Electronic Payment Orders (EPOs) has become a topic of interest to the banking industry.

The Federal Reserve Bank of Atlanta hosted an Electronic Payment Order (EPO) Forum with payments industry participants. This link provides a summary of that forum.  
http://www.frbatlanta.org/documents/rprf/rprf_pubs/130521_summary_paper.pdf?elq=2ad3415b8ee84a1ba01b96cc9ea7a5fb.

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Discussion of the Status of Electronic Payment Orders Under Check Law. ¹

This document provides a discussion summary of the status of Electronic Payment Orders as further defined below (EPOs) under current check law. This document is based upon the status of EPOs under check law today, and does not seek to address or contemplate how EPOs could or would be treated under future amendments or revisions to check law or the check image exchange system rules. This document may be revised from time to time, and is not meant as a definitive review of all legal issues associated with EPOs.

There is no official legal definition of an “EPO” under check law or payment system rules, and the definition of an EPO in this document reflects a common understanding in the check industry of the meaning of the use of the term “EPO.” For purposes of this document, the term “EPO” refers to an image of a purported check that is created in electronic form within a computer or other electronic device and is never printed into paper form prior to imaging and depositing with a bank. There may be EPOs with different technological and informational features. For example, an EPO may be created by a drawer customer from whose account payment is instructed and therefore may purport to bear an electronic representation of the drawer customer’s signature within the EPO. Alternatively, the EPO may be an image of a remotely created check (RCC). An RCC is a check that is not created by the paying bank and that does not bear or purport to bear a signature applied, or purported to be applied, by the person on whose account the check is drawn. ¹ RCC EPOs would typically be created by the payee depositor based upon oral or electronic authorization from the customer holding the account to be debited by the RCC EPO. This document covers issues associated with EPOs generally, including RCC EPOs.

EPOs are not currently eligible for processing under check image exchange system rules. One reason that the check image exchange systems do not authorize a bank of first deposit (BOFD) to submit EPOs into check image exchange is that EPOs do not meet the legal requirements for a negotiable “check” under the Uniform Commercial Code (UCC) and Regulation CC. The check image exchange systems require that an item be a “check” under Regulation CC in order for the item to be imaged and then exchanged into a system used for check processing. This “check” status requirement is in part to ensure that banks and other parties participating in the check image system can appropriately treat all transactions in the system as “check” transactions under law, rules and customer agreements when processing the items, determining final settlement, and dealing with a disputed/erroneous payment. Regulation CC’s definition of “check” refers to the UCC definition of a “negotiable demand draft” drawn on or payable

¹ This document is intended for distribution to ECCHO Members and other financial institutions that are interested in exchanging information and discussion regarding the status of EPOs under current check law and system rules. This document does not constitute a rule, official interpretation or other view of ECCHO or any of its Members. Nothing in this document shall constitute legal advice to a particular financial institution, nor may any person rely upon this document as legal advice. Each financial institution or other entity or person reviewing this document should consult with its legal counsel as appropriate regarding specific questions it may have regarding the status of EPOs under law, rules or customer agreements.
through a bank. Under UCC Article 3, as a condition for a “check” to be a “negotiable instrument”, the item must be an “order” to pay a fixed amount of money, as well as meet certain other requirements. An “order” is further defined in the UCC as a “written instruction to pay money signed by the person giving the instruction.” The term “written” is further defined in the UCC as requiring “reduction to tangible form.” In addition, Regulation CC expressly contemplates that the check image used to create a substitute check arose from the paper original check. Regulation CC defines “substitute check” as “a paper reproduction of the original check” that meets certain other requirements under Regulation CC, and defines “original check” as “the first paper check issued with respect to a particular payment transaction.”

A few questions have been raised in public forums regarding the status of EPOs that are created under specific circumstances. This document seeks to include responsive discussion regarding certain of these specific questions. One question is whether or not the original paper check must be in the possession of the payee depositor for imaging and deposit to the BOFD via remote deposit capture? Or, alternatively, if the original paper check could be located somewhere else outside of the banking system (such as at the drawer issuer) and thereby allow for the drawer to send the check image to the payee depositor. The answer to these questions is that drawer must “issue” the original paper check to the payee depositor, and the payee depositor or its designee (lockbox, for example) must be in the possession of original paper check.

As stated above, under the check image exchange rules only original paper checks are eligible for image exchange under the check system rules. An EPO that a payee depositor receives from a drawer is not a paper check within the UCC and Regulation CC definitions discussed above. In addition, other sections of UCC Article 3 require that a negotiable instrument be “issued” by the drawer in order to achieve the status as a negotiable instrument under the UCC. See UCC Section 3-105 (definition of “issue” means to deliver the “instrument” from the drawer to another person) and Section 3-104(b) (definition of “instrument.”). If the drawer customer transmits an EPO to the payee depositor, it would not appear that the drawer has delivered a paper instrument to the payee depositor within the meaning of UCC Section 3-105. Since the EPO is not issued properly, it is not a negotiable instrument, and does not meet the definition of “check” under Regulation CC, discussed above.

A related second question that has been raised is whether or not a depositor of an RCC EPO must image the actual printed RCC when creating the image for electronic transmission to the BOFD. Or, alternatively, is it sufficient that the depositor of the RCC EPO (i) have the capability of printing a paper RCC from the electronic image, or (ii) have printed a paper RCC but did not create the image from such paper RCC. The answer to these questions is that in order to meet the requirements of the check image exchange rules and applicable check law, the image must be created from the paper RCC to which it relates. (See the above discussion of the requirement of a negotiable check.)
In addition, an EPO that was not created from the paper check itself would not appear to meet the definitional standards for exchangeable images under the two national check image exchange rules -- the ECCHO Rules and the Federal Reserve’s Regulation J and Operating Circular #3 (OC #3). The Federal Reserve’s OC #3 states that “[t]o meet the definition of an electronic item, the data must include an electronic image of a check....[D]ata sent to a Reserve Bank in the form of an electronic item is not an “electronic item” unless the data was captured from a check.” Similarly, the ECCHO Rules’ definition of “Electronic Image” and “Image” require that the image be “an accurate representation of the front and back of the Related Physical Check.”

Furthermore, the warranty provisions under the ECCHO Rules, OC #3 and Regulation J and Regulation CC specifically contemplate that the check image being exchanged by the banks reflects the original paper check. See ECCHO Rules, Section XIX(L)(2) (sending bank warrants that the electronic check image “accurately reflects the Related Physical Check”); Regulation CC, Sections 229.51 and 229.52 (reconverting bank warrants that that substitute check accurately represent[s] all of the information on the front and back of the original check...”); and Regulation J, Section 210.5(a)(4)(i) (sending bank warrants that “the electronic image portion of the item accurately represents all of the information on the front and back of the original check...”). A sending bank would breach these warranty requirements unless the image that the sending bank transmits is created from the paper check itself.

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1 Regulation CC, Section 229.2(fff).
2 Regulation CC, Section 229.2(k)(1).
3 UCC Section 3-104(a), (b),(c) and (f) (definition of “negotiable instrument,” “instrument” and “check”).
4 UCC Section 3-103(a)(8) (definition of “order”).
5 UCC Section 1-201(b)(43).
6 Regulation CC, Section 229.2(www).
7 Operating Circular #3, Section 1.3.
8 ECCHO Rules, Sections I(O) and I(W).