The Wisconsin Credit Union League

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Submitted via email to: regs.comments@federalreserve.gov

July 31, 2017

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Proposed Amendments to Regulation CC
Docket No. R-1564

Dear Ms. Misback:

On behalf of Wisconsin's credit unions® and their nearly 3 million members, the Wisconsin Credit Union League is writing to express its support of the Federal Reserve Board's proposed amendment to Regulation CC.

The proposal would add to Reg. CC a presumption of alteration with respect to any dispute arising under federal or state law as to whether 1) the dollar amount or the payee on a substitute check or electronic check has been altered or 2) the substitute check or electronic check is derived from an original check that is a forgery.

The presumption of alteration

The proposal raises an important issue, given the nearly universal use of electronic imaging in the check collection system. The distinction between the forgery of a drawer's signature and the alteration of a check has become blurred in our electronic age, and the old holding of Price v. Neal (cited in the proposal) no longer fits check disputes as neatly as it once did. When parties cannot or do not examine paper checks, it can be impossible to distinguish between forgeries and alterations.

We believe that this presumption of alteration would clarify the burden of proof and avoid the kinds of inconsistent judicial opinions cited in the proposal. We agree with the U.S. Court of Appeals for the 7th Circuit, which explained in 2006 the dilemma courts face in weighing liability for altered or forged checks that are presented electronically:

> The bank on which a check is drawn (Wachovia in this case) 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. When checks were inspected by hand, when copying technology was primitive, and when cancelled checks were stored rather than digitized copies alone retained, this allocation of liability was consistent with the sensible economic principle that the duty to avoid a loss should be placed on the party that can prevent the loss at lower cost. … Having no dealings with [the drawer of the check], Foster [the depository bank] could not determine at reasonable cost whether, for example, the drawer's signature had been forged. Wachovia might be able to determine this by comparing the signature on the check presented to it for payment with the authorized signature in its files. But Wachovia would have no idea who the intended payee was, while Foster might have

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reason to suspect that the person who deposited the check with it was not the intended payee. And it would be in as good a position as Wachovia to spot an alteration on the check.

But this last point assumes that a payee's name would be altered in the old-fashioned way, by whiting out or otherwise physically effacing the name on the paper check. If the Foster bank customer who deposited the fraudulent check created a new check, there would be no physical alteration to alert Foster when she deposited the check with the bank. That is why Foster complains that Wachovia's failure to retain the paper check prevents determining how the "alteration" was effected – more precisely, whether it is a case of alteration or of forgery. The fact that [the drawer of the check] acknowledges having issued a check to [the legitimate payee] is not conclusive on the question because [the fraudulent payee] might have destroyed that check, rather than altering it, and substituted a copy that seemed perfectly genuine, with her name in place of [the legitimate payee].

So the case comes down to whether, in cases of doubt, forgery should be assumed or alteration should be assumed. If the former, Foster wins, and if the latter, Wachovia. It seems to us that the tie should go to the drawer bank, Wachovia.

Wachovia Bank, N.A. v. Foster Bancshares, Inc., 457 F.3d. 619 (7th Cir. 2006) (emphasis added).

This proposed Reg. CC change would lead to the same conclusion: When there are disputes over electronic checks and whether they have been altered or derived from original checks that are forgeries, the tie should go to the drawer bank, and alteration should be presumed.

Claims of altered dates

The Board has requested comment on whether its proposed presumption should also apply to a claim that the date has been altered on a check presented electronically. We believe that, yes, the presumption should apply to such a claim.

Uniform Commercial Code (UCC) §3-407 defines "alteration" as: "(i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party." The definition is not limited to an alteration of the dollar amount or payee. It seems that a changed date can be considered an "alteration" within the modern UCC definition since it modifies the obligation of the drawer, and we see no reason to treat it differently from an alteration to the payee or amount.

Furthermore, we believe that for the sake of clarity and simplicity, the presumption should apply to any claim of a date change. As explained in the comments to current UCC §3-407: "Former section 3-407 defined a "material" alteration as any alteration that changes the contract of the parties in any respect. Revised section 3-407 refers to such a change as an alteration." (Emphasis added.) The commentary to former §3-407 (before it was revised in 2001) might have led courts to treat some date changes as "material" alterations and some as not. For example, consider this 1994 opinion from a New York appeals court: "Under the Code, in contradistinction to pre-Code law, a postponement of the date on a check, unlike an advance or acceleration of the date, is not a material alteration (sec, UCC 3-407 Comment 1; UCC 3-304 Comment 2)." Davis Auction House v. Ontario National Bank, 201 A.D.2d 878 (N.Y. App. Div. 1994). We believe that financial institutions would be best served by the certainty of treating any claim of a changed date on a substitute check or

electronic check as an alteration, without reference to whether the change allegedly postponed or advanced the date or whether the change was "material."

Loss of the presumption

Under the proposed rule, the presumption of alteration may be overcome by a preponderance of evidence that the substitute check or electronic check accurately represents the dollar amount and payee as authorized by the drawer, or that the substitute check or electronic check is derived from an original check that is a forgery. Under the proposal, the presumption of alteration would cease to apply if the original check is made available for examination by all parties involved in the dispute.

The Board has requested comment on whether the presumption of alteration should apply if the bank claiming the presumption received and destroyed the original check. We believe that, no, the presumption should not apply in such a case. An institution should not benefit from a presumption against another party when it had in its possession the original check – which, if preserved, might have provided evidence to a court to overcome the presumption – but chose to destroy it. (We caution against using the term "destroyed" in the final rule, however, since the original may have been lost or cannot be produced for some other reason. It would be better to say that the presumption is lost if the institution claiming it received the original check but cannot or will not produce it.)

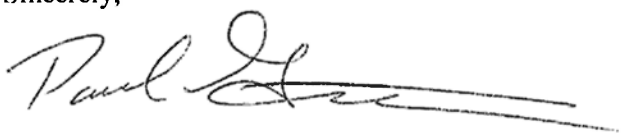
Limiting the presumption this way would prompt financial institutions to retain paper checks after imaging for a period of time (at least until the limitations period on claims of check alteration or forgery expire), so that they can effectively rebut any erroneous claims.

Conclusion

We support adding the proposed presumption of alteration to Reg. CC §299.38. We believe it would serve to clarify the burden of proof in disputes over substitute checks or electronic checks. We believe that a claim of a changed date on a check should be treated as an alteration under the proposal – just like a claim of a changed payee or amount. Finally, we believe that the proposed presumption of alteration should not apply if the financial institution claiming it received the original check but cannot or will not produce it.

Thank you.

Sincerely,



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