"TILA Rescission Requests..."
— from page 7

a case-by-case basis to determine the borrower's ability to tender, or to actually require tender before effectuating rescission. *See, e.g.*, *Yamamoto v. Bank of New York*, 329 F.3d 1167, 1173 (9th Cir. 2003); *Briosos v. Wells Fargo Bank*, 737 F. Supp. 2d 1018, 1028 (N.D. Cal. 2010); *Sipe v. Countrywide Bank*, 690 F. Supp. 2d 1141, 1150 (E.D. Cal. 2010); *Garcia v. Wachovia Mortg. Corp*., 676 F. Supp. 2d 895, 901 (C.D. Cal. 2009); *Carmichael v. JPMorgan Chase Bank, N.A*., Civil No. 15cv1064 JAH(DHB), 2016 WL 9023431, at *4 (S.D. Cal. July 13, 2016).

**Statutes of Limitations in TILA Litigation**

*Rescission Claims.* Even after *Jesinoski*, courts continue to maintain that equitable tolling does not apply to TILA rescission claims: the three-year window to request rescission remains absolute. *Harms v. The Bank of New York Mellon*, No. C 16-01585 CW, 2017 WL 6049402, at *9 (N.D. Cal. Apr. 5, 2017); *Best v. Deutsche Bank Nat'l Trust Co.*, No. EDCV 16-02308-JGB (SPx), 2017 WL 7859406, at *8 (C.D. Cal. Mar. 14, 2017). Borrowers must also specify in their complaints what disclosures were not made during loan origination. *Kang v. Wells Fargo Bank, N.A*., No. 18cv332-MMA (JMA), 2018 WL 1427081, at *8 (S.D. Cal. Mar. 22, 2018).

The Ninth Circuit recently resolved the issue of how long after a rescission request a borrower may wait to bring suit to enforce the request. In *Hoang v. Bank of America, N.A.*, No. 17-35993, 2018 U.S. App. LEXIS 34375 (9th Cir. Dec. 6, 2018), the Court explained that TILA does not provide a limitations period for a borrower's suit to enforce his or her rescission notice. So the court adopted what it considered to be the most closely analogous state law limitations period, which was the limitations period for suit on a written contract. In California, claims for breach of a written contract must be brought within four years. *Peterson v. Highland Music, Inc.*, 140 F.3d 1313, 1320 (9th Cir. 1998).

*Damages Claims. Jesinoski* has also affected the statute of limitations for borrowers to bring TILA damages claims. Under 15 U.S.C. § 1640(e), borrowers have one year to file suit seeking damages after a timely TILA rescission request is received (and the creditor fails to take action to effectuate the rescission). Since *Jesinoski*, several courts have allowed borrowers to file claims up to four years after origination if they can demonstrate: (a) they did not receive required material disclosures during origination, and (b) they timely sent rescission requests within the three-year window to do so. *Patino v. Franklin Credit Mgmt. Corp*., 2017 WL 2289192, at *6 (N.D. Cal. 2017).

Given these harsh results, one thing remains very clear: ensuring compliance with TILA's disclosure requirements during loan origination continues to be the only way for creditors to avoid falling victim to a borrower's belated case of "buyer's remorse."

*For more information about the Truth in Lending Act and defending claims arising from the Act, please contact Stephen Britt at sxb@severson.com.*

## BANK OPERATIONS

## A Presumption of Alteration: Amendment to Regulation CC Resolves An Issue of Liability

By:
Mark Wraight

Modern payments law has centuries-old roots. In 1762 the Court of King's Bench in England articulated the "final payment rule" in the case of *Price v. Neal*, 97 Eng. Rep. 871 (1762). This rule, which places the loss on the drawee (or payor bank) for checks not authorized by the drawer, has been codified in the Uniform Commercial Code ("UCC"). But as technological innovation produces changes to payment systems and process, the law has struggled to keep pace. One example of tension between legacy payments law and modern-day payment systems is how to allocate liability for negotiable instruments under the *Price* final payment rule when an original negotiable instrument has been truncated and all that remains is a substitute check or electronic copy of the original. Without the original item, it can be difficult, if not impossible, to determine whether the check bears a forged maker's signature (as in the case of a counterfeit item) or instead has an altered payee or amount. This gap in payments law has created uncertainty for financial institutions.

In September 2018, the Board of Governors of the Federal Reserve System attempted to resolve this uncertainty by approving an amendment to Subpart C of Regulation CC. Effective January 1, 2019, when a dispute arises between financial institutions over liability for a check, and the original is no longer available, there will be a presumption that the check is altered and not a counterfeit item. *See* 12 C.F.R. § 229.38(i). Although the presumption

(continues on page 9)

is rebuttable, this gives the drawee a decisive advantage in pursuing a warranty claim against the upstream depository institution. There are strategies for rebutting this new evidentiary presumption. But before considering those strategies, it is helpful to understand the legal precedent that resulted in this significant change to Reg CC.

The Fourth Circuit Court of Appeals was one of the first courts to tackle the issue of how to allocate loss between the depository institution and the drawee when the original check is not available. In *Chevy Chase Bank, F.S.B. v. Wachovia Bank, N.A.*, 208 F. App'x 232 (4th Cir. 2006), a check payable to "Kon Pesicka/CJ International" in the amount of $341,187.45 was deposited into an account at Chevy Chase Bank. The drawer of the check, however, made the original check payable to "Hearst Magazines Division." Pursuant to its policy, Wachovia, the drawee, had truncated the original check after storing a digital copy. The drawer altered Wachovia to the fraud. Wachovia credited its customer's account and then sought repayment from Chevy Chase. Chevy Chase initiated the lawsuit, filing a complaint for declaratory relief. Wachovia responded with a cross-claim for breach of warranty. After the parties filed cross-motions for summary judgment, the trial court granted Chevy Chase's motion and denied Wachovia's. The Court of Appeal affirmed, finding that "Wachovia may not recover on its claim for breach of warranty unless it proves that the check it received from Chevy Chase was altered. The district court found that Wachovia failed to carry its burden on this issue. We agree." *Id.* at 235.

In finding that Wachovia failed to meet is burden of proving the check was altered, the Court was critical of the fact that Wachovia presented no evidence about its receipt of the check or the condition of the check. Most importantly, the Court determined that without the original check, Wachovia simply could not meet its burden of proof. "If Wachovia had produced the actual check itself, an examination of the check may have shed light on whether the check was altered. For example, the check may have contained smudges, erasures, chemical bleach marks, broken fibers, or other signs of alteration. Without the original, even Wachovia's own forensic expert testified that he could not say, with a reasonable degree of scientific certainty, that the check had been altered rather than forged or copied (and therefore counterfeit)." *Id*.

Although the *Chevy Chase* decision dealt an initial blow to downstream drawees, the Seventh Circuit reached the opposite result shortly thereafter. In *Wachovia Bank v. Foster Bancshares*, 457 F.3d 619 (7th Cir. 2006), Ms. Choi deposited a $133,026 check into her Foster Bank account. Although the check deposited was payable to Choi, the drawer originally issued the check to "CMP Media." The original item had been destroyed in the payment process. Wachovia, the drawee, sued Foster Bank seeking a declaratory judgment for indemnification based on Foster Bank's breach of its statutory presentment and transfer warranties under UCC sections 3-416, 3-417, 4-207, and 4-208. The trial court granted Wachovia's motion for summary judgment. Foster Bank appealed, making the same argument Chevy Chase Bank successfully made: because the original check had been destroyed by Wachovia, Wachovia could not prove that the check had been altered. Foster Bank's argument focused on the possibility that "Choi used sophisticated copying technology to produce a copy that was identical in every respect to the original check . . . except for an undetectable change of the payee's name." *Wachovia Bank*, 457 F.3d at 621.

The Court of Appeal summarized the issue as follows: "[s]o 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." *Id.* at 622. Although the Fourth Circuit resolved this issue in favor of finding a forgery, the Seventh Circuit resolved the issue in favor of finding an alteration and establishing a new rule "that the tie should go to the drawer bank." *Id*. The Court's reasoning was based on the notion that physical alteration was the traditional method used by crooks and thieves. It dismissed the use of modern technology to create a counterfeit check as a "novel method" and an "[un]common method of bank fraud." The court also suggested that even in the case of counterfeit items, the bank of deposit might still be the "cheaper cost avoider." *Id.* at 623. Although the court may have overlooked the extent of the impact technological advances would have on financial crime, the *Wachovia* rule came to be favored by subsequent courts.

For example, in *Bank of America v. Mazon State Bank*, 500 F. Supp. 2d 803 (N.D. Ill. 2007), George and Cathlyn Murdaugh deposited a $200,000 check issued by the Pharmaceutical Research and Manufacturers of America into their Mazon State Bank account. The check was originally made payable to the "University of Chicago Law School." After the Murdaughs made off with the funds, the fraud was discovered and the original check was turned over the FBI. The FBI apparently indicated that "from the naked eye, it did not appear that the check had been altered and they would have to send it to their laboratory." *Id.* at 805. Bank of America sued Mazon State Bank for breach of the presentment warranty and moved for summary judgment. The trial court originally denied the motion. Bank of America relied on the "tie goes to the drawee" rule established in *Wachovia*. But the Court agreed with Mazon State Bank that the cases should be distinguished, because unlike *Wachovia*, the original check was still available. The Court hypothesized that Mazon

(continues on page 10)

State Bank might be able to prove at trial that the check was forged. In denying the motion, the Court cautioned that its decision "should not be read as a repudiation of the *Wachovia* rule. . . . Rather, my ruling means simply that I am unwilling, at this stage, to declare the question a tie. Mazon is entitled to an opportunity to prove at trial that the check was forged." *Id.* at 807.

However, on reconsideration and after reassignment, the trial court granted summary judgment for Bank of America. The Court found that any differences between the facts of the case and the facts of *Wachovia* were "distinctions without a difference" and that the "*Wachovia* rule" controlled. *Bank of America, N.A. v. Mazon State Bank*, No. 05 C 7165, 2007 WL 2714117, at *3 (N.D. Ill. Sept. 17, 2007). In finally granting summary judgment for Bank of America, the Court was persuaded by evidence presented by Mason State Bank's expert witness. The expert examined the original check at the FBI headquarters and determined that "no conclusion could be drawn as to whether the check was altered or forged." *Id*. So even in a case where the original check was available for inspection, the depository bank was unable to marshall evidence to overcome the "tie goes to the drawee" rule.

Finally, in *J. Walter Thompson, U.S.A., Inc. v. First BankAmericano*, 518 F.3d 128, 134–35 (2d Cir. 2008), the plaintiff, J. Walter Thompson, issued a $382,210.15 check payable to its vendor, Outdoor Life Network. The check was drawn on a Bank of America account. A check in the same amount, but payable to "Diversified Business Enterprises, Inc." was later deposited into an account at First BankAmericano. The fraud was discovered after Bank of America paid the check. First BankAmericano refused Bank of America's demand for return of the funds. In the ensuing litigation, Bank of America brought warranty claims against First BankAmericano. The trial court granted Bank of America's motion for summary judgment. The Court of Appeals affirmed.

The Court did not offer any analysis of how loss should be allocated between financial institutions when the original check is unavailable, but did observe that technology "may render the distinction between forgery and alteration, and its loss allocation rules, obsolete." *J. Walter Thompson,* 518 F.3d at 139. And despite affirming the order granting summary judgment, the Court commented that "it is the role of the U.C.C. drafters, not this Court, to determine whether the [loss allocation] rule should be reconsidered in light of the changing technological landscape." *Id*.

With its amendment to Reg CC, the Federal Reserve has now stepped into the role the *J. Walter Thompson* Court was unwilling to fill. Reg CC's formal codification of the *Wachovia* rule begs the question: how can depository institutions defend warranty claims by rebutting the evidentiary presumption of alteration? There are a few practical strategies.

• For starters, the depository bank should determine whether the original item is available. The presumption only applies if the original item is no longer available. While almost all checks are routinely truncated during today's post-Check 21 collection process, in the rare care where the depository bank did not truncate the check, the bank should confirm whether the original was truncated by a downstream bank.

• Additionally, the depository bank should seek discovery from the drawer, including copies of other checks issued by the drawer. Valuable comparisons can be made between the questioned check and known, authorized exemplars. For example, comparisons can be made of borders, backgrounds, locations of logos and other elements, font sizes and styles, and other visible security features. All of these characteristics should match an altered item identically. But a counterfeiter would need to replicate all of these elements. Any observable or measurable differences would be evidence of a counterfeit item.

• The questioned check can also be examined for any misaligned text for the dollar amount and payee. Misalignment is more likely to occur in an altered item than a counterfeit item as the check stock is run through a printer multiple times.

• Finally, the dollar amount and payee lines of the questioned check can be examined for atypical information that might have been included to cover up traces of an alteration.

Reasonable minds can disagree whether the presumption of alteration is the correct rule for updating payments law. But at a minimum, the rule goes a long way to ending financial institutions' uncertainty created by the prevalence of substitute and electronic checks. The rule will benefit institutions when they are downstream in the check collection and payment process. And while the evidentiary presumption will place upstream institutions in a less advantageous position, there are strategies for rebutting that presumption.

*For more information regarding check forgery claims and the amendment to Reg CC, please contact Mark I. Wraight at miw@severson.com.*