Depositary Bank RDC Risk: The RDC Indemnity and Holder in Due Course
DISCLAIMER

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BOFD Warranties

UCC warranties 3-417, 4-208

- “entitled to enforce”
- The draft has not been altered
- No knowledge that the signature of the drawer is unauthorized

Regulation CC §229.34(a)(ii): no “double debit” warranty

- No person will receive a transfer, presentment, or return of, or otherwise be charged for an electronic check or electronic returned check, the original check, a substitute check, or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid.
RDC BOFD Risk

BOFD does not receive the paper, but the BOFD makes certain presentment warranties

- Item is not altered *UCC*
  - presents additional risk without physical review of the item

- Entitled to enforce *UCC*
  - Terms of indorsement
  - Validity of indorsement

- “Duplicate” warranty
  - Paper is controlled by depositor
  - Risk of paper being re-deposited or cashed
BOFD Warranty Risks

BOFD “duplicate check” warranty

BOFD warrants it is “entitled to enforce”

BOFD risks warranty/indemnity claim if another bank received the paper and suffered a loss due to return/adjustment of item
RDC Indemnity  (229.34(f))

**Purpose of Indemnity:**
- To protect subsequent depositary bank that received deposit of paper check from loss when check is returned unpaid due to duplicate RDC item
- To encourage RDC banks to implement good RDC deposit practices

**Addresses Risk:**
Customer retains original check and may intentionally or mistakenly deposit paper check in another bank
RDC bank’s potential liability rises when it permits customer to truncate check and deposit image
RDC Indemnity Rule Text (229.34(f))

(1) The indemnity described in paragraph (f)(2) of this section is provided by a depositary bank that—

(i) Is a truncating bank under § 229.2(eee)(2) because it accepts deposit of an electronic image or other electronic information related to an original check;

(ii) Does not receive the original check;

(iii) Receives settlement or other consideration for an electronic check or substitute check related to the original check; and

(iv) Does not receive a return of the check unpaid.

(2) A bank described in paragraph (f)(1) of this section shall indemnify, as set forth in §229.34(i), a depositary bank that accepts the original check for deposit for losses incurred by that depositary bank if the loss is due to the check having already been paid.

(3) A depositary bank may not make an indemnity claim under paragraph (f)(2) of this section if the original check it accepted for deposit bore a restrictive indorsement inconsistent with the means of deposit.
Indorsements UCC 3-205, 206

**Blank**
- Payee indorses with name only
- Becomes a bearer instrument

**Special**
- Indorsement identifies a person to whom the check is payable
  - Indorsed by payee, made payable to another person

**Anomalous**
- Indorsed by person who is not the named payee

**Restrictive**
- Indorsement limiting payment to particular condition
  - “for deposit only”
RDC Indemnity: BOFD Terms to Receive the Indemnity

Depositary bank must receive the original check for deposit
- Indemnified depositary bank does not have to send the original check for payment; can send image or IRD to paying bank

Restrictive indorsement may negate indemnity
- If depositary bank accepted for deposit an item contrary to terms of the indorsement

Depositary bank must suffer a loss due to a chargeback due to the check having already been paid

Does not indemnify customer
- RDC bank can allocate loss per customer agreement

Does not indemnify other banks in the collection process
RDC Indemnity: Amount of Liability

- Amount of loss up to the amount of settlement
- Plus interest and expenses (including costs & reasonable attorney’s fees)
- No consequential damages
- Comparative negligence defense available to RDC bank
RDC Indemnity Claim

Remote Deposit Customer

RDC Agreement

IMAGE

BOFD A

Indemnity

Claim

Agreement

Deposits Paper Check with blank indorsement

BOFD B

“Return” as Duplicate

Paying Bank

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RDC Indemnity: Restrictive Indorsement Disclaim

- BOFD A
- BOFD B
- Paying Bank
- Remote Deposit Customer

Indemnity Claim
Disclaim

“Return” as Duplicate

Restrictive Indorsement

Deposit Paper Check

RDC Agreement

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RDC BOFD Risk Considerations

**UCC warranties**
- “entitled to enforce”
  - Properly indorsed
- Not altered

**Regulation CC warranties & indemnities**
- No “double debit”
- RDC indemnity
- ECI indemnity
RDC Deposit Agreement Considerations

Add RDC indemnity language
- Consider addressing RDC customer’s liability for duplicate negotiation of the RDC deposited item

Consider addressing a restrictive indorsement requirement
- “for mobile deposit to XYZ Bank”

Consider restricting certain types of checks from remote deposit
- US Treasury, US Postal Money Orders, etc.
RDC Considerations

Review customer qualifications for RDC deposit
- Length of relationship
- History of account activity
- Credit history, etc.

Consider enforcing restrictive indorsement
- *i.e. “for mobile deposit only to XYZ Bank”*

Establish controls to review submitted RDC items
- Indorsement review

Establish daily/weekly deposit limits
- Item limit
- Deposit limit
Holder in Due Course: **UCC 3-302**

Person that accepted the *paper* check

- For value
- In good faith
- Without notice that the check is overdue or has been dishonored
- Without notice that the check contains an unauthorized signature *or* has been altered
- Without notice of any claim to the check or that any party has a defense or claim

May enforce the check against the drawer

- May result in the drawer paying the same check twice
A guy walks into a bar . . .

. . . and cashes a check
UCC 1-201(21) "Holder" means: (A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession
Holder and Holder in Due Course (HIDC): UCC 3-302

**HIDC**

Holder who has possession, that:

- Took the item in good Faith
- Took item for value
- Without notice the item is overdue or has been dishonored
- Without knowledge of claims against it
- Without notice signature was unauthorized or item altered
- Without knowledge of claims against it
Holder in Due Course (HIDC): *UCC 3-302*

Financial intermediary, such as BOFD, Collecting Bank, check cashier, etc. should not be affected by disputes between the Drawer and Payee of check regarding the underlying transaction.

Can make HIDC claim back to **Drawer**
HIDC Rights

**Drawer**

DRAWER: Means a person who signs a draft and orders payment (an owner of the checking account)
So what do I do…?

...when Holder in Due Course demands payment from the **Paying Bank**

- If the Paying Bank is *not* the drawer
  - It is not subject to HIDC claim

...when my account holder is getting demands for payment from the HIDC

- Drawer is subject to HIDC claim
- Stopping a check payment does not cancel the *obligation* of the drawer
- Drawer and HIDC must resolve outside of banking channels
Holder In Due Course: *UCC 3-302*

- **Depositary Bank (BOFD) is Holder In Due Course**
  - Can make claim back to Drawer

Diagram:

1. Goods Purchased
   - **Salesperson / Payee / Depositor**
2. Goods found to be fraudulent
   - **Drawer**
3. Chargeback Attempt; Payee Closed Account
4. **BOFD / HIDC Claim**
**Wait, can a BOFD be a Holder in Due Course?**

<table>
<thead>
<tr>
<th>IF the BOFD</th>
<th>Took the <em>paper</em> item in good Faith</th>
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<tbody>
<tr>
<td></td>
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| AND the check is returned and BOFD cannot recover from depositor | BOFD *can* make a Holder in Due Course claim against the drawer |

So how is this a *Good* thing?

HIDC is protected from any dispute between drawer and payee (PAID), and protected from any default by drawer (NSF, Account Closed, etc.)

**Risks to Drawer**
- Not released from obligation to HIDC despite disputes between drawer and payee or inability to pay

**Financial Intermediary has recourse**
HIDC Scenario

Depositor

Cash Check

CHECK CASHER HIDC

Electronic Check

Charge Account

BANK OF FIRST DEPOSIT A

Electronic Check

Adjust Duplicate

BANK OF FIRST DEPOSIT B

Electronic Check

Return or Adjust Duplicate

PAYING BANK

STATEMENT

DRAWER

Bank Reimburses Drawer

Drawer Pays HIDC Claim
HIDC and Remote Deposit Capture

A Paying Bank pays the same check twice

Accepted by BOFD A as *RDC deposit*

Accepted **in paper** by check cashier or BOFD B
- *Without a restrictive indorsement*

Drawer’s account is charged twice for the same check

Reg CC 229.34 (ii) “duplicate check” warranty
- No will be asked to pay a check that has already been paid

Drawer makes a claim against Paying Bank

Paying Bank must honor Reg CC warranty
- Reimburses drawer
So what happens when I adjust?

The depositor of the paper check may have holder in due course rights, and bring a holder in due course claim against the drawer after the duplicate check is returned/adjusted

- IF indorsement on the paper does not restrict the means and method of negotiation (i.e. for Remote Deposit only)

Adjusting the duplicate check that was deposited via RDC will debit the source

- The depositing customer who caused the duplicate
- The BOFD who provided the delivery service that facilitated the duplicate

Either duplicate check can be adjusted as ‘PAID’ if exchanged via FRB or ‘Duplicate’ if exchanged under ECCHO Rules
When your customer tells you about a duplicate, what’s the best thing to do here?
And by the way . . .

§229.30 Paying Bank’s Responsibility for return of checks: Expeditious return

A paying bank returns a check in an expeditious manner if it

- Returns check such that the check would normally be received by the depositary bank not later than 2:00 p.m. (local time of the depositary bank)
- By the second business day following the banking day on which the check was presented to the paying bank
- Notice of return for items >$5,000 must be provided
- Expeditious return can serve as notice

229.34 (d)(2) These warranties are not made with respect to checks drawn on the Treasury of the United States, U.S. Postal Service money orders, or checks drawn on a state or a unit of general local government that are not payable through or at a bank.
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