

## **White Paper 2: Additional Issues Regarding Duplicate Payment of Checks involving Third Party Holder Claims<sup>1</sup>**

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### **Introduction**

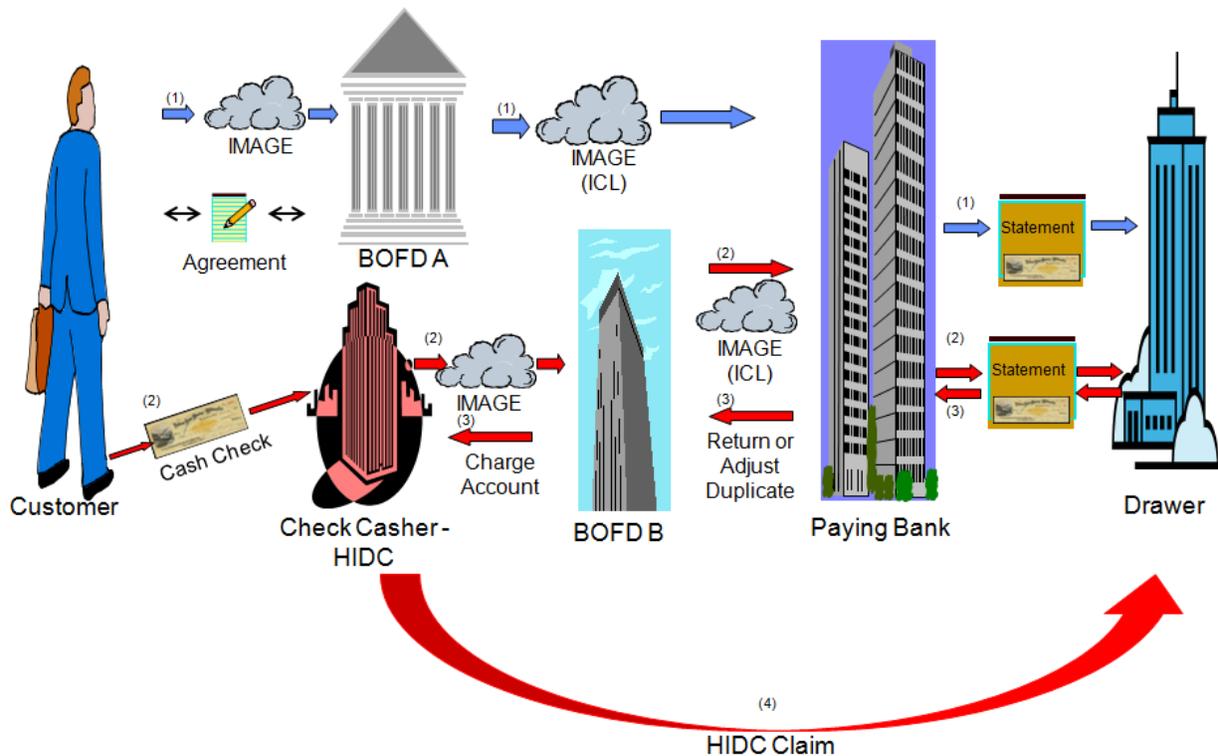
- This paper addresses certain issues with respect to a payment to a holder of an item (including potentially a holder in due course) that may give rise to a subsequent warranty claim by a Paying Bank for a second payment for the same item or image of the same item (referred to in this discussion as a “double payment”). A holder of an item may demand payment on the item directly from the drawer when the item has been returned to the BOFD unpaid by the Paying Bank. UCC Article 3-414(b). These types of claims by a holder are made outside of the check collection process by means of a direct claim (such as demand letter or a lawsuit) against the drawer of the item.

### **Scenario**

- See below graphic of the potential scenario
  - Customer deposits check through remote deposit capture into BOFD A
  - BOFD A sends image to Paying Bank who charges Drawer’s account
  - Customer then brings same check to check casher who deposits image of check into BOFD B
  - BOFD B sends image to Paying Bank who charges Drawer’s account again
  - Drawer informs Paying Bank of duplicate payment
  - Paying Bank returns or adjusts check image to BOFD B
  - BOFD B charges its customer, the Check Casher
  - Check Casher makes Holder In Due Course Claim to Drawer

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<sup>1</sup> 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.



### Status of a Holder under the UCC

- A “holder” is a person that comes into possession of a negotiable instrument that is payable to the bearer or to an identified person that possesses the instrument. UCC Section 1-201. A “holder in due course” is a type of holder, and is a person that takes a check for value, in good faith and without notice that the check is overdue or has been dishonored. In addition, the holder in due course must not have notice that the check contains an unauthorized signature or has been altered or that the payment of the check is subject to certain defenses or subject to certain claims. The check also must not bear apparent evidence of forgery or alteration or otherwise be incomplete. UCC Article 3-302.
- If the holder also qualifies as holder in due course under the UCC, the holder may make such claim against the drawer regardless of certain defenses that the drawer may otherwise have to payment of the item against a holder. (See UCC Article 3-305 for discussion of drawer defenses to payment of an item.) Not every holder of an item would qualify as a “holder in due course,” and the status of the holder will depend on the particular facts and circumstances. For example, a transferee will not qualify as a holder in due course if the paper check that is received by such person: (i) is transferred 90 or more days after the date of the check, (ii) contains a restrictive legend or condition that defeats negotiability (such as “non-negotiable”), or (iii) is missing the endorsement of the payee of the check. A check casher that cashes a check for a payee may qualify as a holder in due course in some situations, and not in others.

### Application of ECCHO Warranty Against Double Payment in Context of a Claim by Holder to the Drawer

- A payment to a holder by a drawer customer or a Paying Bank to resolve a claim by the holder may give rise to a warranty claim under the ECCHO Rules warranty against double payment of an item. An example of a permissible double payment warranty claim by a Paying Bank would include a situation where a Paying Bank has reimbursed its drawer customer because the drawer customer has paid the check/claim to the holder or holder in due course. The double payment arises because there are two payments by a person relating to the same item: (a) the first payment when BOFD A presents the image of the item to the Paying Bank and the Paying Bank pays the item and charges the drawer customer's account, and (b) the second payment occurs when the drawer customer pays the holder for the claim under the UCC based on the original item.
- The ECCHO warranty from BOFD A (referred to as the "sending bank" in the ECCHO Rules) to the Paying Bank against double payment covers the situation where a person (which could include either the Paying Bank or a drawer customer) is "asked to make a payment" twice. The Paying Bank, when it reimbursed its drawer customer (for the payment by the drawer customer to the holder) incurred a loss as a result of the breach of the warranty. As a result of this loss arising from a breach of the warranty, the Paying Bank can make a claim to BOFD A under the warranty and indemnification set forth in Section XIX(L)(7) of the ECCHO Rules.

### **Relationship of ECCHO Rules and Drawer Customer**

- The ECCHO Rules do not provide a warranty from the BOFDs directly to the drawer customer. Rather, the no double payment warranty under the ECCHO Rules is made only to the Paying Bank. The ECCHO Rules also do not address the relationship of the drawer customer to the Paying Bank. In particular, the ECCHO Rules do not establish the responsibility that the Paying Bank may have to its drawer customer to reimburse the drawer customer in the event the drawer customer pays a holder for the item and incurs a loss due to double payment of the same item. However, the Paying Bank could have such legal responsibility to its drawer customer under the account agreement between the drawer customer and the Paying Bank or under other applicable law. The Paying Bank would need to evaluate and determine its potential responsibility under law or contractual agreement to its drawer customer to reimburse the drawer customer for the drawer customer's payment to a holder or to directly pay the claim by the holder on behalf of the drawer customer, based on the particular facts of a situation.

### **BOFD Defenses to Warranty Breach Claim**

- The ECCHO Rules do not establish or limit defenses that a BOFD may raise to a Paying Bank against the warranty claim arising from double payment. The UCC and other law may provide for defenses by the BOFD against the warranty claim in this context.

### **Requirements on the Paying Bank When Making Warranty Claim**

- BOFD A may seek to establish that the person who claimed holder status or holder in due course status was not in fact entitled to payment of the item from the drawer customer or the Paying Bank which gave rise to the second payment. However, there is no requirement under the ECCHO Rules that the Paying Bank include, as an element of the warranty claim made to BOFD A, information or facts that establish that the Paying Bank or its drawer customer was legally obligated to make the payment or reimbursement in connection with a payment to a holder. Furthermore, the Paying Bank is not required under the ECCHO Rules to investigate the alleged claim of the holder prior to payment to obtain all the facts of the holders claim.
- The only elements required under the ECCHO Rules for a Paying Bank to make the warranty claim are for the Paying Bank to establish the existence of a double payment for the same item and that the Paying Bank incurred a loss as a result. Since there are no other preconditions to the making of the warranty claim, BOFD A cannot refuse a warranty claim solely on the basis that the Paying Bank did not provide with the warranty claim information to establish whether the second payment of the item was in fact appropriate in light of the facts and circumstances. The ECCHO Rules governing adjustments and the related Adjustment matrix provide additional detail on the required information for a warranty claim. (Please see Exhibit II Adjustment Matrix of the ECCHO Rules for additional information.)

#### **Policy Basis Supporting This Application of the No Double Payment Warranty**

- The application of the warranty against double payment in the context of holders and holders in due course is consistent with and furthers the general underlying policy -- as expressed in the warranty provisions of Check 21, Regulation CC provisions applicable to substitute checks and the ECCHO Rules -- to protect the Paying Bank and drawer customer from losses associated with double payment of a check image or substitute check. Moreover, since BOFD A introduced the risk of double payment into the system by allowing its customer to engage in remote deposit capture, it is appropriate for BOFDA-- and not the Paying Banks or their drawer customers --to bear risk of loss from any resulting double payments.
- Paying Banks and drawer customers are encouraged to not pay a holder in due course or other holder claims if the Paying Bank/drawer customer believes that the holder does not qualify as a holder in due course or does not have a legitimate claim on the item under the UCC. This could occur, for example, if the drawer customer or the Paying Bank has reason to know or believe that the holder participated in a fraud or theft associated with the original paper item.