

COMMERCIAL LAW

BANKRUPTCY

INSOLVENCY



Payments for Creditors: Wire Transfers, ACH and Checks

Carter Klein, Of Counsel, Jenner and Block, Chicago, IL
Beverly Weiss Manne, Tucker Arensberg, P.C., Pittsburgh, PA

Presented to Members of the Commercial Law League of America
Chicago -- May 2023

Table of Contents

Slide		Slide	
3	Useful Source Materials for Payments Law Issues	14	Wire Transfers – Unauthorized Transfers and Fraud
4	Purpose of Presentation	15	Payment in Full Checks for Less Than the Amount Owed – Do’s, Don’ts and Maybes
5	Scope of Presentation	16	Payment in Full Checks for Less Than the Amount Owed – Exceptions to the Satisfaction Rule
6	Preventing or Mitigating Payment Problems at the Front End of Your Transaction	17	Steps to Avoid Returned Checks
7	Payment Specific Terms and Methods to Consider Using or Incorporating in Your Purchase Contract	18	What To Do If a Check Is Returned?
8	Non-Paper Payments – eChecks	19	Can I Redeposit a Returned NSF check?
9	Non-Paper Payments – Credit Cards	20	What Does Presenting a Returned NSF Check for Collection Do?
10	Non-Paper Payments – Debit Cards	21	Can I Redeposit a Check for Collection on Which Payment Has Been Stopped or Account Closed?
11	Non-Paper Payments – ACH	22	Can the Payee Claim Against the Paying Bank on a Dishonored Check
12	Non-Paper Payments – Wire Transfers	23	Who Bears the Loss if an Incoming Check is Converted
13	Wire transfer Errors	24	Who Bear the Loss if A Check Is Altered

Useful Source Materials

For checking statutory, regulatory and case law on the topics covered by this presentation, the following nonexclusive list of source materials are useful:

- Applicable Sections of the Uniform Commercial Code and the Official Comments to it.
- State case law annotations under the applicable UCC sections, e.g., Klein & Murray, 2A Illinois Practice Series – Uniform Commercial Code with Illinois Code Comments (Thomson Reuters)
- ABA’s Business Lawyer -- Fall Issues, UCC Survey -- Payments
- Klein & Murray, 4 Uniform Laws Annotated, Forms Annotated for Articles 1-7 (Thomson West)
- Uniform Commercial Code Case Digest (Thomson Reuters)
- NACHA’s ACH Rules Handbook

Purpose of Presentation

Purposes of this presentation on payments include –

- Describing different types of payment methods and their advantages and disadvantages.
- Spotting payment issues so you can deal with them proactively or reactively in ways to avoid or mitigate loss.
- Provide leads by UCC section or other cites for further research by you or your attorney.
- Suggest ideas on how to minimize losses due to the method, type or timing of payment.

We expect that members of the audience will have experiences and ideas to share on the topics presented

Scope of Presentation

- We work from the point of view of the seller, lender, creditor or other payee looking to receive payment for its goods, services, loans or other financing extended; we do not do a deep dive into payment issues from the perspective of the buyer, borrower, or payor, such as the debtor's fraud losses, dishonest employees, overdrafts, etc.
- We deal with business purpose or commercial payments; we do not cover consumer payments such as those governed by Regulation E of the FRB nor do we cover other bank regulatory and federal and state laws regulating consumer credit and consumer banking transactions such as credit card laws.
- We do not cover crypto currency payments such as Bitcoin, but point out that the Uniform Law Commission and the ALI have drafted a new Article 12 to the UCC with conforming amendments to other articles to deal with crypto currencies – now called controllable electronic records. Article 12 of the UCC is up for state adoptions and is expected to be adopted by most states by the end of 2024.

Preventing or Mitigating Payment Problems at the Front End of A Transaction

1. Credit check your open account buyers.
2. For large ticket or specially manufactured goods, obtain progress payments, cash in advance or a standby letter of credit to secure payment.
3. If you ship upon receipt of a payment which is made by check, make sure the check clears before you ship.
4. Consider verifying the check with the bank on which it is drawn. Provide the information on the check, such as the account number and the customer's name. Wait for the bank representative to look up the account in the bank's database. Bank staff members cannot provide the exact amount contained in a customer's account but can tell you if the amount is enough to cover the check or not. Some banks have policies against providing check verification information via phone and some banks charge a fee for this service.
5. For large dollar amount sales on credit, consider obtaining a purchase money security interest to secure payment. It can give you a superpriority security interest over any blanket lien security interests already filed against your buyer by its bank lender with blanket liens.
6. For international shipments, obtain a documentary letter of credit or have your bank send drafts/BL's for collection. Unlike letters of credit, documentary collections control goods until payment, but don't assure payment.

Payment Specific Terms and Methods to Consider Using or Incorporating in Your Purchase Contract

- Make sure your terms of payment apply – (i) obtain signed acceptance of the buyer’s order based on your T&C, (ii) obtain a signed override agreement incorporating your T&C, or (iii) use an electronic portal with an “I agree” click to incorporate your T&C as part of the purchase order contract.
- The buyer may use an online procurement platform such as Coupa BSM, SAP Ariba Buying and Invoicing, JAEGGER ONE, Baseware, PRM 360 Procurer to Pay, Oracle Fusion Cloud Procurement, etc. See Gartner, Competitors and Alternatives to Coupa BSM Platform (2022) (<https://www.gartner.com/reviews/market/procure-to-pay-suites/vendor/coupa/product/coupa-bsm-platform/alternatives>).
- With procurement platforms of your buyer, you need to make sure your T&C, including your terms and method of payment and security apply, as well as insecurity clauses, jurisdiction, venue, attorney's fees, return check charges, and other terms to assist you in obtaining a remedy in the event of a buyer default.
- Consider putting terms in your contract requiring payment by methods other than simple checks, such as ACH transfers, eChecks, debit cards, credit cards, cashiers checks, and/or wire transfers. See <https://smallbusiness.chron.com/can-check-see-there-money-customers-bank-account-46720.html>.

Non-Paper Payments -- eChecks

- Electronic checks can be used for any transactions for which purchasers could use a paper check. E-checks are electronically processed through the ACH Network. Every transaction on the ACH network is encrypted, including e-checks.
- eChecks are created when the payer's bank account information is used to electronically send money to the recipient's (your) bank account after a transaction is initiated (an online purchase or online payment from a bank account). You will need to obtain from your customer or the payer their bank account and routing numbers to initiate the transaction. The payment must be authorized by the customer or payer, either by signed contract, acceptance of a website's "Terms and Conditions," or a recorded voice conversation. Most businesses today have websites that can provide a secure form page for this customer information.
- Once the payment form is completed online and submitted, the automated process can begin. A paper check, on the other hand, needs to first run through an electronic scanner that captures the customer's banking information and amount to be debited. Thus, business owners get paid more quickly and efficiently by eCheck than by paper check. See Pay Simple, What is an eCheck and how are they different? <https://paysimple.com/blog/what-is-an-echeck-and-how-are-they-different/#:~:text=Electronic%20checks%20can%20be%20used,paid%20more%20quickly%20and%20efficiently>.
- Note: It sometimes takes a few days to transfer the money from the buyer's bank account to the seller's when an electronic check is used for payment. If funds are not available in the buyer's account when the eCheck is processed, it will be declined. If you accept eChecks through a merchant account, the payment goes through a gateway payment processor before it gets from the customer's bank to you. See <https://smallbusiness.chron.com/should-buyers-echeck-declined-39825.html>.

Non-Paper Payments – Credit Cards

- Credit Cards generally cover the creditworthiness of the buyer or payer, but the merchant credit card processing agreement with your bank or other payment processor contains many terms protective of them, including numerous representations, warranties, indemnities, restrictions on use of credit card payments, and sometimes reserve accounts withholding an amount or percentage from credit card payments to cover chargebacks and other losses.
- Credit card purchases are handled through credit card networks and fees tend to be much larger than those charged for eChecks or ACH transfers. FIS states that if your business regularly processes large payments, say in the thousands of dollars, you can potentially save a significant amount of money by accepting electronic check payments vs. credit card payments. See <https://www.fisglobal.com/en/insights/merchant-solutions-worldpay/article/8-questions-answered-about-electronic-check-payments>.
- Other sources say that credit card payments are more expensive than debit card payments because they draw on a pre-approved line of credit instead of debiting funds in a bank account, thus requiring more steps and processing. In addition, debit card transactions are less susceptible to fraud and credit risk. See, e.g., Nerd Wallet, How Does Debit Card Processing Work? <https://www.nerdwallet.com/article/small-business/debit-card-processing>.
- Maximum liability for charges for “unauthorized charges” is \$50. TILA §133(a)(1)(B); Reg Z §1026.12(b)(1). This applies to commercial cards too!

Non-Paper Payments – Debit Cards

- According to Business.gov, debit cards typically carry lower merchant processing fees than credit cards or checks, which can result in cost savings for the business. Debit card transactions usually require less processing time, meaning that the merchant actually has access to the funds more quickly. See <https://smallbusiness.chron.com/pros-cons-accepting-debit-cards-business-992.html>.
- Fees can be higher for website and telephone debit card transactions (card not present transactions).
- Debit card transactions work very similar to credit card payments. Their network is provided by credit card processing companies. These processing companies have a computerized network that allows businesses to collect consumer information from the debit card and set up a funds transfer from the customer's bank to the business' financial bank account. *Id.*
- Many credit card processors offer debit card solutions for websites. Accepting debit cards through an Internet website is very similar to using a standalone debit card unit in a brick-and-mortar store location. Internet websites along with debit card payment acceptance allow companies to reach a larger target market in the business environment. *Id.*
- Risk of loss with respect to fraudulent transactions is high. No limits for commercial debit card fraud unless bank has a voluntary zero liability policy! If card is tied to a personal account it will be treated as a consumer account - covered by EFTA. In consumer transactions \$50 for liability for unauthorized use if customer quickly notifies the bank. If customer does not initially notify bank, liability is limited to \$500, but can be unlimited if account holder fails to report and dispute improper transactions within 60 days. EFTA §909(a) Reg E 1005.6.

Non-Paper Payments -- ACH

- In 2021, ACH transfers accounted for 5.3 billion B2B payments valued at \$50 trillion. See IR, The Complete Guide to Understanding ACH Payments <https://www.ir.com/guides/ach-payments>.
- ACH credit or push transactions are governed by Article 4A of the UCC and NACHA Rules.
- As long as the electronic payments request is submitted before the cutoff for the day, it's possible for the money to be received within 24 hours. *Id.*
- Same-day one time ACH transfers typically cost a small fee but allow for payments to be processed within the same business day. MineralTree, Electronic Payments: Everything Your Business Needs to Know, <https://www.mineraltree.com/blog/electronic-payments-what-your-business-needs-to-know/>. International ACH transactions (IATs) and high-value transactions (> \$1,000,000) are not eligible for same day transfer.
- ACH transfers are usually for smaller amounts than wire transfers and are cheaper than wire transfers because they are batch processed.
- ACH push transfers can be reversed for a limited period of time, but only for the wrong amount, a duplicate payment or a payment made to the wrong account. In this sense they are subject to similar limits on cancellation as are wire transfers. See next slide.
- ACH transfers go from originating institutions (ODFI's) to one of two ACH payment networks (EPN operated by THC or the FRB Banks). They are sent in batches from the ODFI, usually three times a day. The network then sorts by type and routes the ACH transfers to the receiving depository institutions (RDFI's) which verifies there are sufficient funds and then sends them to the ODFI.

Non-Paper Payments -- Wire Transfers

- Although they cost more than ACH transfers, wire transfers are fast, secure and generally final. CAUTION: Give your customer the correct bank account and routing information. Wire transfers are governed by the account number and not by the name on the account. But if the sender of the funds transfer misidentifies the account to be credited, the loss falls on him and he may have to pay twice. See UCC §4A-207.
- Wire transfers usually cannot be reversed once initiated. Generally, after a funds transfer payment order has been accepted, cancellation or amendment of a payment order for a wire transfer is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank. UCC §4A-211(2). The exceptions to non-reversal are (i) duplicate payments, (ii) wrong beneficiary, or (iii) excessive payment. Id.
- Acceptance occurs when the beneficiary's bank, after receipt of the funds transfer payment order, notifies the beneficiary of receipt of the funds, credits the funds to the beneficiary's account or makes the funds available to the beneficiary. UCC §4A-209(b)(1) & §4A-405. The default rule is that acceptance occurs if the receiving (beneficiary's) bank does not reject the payment order with the 1st hour of the business day after the day it received the order or if it receives payment by final settlement through FedWire.
- Wire transfers covered by Article 4A are for commercial transactions. Consumer transactions are covered by the EFTA. UCC §4A-108.

Wire Transfer Errors

- Wire transfer systems generally hold originator responsible for any mistakes originator makes in describing its order to the originator's bank.
- Common payment error: identify beneficiary by name but to direct payment into a wrong account.
- Wire transfer system allows a beneficiary's bank to rely on the number in the order and deposit into that account even if the designated beneficiary does not own the account. UCC §4A-207. If the bank knows it's the wrong account, the order cannot be accepted and the receiving bank has to send the money back.
- Article 4A limits the right of the party who made the error to pass on its mistake to other parties in the system, but it authorizes recovery from an unintended recipient on common law principals of restitution.

Wire Transfers – Unauthorized transfers and Fraud

- A customer wiring funds is only liable for a wire (a payment order) that they authorize. UCC § 4A-202(a).
- General rule: a bank receiving a payment order bears the risk of loss of unauthorized funds transfers. UCC §4A-204.
- Banks can shift losses back to customer by deeming that customer authorized all orders made in conformity with pre-approved security procedures even if the order is unauthorized. A “security procedure” is established via the agreement of the bank and customer primarily in order to “verify that the payment order or communication amending or cancelling a payment order is that of the customer.” UCC § 4A-201.
- To shift risk back to customer the security procedure must be commercially reasonable. The standard is not whether the security procedure is the best available, but rather whether “the procedure is *reasonable for the particular customer and the particular bank.*” UCC § 4A-203, cmt. 4

Payment in Full Checks for Less Than the Amount Owed – Do's, Don'ts and Maybes

- UCC §3-311 provides for accord and satisfaction of a debt by use of a check. Courts have noted that this section provides an informal and expeditious way to settle disputes.
- The debtor must give conspicuous notice that the check is tendered for full satisfaction of the debt.
- The notice can be on the back of the check or in a separate letter
- The notice must be clear that it the check is tendered in full satisfaction of the indebtedness for which it is tendered.
- **DANGER** – Once these criteria are satisfied, if the creditor deposits and collects the check received with such a notice rather than returning it to the debtor, *subject to the exceptions on the next slide*, the creditor has agreed to settle the claim – the debt is deemed by the UCC to be satisfied and the deficiency cannot be collected.

Payment in Full Checks for Less Than the Amount Owed – Exceptions to Full Satisfaction

Can you deposit and collect the check tendered and still claim the balance owed?

Exceptions to the accord and satisfaction created by accepting a check for less than full payment owed include the following:

1. The notice that the check is in full satisfaction is (a) not conspicuous or (b) ambiguous that it really is in full satisfaction of a debt.
2. The amount owed is liquidated. Example -- \$2500 check tendered in satisfaction of an undisputed \$10,000 balance owed on a truck loan or promissory note. See next slide for examples from actual cases.
3. The debtor is not acting in good faith. He's chiseling for no good reason.
4. The creditor is a business and previously notified the debtor that any payment in full endorsements or checks must go to a specified person or office and the check didn't.
5. The creditor is a business and sends back the amount of the check within 90 days after accepting it.

Don't count on --

6. Crossing out the endorsement that says the check is payment in full.
7. Keeping the check but not depositing it for collection.

Steps to Avoid Returned Checks

- Assuming an ordinary check is given to pay for goods, services or a debt and it is not a cashier's check, the seller should consider collecting the check promptly –
 - Before a stop payment order takes effect, and
 - While funds are still in the account.
 - Using remote deposit capture (RDC) can speed the check collection process.
 - No time wasted taking and depositing the checks received to your bank
 - No time wasted for the depository bank picking up paper checks from where they were deposited and processing them for scanning, routing and sending them through the applicable clearing house.
 - Remote deposit capture (RDC) also more readily and efficiently allows representations.

What to Do If a Check is Returned

- Steps usually recommended – (i) call or email the customer to see if he will pay by credit card or electronic payment or make good on the check; (ii) send a certified demand letter which may give you more rights under bad check laws; (iii) see if your T&C or applicable bad check laws that will give you attorneys’ fees and other damages; (iv) file suit.
- You can sue the drawer of the check for writing an NSF check or for improperly stopping payment on it, but unless you are a “holder in due course” of the check, the drawer can raise good faith defenses to payment of the check, such as goods sold and paid for by the check were defective.
- Consider a check recovery service (see, e.g., <https://www.firstcitizens.com/small-business/cash-management/receivables/check-recovery>);

Can I Redeposit a Returned NSF check?

- How many times can an NSF check be presented for deposit or redeposit? Office of the Comptroller of Currency's answer (OCC, *HelpWithMyBank.com*):
- Generally, a payee's bank (the bank of first deposit or BOFD) may attempt to deposit the check two or three times when there are insufficient funds in the drawer's account. However, there are no laws that determine how many times a check may be resubmitted, and there is no guarantee that the check will be resubmitted at all. [Note: each time a check is processed it or its image is stamped as to how it was handled; after 2 or 3 attempts to collect it, the check will no longer be eligible for collection.]
- Overdraft or insufficient funds fees can be assessed each time the check is submitted. [Note: the drawer of the check is also usually charged fees by its bank for returning its checks]
- Par. 3.1(a) of the Federal Reserve Banks Operating Circular 3 says that the Federal Reserve Bank collection system cannot be used to process a check as a cash collection item when the bank on which the item is drawn has declined to pay the item two or more times. For purposes of this subparagraph 3.1(a) only, the term "item" means a check, substitute check, electronic check, or ACH entry derived from that check; and any photocopy in lieu of the check. FRB Op. Cir. 3, ¶3.1(a).
- Bankers OnLine says: A check that has been returned twice through the clearing system can still be presented as a collection item or over the counter. BankersOnline.com
<https://www.bankersonline.com/qa/how-many-times-can-nsf-be-presented-deposit>.

What Does Presenting a Returned NSF Check for Collection Do?

- Presenting a check for collection means (i) the check is no longer a cash item, (ii) the BOFD will not, under its procedures, provisionally credit to the depositor's account, (iii) the midnight deadline for payment or return no longer applies to the drawee bank, (iv) Regulation CC normal rules for return or credit also do not apply, and (v) the drawee bank will hold the check for a period of time until funds come into the account to pay it or at the end of drawee bank's hold time only if it agrees to do so.
- A payor bank may agree to delay presentment of an item and hold it for collection according to the terms and conditions of the agreement. In such case, presentment may be contingent on other events (e.g., when there are sufficient funds in the account to pay the check) and only upon the occurrence of such events will presentment be made and the "midnight deadline" rule come into play.
<https://web.nebankers.org/handbook/results.aspx?ContentID=446>.
- Collection items are usually subject to special instructions and may involve additional fees. Most banks impose a special fee, called a collection charge, for handling collection items. Most collection items are not checks, but other forms of payment such as a draft. Many banks will not hold checks as collection items.

Can I Redeposit a Check for Collection on Which Payment Has Been Stopped or Account Closed?

- Some experts say that you cannot redeposit a check for collection through your bank on which payment has been stopped, the account is closed or it is stale dated.
- Exceptions exist. One is where the reason for the return of the check has been removed, e.g., stop payment order withdrawn.

Can the Payee Claim Against the Paying Bank on a Dishonored Check

- The payee can claim against the paying bank if the dishonor is wrongful.
- If the bank on which the check is drawn is late in dishonoring the check, i.e., fails to return it or send notice of dishonor within its midnight deadline, it can be liable to the payee for the amount of the check.
- This deadline is generally midnight of the banking day following the banking day of receipt of the check by the paying bank (Uniform Commercial Code §4-302 and Regulation J, §210.12(a)), except as the deadline may be extended under Section 229.30(c) of Reg. CC. See Fed. Reserve Banks Op. Cir. No. 3, fn.9 (Nov. 15, 2021). For purposes of the Fed's midnight deadline under the Uniform Commercial Code and under Regulation CC, items received after 2:00 p.m. for collection or return are considered to be received on the Fed's next day banking day. Id., ¶122.0. Banks may have their own cutoff time for determining when its business day ends.
- If the notice of return is timely, then the BOFD can recover from its customer, the payee that deposited the check, any funds from the that check that it paid to its customer or credited to its customer's account. This is normally done by eliminating the provisional credit to the account before the funds became available to the customer or if the funds were made available before they were collected, debiting the account.
- If the BOFD is late in notifying its customer (you) as payee of return of a dishonored check from the paying bank, it can be liable but only for the amount of the loss caused by the delay, which may be hard to prove.

Who Bears the Loss If An Incoming Check Is Converted By an Employee

- There are many cases where an employer has lost substantial sums due to an employee or agent taking incoming checks and converting them.
- If a check reaches the payee's office and a dishonest employee who has responsibility for handling incoming checks, converts the check by taking it and depositing it to his or her own account set up with a name similar to the payee's name, or otherwise forges the endorsement of the payee to collect the check, then the loss falls on the payee. The rationale is that the payee as an employer has a duty to supervise its employees. UCC §3-405(b).
- UCC §3-405(a)(3) defines "Responsibility with respect a check to mean someone who (i) signs or endorses checks on behalf of the employer, (ii) processes checks received for bookkeeping purposes, for depositing them to an account or otherwise handling them, (iii) to prepare or process checks in the name of the employer, (iv) supplying payee information, (v)controlling the disposition of checks, (vi) otherwise acting in a responsible capacity with respect to controlling checks for the employer.
- Responsibility does not include mere access to checks stored, transported or received or sent by mail.

Who Bears the Loss If A Check Is Altered

If check is altered to increase its amount, payor bank can only charge account and “enforce check” according to the check’s original terms (the lower amount) UCC § 3-407(c). So if check was \$100 and check was altered to \$1,000, the bank can charge customer’s account for the \$100.

Payor bank that honored a check can sue depository bank on presentment warranty. UCC § 4-208(a)(3).

If customer was negligent and that substantially contributed to the alteration, payor bank can charge the account for the entire amount. UCC § 3-406(a).

If check alteration is the “completion” of a signed blank check, Payor Bank can charge customer’s account even if check was stolen because risk of loss is placed back on their customer (the “drawer”) who should not have signed a blank check. UCC § 3-407 Comment 2