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INTEREST ON THE BALANCES OF CHECKING ACCOUNTS

If a promissory note payable to a solvent commercial bank made by one not a customer were discounted for the maker by the bank and the price though due were not demanded by the maker, the financial and legal consequences would be those of a demand loan by maker to bank. If bullion, coins, bank notes, or deposit currency were sold by one not a customer to a bank and the price not demanded when due, the consequences would be those of a demand loan. Similarly, if the discounted note matured but were permitted by the bank to run, the bank would be making a demand loan to the solvent maker. If the check of a third person, representing deposit currency, were indorsed by one not a customer to a bank and paid for before the check is dishonored, between the time the indorser is subjected to a duty to pay, and his prompt payment, there would be a demand loan to him. If a bank honored the "check" of one of its creditors who was not a customer, a demand loan to the drawer would be the consequence. Though all these affairs were transacted within a few days and between the same parties, each would, subject to the qualifications required by permission to join separate causes of action in the same action and by permission to plead counter-claims and set-offs, have legal consequences independent of each of the others. In each the legal duty of the borrower would be measured as to amount by the amount of the particular advance.

Such transactions, the making and receipt of advances by way of demand loan, are the business of the commercial bank. But the bulk of the loans are to and from regular dealers or customers. Hence the device of the current account. In anticipation of a series of advances by one to the other, of which the number, amount, and date cannot be foreseen, the commercial bank and the prospective customer come to the understanding that if nothing to the contrary be agreed at the time of each advance, the receipt of each advance shall indicate that the borrower bargains to pay to the lender upon demand the difference between the sum of the advances by the one and the sum of the advances

by the other, if the difference is in favor of the other; if not, that the advance shall be set off against the difference in his favor. The bargain is sanctioned on the one hand by not imposing on the borrower a duty to repay the advance and, on the other, by subjecting him to a liability to pay upon demand the difference if against him, or, if it is in his favor, by extinguishing *pro tanto* his right to the pre-existing difference.

Not all advances between bank and customer become items of the current account. Which advances enter into the account depends upon the understanding when the account is opened, or the agreement, if any, when the advance is made. From the point of view of the customer, advances by the customer to the bank which enter into the current account are credits; advances by the bank are debits. The difference is the balance. When the sum of advances by customer to bank exceeds the sum of advances by bank to customer, the current account shows a credit balance; when the bank's advances exceed the customer's, a debit balance.

The balance is thus the vector of the obligation to pay, indicating its direction and measuring its amount. The balance performs two other offices. If the bank has promised to make advances to the customer by honoring his orders, the amount up to which the bank is obligated is agreed to be determined by reference to the balance as a gauge. If the bank has promised to pay interest the agreed multiplicand, which is to be multiplied by the agreed rate of interest, is fixed by reference to the balance. The agreement to make advances may fix the amount of the bank's liability at the credit balance, the credit balance plus or minus a stipulated amount, or the debit balance plus a stipulated amount. In respect of interest, similarly, the multiplicand may be the credit balance, or the credit balance minus or plus an amount to be computed by agreed rules. Saving the usury statutes, banking laws, and Clearing House regulations,¹ the parties are permitted to agree upon the methods for computing from the balance the amount up to which advances shall be made and the amount upon which interest shall be paid.

It is clear that different considerations will control the making of the agreement as to what advances shall be upon the current account and effect its balance, the agreement as to how the liability of the bank to make advances shall be gauged, and the agreement as to determining the amount upon which interest shall be paid. For example, when the customer deposits in the bank a check drawn on another bank, the agreement may be either (1) that the bank shall take the check for

¹ Interest Ruling No. 5 of the New York Clearing House Association, quoted *infra*, note 12, illustrates the strong tendency encouraging the use of the credit balance as a gauge of the obligation to pay interest.

collection only, shall not purchase it but shall account for it or its proceeds; or (2) that the bank shall purchase the check and the customer advance the price to the bank on current account, but, as in the case of the "savings" account, with no promise whatever on the bank's part to honor checks. Or, it may be agreed (3) that the bank, though taking for collection, shall add to the balance all collections in computing the amount up to which orders shall be honored. And finally, it is possible, though unlikely, for the agreement to be (4) that the bank shall buy the check but shall not until collection include the customer's advance of the price on current account in computing the amount up to which orders shall be honored. In the first form of agreement the transaction results in no advance by either party; in the second, the customer has made an advance which, furthermore, has become an item of the current account; the third form of agreement presents the case of a promise by the bank to honor orders exceeding in amount the credit balance, *i.e.*, a promise to honor "overdrafts"; the fourth illustrates an advance by the customer to the bank on the current account, which does not affect the liability to honor orders. But whether or not the bank has received an advance on account and comes under an obligation to pay a larger balance, and whether or not it agrees to honor orders at once, the bank will hesitate to pay interest on the amount of the check before collection, and ordinarily will not promise to do so.² Its habitual disinclination is understood and allowed for in interpreting its promise to pay interest to a customer with a current account.

Again, suppose the agreement between bank and customer is that the customer will advise the bank whenever he has drawn an order on it and that upon receipt of the advice the bank may thereafter refuse to honor orders in excess of the credit balance minus the amount of the advised draft. The advice is not an advance by either party and the balance which the bank is under a liability to pay upon demand is not affected. Nor are the funds at the disposal of the bank reduced. A bank, therefore, is not privileged to reduce by the amount of the advised draft the interest multiplicand.³ Receipt of the advice is unlike a cer-

² Interest Ruling No. 15 of the New York Clearing House Association expressly forbids the payment of interest on "uncollected items."

³ Interviews and correspondence with leading New York bankers indicate that banks usually do reduce the interest multiplicand upon receipt of the advice, and restore the deduction if the advice is cancelled, only as of the date of cancellation, but that if pressed they restore also the interest lost by the customer in the meantime. Under the circumstances, the legal relations of the parties are not likely to be exactly defined. The only intimation of the judicial attitude toward the question is a dictum in an unreported English *nisi prius* case, in which Lord Justice Baggallay said "he should have hesitated much before he gave effect to a practice which appeared to him to be both unreasonable and unjust." See *West of England Bank v. Evans*, 1 PAGET, LEGAL DECISIONS AFFECTING BANKERS (1881) 20, 21.

tification. A certification, whether or not at the request of the drawer, is an advance on account to the customer of a different form of commercial bank credit, analogous to an advance in the form of the bank's notes. Since the interest multiplicand is a function of the credit balance, the reduction of the latter reduces the former, and since there is no promise in the certified check to pay interest either to drawer or holder, there is, for reasons which will appear, no obligation to either. In the case of the advice of drawing, the liability to honor the customer's orders is affected, and a liability to the customer to honor the advised order has arisen. But there is no other change in the legal relations of the parties. This situation, therefore, illustrates another possibility of variation between the amount of the balance, the amount up to which orders should be honored, and the amount upon which interest should be paid.

I

The principal motive of the customer who obtains the promise of a bank to honor his checks and opens and maintains a current account by the balance of which is to be gauged the bank's liability under its promise, is to secure a supply of the common medium of exchange, *i.e.*, deposit currency in the checking account form. This the customer has secured the moment the bank's promise is made and a sufficient balance established. The bank's promise is the medium of exchange. The performance of that promise by crediting the checking account of the payee named in the customer's check, or by crediting the checking account of a collecting bank employed by the payee, or by giving its own check on its correspondent, is commonly thought of not as a performance of a promise, but as a step in the transfer of the medium of exchange. To the parties the transaction which takes place whenever the customer makes an advance on the checking account appears as a purchase rather than a loan. Partly for this reason, the vast majority in number of checking accounts are not accompanied by a bargain for the payment of interest by the bank.⁴ On the contrary, the time deposit and the current account of the commercial bank with a customer whose checks it has not promised to honor, *e.g.*, the "savings" account, are usually accompanied by a promise to pay interest. These are bargains in which the customer is seeking investment. Furthermore, they are made with a view to payment or liquidation in the future; and in these two important respects they differ from the bargain for the operation of a checking account.

An express promise to pay interest on the credit balance of a checking account is, then, exceptional. Nor is there a custom on the part of

⁴ But see *infra* p. 639 and note 14.

banks to pay it upon which to support the finding of a promise in the bargain.⁵

But each deposit is, as we have seen, an advance to the bank by way of demand loan. In the case of loans is there not at least a presumption, created upon grounds of fairness perhaps, but stated in terms of agreement, resulting in an obligation to pay interest? Are not most loans of funds made with a view to profit and on the basis of the worth of a dollar today being greater than that of a dollar tomorrow? However compelling these arguments for the presumption may be in the case of other loans,⁶ they have no force in the case of the advance to the bank on the checking account. The customer though making a loan is bargaining in terms appropriate to the purchase of deposit currency.

A duty to pay interest before default on a time loan of money, or before demand on a demand loan,⁷ is not imposed in our law apart from a bargain for interest, or a presumption.⁸ A glimpse through the spectacles of the early common lawyer, colored by the ecclesiastical ban on all interest, will disclose why. The statute of 37 Henry VIII, c. 9, forbidding the taking of interest by agreement at more than ten per cent, permitted for the first time, and then only by a negative implication, an *agreement* for interest at a lesser rate. From all that has been said, it is to be expected that a bank which has not expressly promised to pay interest on the credit balance of a checking account is under no obligation to do so.⁹

⁵ A promise to pay interest has been found in cases where a course of dealing between the parties, *Millar v. Craig*, 6 Beav. 433 (1843), or a usage between other parties similarly situated, *Public Trustee v. Bank of New Zealand*, 6 N. Z. L. R. 680 (1888); *People v. Merchants Trust Co.*, 116 App. Div. 41, 101 N. Y. Supp. 255 (1906), existed.

⁶ There should be such a presumption. The following jurisdictions admit one, *Rodgers v. Clement*, 162 N. Y. 422, 57 N. E. 1123 (1900); *Woerz v. Schumacher*, 161 N. Y. 530, 56 N. E. 72 (1900); *Reid v. Rensselaer Glass Factory*, 3 Cowen 393 (N. Y. 1824), *aff'd*, 5 Cowen 587 (N. Y. 1825); *Liotard v. Graves*, 3 Caines 225 (N. Y. 1805); *Harris v. Mercur*, 202 Pa. 318, 51 Atl. 971 (1902); *Dilworth v. Sinderling*, 1 Binn. 488 (Pa. 1808); *Hodges v. Hodges*, 9 R. I. 32 (1868). In five states the presumption is created by statute, CALIF. CIV. CODE (*Deering*, 1923) § 1914; MONT. REV. CODES (1921) § 7722; N. D. COMP. LAWS ANN. (1913) § 6069; OKLA. COMP. STAT. ANN. (1921) § 5094; S. D. REV. CODE (1919) § 1036; *Seimi-Tropic S. Ass'n v. Johnson*, 163 Calif. 639, 126 Pac. 588 (1912); *Wells, Fargo & Co. v. Enright*, 127 Calif. 669, 60 Pac. 439 (1900). The presumption is of course rebuttable, *Bell v. Rice*, 50 Neb. 547, 70 N. W. 25 (1897); *Hanley v. Crowe*, 3 N. Y. Supp. 154 (1888). For the other view see *infra*, p. 637 and note 8.

⁷ After default on a time loan, and after demand on a demand loan, interest does run, as damages, 17 C. J. 818; English Civ. Prac. Act, 1833, 3 & 4 W. 4 c. 1, § 28; ILL. REV. STAT. (*Cahill*, 1924) c. 74, § 2.

⁸ *Calton v. Bragg*, 15 East 223 (1812); *Sammis v. Clark*, 13 Ill. 544 (1852) *semble*; *Hubbard v. Charlestown R. R.*, 52 Mass. 124 (1846); *Chamberlain v. Smith*, 1 Mo. 718 (1827); 33 C. J. 734. *Cf.*, *supra* note 6.

⁹ *Edwards v. Ware*, 5 B. & Ad. 282 (1833) *semble*; *First Nat. Bank v. Coleman*, 11 Ill. App. 508 (1882); *Clark's Adm'r v. Farmers' Nat. Bank*, 124 Ky. 563, 90 S. W. 679 (1907); *Parsons v. Treadwell*, 50 N. H. 356 (1870) *semble*; *Wainwright v. Marine Nat. Bank*, 72 Pa. Super. 225 (1919).

The time deposit and the current account not coupled with a promise to honor checks, since they do not create a form of deposit currency, are different. But the conclusion in respect of the obligation to pay interest, reached in the case of the checking account, probably holds good in these two cases as well, though for other reasons. True, the bargain between bank and customer is for a loan, but even in a jurisdiction which presumes a promise to pay interest on a loan, the presumption would probably be rebutted when it appeared that such bargains between bank and customer almost universally stipulated expressly for interest; in such a context, absence of an express stipulation is evidence of a contrary intent.¹⁰

Up to this point the focus of discussion has been the credit balance. But the credit balance is built up by a series of advances to the bank, and the payment of interest on each advance might be the obligation of the bank. The privilege or immunity of the bank not to pay interest on each advance may be accounted for not only by the factors already observed, but also by the fact that in case of advances on a current account the bargain equivalent is not the promise of the bank to repay the advance, but the promise to pay the credit balance. In making a loan it is possible, as in the case of some perpetual annuities, to bargain for interest to be computed on a multiplicand which is the amount advanced and not the amount to be repaid. But in the absence of an express promise, which is never made, the finding of such a bargain, or the presumption of such an agreement is no more to be anticipated than the finding of a promise to pay interest on the price prepaid under a contract to sell.

II

As an outcome of the bargaining struggle, and still more of the competitive struggle, banks do often promise to pay interest on the credit balance of checking accounts. Since the rate of interest so promised is usually less than the prevailing loan rate, the bank may profitably pay interest to customers who maintain balances large and steady enough to cover the overhead costs. The practice was much more frequent before the establishment of the federal reserve system than it has been since. At that time banks in reserve cities, vying with each other for the business of the country banks and for the reserve balances that went with that business, frequently promised to pay such

¹⁰ Cf. cases of promissory notes on which interest is not allowed unless stipulated. Time notes, *Jefferis v. Mullen*, 130 Atl. 39 (Del. 1925); *Usefof v. Herzenstein*, 65 Misc. 45, 119 N. Y. Supp. 290 (1909); demand notes, *Knight v. Barnwell*, 130 Atl. 736 (N. J. 1925); *Van Vliet v. Kanter*, 139 App. Div. 603, 124 N. Y. Supp. 63 (1910).

high rates of interest as to make the whole transaction unprofitable, and at times extremely dangerous.¹¹ Clearing house associations attempted to restrict the competition by fixing a maximum rate which their members could pay.¹² With the advent of the federal reserve system, its compulsory reserve balances made it difficult for country banks to maintain balances in other banks, and its clearing facilities made the practice unnecessary.¹³ However, private clearing and correspondent banking continues, and so does the payment of interest on the credit balance. Of course large customers other than banks can also exact such promises.¹⁴

Subject to rate limitations imposed by usury statutes, an express promise to pay simple interest is now everywhere enforceable. But the way in which banks habitually perform their promises to pay interest on the credit balance results in the payment of interest upon interest, a consequence which is doubtless anticipated. If the payment of interest upon interest is in pursuance of a prior bargain, it may be, because of the doubt which still exists as to the enforceability of such agreements, that the bank will not be obligated to pay it. With this in mind, the practice of banks in respect of the payment of interest must be examined.

The basis for the computation of interest is the daily credit balance. Whether or not the liability to honor the customer's orders is co-

¹¹ See 2 WESTERFIELD, *BANKING PRINCIPLES AND PRACTICE* (1921) c. XXI; SPAHR, *CLEARING AND COLLECTION OF CHECKS* (1926) 110.

¹² See 3 WESTERFIELD, *op. cit.* 650; SPAHR, *op. cit.* 134, 416; 1 LANGSTON, *PRACTICAL BANK OPERATION* (1921) 75-77. The constitution of the New York Clearing House Association, Article XI, affects the payment of interest only on domestic accounts (§ 3). For balances not subject to check and less than \$15,000 it fixes a maximum rate of 3% (§ 1); all others are subject to regulation by the Clearing House Committee (§ 2); the penalty for violations is a \$5,000 fine for the first offense, and expulsion for the second (§ 6).

Interest Ruling No. 5 illustrates a restriction on the permissible methods of computing the amount on which interest may be paid. "*Question*: In cases where member banks have an arrangement with correspondent banks to charge to the correspondent's account, on the day forwarded, items sent them for collection, is it permissible, under the rules, to allow interest on the amount of items forwarded for the number of days required to convert the items into cash, if they were deposited in the Federal Reserve Bank? *Ruling*: The Committee rules that the above practice may lead to abuses and violations of the spirit of the amendment, and requests the members to adopt the plan of a delayed charge in accordance with the time schedule of the Federal Reserve Bank of New York, without allowance of interest or exchange."

¹³ Article XI, § 4 of the New York Clearing House Constitution provides: "No member of this Association, or bank or trust company or others clearing through any member, shall pay exchange or other charges, or allow time, in connection with the collection of any item collectible through the Federal Reserve Banks, but which is collected through other sources, in excess of the charges which would have been payable or the time allowed had such item been collected through the Federal Reserve Banks."

¹⁴ It is estimated by New York bankers that banks in the financial district, whose customers are largely brokers, pay interest on most of their accounts.

extensive in amount with the credit balance, it is clear that the amount upon which interest is paid is not. That amount is determined as follows: to the balance at the close of the previous day are added all advances by the customer made during the day, and from this sum are subtracted the advances by the bank made during the day and also an item to compensate for "interest delays," arrived at by multiplying each of the customer's advances by the number of days which will elapse before the check or other item purchased by the bank can be collected.¹⁵ Once a month (in some banks once every three months) interest is computed by multiplying by the agreed rate per month (*i.e.*, the agreed annual rate divided by 12) either the smallest "interest balance" shown on any day during the period, or the average daily "interest balance" (*i.e.*, the sum of the actual daily "interest balances" divided by 30), or by multiplying by the agreed rate per day (*i.e.*, the agreed annual rate divided by 360) the sum of the products of each new "interest balance" and the number of days it remained stationary. Obviously the first method will yield a smaller total than the second and third; the latter two yield the same result. The first is the common method used in computing interest on "savings" accounts; the third is the English formula and is used by American banks on foreign accounts; the second is the prevailing American formula for domestic accounts. The sum of interest thus arrived at is then credited to the customer's account.¹⁶ Two important elements stand out from this practice; that the bank pays its interest monthly, and that it pays its interest by crediting the customer's account. The understanding between bank and customer, made when the account was opened, compounded of words as to payment and these usages as

¹⁵ The following table, showing "a comparison of an interest balance with an actual balance for a given day" is given in 2 LANGSTON, PRACTICAL BANK OPERATION, (1921) 552:

	Interest Balance	Actual Balance
Actual balance as shown by ledger at beginning of day ..	\$75,000	\$75,000
Deposited today:		
Proceeds from discounts, loans, and other immediately available items	25,000	25,000
Clearing house checks, country checks with exchange trusts, etc., arriving too late to be collected today	10,000
Country checks (discretionary, 3 days)	5,000
	\$100,000	\$115,000
Less checks paid	20,000	20,000
	\$80,000	\$95,000
Less interest delay \$5,000 at 2 days	10,000
	\$70,000	\$95,000
Balance for today	\$70,000	\$95,000
Balance forwarded to next day's work	\$95,000	\$95,000

¹⁶ This account of banking practice is based on interviews and correspondence with leading New York bankers.

to mode of payment, is for a periodic transformation of interest into interest-bearing principal. It should be noted, however, that the understanding does not contain a promise, *i.e.*, an assurance, to pay interest upon interest. The understanding is not a bargain at all; it is rather an agreement upon the terms of bargains to be made at the making of each advance. Not until the making of each advance, *vis.*, as part of the bargain under which the advance is made, does the bank promise to pay interest. When interest accrues and is not claimed by the customer and becomes itself an advance, a bargain for the payment of interest upon it is then consummated exactly as upon the making of any other advance by customer to bank. Then for the first time the bank promises to pay interest on interest. Thus the promise to pay interest on interest is not made before the interest accrues. This distinction between understanding and promise, however available, may be thought not potent enough to exorcise the demon of "compound" interest. If the court should find that a bargain, and not an understanding, for the payment of interest upon interest during the entire life of the current account was made at the time of the original advance, will an obligation to pay interest upon interest be imposed?

The English Chancellors refused to enforce an agreement made before interest is payable to turn that interest, if not paid, into principal.¹⁷ Chancellor Kent, who transplanted the doctrine to America, was the first to articulate reasons for it; he feared that to enforce such agreements would be harsh and oppressive, and would tend to make debts "accumulate with a rapidity beyond all ordinary calculation and endurance."¹⁸ There was no pretense that the unenforcibility was the result of statutory prohibitions of usury.¹⁹ It is easy to see that the promise ordinarily is not usurious.²⁰ In the first place, the rate promised may be so low or the occasions for turning interest into principal so infrequent that the aggregate of interest accruing during the life of the loan will not exceed the aggregate resulting from a computation on the basis of simple interest at the maximum permissible rate. But even if it does, there is only one situation in which the promise is usurious:

¹⁷ *Ossulston v. Yarmouth*, 2 Salk. 449 (1707); *Ex parte Bevan*, 9 Ves. Jr. 223 (1803). The result was that interest upon interest could not be collected. However, the principal and simple interest on the principal could be recovered, and if interest on the interest was voluntarily paid it could not be recovered back, see *Mowry v. Bishop*, 5 Paige 98, 103 (N. Y. 1835). This is quite in contrast with the heavy penalties imposed by usury statutes, ranging in severity from loss of the usurious interest, IND. STAT. ANN. (Burns, 1926) § 9331, to forfeiture of the entire debt, Stat. 12 Anne, c. 16; N. Y. Gen. Business Law § 373.

¹⁸ See *Connecticut v. Jackson*, 1 Johns. Ch. 13, 17 (N. Y. 1814).

¹⁹ See *ibid.* 20.

²⁰ Of course, in jurisdictions where corporations are not permitted to plead usury, ILL. REV. STAT. (Cahill, 1924) c. 74, § 11; N. Y. Gen. Business Law § 374, such a defense if it existed here would not be available to incorporated banks.

when the borrower has no power to avoid the accumulation. For if he is privileged under the agreement to pay the interest at the time set for its becoming principal if it is not paid,²¹ and still more if he is under a duty to pay it at that time, interest on the unpaid interest is not usurious.²² It is only where the compounding cannot be avoided, where it is a method of computation rather than a method of fixing the date for the payment of interest, that the agreement is usurious.²³ This single case is impossible under the commercial bank's current account agreement. It is always within its power to avoid the compounding by tendering to the customer the amount of the credit balance. An additional reason in the case of a current account coupled with a promise to honor checks for judging that the bank's promise will be held not usurious is the accepted rule governing the application of payments to an account made up of principal and interest, which directs that payments shall be applied first to discharge interest.²⁴ It is an uncommon checking account indeed in which the debits during any month do not exceed in amount the credit for interest on credit balance which accrued the preceding month. The instances in such accounts in which that will not be true and in which, consequently, interest will be paid on interest, while common enough in the operation of "savings" current accounts, are so rare that they should be judged not the end towards which the parties bargained.²⁵ The bargain therefore is not usurious.

As for the notion that an agreement before the interest is payable to turn it into principal, though not usurious, should not be enforced, whatever may have been its merits when applied to the English landowner of the eighteenth century, to the American settler, or to the contemporary *petit bourgeois*, it is surely inappropriate in the context we are considering. Banks do not need protection against overreaching by their customers, and protection against their own excessive eagerness to pay greater interest on deposits than is consistent with sound banking had better be left to the clearing house associations. Furthermore, even if blinded Justice cannot see the distinction between banks and other borrowers, the infrequency of occasions in which compound-

²¹ *Crider v. San Antonio Loan Ass'n*, 89 Tex. 597, 35 S. W. 1047 (1896).

²² *Hochmark v. Richler*, 16 Colo. 263, 26 Pac. 818 (1891); *Bowman v. Neely*, 137 Ill. 443, 27 N. E. 758 (1891); *Ragan v. Day*, 46 Iowa 239 (1877); *Jones v. Nossaman*, 114 Kan. 886, 221 Pac. 271 (1923); *Re Diven*, 115 Kan. 119, 222 Pac. 106 (1924); *Newton v. Woodley*, 55 S. C. 132, 32 S. E. 531 (1898); *Crider v. San Antonio Loan Ass'n*, 89 Tex. 597, 35 S. W. 1047 (1896). See *Connecticut v. Jackson*, 1 Johns. Ch. 13, 14 (N. Y. 1814); *Hale v. Hale*, 41 Tenn. 233, 235 (1860).

²³ See *Crider v. San Antonio Loan Ass'n*, 89 Tex. 597, 600, 35 S. W. 1047, 1048 (1896).

²⁴ *Connecticut v. Jackson*, 1 Johns. Ch. 13 (N. Y. 1814). See 33 C. J. 250, 251.

²⁵ *Cf. First Nat. Bank v. Waddell*, 74 Ark. 241, 85 S. W. 417 (1905); *Hatch v. Douglas*, 48 Conn. 116 (1880).

ing results on a checking account (because of the rule for the application of payments) makes the bargain so unlikely to result in oppression as to negative the conclusion that the promise was extorted by superiority of bargaining power. That the awarding to a bank of a privilege or immunity to disregard its promise to pay interest by crediting it, would be an empty gesture, is indicated by the fact that, notwithstanding the long established practice of banks to make such promises, there is no case in the books in which a bank has disputed a claim for interest on the ground that it was compounded. Nevertheless, if the case should arise, the probable result is by no means certain. The dictum of Chancellor Kent is still echoing.²⁶

III

At the beginning of the discussion of interest upon interest it was suggested that the behavior of bank and customer before interest accrued amounted, first, to an understanding as to the terms of future bargains and, secondly, to a series of such bargains, made upon each advance by customer to bank, in which the bank promised to pay interest on the credit balance including the particular advance. In consequence, it was suggested that the bank did not promise to pay interest on that interest until the interest accrued and became an advance on the current account by customer to bank. In the argot this promise, when made, because it is made after simple interest accrues, would be called a "subsequent" agreement for compound interest. In content this promise is quite different from that considered above, called an

²⁶ A promise in the loan agreement to pay compound interest is in nearly all jurisdictions unenforceable, *Ossulston v. Yarmouth*, 2 Salk. 449 (1707); *Ex parte Bevan*, 9 Ves. Jr. 223 (1803); *Eslava v. Lépretre*, 21 Ala. 504 (1852); *Pauling v. Creagh*, 54 Ala. 646 (1875) *semble*; *Breckenridge v. Brooks*, 2 A. K. Marsh. 335 (Ky. 1820); *Henry v. Flag*, 54 Mass. 64 (1847); *Cox v. Smith*, 1 Nev. 161 (1865); *Connecticut v. Jackson*, 1 Johns. Ch. 13 (N. Y. 1814) *semble*; *Catlin v. Lyman*, 16 Vt. 44 (1844). *Contra*: *Scott v. Saffold*, 37 Ga. 384 (1867) *semble*; *Hale v. Hale*, 41 Tenn. 233 (1860). But none of these cases adjudicates the validity of such a promise in connection with a current account. For cases enforcing a customer's promise, and indicating *a fortiori* that the bank's promise would be enforceable, see *infra*, note 43. Even a promise in the loan agreement to pay simple interest on unpaid interest from the time of default until payment, is in many states unenforceable. That it is enforceable, *Vaughan v. Kannan*, 38 Ark. 114 (1881); *Hovey v. Edmison*, 3 Dak. 449 (1884); *Neel v. Young*, 78 Ga. 342 (1886); *Ellard v. Scottish-American Mtg. Co.*, 97 Ga. 329 (1895); *Pawling v. Pawling*, 4 Yeates 220 (Pa. 1805); *Hale v. Hale*, 41 Tenn. 233 (1860); *Lewis v. Paschal*, 37 Tex. 315 (1873). That it is not enforceable, *Hochmark v. Richler*, 16 Colo. 263, 26 Pac. 818 (1891); *Bowman v. Neely*, 137 Ill. 443, 27 N. E. 758 (1891); *Niles v. Commissioners*, 8 Blackf. 158 (Ind. 1846); *Hoyle v. Page*, 41 Mich. 533 (1879). See *Connecticut v. Jackson*, 1 Johns. Ch. 13, 14-17 (N. Y. 1814). In the latter group a familiar exception is made in favor of "coupon notes," so that separate notes, themselves bearing interest, given for interest on the principal obligation, are everywhere enforced. *Parker v. McGinty*, 77 Colo. 458, 239 Pac. 10 (1925). See 37 A. L. R. 325, 344; 27 *ibid.* 81, 89.

agreement "in advance." That promise was to pay interest on the principal, and if the interest was not paid, to pay interest on the interest. The "subsequent" agreement is to pay simple interest on a sum which includes principal and accrued interest. The outcome of the two promises is identical, but the fact that the latter is in terms a promise to pay only simple interest has been seized upon as a point of distinction. The "subsequent" agreement is, of course, not usurious,²⁷ and has always been enforceable everywhere.²⁸

An express agreement made after interest has accrued is no less enforceable because it follows an unenforceable agreement made before interest had accrued. And of course a subsequent agreement, like any of the others we are considering, may be implied in fact as well as express. The question arises whether, in the presence of an unenforceable agreement in advance, a new, subsequent, and therefore enforceable agreement may be found from acts which but for the unenforceability of the prior agreement would be looked upon as done in pursuance of the prior agreement and as nothing more. For example, banks commonly render to their customers monthly statements showing the credits and debits of the current account during the preceding month and the balance at the end of the month. On an interest-bearing account, the statement will show that the bank, in accordance with its practice, has credited the account with the sum due for interest on the credit balance. Now if a court should find, contrary to our suggestion, that there was a bargain between bank and customer, before interest accrued, and not merely an understanding, and furthermore that such a bargain "in advance" was unenforceable, could it find that the rendering of the statement by the bank and the reliance upon it by the customer amounted to a bargain that the balance on which interest was to be calculated during the succeeding month should contain the item of interest just accrued? Whether or not it would find such an agreement depends, as does the existence of many implied-in-fact agreements, upon whether or not it is desired to impose such an obligation as would be imposed if an agreement in fact existed. The court's view as to the social wisdom of regulating the payment of interest, as to the financial

²⁷ *Jones v. Nossaman*, 114 Kan. 886, 221 Pac. 271 (1923); *Keiser v. Decker*, 29 Neb. 92, 45 N. W. 272 (1890); *Spain v. Talcott*, 165 App. Div. 815, 152 N. Y. Supp. 611 (1915). For cases holding such a promise by a customer not usurious, see *infra*, note 44.

²⁸ *Ossulston v. Yarmouth*, 2 Salk. 449 (1707) *semble*; *Bruce v. Hunter*, 3 Campb. 467 (1814); *Pauling v. Creagh*, 54 Ala. 646 (1875); *Wigton v. Elliott*, 49 Colo. 115, 111 Pac. 713 (1910). See *Ex parte Bevan*, 9 Ves. Jr. 223, 224 (1883); *Crosskill v. Bowes*, 32 Beav. 86, 100 (1863); *Van Benschooten v. Lawson*, 6 Johns. Ch. 313, 315 (N. Y. 1822). For cases enforcing such a promise by a customer, and indicating a *fortiori* that the bank's promise would be enforceable, see *infra*, note 44.

wisdom of banks' paying interest on checking accounts, as to the role which favoritism, due, for example, to an official relation of customer to bank, plays in the making of interest agreements, and if the bank is insolvent, as to equality in distribution among those customers and stockholders who have made contribution to the insolvent estate, would probably be the determining factors.

If we are predicting the reaction of a court which, notwithstanding its view that an unenforcible bargain for interest upon interest was made when the account was opened, is prepared to find and enforce a new bargain at the time of each advance of interest, basing its finding upon the inclusion of interest in the credit balance and the reliance of the customer on a statement rendered, there remains another situation of fact to be evaluated as a stimulus. Let it be supposed that interest accruing on the credit balance during the first month of an account is added to the credit balance at the end of that month but that no statement is rendered and that there is no other basis for finding knowledge and reliance by the customer. At the end of the second month a statement is rendered and received. It indicates not only that interest which accrued during the second month was added to the credit balance at the end of that month, but also that the balance at the beginning of the second month, with reference to which that interest was calculated, included interest which accrued during the first month. The court would then have before it facts from which could be implied what is called a "subsequent *retrospective*" agreement. Here again Chancellor Kent's voice is heard. Such an agreement, he said, was as unconscionable as an agreement in advance. To exact, as the price of further forbearance, an assent by the borrower to a calculation of interest in a manner for which he had not contracted when he entered into the debt was harsh, oppressive, and tended to usury.²⁹ Why it is not actually usury is at first hard to see. Since there was no promise in advance, or at least no enforcible promise in advance, to pay interest on unpaid interest, only simple interest grew on the principal,³⁰ or at most, in some jurisdictions, simple interest on that interest,³¹ but certainly not interest compounded periodically. If the borrower then, in return for a promise

²⁹ Van Benschooten v. Lawson, 6 Johns. Ch. 313 (N. Y. 1822).

³⁰ The rule in many states, denying interest as damages on defaulted interest, Leonard v. Villars, 23 Ill. 377 (1860); Niles v. Commissioners, 8 Blackf. 158 (Ind. 1846); Grimes v. Blake, 16 Ind. 160 (1861); Connecticut v. Jackson, 1 Johns. Ch. 13 (N. Y. 1814); Genin v. Ingersoll, 11 W. Va. 549 (1877); see Young v. Hill, 67 N. Y. 162, 167 (1876); is an exception to the rule allowing interest as damages on defaulted obligations for the payment of money. See *supra*, page 637 and note 8.

³¹ Burke v. Trabue, 137 Ky. 580, 126 S. W. 125 (1910); Mann v. Cross, 9 Iowa, 327 (1859); Pierce v. Rowe, 1 N. H. 179 (1818); Kennon v. Dickens, 1 Conf. 357 (N. C. 1800); Bledsoe v. Nixon, 69 N. C. 81 (1873); Roane v. Ross, 84 Tex. 46, 19 S. W. 339 (1892); Catlin v. Lyman, 16 Vt. 44 (1844).

by the lender to forbear suit on the amount at that time recoverable, promises to pay that amount with interest at the maximum legal rate on a greater amount, is not the promise usurious? A negative answer has been based on the argument that the greater sum (*i.e.*, compound interest to date) although not due at law, was "morally" due, and that it was not usurious to promise to pay what was morally due.³² At any rate it is admitted on all hands that the subsequent retrospective agreement is not usurious.³³ Then why is it "unconscionable"? No good reason appears, certainly none in the case of bank and customer. Even in Kent's jurisdiction it has been assumed that a subsequent retrospective agreement is obligatory.³⁴

IV

In American commercial banking the credit balance represents the normal state of the current account. Though the customer's indebtedness to the bank on his discounted notes exceed the indebtedness of the bank to the customer, as is most often the case, the balance of the current account is in favor of the customer. This is because the bank buys the specific obligations of its customer in the form of notes and bills for a price forthwith payable. The purchase of the paper is quite independent of the current account. The transaction is not on the current account until an advance is made, and when one is made it is an advance from customer to bank of the unpaid purchase price. A debit balance exists only when the advances by the bank exceed all advances of the customer including his advance of the unpaid purchase price of his paper. The debit balance is an oddity, infrequent in occurrence and short in duration. So firmly imbedded is the notion of the normality of the credit balance and the abnormality of the debit balance that it has colored even the terminology; debit balances are called "overdrafts."

Being unexpected, overdrafts are unsecured, and therefore have come to be regarded as "forced loans" and generally disreputable. Of course there is no reason why a bank may not agree to make advances exceeding the amount of the credit balance. Some form of security, *e.g.*, bills of lading, corporate stocks or bonds, or personal guaranties, may be arranged before the bank begins its advances to the customer.

³² *Camp v. Bates*, 11 Conn. 487 (1836); *Mowry v. Bishop*, 5 Paige 98 (N. Y. 1835).

³³ *Camp v. Bates*, 11 Conn. 487 (1836); *Gilmore v. Bissell*, 124 Ill. 488 (1888); *Breed v. Baird*, 139 Ill. App. 15 (1907); *Sanford v. Lundquist*, 80 Neb. 414, 118 N. W. 129 (1907); *Kellogg v. Hickok*, 1 Wend. 521 (N. Y. 1828); *Stewart v. Petree*, 55 N. Y. 621 (1874); *Young v. Hill*, 67 N. Y. 162 (1876) *semble*; *Parham v. Pulliam*, 45 Tenn. 497 (1868).

³⁴ *Young v. Hill*, 67 N. Y. 162 (1876), current account between principal and agent; *Neuberger-Morris Co. v. Talcott*, 219 N. Y. 505, 114 N. E. 846 (1916), current account between finance company and customer.

In no respect would such an agreement be inferior in dignity to an extension of bank credit by means of a loan or discount. Such is the established British and British colonial practice.³⁵ But the American banks, except in the case of foreign accounts,³⁶ do not extend credit by means of overdrafts. There is, to be sure, one relevant difference in result between the American and British systems which may account for the attachment of the American bankers to their own. It is that under the American system the customer pays interest on his note at the

³⁵ In Scotland, where in 1730 the overdraft as a conventional form of the extension of bank credit seems to have had its birth, it is known as a cash credit. A joint and several bond is executed by the customer and two cautioners binding them to repay on demand with interest the amount of any overdraft to the limit agreed upon. The bank will revoke its offer if the overdraft becomes a dead loan; but the offer may be outstanding for years if the bank does not become dissatisfied with the bondsmen or they do not withdraw from the obligation. It seems that the Scottish system grew out of a desire on the part of the Scottish banks to dispose of superfluous credit in the form of their bank notes. See ADAM SMITH, *WEALTH OF NATIONS* (1776) Bk. II, c. 2 (Seligman's ed. 1910, 263 *et seq.*); 1 HUME, *ESSAYS, Essay on Balance of Trade* (Green & Grose ed. 1875) 339 ("... one of the most ingenious ideas that has been executed in commerce"). It is said that to the cash credit system is due largely the growth of the Scottish agricultural and middle classes and the possibility of the rise of propertyless individuals who cannot afford to pay interest on loans or risk their repayment. The advantage to the bank is in the form of the higher rate of interest demanded, the interest being computed on daily balances, see GILBART, *PRINCIPLES AND PRACTICE OF BANKING* (1870) 129-134, 506-511; MACLEOD, *THEORY AND PRACTICE OF BANKING* (1911) 344-351; JOHNSTON, *Scottish Banking System, PROCEEDINGS OF AMERICAN BANKERS ASS'N 28TH ANNUAL CONVENTION* (1902) 75, 78; SPALDING, *BANKERS' CREDITS* (1921) 9 *et seq.*; *Interviews on Banking*, 1 REPORT NAT. MONETARY COMMISSION (1911) 135, 150, 165; WITHERS, *THE ENGLISH BANKING SYSTEM* (1910) 42. In India, it is customary to give a demand note for the maximum of the overdraft allowed with the surety as accommodation maker and the customer as payee-indorser. The Australian practice is described in HAMILTON, *LAW AND PRACTICE OF BANKING IN AUSTRALIA AND NEW ZEALAND* (2d ed. 1900) 150-179; and see, *e.g.*, *Bank of Victoria v. Brown* [1875] 1 Vict. L. R. (law) 47. In England, overdrafts were formerly used extensively only in the country, DAVIS, *BANK ORGANIZATION AND MANAGEMENT* (1910) 94; GILBART, *PRINCIPLES AND PRACTICE OF BANKING* (1870) 174, 399; but they are becoming increasingly common and loans on notes (taken as security) corresponding less common. In 1911 the Bank of England reported that its practice was to allow no overdrafts, see *Interviews on Banking, supra*, 234. By 1919 it was reported that the five big joint-stock banks made advances in the form of agreed-to overdrafts amounting, in the case of at least one bank, to about one-fifth of the number of loans but much more in the volume of credit since it is used most extensively by the very large firms. The practice is to place securities in the bank which serve against both loans and overdrafts. The limit fixed is generally approximate and the exact sum is left to the requirements of the firm. The customer fills out a form or signs his account as an acknowledgment and though the date when the customer expects to pay must be stated large firms have heavy overdrafts almost continuously. GRADY, *Use of the Trade Acceptance in British Domestic Business*, COMMERCE REPORTS (July 22, 1919) No. 170, 417-418. At the present writing, correspondence and interviews with persons acquainted with English banking practice indicate that the agreed-to overdraft is even much more common today than in 1919; but there exists an opinion that in spite of the fact that the rate of interest is somewhat higher than the daily bank rate the banks will tend to discourage overdrafts and prefer to lend agreed sums for agreed periods.

³⁶ 2 LANGSTON, *PRACTICAL BANK OPERATION* (1921) 565.

agreed rate for the agreed time no matter how little of its proceeds he may actually use (as shown by the size of his credit balance in the meantime), while under the British practice, the amount on which he pays interest does not exceed the bank's advances.

Since the debit balance is abnormal in the United States, we do not find formal agreements between customer and banker for the payment of interest by the customer on debit balances. Not being contemplated, the contingency is not provided for. In many jurisdictions there is no obligation to pay interest on a loan unless interest is in terms bargained for.³⁷ In them there is no obligation upon the customer to pay interest on debit balances if they do occur.³⁸ However, in states where an obligation to pay interest on a loan is built upon the presumption of interest on a loan,³⁹ the customer may be obligated.⁴⁰ Certainly the presumption is not rebutted, as it is in the case of the credit balance. The customer's obligation to pay a debit balance, unlike the bank's obligation to pay a credit balance, does not result from a bargain for the "purchase" by the customer of deposit currency. But if there is a bargain for interest, in terms or by presumption, what is its content as to time and mode of payment?

If there is a bargain in terms, as in Great Britain and the British Colonies, there is usually a writing containing a promise to pay interest, which together with the banking practice of debiting interest, results in a bargain to pay interest on the debit balance periodically by adding it to the debit balance.⁴¹ If there is no bargain in terms, the obligation, if there is one, is said to rest upon the presumption of a promise. Doubtless in constructing the presumed promise in the process of formulating the obligation, the courts will piece the promise together out of English practice and American practice in respect of foreign accounts. The promise, then, will be said to be one to pay interest periodically by debiting it.

Whether the bargain is in terms or presumed, probably the same question as to the time of its making will be posed as that discussed in connection with the bargain for interest upon interest on the credit balance. Is the bargain made at the time of opening the account? Is it made at the time the bank makes its advance, *i.e.*, at the time interest becomes due? A finding that the bargain is made when interest becomes due and is debited opens wide the door to the court disposed to impose

³⁷ See cases cited *supra*, note 8.

³⁸ *Hubbard v. Charlestown R. R.*, 52 Mass. 124 (1846).

³⁹ See *supra*, note 6.

⁴⁰ *Casey v. Carver*, 42 Ill. 225 (1866) *semble*.

⁴¹ *National Bank of New Zealand v. Grace*, 8 N. Z. L. R. 706 (1890); *Moore v. Voughton*, 1 Stark. 487 (1816) *semble*.

an obligation to pay interest upon interest.⁴² Even a finding fixing its date at the opening of the account by no means closes the door.⁴³

The court which can see no bargain for interest upon interest except in the rendering of a statement, or which, doubting the validity of a prior agreement, relies upon the statement, can put the case into the class of either a "subsequent" or a "subsequent retrospective" agreement.⁴⁴

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⁴² A bargain at the time the interest is debited that the customer shall pay the bank interest upon interest included in the debit balance is obligatory. See the cases cited *infra*, note 44, holding that an agreement subsequent to the debiting, *e.g.*, at the time of rendering a statement, is not usurious and is enforceable.

⁴³ A bargain between bank and customer said to be made when the account is opened is not usurious, *First Nat. Bank v. Waddell*, 74 Ark. 241, 85 S. W. 417 (1905); *Hillsboro Oil Co. v. Citizens' Nat. Bank*, 32 Tex. Civ. App. 610, 75 S. W. 336 (1903); and is enforceable, *Stewart v. Stewart*, L. R. 27 Ir. 351 (1891); *McLeod v. Nat. Bank of New Zealand*, 6 N. Z. L. R. 3 (1888); *National Bank of New Zealand v. Grace*, 8 N. Z. L. R. 706 (1890); *Parr's Banking Co. v. Yates* [1898] 2 Q. B. 460, *semble*. But see, *Montgomery v. Ryan*, 9 Ont. 572, 584 (1907).

Accord: *Hatch v. Douglas*, 48 Conn. 116 (1880) stockbroker's account, not usurious; *McManus v. Sawyer*, 231 Fed. 231 (S. D. N. Y. 1915) finance company's account, enforceable. *Contra*: *Neuberger-Morris Co. v. Talcott*, 219 N. Y. 505, 114 N. E. 846 (1916); and *Lemnos Silk Works v. Spiegelberg*, 217 N. Y. Supp. 595 (1926) finance company account unenforceable though not usurious.

⁴⁴ A "subsequent" agreement found from the rendering of a statement by bank to customer is not usurious, *Calot v. Walker*, 2 Anstr. 495 (1794); *Timberlake v. First Nat. Bank*, 43 Fed. 231 (C. C. Miss. 1890); and is enforceable, *Haridas Ranchordas v. Mercantile Bank of India*, 44 Bombay 474 (1919); *Clancarty v. Latouche*, 1 Ball & B. 420 (1810); *Eaton v. Bell*, 5 B. & Ald. 34 (1821); *Rufford v. Bishop*, 5 Russ. Ch. 346 (1829); *Williamson v. Williamson*, 7 Eq. Cas. 542 (1869); *Isett v. Oglevie*, 9 Iowa, 313 (1859). *Contra*: *Montgomery v. Ryan*, 9 Ont. 572 (1907) *semble*. There are no cases of "subsequent retrospective" agreements.