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Recommended Citation

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More Steps Toward Fully Electronic Interbank Check Collection and Return: Amendments to Federal Reserve Board Regulation CC and a Regulatory Resolution of a Circuit Split

*Sarah Jane Hughes**

*This article analyzes two actions in 2017 and 2018, respectively, by the Board of Governors of the Federal Reserve System that amend Regulation CC, which governs expedited deposit availability and collection of checks generally and implements the Expedited Funds Availability Act of 1987 and the Check Clearing for the 21st Century Act of 2003. It selects examples from the two sets of amendments that highlight regulatory strategies being used by the Board to facilitate faster payments through the movement of electronic images of checks or electronic information among banks in the check-collection process. Those strategies involve creation of new forms of instruments that can be treated as checks or used to return checks to depository banks, and, in the 2018 amendments, establishment of a presumption that re-allocates risks in collection long a feature of Anglo-American payments law, the doctrine of *Price v. Neal*. The strategies offer evidence of the surgical precision with which the Board has acted over the past 30 years to modernize check collection regulation with little use of its authority to preempt state laws, primarily Articles 3 and 4 of the Uniform Commercial Code (“UCC”). This article does not describe or evaluate all provisions of Regulation CC that the Board revised or added in 2017 and 2018.*

I. Introduction

On June 15, 2017, the Board of Governors of the Federal Reserve Board (“Board”) published final amendments to

Regulation CC, 12 C.F.R. Part 229,¹ (the “2017 Reg CC Amendments”). The final amendments focus on making deposit availability and check returns faster and on assigning losses to the bank with the best opportunity to prevent it. They contain incentives to encourage banks to make returns of dishonored checks by electronic means,² provide for fee-free same-day settlements,³ and new warranties and indemnities for payments for which the orders were never in paper form⁴ and for “remote deposit capture.”⁵ These amendments represent giant steps towards fully electronic interbank

¹Board of Governors of the Federal Reserve System, Availability of Funds and Collection of Checks (Regulation CC), 82 Fed. Reg. 27552 (June 15, 2017).

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As explained later in this article, Professor Hughes is indebted to two Maurer School of Law colleagues, Executive Associate Dean Donna M. Nagy and Professor Robert L. Fischman, for examples of the regulatory exercise of authority to overrule or resolve splits of authority among federal Circuit Courts of Appeal and otherwise. All opinions—any every error—in this article Professor Hughes claims for herself.

Professor Hughes appreciates the invitation of Kristen David Adams, Interim Dean and Professor of Law at Stetson University’s School of Law and outgoing chair of the UCC Committee of the American Bar Association’s Business Law Section, to offer this article to the *Uniform Commercial Code Law Journal*. Professor Hughes can be reached at sjhughes@indiana.edu.

²82 Fed. Reg. 27552, 27553.

³82 Fed. Reg. at 27554 (to be codified at 12 C.F.R. § 229.36(f)) (fee-free subject to conditions).

⁴E.g., 82 Fed. Reg. at 27554–27555.

⁵82 Fed. Reg. at 27555.

check collection and return and, one might say, they regularize trends in banking such as “remotely deposited checks”⁶ and will facilitate uses of “electronically created item[s].”⁷

The Board also re-used two of the plays from the playbook first seen when the Board implemented the Check Clearing for the 21st Century Act⁸ 14 years ago⁹—the creation by regulation of new classifications of payments or payments terminology and other regulatory actions that take further steps to resolve what economists call “hold out problems.”¹⁰ In the context of interbank agreements to utilize electronic presentments and the like, a holdout or small group of them can frustrate a smoother-operating system. A regulation such as Regulation CC or a federal statute such as Check 21 use regulatory approaches to resolving holdout problems. Thus, instead of collective action by groups of stakeholders, the government—whether via legislation or regulation, or both, takes over the role of collective action and frees up those held up by the holdout to engage in transactions that the government deems useful for a common purpose. In some ways, the return to these two regulatory strategies make the 2017 and 2018 amendments to Regulation CC fine examples of surgical precision typical in my opinion of the Board’s work in this arena since 1987.

The 2017 amendment also preserves room for variation by

⁶Board of Governors of the Federal Reserve System, Amendments to Regulation CC and J Addressing Remotely Created Checks, 70 Fed. Reg. 71218 (Mar. 16, 2006) (define the term “remotely created checks” and creating transfer and presentment warranties for banks dealing with them).

⁷82 Fed. Reg. at 275579 (codified at 12 C.F.R. § 229.2(hhh)).

⁸Pub. L. No. 108-100, 117 Stat. 1177 (Oct. 28, 2003) (commonly referred to as “Check 21”).

⁹69 Fed. Reg. 47290 (Aug. 25, 2004) (codified at 12 C.F.R. Part 229, Subpart D).

¹⁰See “*Supplemental Information — I. Statutory and Regulatory Background*,” 2017 Reg. CC Amendments, 82 Fed. Reg. at 27552. For an excellent analysis of the “hold-out” problem generally, see Lloyd Cohen, *Holdouts and Free Riders*, 20(2) J. Leg. Studies 351, 358 (1991) (defining holdouts as “bilateral monopolist engaged in negotiations on how to divide up the pie”). In the context of interbank agreements to utilize electronic presentments and the like, a holdout or small group of them can frustrate a smoother-operating system.

agreement of the banks involved,¹¹ which U.C.C. § 4-103 allows, and for interbank agreements regarding electronic presentment,¹² which U.C.C. Sections 4-110 and 4-209(b) require.

In the second group of amendments to Regulation CC, on September 17, 2018, the Board's action focused on rules applicable if there is a dispute between depository and payor/paying banks about the character of the check as altered or forged.¹³

This article looks at the 2017 and 2018 new final amendments to Regulation CC that implement the rules for electronic items, remotely created checks. Part II evaluates new definitions related to use of electronic images and electronic information in the check-collection process. Part III explains new rules extending Regulation CC's Subpart C to items not presented in paper form. Part IV looks at the new provisions governing remotely created checks in 12 C.F.R. § 229.34(b). Part V reviews the new "Remote Deposit Capture Indemnity in Section 229.34(f) that is similar to the warranties for "remotely created checks" that are familiar to many readers of the *Uniform Commercial Code Law Journal*. Part VI presents views on the September 12, 2018 new "alteration presumption" in 12 C.F.R. § 229.38(i). Lastly, Part VII offers modest conclusions about the state of electronic payments transactions subject to Regulation CC.

¹¹See, e.g., 12 C.F.R. § 229.30(b) (Writings); 2017 Reg CC Amendments, 82 Fed. Reg. at 27579.

¹²See, e.g., 12 C.F.R. § 229.36(a) (Presentment and issuance of checks—Receipt of electronic checks); 2017 Reg CC Amendments, at 27583.

¹³Board of Governors of the Federal Reserve System, Availability of Funds and Collection of Checks, 83 Fed. Reg. 46849 (Sept. 17, 2018) (to be codified at 12 C.F.R. § 229.38(i)) (hereinafter referred to as the "Alteration Presumption" Rule). The proposed rule has been published on June 2, 2017, at 82 Fed. Reg. 25539.

II. Defining and Adding Rules Facilitating Uses of Electronic Images and Information in the Check-Collection Process

In its 2017 amendments to Regulation CC (the “2017 Reg CC Amendments”),¹⁴ the Board promulgated numerous changes and additions—one of the most important of which is the new definitions of “electronic checks” and “electronic returned checks”¹⁵ and of “electronically-created item”¹⁶ and new rules regarding these three categories. The 2017 Reg CC Amendments went into effect on July 1, 2018.¹⁷

The new “electronic check” and “electronic returned check” definitions include

. . . an electronic image of, and electronic information derived from, a paper check or paper returned check, respectively, that — (1) Is sent to a receiving bank pursuant to an agreement between the sender and the receiving bank; and (2) Conforms with ANS X9.100-187, unless the Board by rule or order determines that a different standard applies or the parties otherwise agree.

These amendments establish a new class of “item” to which Regulation CC will apply—the “electronically-created item.”¹⁸ This new term is defined as “. . . an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not derived from a paper check.” Additionally, as a new class of “item”—a term defined in U.C.C. § 4-104(a)(9)¹⁹—an “electronically-created item” may be a class of “item” to which U.C.C. Article 4 will apply.

The 2017 Reg CC Amendments contain special provisions respecting “electronically-created items.” Among these is a new indemnity respecting electronically-created items in 12

¹⁴2017 Reg CC Amendments, at 27552.

¹⁵2017 Reg CC Amendments, at 27579 (§ 229.2(ggg)).

¹⁶2017 Reg CC Amendments, at 27579 (§ 229.2(hhh)).

¹⁷2017 Reg CC Amendments, at 27552.

¹⁸U.C.C. § 4-102 (Applicability).

¹⁹The term “item” means “an instrument or promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip.”

C.F.R. § 229.34(g) and the extension of the 12 C.F.R. § 229.34(i) indemnity amounts to electronically-created items. The new indemnity provides:

Each bank that transfers or presents an electronically-created item and receives a settlement or other consideration for it shall indemnify, as set forth in § 229.34(i), each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against losses that result from the fact that-

- (1) The electronic image or electronic information is not derived from a paper check;
- (2) The person on whose account the electronically-created item is drawn did not authorize the issuance of the item in the amount stated on the item or to the payee stated on the item (for purposes of this paragraph (g)(2), “account” includes an account as defined in section 229.2(a) as well as a credit or other arrangement that allows a person to draw checks that are payable by, through, or at a bank; or
- (3) A person receives a transfer, presentment, or return of, or otherwise is charged for an electronically-created item such that the person is asked to make a payment on an item or check it has already paid.

The accompanying indemnity provisions for electronically-created items (and remote deposit capture under a new indemnity in 12 C.F.R. § 229.34(f), discussed in the next section of this article) includes interest and the indemnified bank’s costs and reasonable attorney’s fees and other costs of representation.²⁰ It also specifically preserves in connection with a loss that “results in whole or in part from an indemnified bank’s negligence or failure to act in good faith”²¹ and “the rights of a person under the U.C.C. or other applicable provision of state or federal law.”²² As a result, the 2017 Reg CC Amendments provide a remedy for electronically-created check that are similar to the new warranties provided for remotely created checks in Section 229.34(b), which are discussed later in this article. The 2017 Reg CC Amendments introduce indemnity provisions into Subpart C of

²⁰12 C.F.R. § 229.34(i)(1); 2017 Reg CC Amendments, at 27582.

²¹12 C.F.R. § 229.34(i)(2)(ii); 2017 Reg CC Amendments, at 27582.

²²12 C.F.R. § 229.34(i)(2)(i); 2017 Reg CC Amendments, at 27582.

Regulation CC; prior to these June 2017 amendments, indemnity provisions only existed in Subpart D of Regulation CC.²³

III. Applying Regulation CC's Subpart C to Presentments of Checks that Did Not Derive from Paper Checks

The 2017 Reg CC Amendments bring new classes of instruments under Regulation CC's scope in revised Section 229.30(a):

Checks under this subpart. Electronic checks and electronic returned checks are subject to this subpart as if they were checks or returned checks, except where "paper check" or "paper returned check" is specified. For the purposes of this subpart, the term "check" or "returned check" as used in Subpart A includes "electronic check" or "electronic returned check," except where "paper check" or "paper returned check" is specified.

As explained elsewhere in this article, the terms "electronic check" and "electronic returned check" are newly defined in Regulation CC.²⁴

IV. New Provisions on Remotely Created Checks—229.34(b)

Continuing, the 2017 Reg CC Amendments added new Transfer and Presentment Warranties with respect to remotely created checks in Section 229.34(b). These warranties cover the amount and payee stated on the check²⁵ mirror the transfer and presentment warranties in the 2002 amendments to U.C.C. Sections 3-416(a)(6), 3-417(a)(4), 4-207(a)(6), and 4-208(a)(4). Also, in addition to the new warranties, Section 229.34(b)(2) provides a warranting bank to defend by proving that the customer involved is precluded under U.C.C. Section 4-406 from "asserting against the paying bank the unauthorized issuance of the check." The 2002 amendments to the U.C.C. transfer and presentment war-

²³Compare 12 C.F.R. § 229.34 (2016) with the 2017 Reg CC Amendments, at 27581–27582.

²⁴See text accompanying note 15, *supra*; 12 C.F.R. 229.2(a)(ggg).

²⁵12 C.F.R. § 229.34(b)(1).

ranties had not been widely enacted by the states.²⁶ Final amendments to Regulation CC, and Regulation J (for collections through Federal Reserve Banks)²⁷ adopted provisions related to remotely created checks but did not provide comprehensive coverage of issues associated with them. Thus, the 2017 Reg CC Amendments by adding new transfer and presentment warranties expanded the Board’s rules governing remotely created checks.

V. Addition of a New “Remote Deposit Capture” Indemnity—12 C.F.R. § 229.34(f)

A new provision in the 2017 Reg CC Amendments created an indemnity for “remote deposit capture.”²⁸ This new indemnity is provided by any depository bank that

- . . . (i) Is a truncating bank under § 229.2(a)(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.²⁹

The new indemnity contains two additional provisions. First,

²⁶See Ana R. Cavazos-Wright, *An Examination of Remotely Created Checks*, 11 & notes 73–75 (undated), available at https://www.frbatlanta.org/-/media/documents/rprf/rprf_resources/rprfwp0510.pdf (listing enacting states as Arkansas, California, Colorado, Hawaii, Idaho, Minnesota, Nebraska, new Hampshire, North Dakota, Oregon, Tennessee, Texas, Utah, Vermont, West Virginia, and Wisconsin) [hereinafter “Cavazos-Wright”]. For additional discussion of remotely created checks generally, see *id.* at 3, 11. Despite the absence of a date from the electronic copy of this research available to this author, it appears that this analysis was prepared following the 2005 amendments to Regulation CC and the 2008 amendments to Federal Reserve Bank Operating Circular No. 3. Indeed, the date on the URL appears to suggest publication in May 2010. For more analysis of the 2005 and 2008 amendments to Regulation CC, see *id.* at 3, 11.

²⁷12 C.F.R. Part 210.

²⁸12 C.F.R. § 229.34(f); 2017 Reg CC Amendments, at 27582.

²⁹12 C.F.R. § 229.34(f)(1); 2017 Reg CC Amendments, at 27582.

the indemnity runs from the truncating bank³⁰ to a depository bank that incurs a loss if the loss is due to the check “having already been paid.”³¹ In addition, the indemnity is not available to a depository bank that accepted an original check that “bore a restrictive indorsement inconsistent with the means of deposit.”³²

In this new provision, the Board has filled the gap left when only 14 states enacted the transfer and presentment warranties that the 2002 amendments to U.C.C. Articles 3 and 4 provided. This is an example of the Board’s use of its regulatory authority to fill gaps in otherwise applicable state-law coverage of emerging payments issues. The Board cited as authority for all of the 2017 Reg CC Amendments authority granted it in both the EFAA and Check 21, as well as “the official staff commentary to [Regulation CC].”³³ There is no question that the EFAA³⁴ and Check 21³⁵ provide the Board with ample authority for Regulation CC amendments, such as the addition of the “remote deposit capture” indemnity. The claim that prior staff commentaries also provide authority seems like a stretch from an administrative-law perspective.

VI. Establishment of a Presumption of “Alteration” rather than of “Forgery” in Disputes among Banks when the Original Paper Check Is Not Available for Inspection, 12 C.F.R. § 229.38(i)

In the most recent changes to Regulation CC made, on September 12, 2018, the Board announced its final rule amending Section 229.38 to include a special new liability provision (“the Alteration Presumption Rule” for purposes of

³⁰ 12 C.F.R. § 229.2(eee) (definition of “truncating bank” added following Check 21 in the 2004 amendments to Regulation CC, 69 Fed. Reg. 47290, 47320 (Aug. 4, 2004)).

³¹ 12 C.F.R. § 229.34(f)(2); 2017 Reg CC Amendments, at 27582.

³² 12 C.F.R. § 229.34(3); 2017 Reg CC Amendments, at 27582.

³³ 2017 Reg CC Amendments, at 27552 (summary of the final rule) (claiming authority under an agency’s own commentary explaining its regulations is unusual).

³⁴ 12 U.S.C.A. §§ 4008, 1086(d).

³⁵ 12 U.S.C.A. § 5014.

this article). The Alteration Presumption Rule will be effective on January 1, 2019,³⁶ and will be applicable to disputes as to whether a check was altered or was issued with an unauthorized signature and the original paper check is not available for inspection by the parties at the time the dispute arises.³⁷ The Board opted to do as it had proposed to do: to resolve this species of dispute *between banks* with a presumption that the check was altered.³⁸ The Board cites as its authority to promulgate this presumption the Congress grant in the Expedited Funds Availability Act of 1987 (the “EFAA”).³⁹

The Alteration Presumption Rule establishes a presumption that augments risk-allocation principles embedded in Article 4 of the Uniform Commercial Code since the early 1960’s—that depositary and collecting banks—and their transferors—warrant to the payor bank that the draft presented for payment or acceptance and paid or accepted has not been altered.⁴⁰ In Article 4, transferors also warrant along the collection chain until presentment and payment or acceptance that the transferred draft has not been altered.⁴¹ The risk of paying a check that its customer did not authorize (a “forged check”) goes to the payor bank. Article 4’s warranties run to the payor bank making payment from persons, including banks, who present checks for payment or acceptance that in fact the payor bank pays or accepts.⁴²

U.C.C. Section 3-407(a) defines the term “alteration” as:
 “Alteration” means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a

³⁶ 12 C.F.R. § 229.38(i).

³⁷ Board of Governors of the Federal Reserve System, Press Release, Federal Reserve Board approves changes to liability provisions in Regulation CC, Sept. 12, 2018 3:00 pm, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180912a.htm>.

³⁸ Alteration Presumption Rule, at 46849, 46853.

³⁹ 12 U.S.C.A. § 4008, Pub. L. No. 100-86, 101 Stat. 647 (rulemaking authority and specific goals).

⁴⁰ Alteration Presumption Rule, at 46849, 46853.

⁴¹ U.C.C. § 4-207.

⁴² U.C.C. § 4-208(a)(2) (“ . . . the warrantor warrants that . . . the draft has not been altered; . . .”).

party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.

The principle that assigned different risks to depository and payor/paying banks⁴³ is embedded deeply in Anglo-American payments law. It owes its origin to the case of *Price v. Neal*.⁴⁴ That decision rested on the premise that the drawee had superior knowledge over, and therefore better ability, than an intermediary such as the depository bank to judge the regularity and appearance of the drawer's signature on the check.⁴⁵ As noted by the Board's Federal Register notice of the Alteration Presumption Rule, depository banks know more about their customer's deposit habits and account and they, in essence, "take responsibility for" the checks they take for deposit.⁴⁶ Thus, the Alteration Presumption Rule is consistent with the notion that depository banks are gatekeepers.

The term "forged checks" is not defined in the U.C.C. The term "unauthorized signature" is defined in U.C.C. § 1-201 and discussed in U.C.C. § 3-403; both recognize unauthorized signatures as including forgeries and signatures made without actual or apparent authority. The Board's Commentary explaining the Alteration Presumption Rule cites both aspects of the U.C.C.'s forgery rules.⁴⁷

Risks of paying "forged checks" are normally assigned to the drawee-payor bank and render the draft "not properly payable" and, therefore, not properly chargeable against the alleged drawer's account under U.C.C. § 4-401. Checks bearing alterations, as U.C.C. § 3-407(a) defines them, and, in the absence of negligence that contributed to the alteration, may be collected by payor banks and drawees or persons who took for value, in good faith, and without notice of the altera-

⁴³U.C.C. § 4-105 ("payor bank" defined); 12 C.F.R. § 229.2(z) ("paying bank" defined). Despite the different terms, the two definitions identify the same bank in the check-collection process for purposes of this article.

⁴⁴97 Eng. Rep. 871 (K.B. 1762) (establishing the rule that the payor bank bears the risk of loss in cases of "forged drafts").

⁴⁵97 Eng. Rep. 871.

⁴⁶Alteration Presumption Rule, at 46849.

⁴⁷Alteration Presumption Rule, at 46853.

tion up to either the original, unaltered terms of the check or in cases of incomplete checks altered by unauthorized completion the terms as completed.⁴⁸

Collection of checks has changed since the enactment of the EFAA, the Check Clearing for the 21st Century Act (“Check 21”),⁴⁹ and the Board’s own Regulation CC amendments implementing the former in 1988⁵⁰ and the latter in 2004.⁵¹ The Federal Register notice for the Alteration Presumption Rule explained that “the check collection system has become virtually all-electronic, and the number of instances in which the original paper check is available for inspection in [disputes over altered versus forged checks] will be quite low.”⁵² Additionally, in this check-collection environment, the Board cited the fact that the original paper check “is typically truncated by the depository bank or a collecting bank before it reaches the paying bank.”⁵³ These technological changes have occurred since two 2006 United States Circuit Courts of Appeals decided cases⁵⁴ and the dif-

⁴⁸U.C.C. § 3-407(c).

⁴⁹Pub. L. No. 108-100, 117 Stat. 1177 (Oct. 28, 2003).

⁵⁰Board of Governors of the Federal Reserve System, Availability of Funds and Collection of Checks, 12 C.F.R. Part 229 (1988).

⁵¹Board of Governors of the Federal Reserve System, Deposit Availability and Collection of Checks, 69 Fed. Reg. 47290 (Aug. 4, 2004) (codified at 12 C.F.R. Part 229). For a superb analysis of issues in check collection following the Check 21 Act, see Fred H. Miller and Linda J. Rusch, “Request for Comments on Issues under U.C.C. Articles 3 and 4 (March 16, 2009), available at http://uniformlaws.org/Shared/Docs/Payment%20Issues_MillerRusch%20Memo_031609.pdf.

⁵²Alteration Presumption Rule, at 46849.

⁵³Alteration Presumption Rule, at 46849–46850.

⁵⁴*Chevy Chase Bank, F.S.B. v. Wachovia Bank, N.A.*, 208 Fed. Appx. 232, 235, 61 U.C.C. Rep. Serv. 2d 458 (4th Cir. 2006) (unpublished), available at https://law.justia.com/cases/federal/appellate-courts/ca4/04-2569/042569_u-2011-03-14.html (hereinafter “Chevy Chase Bank”); *Wachovia Bank, N.A. v. Foster Bancshares, Inc.*, 457 F.3d 619, 60 U.C.C. Rep. Serv. 2d 1126 (7th Cir. 2006) (hereinafter “Foster Bancshares”) (appeal from a procedurally complicated district court decision effectively granting a declaratory judgment to Wachovia). For additional discussion of these decisions, see Sarah Jane Hughes, *Duty Issues in the Ever-Changing World*

fering outcomes in those cases prompted the Board's Alteration Presumption Rule.⁵⁵

In the first of these Court of Appeals decisions, *Chevy Chase Bank, FSB, v. Wachovia Bank, N.A.*, the Fourth Circuit affirmed a grant of summary judgment to Chevy Chase Bank ("Chevy Chase Bank"), the depositary bank, after Wachovia Bank had performed its duties under a "positive pay agreement" between Wachovia and its customer based on the date, check number, and amount of the check.⁵⁶ The alteration alleged by Wachovia and its customer was of the payee's name. When Wachovia sued Chevy Chase Bank for breach of warranty, Chevy Chase argued that the original check had been altered to show a different payee, and Wachovia argued that Chevy Chase had presented a forged or counterfeit check using the same date, number, and amount as the original check.⁵⁷ A factor in the Fourth Circuit's decision was that Wachovia also had destroyed the original check after creating and storing a digital copy of it.⁵⁸ Thus, the Fourth Circuit found that Wachovia was unable to show that the check it paid had been altered,⁵⁹ and had failed to offer other persuasive evidence.⁶⁰

The Court of Appeals for the Seventh Circuit in *Wachovia Bank, N.A. v. Foster Bancshares, Inc.* ("Foster Bancshares"), an action for declaratory judgment brought by Wachovia,⁶¹ which was also the payor bank in this dispute. Wachovia, following the same destruction-and-storing-digital-copies-of-paid-checks practice described above, again could not prove whether the check had been altered or was forged or

of Payments Processing: Is It Time for New Rules?, 83 Chi.-Kent L. Rev. 721 (2008).

⁵⁵Alteration Presumption Rule, at 46849.

⁵⁶Chevy Chase Bank, at 3.

⁵⁷Chevy Chase Bank, at 4, 6.

⁵⁸Chevy Chase Bank, at 4-5, 8.

⁵⁹Chevy Chase Bank, at 8.

⁶⁰Chevy Chase Bank, at 8.

⁶¹Foster Bancshares, at 621.

counterfeit.⁶² The Court of Appeals panel found in favor of Wachovia again—this time as the payor bank because the principle and outcome urged by Foster Bancshares that would have prohibited the payor bank from enforcing the Article 4 presentment warranty unless the payor bank had retained the original paper check and that such a result would impose additional storage costs on payor banks.⁶³

The Seventh Circuit panel concluded that Foster Bancshares had failed to offer evidence to support a favorable result for itself and a decision against Wachovia.⁶⁴ As a result, the Seventh Circuit affirmed the district court's decision placing the liability on the depository bank, Foster Bancshares,⁶⁵ and set up the split of authority with the Fourth Circuit favoring the depository bank with its finding that the payor bank had not proved that the check had been altered, and the Seventh Circuit finding that the depository bank had not proved that the check was forged.

The Alteration Presumption Rule resolves this split—albeit 12 years after it first occurred—in part based on the high percentage of checks presented electronically and adopts a presumption that, to the extent that the original paper check is not available for inspection at the time of the dispute between banks, the check is an altered check, not a forged check.⁶⁶ This presumption places the risk squarely on depository banks. The Rule also does not apply the presumption if the original paper check becomes available for inspection by the banks involved in the dispute.⁶⁷

Additionally, Subsection 229.38(i)(2) explains that the presumption

may be overcome by proving by a preponderance of evidence that either the substitute check or electronic check does not contain an alteration, or that the substitute check or electronic

⁶²Foster Bancshares, at 621.

⁶³Foster Bancshares, at 623.

⁶⁴Foster Bancshares, at 622–623.

⁶⁵Foster Bancshares, at 623.

⁶⁶Alteration Presumption Rule, at 46849–46850.

⁶⁷Alteration Presumption Rule, at 46853 (§ 229.38(i)).

check is derived from an original check that was issued with an unauthorized signature of the drawer.⁶⁸

Should it matter which bank or other person has destroyed the original paper check? Looking back to the *Chevy Chase Bank* and *Foster Bancshares* decisions, it is important to note that the Seventh Circuit refused to establish a rule that the payor bank could meet its burdens to show breach of the “no-alteration” presentment warranty only if the payor bank had retained the original paper check.⁶⁹ These decisions, thus, set up the need for a resolution of the burden of proof needed in cases in which some bank in the collection chain had destroyed the original paper check.

The Alteration Presumption Rule also allows banks in the collection process to alter its effect by agreement⁷⁰—a risk-allocation tool that is present in most provisions of U.C.C. Article 4.⁷¹ This tool is also used by the Board in the 2017 Reg CC Amendments.⁷² The broad allowance of variation by agreement that the Board has deployed in its amendments of Regulation CC’s Subpart C would not be as widely available under Subpart D because the Check 21 Act limits banks’ ability to vary its requirements to variations of “Section 8” of the Check 21 Act.⁷³

Finally, in the Alteration Presumption Rule, the Board did not extend the new presumption to all disputes whether the check in issue had been altered or forged. Rather, it limits the reach of the Alteration Presumption Rule to disputes between banks⁷⁴—as it happened this author had urged in a

⁶⁸*Id.* (§ 229.38(i)(2)).

⁶⁹*Foster Bancshares*, at 623.

⁷⁰Appendix E to Part 229—Commentary, cmt. I 229.38(i)(3) Presumption of Alteration (permitting variation by agreement “to the extent permitted under § 229.37”); Alteration Presumption Rule, *supra* note 13, at 46853.

⁷¹U.C.C. § 4-103.

⁷²2017 Reg CC Amendments, at 27579.

⁷³12 U.S.C.A. § 5013.

⁷⁴12 C.F.R. § 229.38(i)(1); Alteration Presumption Rule, at 46853.

comment on the 2017 Alteration Presumption proposal.⁷⁵ It also does not apply to disputes between banks where the “original check was transferred between [banks in the collection chain in the dispute], even if that check is subsequently truncated and destroyed.”⁷⁶

Several aspects of the Alteration Presumption Rule are remarkable from an administrative-law perspective. First, the Rule may be the first exercise by the Board of authority under the EFAA⁷⁷ that has little to do with encouraging faster deposit availability. Rather, it seems more supportive of the realities of the check-collection eco-system in which check-truncation prior to presentment for payment is the norm.⁷⁸

Second, the Alteration Presumption Rule also represents a relatively rare case of a regulator using authority to resolve a split among two Circuit Courts of Appeal. On the former point, the Board admitted that the Rule is new.⁷⁹ The Board is not alone in using regulatory authority to resolve circuit-court splits of authority, however. A quick consultation with two Maurer School of Law faculty Donna M. Nagy and Robert L. Fischman since the September 17, 2018 publication of the Alteration Presumption Rule produced numerous examples of such uses by other agencies. For example, Professor Nagy mentioned the Securities and Exchange Commission’s Rule 10b5-2⁸⁰ and its shift away from the perceived

⁷⁵Board of Governors of the Federal Reserve System, Availability of Funds and Collection of Checks, 82 Fed. Reg. 25539 (June 2, 2017) (proposed rule would have reached “any dispute arising under Federal or state law” regardless of the parties to the dispute).

⁷⁶Alteration Presumption Rule, at 46851 (discussion of rule’s scope and decision not to adjust application of the presumption based on which bank destroyed the original check).

⁷⁷Alteration Presumption Rule, at 46853.

⁷⁸Alteration Presumption Rule, at 46849–46850.

⁷⁹Alteration Presumption Rule, at 46849 (“Regulation CC does not currently address whether a check should be presumed to be altered or forged in cases of doubt.”).

⁸⁰Sec. and Exch. Comm., Duties of Trust or Confidence in Misappropriation Trading Cases, 17 C.F.R. § 240.1065-2 (2016).

narrowness outcome in *United States v. Chestman*⁸¹ in tipper-tippees insider trading prosecutions.⁸² More generally, Professor Fischman described agencies' resolving splits as "common"⁸³ and offered up three examples of agency action that resolves or preempts a circuit-court split⁸⁴ based on judicial deference to their exercise of their regulatory authority under *Chevron*.⁸⁵

Professor Fischman sees the Alteration Presumption Rule as different from the examples he gave because the rule does not interpret the meaning of the text of a statute. Rather, he observed:

[The EFAA] is just one that instructs an agency to "regulate any aspect of the payment system in order to carry out the general goal of prompt funds availability. Few agencies are given the breadth of discretion that the Federal Reserve has Certainly, EPA generally does not have that kind of delegation except in an imminent/emergency situation."⁸⁶

Finally, the Alteration Presumption Rule technically does

⁸¹U.S. v. Chestman, 947 F.2d 551, Fed. Sec. L. Rep. (CCH) P 96259 (2d Cir. 1991) (en banc).

⁸²See Nagy, Insider Trading and the Gradual Demise of Fiduciary Principles, 94 Iowa L. Rev. 1315, 1357–1364 (2009).

⁸³Email from Robert L. Fischman to Sarah Jane Hughes, September 26, 2018 (on file with Sarah Jane Hughes) (hereinafter "Fischman Email").

⁸⁴*Id.* In the first, Professor Fischman cited a 2016 amendment by the U.S. Fish and Wildlife Service of 50 C.F.R. § 402.2's definition of "destruction of adverse modification" in a manner that "satisfied those circuits that took a stricter, more precise reading of the text of the Endangered Species Act." Fischman Email, *supra* note 83. The second example involved the Environmental Protection Administration's 2008 "Water Transfers Rule," [73 Fed. Reg. 33697 (June 13, 2008) (codified at 40 C.F.R. § 122)] in which the agency identified a circuit split as a reason to make an initial rule on a subject. The third example follows the second in that the agency and the Army Corps of Engineers used rulemaking in what Professor Fischman described as a "preemptive effort to avoid circuit splits in determining which wetlands constitute ["Waters of the United States"] . . . subject to Clean Water Act regulations." Fischman Email, *supra* note 83.

⁸⁵*Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694, 21 Env't. Rep. Cas. (BNA) 1049, 14 Env'tl. L. Rep. 20507 (1984) (establishing a two-part test for regulation's interpretations of agencies' organic authority).

⁸⁶Fischman Email, *supra* note 83.

not preempt provisions of Articles 3 and 4 of the Uniform Commercial Code. Rather, it is more in the nature of a regulatory over-turning of an ancient court decision—in this case, the doctrine originating from *Price v. Neal*, as previously noted in this article.⁸⁷ In this respect, although the Alteration Presumption Rule allocates the risk, it is an example of surgical precision by the Board in using its EFAA authority to facilitate faster funds availability by reducing legal friction in the check-collection process.

It is too soon to predict how the Alteration Presumption Rule may change behavior in the check-collection processes—although the Board recites its sense that the rule favors payor/paying banks.⁸⁸ It also is unclear whether banks in the collection chain will vary the presumption by agreement, as the Alteration Presumption Rule permits.⁸⁹ Similarly, we do not know how the Alteration Presumption Rule will alter disputes between banks and their customers or the banks' willingness to permit truncation by their customers. These questions must be left for another day.

VII. Conclusion

In its 2017 and 2018 amendments and additions to Regulation CC, the Board has laid foundations for enhanced uses of payments technology through surgical uses of its organic authority under the EFAA and Check 21. In so doing, it has avoided using its preemption authority⁹⁰ to preempt specific provisions of U.C.C. Article 4 and has augmented the provisions of U.C.C. Article 4 and its own prior regulations implementing the EFAA and Check 21 by filling gaps.

The Board, in addition, has exercised authority on issues formerly governed by judicial precedent—resolving a split of

⁸⁷ See text accompanying notes 9–10, *supra*.

⁸⁸ Alteration Presumption Rule, at 46851.

⁸⁹ Alteration Presumption Rule, at 46853 (Appendix E to Part 229—Commentary, cmt. I, 229.38(i).3 *Presumption of Alteration*). Readers should notice that this Comment is exclusive to Section 229.38(i) and is not embedded in the more general Regulation CC provision on variation by agreement at 12 C.F.R. § 229.37.

⁹⁰ 12 U.S.C.A. § 4007(b) (EFAA's grant of conflict preemption authority including over provisions of the Uniform Commercial Code enacted by states); § 5012 (Check 21's full conflict preemption grant).

authority between the United States Courts of Appeals for the Fourth and Seventh Circuits that had stood since 2006 and altering—for the second time—part of Anglo-American payments law stemming from the 1762 decision in *Price v. Neal*.⁹¹ The Board also continued to allow interbank variations by agreement of provisions of Regulation CC, which U.C.C. § 4-103 also permits.

Finally, in the Alteration Presumption Rule, the Board did not extend the new presumption to all disputes whether the check in issue had been altered or forged. Rather, it limits the reach of the Alteration Presumption Rule to disputes between banks and does not alter the presumption to work against banks that destroyed original checks. Thus, the Board has followed in own history since the EFAA of engaging in rulemaking in the area over which it has the longest authority—the regulation of banks and the check-collection processes used by banks.

⁹¹The former alteration of the doctrine of *Price v. Neal* was achieved by the 2002 Amendments to U.C.C. Articles 3 and 4. For an excellent discussion of those amendments and the doctrine, see Cavazos-Wright, *supra* note 26, at 10–11 and notes 73–75.