

White Paper: Additional Issues Regarding Possible Duplicate Payment of Check Items¹

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A. Introduction

As part of its ongoing efforts to serve as a clearing house of information and education for financial institutions regarding check image exchange, Electronic Check Clearing House Organization (“ECCHO”) has prepared this white paper addressing certain issues associated with duplicate presentment of check images. This white paper was prepared by ECCHO in cooperation with representatives of various member financial institutions and other interested persons.

For additional information regarding operational and other issues associated with potential duplicate images, please see the ECCHO and CheckImage Central web sites for the following documents:

- *Avoid Duplicates!*
http://www.eccho.org/documents/Duplicates_000.pdf
- *A Guideline Document on Duplicate Image/IRD Prevention and Detection*
<http://checkimagecentral.org/pdf/DuplicatePreventionAndDetection.pdf>
- *Resolving Duplicates as Adjustments versus Returns*
<http://checkimagecentral.org/pdf/ResolvingDuplicatesAsAdjustmentsVersusReturns.pdf>

In addition, financial institutions offering remote deposit capture (“RDC”) should have already reviewed and implemented as appropriate the guidance published by the Federal Financial Institutions Examination Council (“FFIEC”) relating to offering RDC services to customers. This FFIEC guidance addresses, among other topics, a financial institution’s responsibility to identify and control various risks, including risk of duplication, associated with offering RDC services. The FFIEC Guidance is located on the FFIEC website at: http://www.ffiec.gov/pdf/pr011409_rdc_guidance.pdf

¹ IMPORTANT INFORMATION ABOUT THIS DOCUMENT: The content of this document was prepared by ECCHO and an informal working group of representatives of various financial institutions. The views expressed in this document are not indorsed by, and do not necessarily reflect the views of, ECCHO or the representatives or financial institutions that participated in the working group. This document is not intended as legal advice or opinion or any other form of legal or business recommendation to any person. To the extent that the document identifies or discusses a legal matter, a reader or other user of the document should consult with their legal counsel as to its application to them or to a particular situation.

B. Claims Arising From Duplicate Payment of Check Images Presented from Two Different Banks of First Deposit

There have been noted certain situations where the paper check and/or check images of the same paper check are deposited at two different banks of first deposit (BOFDs).

The following is an example of how this duplicate scenario can arise. Payee Customer of BOFD Bank A uses remote deposit capture to deposit a check image of a paper check with BOFD Bank A. The check is drawn on Paying Bank C, and is cleared through a check image exchange network to Paying Bank C which pays the item and posts the item to the Drawer Customer's account. The Payee Customer then takes the paper check to BOFD Bank B and deposits the paper check with BOFD Bank B either in paper form or in check image form by means of remote deposit capture. (The Payee Customer may be acting out of mistake or fraudulent intent in connection with the second deposit.) The check image is presented for payment to Paying Bank C. Paying Bank C either returns the item to BOFD Bank B within the midnight deadline (if the item is identified as a duplicate in a timely manner), or Paying Bank C pays the item, potentially posts the item to the Drawer Customer's account, and subsequently makes a warranty claim to BOFD Bank B or BOFD Bank A for the duplicate payment of check images arising from the same item. It is assumed that BOFD A, BOFD B and Paying Bank C are ECCHO members or otherwise subject to the ECCHO Rules, and that the ECCHO Rules govern the check image exchange in question.

ECCHO has received questions from member financial institutions regarding the above scenario.

1. BOFD Banks Subject To Warranty Claim For Duplicate Payment

Question: Assuming there is a duplicate payment relating to check images from the same paper check, can Paying Bank C make a warranty claim under ECCHO check image rules against either BOFD Bank A or BOFD Bank B for the duplicate payment?

Answer: Yes. The ECCHO Rules provide that a BOFD that presents an item to the Paying Bank makes a warranty to the Paying Bank that the Paying Bank will not be asked to make payment twice on the same item. Specifically, under the ECCHO Rules, each BOFD warrants to the Paying Bank that the Paying Bank and any other person will not receive a transfer, presentment or return of, or otherwise be charged for, the Electronic Image, the Related Physical Check of that Electronic Image, or a paper or electronic representation of the Related Physical Check such that the Paying Bank will be asked to make a payment based on an item that it already has paid. ECCHO Rules Section XIX(L)(7). A BOFD that breaches this warranty to the Paying Bank indemnifies the

Paying Bank and holds it harmless from and against any damages, expense or loss, including attorney's fees, suffered as a result of the breach. ECCHO Rules Section XIX(L).

This ECCHO warranty against duplicate payment is made by both BOFD Bank A and BOFD Bank B in the above situation, and Paying Bank C has the option of proceeding against either of the BOFDs in connection with its claim for a breach of this warranty. The fact that BOFD Bank B was the second bank to present the item to Paying Bank C does not limit the ability of Paying Bank C to make a warranty claim against BOFD Bank A or BOFD Bank B. The ECCHO warranty against duplicate payment extends to both a situation where the check image presented causes the duplicate payment and a situation where a check image or paper check presented in the future causes the duplicate payment.

As noted in the commentary to the ECCHO Rule Section XIX(L)(7), the ECCHO warranty against duplicate payment is structured to be similar to the warranty under Regulation CC that protects against duplicate payment of substitute checks by a paying bank or other person. While Regulation CC does not expressly address check image exchange, the text of the ECCHO warranty against duplicate payment is substantially based on the text of the warranty in Regulation CC relating to duplicate payment of substitute checks and images of substitute checks. The commentary to Regulation CC Section 229.52(a)(2) relating to duplicate presentment of substitute checks is illustrative of the right of the Paying Bank to make a warranty claim against either BOFD.²

Specifically, the Commentary to Section 229.52(a)(2) of Regulation CC provides that:

5. The warranty in Section 229.52(a)(2), which addresses multiple payment requests for the same check, is not linked to a particular substitute check but rather is given by each bank handling the substitute check, an electronic representation of a substitute check, or a subsequent substitute check created from an electronic representation of a substitute check. All banks that transfer, present, or return a substitute check (or a paper or electronic representation thereof) therefore provide the warranty regardless of whether the ultimate demand for double payment is based on the original check, the substitute check, or some other electronic or paper representation of the substitute or original check, and regardless of the order in which the duplicative payment requests occur. **This warranty is given by the banks that transfer,**

² The Regulation CC commentary provides background material to explain the Federal Reserve Board's intent in adopting a particular part of Regulation CC. It also provides examples to help readers understand how a particular requirement is to work. See Note on Regulation CC, 12 CFR Part 229.

present, or return a substitute check even if the demand for duplicative payment results from a fraudulent substitute check about which the warranting bank had no knowledge.

(Emphasis added).

Example.

A nonbank depositor truncates a check and in lieu thereof sends an electronic version of that check to both Bank A and Bank B. Bank A and Bank B each uses the check information that it received electronically to create a substitute-check, which it presents to Bank C for payment. Bank A and Bank B each is a reconverting bank that made the substitute check warranties when it presented a substitute check to and received payment from Bank C. **Bank C could pursue a warranty claim for the loss it suffered as a result of the duplicative payment against either Bank A or Bank B.** Regulation CC Commentary Section 229.52(a)(2)-5. (Emphasis added)

This white paper does not discuss issues arising under the Federal Reserve System's check image exchange rules (Regulation J and Operating Circular #3). A financial institution should consult these Federal Reserve rules for those matters that involve check images exchanged through the Federal Reserve System. It is noted that the warranties in Regulation J³ that address a sending bank's responsibility for duplicate items are textually similar to the warranties against duplicate payment under Regulation CC for substitute checks and Section XIX(L) of the ECCHO rules for check images subject to the ECCHO Rules.

2. Claim Between BOFD Banks Relating To Liability on Warranty Claim for Duplicate Payment

Question: In the above scenario, is there a basis for a claim for loss sharing under the ECCHO Rules between BOFD Bank A and BOFD Bank B, in the event one of the two BOFDs incurs liability as a result of a duplicative payment warranty claim from Paying Bank C?

Answer: The ECCHO Rules do not address claims between two BOFDs that are involved in the duplicate presentment of check images. Since there is no exchange of checks or check images between BOFD Bank A and BOFD Bank B, there are no warranties made between BOFD Bank A and BOFD Bank B under the ECCHO Rules. Warranties relating to check images arise under the ECCHO Rules from the exchange of the check images. Similarly, for substitute checks, Regulation CC does not address the

³ 12 CFR Sections 210.5(a)(4)(ii) and 210.6(b)(3)(i).

relationship of two BOFDs in the event both BOFDs present substitute checks that result in duplicate payment by the Paying Bank.

ECCHO does not take a position on whether or not there could be a basis under other applicable law for a loss sharing claim between the two BOFDs involved in the duplicate payment scenario described above. A BOFD that receives a warranty claim for duplicate payment that includes participation of a second BOFD may want to consult with its legal counsel and/or discuss the matter with the second BOFD to see if there is a means to a possible agreement to share losses associated with the duplicate payment.

3. Identification of Items As Duplicate Items or Different Counterfeit Items

Question: Do different endorsements associated with two check images indicate that the check images must have arisen from different paper checks even if the front of the check image appears to be identical?

Answer. By way of background, the warranty against duplicative payment under the ECCHO Rules requires as an element of the warranty claim that the duplicate payment by the Paying Bank arose from the same Electronic Image, the original paper check that was the source of that Electronic Image, or any other paper or electronic representation of that same original paper check. (ECCHO Rules, Section XIX(L)(7).) Accordingly, if the two payments by the Paying Bank at issue arise from two different original paper checks, then the Paying Bank would not have a proper claim under this ECCHO warranty.

As a general matter, the fact that there are different endorsements associated with two check images is not in itself determinative of whether or not the two check images arose from different paper checks. Rather, the banks involved in such a potential duplicate payment scenario will have to undertake additional review and investigation, beyond just a review of the endorsements associated with the check images, to make a determination as to the nature of the two check images and their respective source(s).

Below are four examples for consideration:

- The Payee Customer uses an electronic overlay endorsement on the first image deposit by remote deposit capture to BOFD Bank A. Then, the Payee Customer takes the paper check and endorses it to a check casher who then deposits the check image at BOFD Bank B. In this case, the two check images received by the Paying Bank would have different payee and bank endorsements, but the check images arose from the same original paper check. The Paying Bank's payment of these two check images would give rise to a duplicate payment breach of warranty claim by the Paying Bank under the ECCHO Rules.

- The Payee Customer endorses the paper check with an ink endorsement, and deposits it by remote deposit capture to BOFD Bank A. The Payee Customer then deposits the paper check at BOFD Bank B. BOFD Bank B creates a check image from the paper check for image exchange. In this case, the two check images received by the Paying Bank would have the same payee endorsements and different bank endorsements, but the check images arose from the same original paper check. The Paying Bank's payment of these two check images would give rise to a duplicate payment breach of warranty claim by the Paying Bank under the ECCHO Rules.
- A fraudster creates multiple counterfeit paper checks and deposits each paper check at different BOFDs. The BOFDs each create a check image from the paper check for image exchange. These check images look the same on the front, but have different payee endorsements reflecting different payees (fraudulent) and different BOFD endorsements. Since these check images are from different original checks, the payment of these items would not give rise to a duplicate payment breach of warranty claim by the Paying Bank under the ECCHO Rules.
- A corporate Drawer Customer prints and signs two identical checks, with same amounts and same payees. The Drawer Customer mails these two checks to the Payee Customer. The Payee Customer uses remote deposit capture to deposit the two checks at either the same BOFD or at different BOFDs. Since these two check images were created from different original checks, the payment of these items would not give rise to a duplicate payment breach of warranty claim by the Paying Bank under the ECCHO Rules.

It is beyond the scope of this white paper to address the full range of operational risk and related issues associated with properly identifying two check images (or two substitute checks) as either arising from the same or different original paper checks. Please see the white papers identified above on the Check Image Collaborative website for more information on identifying duplicates and/or fraudulent items.

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