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NEW LAW ON REMOTELY CREATED CHECKS

by J. Benjamin Davis

Remotely created checks, also known as "telechecks," are typically created when the holder of a checking account authorizes a payee (often a telemarketer or a credit card company) to draw a check on that account—but does not actually sign the check. Instead of a signature, the check often bears a statement that the customer authorized the check or bears the customer's printed or typed name.

Remotely created checks can be useful payment devices. For instance, a person without a credit or debit card can purchase an item from a telemarketer by authorizing the seller to create a remotely created check. Similarly, a customer can authorize a credit card company to create a remotely authorized check by telephone, which may allow the customer to avoid late charges by paying his credit card bill in a timely manner.

However, remotely created checks are vulnerable to fraud because they do not bear the drawer's signature or other readily verifiable indication of authorization.

Who is liable for unauthorized remotely created checks?

In North Carolina, as in most states, the Uniform Commercial Code ("UCC") requires a bank to recredit its customer's account for the amount of any unauthorized check the bank pays, including any unauthorized remotely created check. *However, the Federal Reserve has amended Regulation CC regarding bank liability for unauthorized remotely created checks.* This amendment preempts the UCC with regard to remotely created checks. Beginning July 1, 2006, a bank that transfers or presents a remotely created check for consideration warrants to the transferee bank, any subsequent collecting bank, and the paying bank, that the person on whose account the check was drawn authorized the check in the amount stated on the check and to the payee stated on the check.

Why did the Federal Reserve change the liability rules for remotely created checks?

The policy rationale for the UCC liability rule is that the paying bank, rather than the depositary bank, is in the best position to judge whether the signature on a check is the authorized signature of its customer. However, remotely created checks do not bear a handwritten signature, thus undermining the rule's rationale. Also, some states had amended their UCC provisions to shift liability to depositary banks for unauthorized remotely created checks, while most states kept the original UCC rule. The Regulation CC amendment preempts any contrary language contained in UCC provisions, which ensures a uniform rule nationwide.

Are commercial accounts affected by the Regulation CC amendment?

Yes. Since remotely created checks can be drawn on consumer and commercial deposit accounts, as well as deposit accounts held by governmental units, trusts, or any other entity or organization, the new liability rule extends to all these accounts.

What do the new warranty provisions mean?

The warranties are given only by banks and only to subsequent banks in the collection chain. The warranties shift the liability for loss created by an unauthorized remotely created check to the depositary bank (rather than the payee bank). The depositary bank *cannot* assert the transfer and presentment warranties against its depositor.

How can a depositary bank protect itself from liability when its deposit account holder generates unauthorized remotely created checks?

A depositary bank should amend its deposit account agreements to allocate liability for unauthorized remotely created checks to account holders.

Are there any defenses a depositary bank could raise against a claim that it breached the new transfer and presentment warranties?

Yes. The depositary bank could defend against a warranty claim by proving that the customer of the paying bank failed to discover the unauthorized remotely created check in a timely manner. Another possible defense could be that the remotely created check was, in fact, authorized. The telecheck warranty rules do <u>not</u> apply when a customer originally authorizes a check but then experiences "buyer's remorse" and tries to revoke the authorization. The Federal Trade Commission's Telemarketing Sales Rule requires telemarketers that submit checks for payment to obtain a customer's "express verifiable authorization" (which may be in writing or tape recorded and which must be made available upon request to the customer's bank). If the depositary bank suspects "buyer's remorse" on the part of the paying bank's account holder, then it can obtain from its own customer (the telemarketer), evidence of the express verifiable authorization of the check.

CONCLUSION

Remotely created checks can create problems for banks in several ways. Some bank customers may believe that remotely created checks are not binding on them simply because the customer did not sign them manually. Those customers are wrong as a matter of law. The greatest challenge to the bank in those cases may be public relations.

On the other hand, a bank may have an account holder that creates and deposits remotely created checks into its account. Where such checks are not authorized, the bank may be liable under Regulation CC's new transfer and presentment warranties if the bank transfers the check for collection. The bank should add language to its deposit account agreement to shift this liability to the account holder.

When a depositary bank is faced with a warranty claim involving a remotely created check, the bank should ensure it investigates the underlying facts of the case—defenses may be available depending on the circumstances involved.

Please contact your Brooks Pierce advisor if you would like to discuss these issues.

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