by the account is impaired, usually permanently. If, therefore, bank accounts are “necessities of life” as held by the *Randone* court, the prac-

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\(^{138}\) Robinson v. Loyola Foundation, Inc., 236 So. 2d 154 (Fla. 1970).


\(^{141}\) “The greater the deprivation an individual will suffer by the attachment of property, the greater the public urgency must be to justify the imposition of that loss on an individual before notice and a hearing, and the more substantial the procedural safeguards that must be afforded when such notice and hearing are required.” *Id.* at 558, 488 P.2d at 28, 96 Cal. Rptr. at 724.
tice of banking setoff must fall because of its noncompliance with due process.

However, the courts are not at all certain that all bank accounts are protected. If a financially stable corporation's checking account is attached, for example, *Sniadach* is not deemed applicable; but if the corporation is a closely-held family corporation, the result may well be different.\(^{142}\) In the first instance the checking account does not represent "necessities of life" while in the latter the account may represent the entire assets of the corporation.

Individual accounts, on the other hand, are of a different nature. The meteoric rise of demand deposit accounts by the individual consumer emphasizes their commercial significance.\(^{143}\) This growth must also be considered in light of the increasing practice of banks to become involved in the credit card field.\(^{144}\) As noted at the outset of this note,\(^{145}\) setoff may often occur in connection with charges incurred on the credit card issued by a bank. For example, the situation may arise where the depositor incurs a $400 debt on his Master Charge credit card, and reduces it to $200. Later, a dispute arises as to an item charged to the card and the bank seizes almost the entire amount in the depositor's checking account. The depositor is not notified of the setoff until five days later but, in the interim, has written numerous checks, all of which are dishonored by the offsetting bank, which also assesses a four dollar fee per check.\(^{146}\) Furthermore, the merchant-


\(^{143}\) The following table shows that, in one decennial period, the percentage of the adult population maintaining checking accounts increased from 41% to 53%. In 1960 over half the adult population maintained a demand deposit account:

<table>
<thead>
<tr>
<th>Period</th>
<th>Adult Population (millions)</th>
<th>Demand Deposit Accounts (millions)</th>
<th>Volume of Checks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949</td>
<td>96.4</td>
<td>40.7</td>
<td>Total</td>
</tr>
<tr>
<td>1955</td>
<td>102.4</td>
<td>52.1</td>
<td>Avg. no. per acc'lt</td>
</tr>
<tr>
<td>1960</td>
<td>108.3</td>
<td>57.1</td>
<td>1,848</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2,644</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3,419</td>
</tr>
</tbody>
</table>

85 MONTHLY LAB. REV. 989, 991 (1962).

Financial institutions have eagerly solicited the average consumer account. One author noted that "in order to make up for the drop in corporate deposits, many banks aggressively went after the small, individual depositor. Special checking accounts (requiring no minimum balance) and a friendly, welcome-to-the-public image were the chief avenues of attack. Most banks geared themselves to an all out 'retail' operation, offering a broad range of banking services in easily accessible branches to reach an ever-widening segment of the population. The trend has been called a 'shift from class banking to mass banking.'" B. YAVITZ, AUTOMATION IN COMMERCIAL BANKING 10-11 (1967).

\(^{144}\) See note 77 supra.

\(^{145}\) See note 1 & accompanying text supra.

\(^{146}\) Essentially, these are the facts in a suit filed recently in federal court chal-
payee of the dishonored checks may also levy a fee on the depositor-drawer. The ultimate indignity, however, is that the depositor’s credit reputation is irreparably damaged with that merchant. Had the depositor been given sufficient prior notice, he might have been able to deposit sufficient funds to prevent his account from being overdrawn.

Disputes over a credit card balance may arise from a number of causes, including computer error, merchant error, stolen card or exchanged goods. Once the bank chooses to set off the disputed charges against the cardholder’s demand account, any protests will be to no avail. The cardholder will probably demur in bringing suit (enforcing his chose in action) for the amount of a small purchase which the bank has debited to his bank account.

To justify the deprivation of a debtor’s property interest before notice and a hearing, some state or creditor interest of overriding significance must be served. The arguments made by the attaching creditor in Randone are strikingly similar to those that the bank might advance in defending its right of setoff. The creditor in that case contended that creditors would encounter greater difficulty and expense in collecting debts; that credit rates would consequently be increased; and that extension of credit to certain high-risk debtors would have to be terminated. Yet, empirical studies have discounted the possibility of a tighter credit market merely because of the loss of available attachment statutes. Without the benefit of similar studies on
the effect of proscribing banking setoff, no unequivocal statement can be made about the effect it would have on the credit industry.\textsuperscript{161} The ultimate issue, however, is whether the desire for liberalized credit is outweighed by allowing a practice devoid of procedural safeguards to perpetuate the private interests of the creditor bank.

The final contention asserted by the creditor in \textit{Randone} might also be utilized by an offsetting bank—i.e., the danger of a debtor absconding with the money in his account when notified of the debt action (or setoff) against him. Even this argument failed to impress the court:

\begin{quote}
\hspace{1cm} [A] creditor's interest, even in these "special circumstances," is not sufficient to justify depriving a debtor of "necessities of life" prior to a hearing on the merits of the creditor's claim.\textsuperscript{152}
\end{quote}

Thus, the \textit{Randone} court held that a creditor's private interest is never sufficient when dealing with a debtor's "necessities of life."\textsuperscript{153} If, therefore, the court is correct in listing bank accounts as "necessities of life," the private interests of the offsetting bank should never be sufficient to allow such a summary procedure as setoff. When a family is dependent on the use of its checking account, setoff of past indebtedness without notice would enable the bank to "drive a debtor and his family to the wall."\textsuperscript{154}

Finally, it should be noted that there is no essential difference between wages in a bank account which is garnished and those in an account which is subject to setoff. Setoff is nothing more than a form of nonstatutory, nonjudicial prejudgment attachment that permanently freezes the "necessities of life" without even the minimal protection of a later adjudication of rights which was always present in attachment and garnishment proceedings. Setoff and attachment are so analogous in both operation and effect that they defy differentiation—no doubt because the substantive evils are no different.

\section*{Conclusion}

Banking setoff has been an accepted commercial practice for centuries, but "[t]he fact that a procedure would pass muster under a feudal regime does not mean it gives necessary protection to all prop-

\begin{footnotes}
\footnotetext{151}{A BankAmericard official stated to the author in August, 1971, that he recently answered, in the negative, a questionnaire whose purpose was to determine whether banks would object to the repeal of the banker's lien. The official also noted that setoff was only used as a "last resort" and "isn't very popular."}
\footnotetext{152}{5 Cal. 3d 536, 556 n.19, 488 P.2d 13, 27 n.19, 96 Cal. Rptr. 709, 723 n.19.}
\footnotetext{153}{\textit{Id.} at 558, 488 P.2d at 27, 96 Cal. Rptr. at 723.}
\end{footnotes}
The practice itself, however, is harmless, once the abuses are eliminated. There is no cogent argument for disallowing setoff where the bank discloses its right in plain language prior to exercise and has the prior consent of its customer. Similarly, there is no reason why a bank and its depositor cannot contract to give the bank the right, provided it is not a contract of adhesion.

The present abuses, however, clearly require an overhaul of the procedure. Setoff is an undisclosed security interest which generally exalts the bank as a preferred creditor by allowing the peremptory deprivation of the use by a customer of his bank account. The abuses so summarized can be effectively restricted by a liberal, although justified, interpretation of the CCPA and UCCC and eliminated completely by extending the principles of *Sniadach* a logical step further. Setoff and attachment are both useful tools for the creditor and may remain so provided they are not permitted to have a debilitating effect on the consumer and other less fortunate creditors.

*Thomas G. Dobyns*


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