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Remote Deposit Capture and Multiple Presentment of Checks: New Learnings From *1409 West Diversey Corporation v. JPMorgan Chase Bank, N.A.*

This Bulletin was prepared by Ted Teruo Kitada,¹ Senior Company Counsel for Wells Fargo Bank and Chairman of CBA's Legal Affairs Committee

I. Background

“Remote deposit capture” is the convenient, innovative process of depositing a check to a deposit account through the digital transmission of an image of a check and other related transaction information to a depository bank by its accountholder. By digitally transmitting this image and information, the accountholder is not required to tender a paper check to a retail banking location or an automated teller machine to facilitate the deposit of the check. While this banking service originally was offered generally to commercial accountholders shortly after October 28, 2004, the effective date of the federal Check Clearing for the 21st Century Act,² many banks now offer the service to consumer accountholders. The transmission of the image and information associated with the check is often enabled through an application downloaded to a handheld device, such as a smartphone. Up to three parties may be involved in remote deposit capture: an accountholder, the

acountholder's depository bank, and the bank on, at, or through which the check is payable. Only one bank may also be involved: If the check is an “on-us” check, the depository bank and the paying bank are the same bank.

One mischief afforded under this process is that an accountholder may deposit a check one or more instances through remote transmission and negotiate the paper check with an apparent innocent party, to reap two or more payments under the same instrument. The allocation of loss among parties involved under such malfeasance has not been addressed squarely by a court; the author is not aware of any reported case, until the announcement of *1409 West Diversey Corporation v. JPMorgan Chase Bank, N.A.*, 2016 WL 4124293 (N.D. Illinois, Eastern Division, August 3, 2016).

II. The ruling in *1409 West Diversey Corporation v. JPMorgan Chase Bank, N.A.*

Plaintiff 1409 West Diversey Corporation does business as the Bellwood Hotel at 1409 West Diversey in Chicago, Illinois. Plaintiff employed Marie Liszewski; it issued two payroll checks to her in February 2014. Liszewski deposited the checks to her deposit account at JPMorgan Chase Bank, N.A. (“Chase”), using remote deposit capture made available by Chase through a smartphone application. These two remotely

¹ Mr. Kitada can be reached at 415-396-5461 or kitadat@wellsfargo.com.

² 12 USC §§ 4001-4010, signed into law on October 28, 2003, becoming effective on its first anniversary date.

captured checks were presented to plaintiff's bank, MB Financial Bank ("MB"), through a forward collection electronic cash letter and MB posted the checks against plaintiff's account.

Shortly thereafter, Liszewski tendered the two checks at a currency exchange and again received payment under the checks. When the two checks were presented to MB in the regular forward collection process, MB dishonored the checks as suspected duplicate checks. Upon dishonor, the currency exchange made demand for payment to plaintiff; plaintiff honored the demand. Plaintiff filed a state court action against Chase on a common law negligence cause of action. Plaintiff also sought to certify a class in the action. Chase removed the state action to federal court and moved to dismiss the action. The federal court through Judge Samuel Der-Yeghiayan granted Chase's motion to dismiss.

In its successful motion to dismiss, Chase advanced two theories: Chase contended that it cannot be liable to a third party for negligence under Illinois law and further contended that even if it could be held liable as a national bank the negligence claim is preempted by federal law.

A. Plaintiff's negligence claim

The federal court observed that under Illinois law, a plaintiff is required to establish the following: (1) Chase owed a duty of care to plaintiff; (2) Chase breached that duty; and (3) plaintiff suffered an injury proximately caused by that breach. Chase maintained that plaintiff and Chase had no contractual relationship as plaintiff did not maintain an account with Chase. As plaintiff and Chase had no contractual relationship, Chase owed no duty to plaintiff. In observing Illinois law, the court concluded

that a bank owes no duty to a non-accountholder, even under instances when the bank provisions a remote deposit capture service to an accountholder. In this regard, the court provides a curious observation:

In addition, if the Hotel faces a repetition of such conduct by its employees with Chase accounts and the Hotel is dissatisfied with the services it receives, the Hotel can always choose in this free market place to switch to a new bank.³

This statement makes little sense as plaintiff does not bank with Chase, it banks with MB. Chase does not provide banking services to plaintiff.

B. Federal preemption

Chase further argued that even if plaintiff states a negligence claim, such claim is preempted by federal law. Pursuant to the federal constitution's Supremacy Clause, a state law that interferes with, or contrary to the laws of congress, made in pursuance of the constitution is invalid. The National Bank Act ("Act")⁴ grants national banks authority to exercise all incidental powers as necessary to carry out its business, including receiving deposits. This authority is confirmed by the Office of the Comptroller of Currency through regulations implementing the Act,⁵ acknowledging a national bank's authority to provide banking services by electronic means of delivery. A

³ *1409 West Diversey Corporation v. JPMorgan Chase Bank, N.A.*, 2016 WL 4124293, 2 (N.D. Illinois, Eastern Division, August 3, 2016).

⁴ 12 USC § 1 *et seq.*

⁵ 12 C.F.R. § 7.5002(a) provides in part: "(a) Use of electronic means and facilities. A national bank may perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide, or deliver,...."

state's regulation of a national bank is not permitted to prevent or significantly interfere with the bank's exercise of its powers. In holding that plaintiff's negligence claim is preempted under the Act, the court voices prescience regarding benefits of permitting a national bank to advance the role of technology in banking services unencumbered by state regulation:

In the instant action, the negligence claim that the Hotel seeks to bring would impose a common law obligation under Illinois law on banks that would significantly interfere with their authorized power to take deposits. Particularly as technology advances and paperless deposits become more prevalent allowing a state common law to micro-manage the deposit procedures of banks would intrude far into the realm reserved for federal law when regulating national banking institutions. Absent a preemption of such common law claims, banks could also face a myriad of conflicting laws across this country relating to deposit procedures. Thus, even if the Hotel had stated a valid claim in this case, it would be preempted by federal law.⁶

The court's observations regarding the importance of granting a generous license to national banks to advance innovation free of interference from state law are particularly noteworthy.

⁶ *1409 West Diversey Corporation v. JPMorgan Chase Bank, N.A.*, 2016 WL 4124293, 3 (N.D. Illinois, Eastern Division, August 3, 2016).

III. Breach of warranty claim under the Electronic Check Clearing House Organization Operating Rules.

Plaintiff's action against Chase as a depository bank offering a remote deposit capture service is novel and curious. Virtually all paper checks are cleared electronically through electronic cash letter files. The clearing of files may be conducted directly between banks or through intermediaries, such as Endpoint Exchange, LLC, or Fiserv, Inc. These electronic file exchange arrangements are frequently governed by the Electronic Check Clearing House Organization Operating Rules ("Rules"). Normally, in instances where a drawer of a check faces a claim from a holder in due course as a result of the holder giving value for a paper check previously remotely captured and paid against the drawer's paying bank account, the drawer may pay the holder's claim. Upon such payment, the drawer is regularly made whole by its paying bank, absent a defense enjoyed by the paying bank against the drawer. Additionally, a paying bank may directly pay a holder asserting such a claim against a drawer of a check previously paid.

Upon such payment to a drawer to reimburse the drawer upon payment of a holder's claim or directly to a holder maintaining a claim against a drawer, the paying bank has remedies under the Rules to pursue a breach of warranty claim against the holder's bank or the bank of the wrongdoer receiving the benefit of multiple payments. This warranty under the Rules is set forth at section XIX(L)(7):⁷

⁷ Under Regulation J a similar warranty is granted by a sender to a Reserve Bank under § 210.5(a)(4):

(4) *Warranties for electronic items that are not representations of substitute checks.* If an electronic item is not a representation of a substitute check, the sender of that item

L. Sending Bank Warranties and Indemnification. In addition to the warranties otherwise provided in the Code, Regulation CC, the Rules or other law, each Sending Bank warrants to the Receiving Bank with respect to each Electronic Image sent to the Receiving Bank that:

(7) the Receiving Bank and any other person will not receive a transfer, presentment or return of, or otherwise be charged for, the Electronic Image, the Related Physical Check of that Electronic Image, or a paper or electronic representation of the Related Physical Check such that the person will be asked to make a payment based on an item that it already has paid.

This warranty is commonly referenced as the “no double debit” warranty. Prior to December 1, 2013, it was not entirely clear under the Rules whether a paying bank could exercise rights as a warrantee under section XIX(L)(7) if it paid its drawer account holder or the holder in due course. Effective December 1, 2013, a new unnumbered comment to this section under the Rules has made it abundantly clear that the warrantee may so pay and continue to enjoy rights under the Rules:

Commentary: A payment to a holder of an item (outside of the check

warrants to each Reserve Bank handling the item that—

...

(ii) No person will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the original item such that the person will be asked to make payment based on an item it already has paid.

exchange system) may give rise to a warranty claim to the Sending Bank under the ECCHO Rules warranty against double payment of an item. A holder of an item may demand payment on the item directly from the drawer when the item has been returned unpaid by the paying bank. (UCC Article 3-414(b)). An example of a double payment warranty claim by a Receiving Bank (that is a paying bank) would include a situation where a Receiving Bank has reimbursed its drawer customer because the drawer customer has paid the check/claim to the holder or holder in due course. The ECCHO warranty from a Sending Bank to the Receiving Bank against double payment covers the situation where a person (which could include either the Receiving Bank or a drawer customer) is “asked to make a payment” twice. The double payment arises in this holder situation because there are two payments by a person relating to the same item: (a) the first payment occurs when the Sending Bank presents the image of the item to the Receiving Bank and the Receiving Bank pays the item and charges the drawer customer’s account, and (b) the second payment occurs when the drawer customer pays the holder for its claim to the drawer under the UCC based [on] the original item. As a result, the Receiving Bank can make a warranty claim under Section XIX(L)(7) of the ECCHO Rules to a Sending Bank that previously presented an image of the same item to recover the Receiving Bank’s losses in compensating its drawer customer or paying the holder directly. The application of the

warranty against double payment in the context of a payment to a holder of an item is consistent with the underlying policy – as expressed in the warranty provisions of Check 21, Regulation CC and the ECCHO Rules -- to protect the paying bank and drawer customer from losses associated with double payment of a check image or substitute check.

Because many electronic files are exchanged under the Rules, a paying bank would normally pay a holder in due course or a drawer suffering such a claim and maintain a breach of warranty claim under the Rules. Thus, the claim by plaintiff in this reported case is most unusual and curious, unless plaintiff's right to be reimbursed by its paying bank has been impaired or compromised. Plaintiff also may not have known that it could look directly to MB for relief.

IV. Conclusion

By precluding a direct action by a drawer against a depository bank providing a remote deposit capture service upon the drawer suffering a claim pressed by a holder in due course providing value for a previously captured and posted check, this ruling encourages banks to offer this service. As this ruling is likely the first definitive word through a reported decision on this important topic, a brief respite may have been granted to the banking industry: As plaintiff has on August 29, 2016, filed a notice of appeal of this ruling to the Seventh Circuit Court of Appeals, cautiously stay tuned. Further, this author speculates if a different result could ensue if a plaintiff under similar facts were a consumer, rather than a business.

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