

To: Subscribers to *The Law of Bank Deposits, Collections and Credit Cards*

From: A.S. Pratt & Sons

Subject: Highlights

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The rules governing bank deposits and collections are not always clear. Yet strict deadlines force you to make decisions fast—knowing that one wrong move could mean serious legal trouble for your bank.

The enclosed update to *The Law of Bank Deposits, Collections and Credit Cards* includes new and revised information in the following areas:

- **Congress continues to consider tight regulation of overdraft protection programs.** In 2007, as in prior years, Congress has been considering tighter regulation of overdraft banking products. Two key changes have been urged by consumer advocates: (1) requiring disclosure of overdraft fees as TILA Annual Percentage Rates and (2) outlawing high-to-low check posting. We analyze these legislative initiatives in Chapter 3. ¶ 3.05[5][g].
- **Texas Supreme Court upholds arbitration clause in deposit agreement.** In a case of first impression, the Texas supreme court has given an okay to the use of an arbitration clause in a deposit agreement. Though the case involved a business customer, the rationale of the decision seems to carry over to consumer deposit accounts. The unanswered question: Are class action waivers enforceable? We discuss these issues and the Texas case in Chapter 3. ¶ 3.14[4].
- **Seventh Circuit allows affirmative claim for notice of breach of fiduciary duty.** An important check fraud rule is found in UCC 3-307, which deals with a depository bank’s notice of its customer’s breach of fiduciary duty. One important issue in this area is whether the UCC rule allows the customer’s employer to recover affirmatively from the bank of first deposit. In a case of first impression, the Seventh Circuit says “Yes.” We analyze this important new decision in Chapter 5. ¶ 5.07[12].
- **What is the proper relationship between a bank’s exercise of charge-back and its customer’s continued “ownership” of the**

**funds in the account?** A recent federal case from Pennsylvania wrestles with this issue in the context of a government seizure of the deposit account. We take a close look at this decision, as well as the bank’s right to expand charge-back by a contractual provision in the deposit agreement. ¶ 5.08[7].

- **OCC issues a special bulletin on handling fraudulent cashier’s checks.** Fraudulent cashier’s checks—often involving bad actors from overseas—continue to be a significant instrument of check fraud. In response to this scourge, the OCC has recently issued a bulletin that outlines recurrent factual scenarios and provides recommendations for banks handling these sometimes dangerous animals. We discuss this new bulletin in Chapter 10. ¶ 10.14[2].
- **Is it a counterfeit check or an alteration?** Federal appellate courts clash. There is a big difference between a counterfeit check and an alteration. Under the rules of the UCC, liability for counterfeit checks generally lands on the shoulders of the payor bank. By contrast, the liability for alterations can be shifted back to the bank of first deposit on a warranty theory. The problem is, new desktop publishing technology makes it very difficult to determine whether the bogus check is an alteration of the original or is a new check created by digital means. At ¶ 11.08, we analyze two recent federal appellate decisions that come to polar-opposite conclusions on this important check fraud issue.
- **Five defenses to upstream warranty claims.** When a depository bank receives a claim from the payor bank that a check bears a forged indorsement or alteration, what defenses can the depository bank raise? At ¶ 12.04, we identify five defenses that may be available to the depository bank.
- **Back office conversion (BOC) under the NACHA rule.** Check conversion to ACH is all the rage. As of March 16, 2007, NACHA allows a new form of check conversion for bank customers—back-office conversion. This new approach is similar to remote deposit capture, though the legal framework for BOC is found in the NACHA rules and Regulation E, while remote deposit capture is typically controlled by check law under the UCC and Regulation CC. In Chapter 16, we provide an overview of BOC. ¶ 16.05[4].
- **Is a digital image of a check an “item” under the UCC?** Although the UCC allows electronic check presentment, it is not clear that a digital image of a check is an item prior to the time of presentment. That lack of clarity has important implications for banks seeking to

shift warranty liability to their customers. At ¶ 16.08[10], we discuss how to clear up these muddy waters.

- **Three examples of payment convergence.** Most people in the financial services industry think that we should not have separate legal silos for ACH and checks. At ¶ 16.11, we provide three recent examples of payment convergence that respond to the silo problem. One important example is NACHA's pilot program, which will be launched in 2008, combining check law with ACH collection procedures.
- **Wire transfers: garnishing intermediary banks.** In recent years, the New York courts have been the epicenter of big disputes regarding the right of a creditor to garnish funds that are on their way by wire transfer from the originator's bank to the beneficiary's bank. Based on a conduit theory, the UCC does not allow garnishment of intermediary banks. By contrast, admiralty law okays such garnishments. At ¶ 17.05 we analyze the exploding case law on this issue.
- **How do you perfect a security interest in a consumer's deposit account?** Revised Article 9 of the UCC allows creditors to take consensual security interests in commercial deposit accounts. By contrast, security interests in consumer deposit accounts are outside the scope of Article 9. Does that mean that security interest in consumer deposit accounts, such as book-entry CDs, is invalid? We do not think so. Instead, the rules of Article 9—particularly the control concept—should be used by analogy. We discuss this important issue at ¶ 18.15[9].
- **Bank regulators suggest new best practices for handling garnishments against consumer accounts containing exempt federal benefits such as social security.** On September 28, 2007, the federal bank regulators issued suggested best practices that would protect the exemption enjoyed by individuals regarding social security payments and other federal entitlements that are directly deposited into their bank accounts. At ¶ 21.02, we take a close look at these best practices and the compliance challenges they can pose for depository institutions.