

You be the Judge

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# Special Disclaimer

- Repeat after me
- I (state your name) do solemnly swear on a copy of the Nacha Rules that if I recognize any financial institution in any of the following scenarios, I will keep it to myself except for the first two that are actual court cases so we will be naming names
- With liberty and justice for all



# Studco Building Systems vs. 1<sup>st</sup> Advantage FCU

- Upon account opening, 1<sup>st</sup> Advantage failed to verify the identity, physical/ mailing address, prior banking history, whether the individual was eligible to be a member, or the source of funds intended for the account
- The individual began sending fraudulent emails to Studco pretending to be an employee of Olympic Steel, a supplier of Studco, with instructions to send payment to the supplier at an account held at 1<sup>st</sup> Advantage
- Studco sent CCD Entries totaling more than \$550k to an account that was a personal account in the name of an individual but identified Olympic Steel as the beneficiary
- UCC 4A-207 provides that if the bank receives a payment order identifying the beneficiary by name and account number, the bank may rely on the account number even if the number and name identify different persons, UNLESS the bank knows the number and name refer to different persons

# Studco

- The facts in the complaint alleged that 1<sup>st</sup> Advantage knew Olympic Steel was NOT a member/customer
- “If true, Studco could show that its wire transfers, which were commercially coded as ‘CCD’ for Olympic Steel, did not match the name and number for any existing account at 1st Advantage for Olympic Steel. Notably, Olympic Steel has never had an account at 1st Advantage but the ACH transfers transferred into a Personal Account in the name of John Doe.”
- Court also allowed claim of “fraudulent concealment” to proceed to trial against 1<sup>st</sup> Advantage for alleged misrepresentations made during the investigation
- Bench Trial occurred on September 13, 2022.

# The Result

- Court rendered a decision in favor of Studco (against the credit union) for \$550k on January 12, 2023
- Do you think the judge got this right?

# Provident Savings Bank v. Focus Bank

- \$150k Check drawn on Focus Bank deposited at Provident Bank on 4/29/2019
- Presented by Provident Bank to Focus Bank for payment on 4/30/2019 (check honored and paid)
- Drawer notified Focus Bank that check was fraudulent and Focus returns the check to the FRB on 5/14/2019.
- FRB debits Provident Bank's account and Provident (3 days later) makes a claim of late return to FRB – resulting in credit to Provident Bank.
- Focus responds that “The item presented was altered or fictitious because the security features stated on the face of the check don't appear to have been present” and that it “took all action necessary to entitle us to recover our payment within the deadlines in Regulation J and CC.” Focus Bank also submitted an “Affidavit of Alteration” claiming that the Check was a “fraudulent item” and contained a “forged signature.”
- FRB debits Provident Bank's account again and then Provident Bank's lawyer sent a demand letter to Focus Bank.

# Provident Savings Bank vs Focus Bank

- After filing suit, Provident Bank argued that UCC 4-302 imposes strict liability on payor banks that fail to return checks within the midnight deadline.
- “Focus Bank will be liable to Provident Bank for the amount of the Check unless it can establish a defense.”
- Two Defenses available: (1) breach of presentment warranty or (2) fraud by person seeking enforcement.
- The Court analyzed whether there was a breach of presentment warranty by Provident Bank.



# Provident Savings Bank vs Focus Bank

- UCC 4-208(a) Presentment Warranties
- (a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:
  - (1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;
  - **(2) the draft has not been altered;**
  - **(3) the warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized; and**
  - (4) if the draft is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as drawer. Nothing in this section shall be construed to impair the rights of the drawer against the drawee

# Provident Savings Bank vs Focus Bank

- Was the Check Altered or a Fraudulent Item?
  - Check deposited appears to have been electronically duplicated because evidence was discovered of a SECOND check that was nearly identical to the check at issue (but with a different payor).
  - Focus Bank argued the signature and check stock all appeared genuine and, thus, claimed the check was an alteration.
- Under the UCC, courts distinguish between altered and counterfeit checks. “The bank on which a check is drawn warrants to the presenting bank that the check is genuine, ... hence not forged, while as we know the presenting bank warrants that the check hasn’t been altered since its issuance.”

# Provident Savings Bank vs Focus Bank

- “Courts that have addressed the issue appear to uniformly hold that a counterfeit check—i.e., one that is not a modification of an original check but rather is a copy or is a new, different check—is not an altered check under the UCC”
- “Focus Bank does not cite any case to support the proposition that a digitally altered copy of a genuine check, modified and then printed on commercially available check stock, is an ‘alteration’ under the UCC”
- Provident Bank did NOT breach presentment warranty because “The evidence does not establish a genuine issue of material fact as to whether the Check was altered.”
- Court denied summary judgment on claim to Provident on the other breach of warranty claim, however, because Bank policies were not followed with regard to the deposit
- “The depository bank has an opportunity to examine the check free of the time pressures which prevent collecting banks from giving checks more than a cursory glance. Perhaps more important, the depository bank is in the unique position of being able to examine both the depositor and the check”

# Arbitration

- Low cost, expeditious mechanism for resolving disputes within the ACH Network, bypassing the need to resolve disputes through the court system

# Arbitration

- Damages claimed must be \$250 or more
- \$250 non-refundable application fee
- Claim submitted by officer of complainant to Nacha
- Within 2 years of alleged violation

# 3 Procedures for Arbitration

- Arbitration Procedure A
  - Damages of \$250 or more but less than \$10,000
  - Mandatory for both parties
  - No hearing is held
  - 1 arbitrator
  - Stipend to the arbitrator is \$100
- Arbitration Procedure B
  - Damages of \$10,000 or more but less than \$50,000
  - Mandatory for both parties
  - No hearing is held
  - 3 arbitrators
  - Stipend is 1% of decision for each arbitrator

# 3 Procedures for Arbitration

- Arbitration Procedure C
  - Damages are \$50,000 or more
  - Both parties must first agree to arbitration
  - Hearing is held
  - Parties can agree to Procedure B
  - Legal counsel may be present at hearing
  - 3 arbitrators
  - Stipend is 1.5% of decision for each arbitrator

I mean, I'm in no position  
to judge.....but I'm going  
to anyway.



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