

Check Warranties and Indemnifications

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Definitions



Warranty

- Collateral undertaking that a fact regarding the subject of a contract is, or will be, as it is expressly, or by implication, declared or promised to be [Merriam-Webster]
- Promise that some consideration of the contract is guaranteed by one of the contractors [Wikipedia]

Indemnification

- Action of making compensation to [someone] for incurred hurt, loss, or damage [Merriam-Webster]

Warranties & Indemnifications Allocate Loss

Warranties allocate loss to the warrantor (person making warranty)

- Warrantor may allocate loss to a previous warrantor or through agreement, such as RDC agreement

Warranties & indemnifications can assist error resolution

Some check warranties have associated adjustment claims

Some warranty claims must be made via bank-to-bank demand letter

Indemnifications may have adjustment claim, too

Warranty Examples (Not a Complete List!)

Transfer
warranties
[UCC §3-416
& §4-207]

Presentment
warranties
[UCC §3-417
& §4-208]

Electronic
check &
electronic
returned
check
warranties
[Reg CC
§229.34(a)]

Remotely
Created
Check
transfer and
presentment
warranties
[Reg CC
§229.34(b)]

Encoding
warranty
[Reg CC
§229.34(c)]

Returned
check
warranties
[Reg CC
§229.34(d)]

Substitute
check
warranties
[Reg CC
§229.52(a)]

Indemnification Examples (Not a Complete List!)

- Remote Deposit Capture indemnification [Reg CC §229.34(f)]
- Electronically Created Item indemnification [Reg CC §229.34(g)]
- Substitute check indemnification [Reg CC §229.53(a)]



Forged Drawer's Signature Example



Thomas steals Dorothy's checks, forges Dorothy's signature as drawer on a check, and makes the check payable to the order of Thomas (himself)



Thomas indorses the check by signing his name on the back and cashes it at a local retail store, Mom's & Pop's



Mom's & Pop's then deposits the check in its account at depository bank, which presents the check to paying bank



Thomas' signature is not effective as the drawer's (Dorothy's) signature

Forgery does *not* create liability for the drawer because it's not the drawer's signature

Forged Drawer's Signature Warranties



Thomas makes both the transfer warranties and the presentment warranties

Transfer warranties to Mom's & Pop's and depositary bank

Presentment warranties to paying bank



Mom's & Pop's makes both the transfer warranties and the presentment warranties

Transfer warranties to depositary bank

Presentment warranties to paying bank



Depositary bank makes the presentment warranties to paying bank

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MAKING PAYMENTS - EVERYWHERE

 **PAYMENTS**

 **UNIVERSITY**

UCC Transfer Warranties

Person or collecting bank transferring item warrants to the transferee and any subsequent transferee

Entitled to enforce the item

All signatures on the item are authentic and authorized

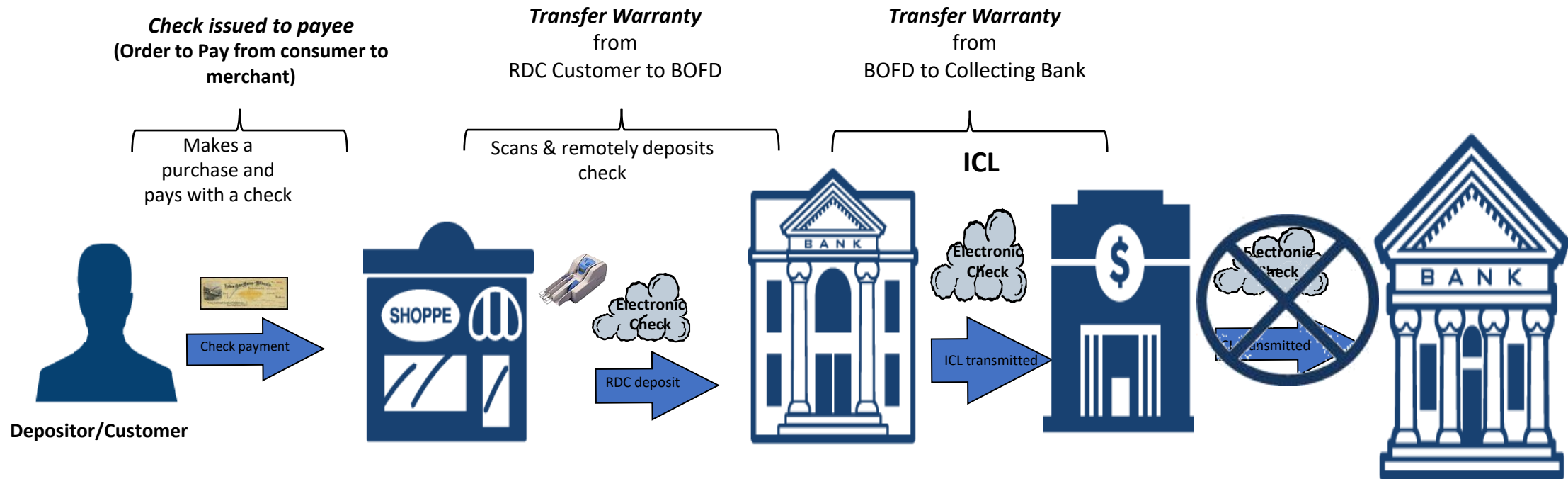
Item has not been altered

Item is not subject to a defense or claim

Warrantor has no knowledge of any insolvency proceeding with respect to the maker

For remotely created consumer item, person on whose account the item is drawn authorized item and amount for which it is drawn

UCC Transfer Warranties



- Transfer Warranties travel with the item (chain of warranties) from drawer to payee, payee to Depository Bank and Depository Bank to Intermediary/Collecting Bank
- Presentment Warranties are made from the Presenting Bank to the Paying Bank
- Warranties **provide recourse** if breach of warranty occurs

Presentment Warranties

Person presenting item and every previous transferor warrants to the drawee

Entitled to enforce draft

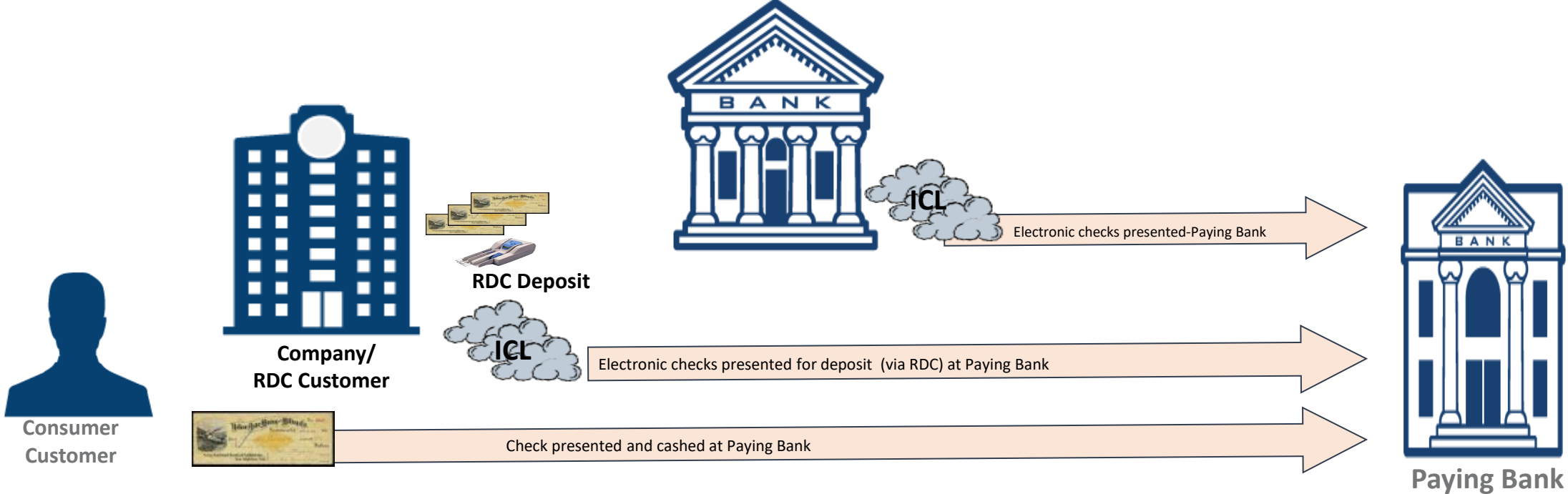
Item has not been altered

Warrantor has no knowledge that signature of the purported drawer of the draft is unauthorized

For remotely created consumer item, person on whose account the item is drawn authorized item and amount for which it is drawn

Or authorized to obtain payment / acceptance of draft on behalf of a person entitled to enforce the draft

UCC Presentment Warranties Flow



Which institution receives the UCC presentment warranties?
Paying bank only

Forged Drawer's Signature Warranties

- Thomas' unauthorized signature is a breach of the transfer warranties
- Assuming usual case where only Thomas is aware of the forgery, Thomas is the only person with 'knowledge' the signature of the drawer is unauthorized
 - Only Thomas breaches the presentment warranty



Forged Drawer's Signature



Initial claim made by drawer to paying bank



Paying bank must make claim through return



No breach of warranty occurred*



Paying bank may return check timely using

L – Signature(s) irregular, suspected forgery

Z – Forgery – an affidavit shall be available upon request

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AND PAYMENTS - EVERYWHERE

Forged Drawer's Signature Responses

After returning the check timely

- Depository bank makes transfer warranty breach to Mom's & Pop's
- Mom's & Pop's makes transfer warranty breach to Thomas (if they can find him)

If return time passed do the following

Determine if drawer met their 'duty to report'

- Stated in check writing agreement (customer / member agreement)
- 1 year generally the outside limit for drawer to make claim to paying bank

Determine if the exchange is governed by the ECCHO rules

- No: No breach of warranty for forged Drawer's signature except by Thomas (good luck finding him)
- Yes: Make Rule 9 claim thanks to extra warranty under rules

Speaking of Returns Timing....

All returns must meet UCC and Reg CC return deadlines

- UCC requires the determination to pay or return the item by midnight of the banking day following presentment (UCC §4-301)
- Reg CC requires the return to be handled expeditiously (§229.30)
 - Return must reach depository bank by 2:00 p.m. (local time of depository bank) 2 business days after presentment

There is no such thing as “doing a late return”

Beyond return time frame, paying bank must complete adjustment or make warranty claim, if applicable

Return Warranty Scenario

- Check presented to Dorothy's account Monday
- Dorothy informs paying bank of unauthorized signature on Thursday
- Paying bank initiates return on Thursday that is made available to depository bank by 2:00 p.m. on Friday
- In the applicable week, all weekdays are business days according to Regulation CC



Returned Check Warranties

Returning bank makes Regulation CC returned check warranties to the transferee returning bank, to any subsequent returning bank, to the depository bank, and to the owner of the check

- Paying bank is a returning bank when check returned

Warrants

- Returned the check within its deadline under the UCC or Regulation CC
- Authorized to return the check
- Check has not been materially altered

Returned Check Warranties

Paying bank in breach of returned check warranty that returned the check within its deadlines under UCC or in an expeditious manner such that the check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented
[§229.34(d)]

- UCC midnight deadline found in UCC §4-401



Depository bank can make breach of warranty claim if expeditious return time frame not met

Late Return Claim Responses by Depository Bank



Is check greater than \$100?

Yes: make claim through Late Return Claim adjustment

No: make demand letter bank-to-bank



In either circumstance, initiate 2 adjustments to build supporting evidence

Disposition (DISP) identifies where / when the item was presented

- Documents when presentment occurred

Source or Receipt (SOR) identifies the source of item including date initiated

- Documents when FRB sent return image cash letter to you, typically same or next banking day paying bank initiated RICL to FRB

Supporting evidence to make late return claim to paying bank

Late Return Claim Responses by Paying Bank

Use Late Return Disclaimer to disclaim depository bank's claim made through Federal Reserve Bank

- Do not make false claim to FRB

Is return late?

Respond to demand letter with applicable dates proving return made within statutory deadlines, e.g., date return letter initiated compared to presentment date

Yes: settle breach of warranty claim

No: disclaim late return claim

Forged Indorsement Example



Thomas steals a check payable to Peter and drawn on Dorothy's account



Thomas forges Peter's signature and now claims to be a holder of the check



Thomas indorses the check by signing his name on the back and cashes it at a local retail store, Mom's & Pop's



Mom's & Pop's then deposits the check in its account at depository bank, which presents the check to paying bank



Forged indorsement breaches both transfer and presentment warranties

Forged Indorsement Applicable Warranties



Thomas makes both the transfer warranties and the presentment warranties

Transfer warranties to Mom's & Pop's and depositary bank

Presentment warranties to paying bank



Mom's & Pop's makes both the transfer warranties and the presentment warranties

Transfer warranties to depositary bank

Presentment warranties to paying bank



Depositary bank makes the presentment warranties to paying bank

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ACH AND PAYMENTS - EVERYWHERE

Forged Indorsement Breaches of Warranty

Thomas' forged indorsement is a breach of the transfer warranty that all signatures are valid

- Even though Thomas is the only person aware of the forgery, all transferors make the warranty

Thomas' forged indorsement is a breach of the presentment warranty that the transferors and presenters are persons entitled to enforce the check

- Forged indorsement is not effective to change the person to whom the check is payable
- Consequently, no one else can be a holder of that check (except Peter)

Forged Indorsement

Initial claim typically made by payee to drawer

Drawer relates claim to paying bank

Paying bank may make claim through return if within time frame

Paying bank may return check using

- I – Indorsement missing

Forged Indorsement Responses

Return check timely

If return time passed:
make breach of
presentment
warranty claim to
depository bank

- Send demand letter bank-to-bank
- Include reference to UCC presentment warranties
- Include settlement information (where respondent remits payment)

No adjustment claim
to assist making
claim

Depository bank can
make transfer
warranty breach
claim to depositing
customer / member
(Mom's & Pop's)

Mom's & Pop's can
make transfer
warranty breach
claim to Thomas (if
they can find him)

Alteration Example

- Dorothy issues a check payable to Thomas
- Thomas alters the \$50.00 check to read \$500.00
- Thomas deposits check at depository bank
- Typically, the paying bank will pay the check when presented and rely on the drawer to notify of the alteration
- Dorothy notifies the paying bank of the alteration
- Alteration breaches both transfer and presentment warranties



Alteration UCC §3-407

Payor bank or drawee paying a fraudulently altered instrument may enforce rights with respect to the instrument either

- According to its original terms
- In the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed

Alteration Applicable Warranties

Thomas makes both the transfer warranties and the presentment warranties

- Transfer warranties to depository bank
- Presentment warranties to paying bank

Depository bank makes the presentment warranties to paying bank

Difference between alteration and forged indorsement scenario is check remains properly payable as originally written, i.e., for \$50.00

Alteration Breaches of Warranty

Thomas' alteration is a breach of the transfer and presentment warranties that the check has not been altered

Thomas' alteration puts the depository bank in breach of presentment warranty that the check has not been altered

Alteration



Initial claim typically made by drawer to paying bank



Paying bank may make claim through return if within time frame



Paying bank may return check using

N – Altered / fictitious item / suspected counterfeit / counterfeit

Alteration (Amount) Responses

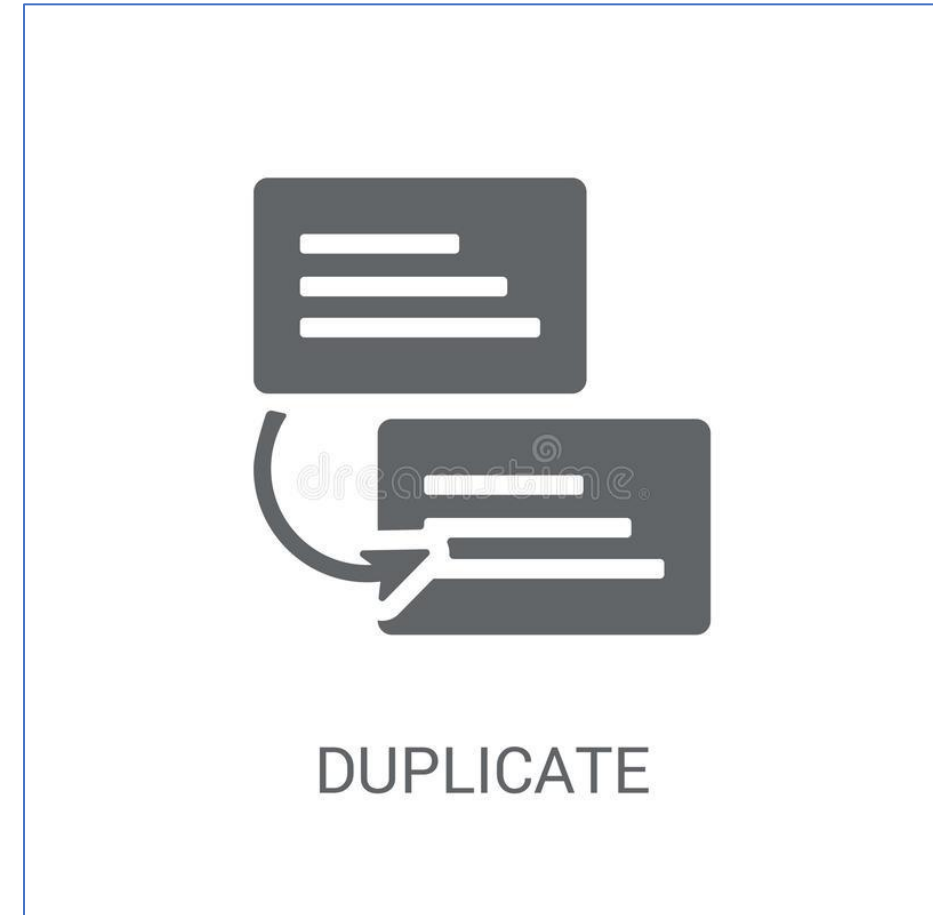
Return	Make	Claim	Make
<p>Return check timely</p>	<p>If return time passed: make breach of presentment warranty claim to depository bank</p> <ul style="list-style-type: none">• Send demand letter bank-to-bank• Include reference to UCC presentment warranties• Include settlement information (where respondent remits payment)	<p>Claim for altered amount is made for damages</p> <ul style="list-style-type: none">• Damages include difference between amount check written for and amount paid (\$450.00 in example) plus expenses and loss of interest, if applicable	<p>Depository bank can make transfer warranty breach claim to depositor (Thomas)</p>

Alteration (Payee) Responses

Return	Make	Claim	Make
<p>Return check timely</p>	<p>If return time passed: make breach of presentment warranty claim to depository bank</p> <ul style="list-style-type: none">• Send demand letter bank-to-bank• Include reference to UCC presentment warranties• Include settlement information (where respondent remits payment)	<p>Claim for altered payee is very similar to forged indorsement because true negotiation cannot occur</p> <ul style="list-style-type: none">• No one but the true payee can be a holder of the check	<p>Depository bank can make transfer warranty breach claim to depositor (Thomas)</p>

No Double-Debit Warranty

- ‘No duplicate’ warranty is really a ‘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 [Reg CC warranty §229.34(a)(ii)]



Double-Debit Breaches of Warranty Examples

Depository bank #1 takes deposit from Thomas through mobile RDC

- Presents item to Paying bank the next banking day

Depository bank #2 takes deposit from Thomas through drive-through

- Presents item to paying bank the next banking day

Both depository banks in breach of warranty when check paid more than once

Paying bank returns the same check 2 or more times

- Paying bank in breach of warranty if depository bank pays return more than once

Double-Debit

Initial claim typically made by drawer to paying bank

- But may be identified by paying bank through duplicate detection processes

Paying bank may make claim through return if within time frame

Paying bank may return check using

- Y – Duplicate presentment
- As in “Y did you send this to me again?”

Double-Debit Responses Paying Bank

Return

Return check timely

Make

If return time passed: make breach of electronic check warranty to depository bank either

- Send PAID adjustment through FRB or DUP adjustment through ECCHO exchange agreement
- Send demand letter bank-to-bank

Charge

Depository bank can charge item back to depositing owner based on its account holder agreement

Double-Debit Responses Depository Bank

For double-debit with respect to electronic returned check, make breach of electronic returned check warranty to paying bank either

- Send PAID adjustment through FRB or DUP adjustment through ECCHO exchange agreement
- Send demand letter bank-to-bank

For double-debit with respect to multiple adjustment claims for same check

- Send DUP adjustment through FRB or DUP adjustment through ECCHO exchange agreement

Summation

Warranties allocate liability between check system participants

UCC warranties statute of limitation = 3 years

Regulation CC warranties statute of limitation = 1 year

Warranties can help recover loss in certain breach of warranty situations

Indemnifications also help recover loss under certain circumstances

