Vote Record

Committee on Agriculture, Financial Institutions and Insurance

Date: July 26, 2004

Bill Number: _____ Clearinghouse Rule # **CR 04-041**

Moved by: _____ Seconded by: _____

Motion: To object TO CR-04-041 on the basis that it is ARbitrary & CAPRICIOUS AS WELL AS Imposing AN UNdue hardship ON SMALL businesses. DFI ALSO FAILED TO Conduct A SMALL Business Impact Study

Committee Member	Aye	No	Absent	Not Voting
Senator Dale Schultz, Chair	☑	☐	☐	☐
Senator Ronald Brown	☑	☐	☐	☐
Senator Neal Kedzie	☑	☐	☐	☐
Senator David Hansen	☑	☐	☐	☐
Senator Julie Lassa	☑	☐	☐	☐
Totals:	5	0	___	___

☐ Motion Carried ☐ Motion Failed

Committee Meeting Attendance Sheet

Committee on Agriculture, Financial Institutions and Insurance

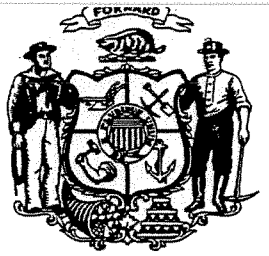
Date: July 26, 2004 **Meeting Type:** PUBLIC HEARING

Location: ROOM 412 EAST, STATE CAPITOL

Committee Member	Present	Absent	Excused
Senator Dale Schultz, Chair	☑	☐	☐
Senator Ronald Brown	☑	☐	☐
Senator Neal Kedzie	☑	☐	☐
Senator David Hansen	☑	☐	☐
Senator Julie Lassa	☑	☐	☐

Totals: 5 0 ____

John O'Brien
Committee Clerk



Senate Committee on Agriculture, Financial Institutions and Insurance

Room 18 South State Capitol, PO Box 7882, Madison WI 53707-7882
(608) 266-0703

Senator Dale W. Schultz, Chairman

Committee Clerk. John O'Brien

July 26, 2004

Lorrie Keating Heinemann, Secretary
Wisconsin Department of Financial Institutions
345 W. Washington Ave.
5th Floor
Madison, WI 53703

Re: CR 04-041

Dear Secretary Heinemann,

This letter is to inform you that during today's public hearing, the Senate Committee on Agriculture, Financial Institutions and Insurance took Executive Action on Clearinghouse Rule 04-041, relating to authorization to collect a returned check fee.

On a unanimous vote, the committee objected to CR 04-014 on a motion that the rule was. "Arbitrary and capricious as well as imposing an undue hardship on small business." The motion included an objection to the Department of Financial Institutions failure to conduct the required Small Business Impact Study.

If you have questions related to the committee's action, feel free to contact the committee clerk.

Thank you.

Dale W. Schultz, Chairman

NFIB
The Voice of Small Business®

WISCONSIN

Memorandum

TO: **Members of the Senate Committee on Agriculture, Financial Institutions and Insurance**

FROM: **Bill G. Smith**
State Director

DATE: **July 26, 2004**

RE: **Clearinghouse Rule 04-041**
(Returned Check; Fee)

A recent study published by the NFIB Research Foundation entitled, *Getting Paid,* found small business customers typically pay for their goods and services by check – more customers pay by check than cash. In fact, 95% of the small business owners reported they accept checks for payment.

The study also found the problem of bad checks was the second most often cited problem with getting paid.

Getting paid has immediate practical consequences for small business owners. The longer money is retained by customers in lieu of payment, the more difficult it is for small business men and women to pay their bills, which is what ultimately grows the economy of their community.

The rule before the Committee (CR 04-041) would make it illegal to collect a returned check fee "without proper authorization from the customers." We believe this requirement will not only dramatically slow the transaction, but will also increase the costs associated with collecting on the original check – costs that will either be passed on to customers or "absorbed" by the merchant.

We urge the Committee to carefully review CR 04-041, and hope Committee members will object to the rule proposal.

Thank you for your consideration.

National Federation of Independent Business – WISCONSIN
10 East Doty Street, Suite 201 • Madison, WI 53703 • 608-255-6083 • Fax 608-255-4909 • www.NFIB.com/WI

Wisconsin Collectors' Association

July 26, 2004

The Wisconsin Collectors Association's Position On The Department Of Financial Institutions' Proposed Order To Create ss. DFI-Bkg 74.14(16) and (17), Relating To Authorization To Collect A Return Check Fee

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The Wisconsin Collectors Association urges the adoption of the proposed rule.

The Wisconsin Collectors Association (WCA), founded in 1938, is the professional trade association for third party collection agencies in the state of Wisconsin. The WCA represents 83 debt collection agencies and related affiliates. Among its members' clients are Wisconsin merchants who have received dishonored checks from their customers.

It is appropriate for merchants to assess a fee of $25.00, $30.00, or more to the bad check passer if proper notice is given When a dishonored check is returned to a merchant, the merchant not only loses the value of the unpaid merchandise (i.e., the face amount of the check), he is also charged an amount by his bank, usually between $5.00 and $10.00 per check presentment. In addition to these clear monetary charges, the merchant must spend more time and effort to contact the passer of the bad check and arrange for payment. Merchants often do not have the time or expertise to collect bad checks. Accordingly, it is fair to compensate the merchant for these additional costs of doing business with the passer of the bad check.

WCA members have successfully done business under the proposed rule for years. Collection agencies in Wisconsin are licensed and regulated by the state's Department of Financial Institutions (DFI). DFI has long required collection agencies to collect a bad check fee only if a notice had been posted at the point of sale where the bad check was passed or if the consumer had otherwise been advised of the possibility of such a fee before or at the time that the check was written. WCA members have long required that their merchant clients comply with this requirement. That is one reason why many supermarkets, fast food outlets, service stations, and other merchants post appropriate notices at their checkout counters.

The Proposed Order To Create ss. DFI-Bkg 74.14(16) and (17) mandates a fair and reasonable process. It is an order that licensed collection agencies in Wisconsin have been following for years. It is fair and reasonable to the consumer and to the business that implements it. DFI has been consistent and clear in its requirements and has applied them uniformly. The WCA urges the adoption of the proposed rule.

Wisconsin Collectors' Association
Dennis P. Donohue
Associated Collectors, Inc.
Tel: 608-754-4425

CONFERENCE OF RETAIL ASSOCIATIONS

Wisconsin Retail Associations Working Together

Midwest Equipment Dealers Association

Midwest Hardware Association

National Federation of Independent Business

Outdoor Advertising Association of Wisconsin

Petroleum Marketers Association of Wisconsin

Wisconsin Association of Convenience Stores

Wisconsin Automobile & Truck Dealers Association

Wisconsin Automotive Parts Association

Wisconsin Automotive Aftermarket Association

Wisconsin Grocers Association

Wisconsin Merchants Federation

Wisconsin Restaurant Association

Date: July 26, 2004

To: Members of the Senate Committee on Agriculture, Financial Institutions and Insurance – Senator Dale Schultz, Chair

From: Conference of Retail Associations (CORA)
Gary Manke, President

Re: Opposition to Clearing House Rule 04-041, relating to authorization to collect a returned check fee

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Chairman Schultz and distinguished committee members, the Conference of Retail Associations (CORA) is an umbrella group representing main street retail business interests in Wisconsin. We are contacting you to register our opposition to Clearing House Rule 04-041 from the Department of Financial Institutions (DFI).

This rule seeks to require prior customer authorization for the collection of returned check fees through an Automated Clearing House Network transaction or paper draft.

Current law permits retailers to collect the face value of a dishonored check, along with reasonable costs associated with collecting the money owed to the retailer – a returned check fee. Many retailers choose to automatically have the original amount owed and the returned check fee electronically deducted from the check writer's bank account.

If retailers chose this option, they display a notice at the point of purchase to inform customers of their policy to debit from the customer's account the value of any check returned for insufficient funds, plus a returned check fee.

There is no requirement in state law for this rule change and no other state has this proposed rule in place. Additionally, the practice of automatically deducting a returned check fee without prior written authorization is expressly permitted under federal law.

Retailers do not want to ask their customers to sign an authorization form when they are making a purchase. Not only does it slow down the purchasing process, but it is bad customer relations and it is bad for business.

The automated collection of returned checks and returned check fees is allowed by law and is efficient for both consumers and for business.

We ask that you oppose Clearing House Rule 04-041.

Thank you for your consideration.

aegis associates, LLC

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Denver, CO 80247
Phone: (303) 368-5594
Fax: (303) 695-5621
cybrcollect@aegisvip.com
www.aegisvip.com

July 21, 2004

ATTN: **Committee on Agriculture, Financial Institutions and Insurance**
Committee on Financial Institutions

Objection to Clearing House Rule 04-401

I am writing to voice my objection to House Rule 04-401, which would require merchants to obtain a customer's written authorization for each check before a, NSF collection fee can be electronically debited from the customer's bank account, and would disallow the use of paper drafts for the purpose of collecting service fees. Written notification, rather than written authorization, is set forth in the Electronic Fund Transfer Act, as interpreted by the Federal Reserve Board, and House Rule 04-401 directly contradicts current Federal law.

As a consultant specializing in electronic cash management applications, it is my opinion that if adopted, this legislation will greatly increase merchant AND consumer check collection costs, and will adversely affect the financial industry.

In North Dakota, an **Administrative Law Judge ruled in favor of written notification versus written authorization.** Ignoring that ruling, the North Dakota DFI overruled the ALJ decision and issued a Cease and Desist Order. **In subsequent legal action, the North Dakota District Court overturned the DFI decision, and the DFI commissioner was ordered to take no further action in the matter.**

It is my opinion that the traditional collection industry (utilizing much more costly collection methods, which are paid for by merchants and consumers) is the driving force behind this proposed legislation, in an attempt to regain a market share that is being lost to a more cost-effective and customer-friendly electronic collection process.

I respectfully request that you consider the negative financial impact for merchants and consumers with House Rule 04-401. **Please oppose this proposed rule.**

Sincerely,

Kimberly Harvey
Managing Partner

aegis associates, LLC
Denver, Colorado
303-368-5594
kharvey@aegisvip.com

MORRISON & FOERSTER LLP

M O R A N D U M

TO: The Members of Senate Committee on Agriculture, Financial Institutions and Insurance

FROM: Oliver Ireland
Morrison & Foerster LLP

DATE: July 24, 2004

RE: Reauthorization for ACH Transactions

I understand that the State of Wisconsin Department of Financial Institutions is considering adopting DFI—Bkg 74.14(16) ("Proposed Rule"). The Proposed Rule would provide that it is an oppressive and deceptive practice to collect a returned check fee through the use of an Automated Clearing House Network transaction without proper authorization from the customer. The Proposed Rule would go on to provide that proper authorization shall comply with National Automated Clearing House Association Rules and guidelines addressing such transactions. The analysis of the Proposed Rule prepared by the Department of Financial Institutions, Division of Banking, notes that the Proposed Rule codifies an existing practice. I understand that it has been asserted that the NACHA Rules do not bind merchants or their agents who initiate electronic debits from consumer accounts.

As explained more fully below, under the NACHA Rules, an ACH debit entry that is initiated to collect a returned check fee requires written authorization. Although the NACHA Rules do not apply automatically to a merchant or an agent of a merchant who initiates an electronic debit to the account of a consumer, the NACHA Rules do apply automatically to the bank, or "ODFI,"[1] whose customer initiates the electronic debit. Failure of the ODFI to require its customer to be bound by the NACHA Rules is a violation of the NACHA Rules. Even if the NACHA Rules do not apply to a merchant or its agent, an ODFI would be liable for the amount an entry that is not authorized under the NACHA Rules. If the ODFI was not able to charge the entry back to its customer, the ODFI would be required to absorb the loss.[2]

Entities Subject to the NACHA Rules

The NACHA Rules apply to all entries transmitted through an ACH Operator. Each Participating DFI agrees to comply with the NACHA Rules. Under subsection 2.1.1 of the NACHA Rules, it is a prerequisite to the origination of an ACH entry that the Originator has agreed to be bound by the NACHA Rules. Under subsection 2.2.1.3 of the NACHA Rules, an

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[1] Capitalized terms used in this memorandum that are not defined in this memorandum are used as defined in the NACHA Rules.

[2] The provisions of the Electronic Fund Transfer Act ("EFTA") (15 U.S.C. §§ 1693-1693r) and Regulation E (12 C.F.R. pt. 205.), which was adopted by the Board of Governors of the Federal Reserve System to implement the EFTA would not shield the ODFI from this potential liability.

Rules. Further, failure of the Originator to obtain proper authorizations also may result in the ODFI being subject to fines under Appendix Eleven of the NACHA Rules.

In light of this potential liability, for their own protection, all ODFI's should require their customers to agree to be bound by the NACHA Rules. Where a merchant customer is bound by the NACHA Rules, the customer would be required to obtain written authorizations for returned check fees as required by the NACHA Rules, and the Proposed Rule would be codifying that practice. To the extent that an ODFI does business with customers that are not bound by the NACHA Rules, the ODFI would be exposing itself to liability that could be significant.

Testimony of Ray Carey on behalf of CybrCollect
Senate Committee on Financial Institutions
July 26, 2004

- Good Morning, my name is Ray Carey, with Foley & Lardner, representing CybrCollect. With me today is the owner and founder of CybrCollect, Gary Doherty. CybrCollect opposes the proposed DFI rule and urges this committee to object to its promulgation. In a moment, Gary will share some information about his company, but first I want to lay out the "big picture" of why we oppose the rule.

- The rule will require written authorization from a customer before a returned check fee can be electronically debited from the customer's account. To do otherwise, according to this proposed rule, would constitute an "oppressive and deceptive practice". It would join the list of other banned debt collection practices such as threatening physical force, abusive language, harassment, etc. I think intuitively, everyone realizes that electronically collecting a bad check fee from people who bounce checks is not an oppressive trade practice and does not belong on this list.

- I'll remind the committee that state law expressly allows a merchant to collect the face value of a dishonored check, along with the reasonable costs associated with collecting the money owed to the merchant – a "bad check fee". DFI does not dispute the right to collect the fee, it is simply trying to outlaw the efficient, electronic collection of those fees.

- This rule is a bad idea and, in our opinion, an example of a government agency abusing its authority. There are three main reasons why we oppose this rule. First, the rule will have harmful, unintended consequences because it will outlaw a modern, efficient form of debt collection. The result is bad for merchants and bad for consumers. Second, the writers of bad checks have notification and other legal protections under the law; for example, at the point of purchase a sign must be posted informing customers that if they write a bad check, a fee will be electronically debited from their account. Finally, the impetus for this rule is hazy, at best. It is not explicitly required by state or federal law, there are no other states that we are aware of that have a similar rule, and federal law explicitly allows the electronic debiting of bad check fees without prior written authorization, provided there is notice at the point of purchase. In other words, the Department has developed a solution that is searching for a problem.

- Now, Mr. Doherty will discuss his company and how this rule will impact it.

- Let me return to the three points I mentioned earlier. The first one is harmful unintended consequences. As Gary pointed out, merchants will not request written authorization from their customers. It won't happen. Logically, if the bad check fee can't be collected electronically, then the bad check itself won't be

either (the collection service needs to be paid for, and small businesses can't do this on their own). This emphasizes why this rule is an assault on small business: it may be the case that the Wal-Mart's of the world can make arrangements to collect on bad checks, without contracting with a third party for assistance. The neighborhood grocery store, corner tavern or road-side gas station cannot.

- So, once DFI effectively outlaws this method of debt collection, what will be the reaction of small businesses? It will be to a) eat the cost of the bad check; b) pass those costs on to the 99% of consumers who don't bounce checks or c) rely on traditional debt collection methods that include credit reporting, higher fees and lawyers.

- None of those consequences are good for the small businesses that must deal with bad checks or the customers that write them.

- The second point is that customers are currently protected. Any merchant who wishes to use CybrCollect's services must post a conspicuous sign informing the customer that a bad check fee could be deducted from their account. Therefore, at the point of purchase, consumers have adequate notice of the consequences of writing a bad check **before** writing that check. And I think it is safe to say that most people who write bad checks intuitively understand that there is a penalty associated with that behavior.

- The Federal Reserve Board, in its regulations to enforce the Electronic Funds Transfer Act ("EFTA") has stated that a check writer specifically authorizes an electronic debit when "the consumer has received notice that a fee imposed for returned checks will be debited electronically from the consumer's account." Current practice in the state, therefore, complies with federal law designed to specifically protect consumers.

- Finally, in the highly unlikely event that a consumer's account is mistakenly debited, federal law provides that consumer 60 days to reverse the debit.

- The final point we raised is that it is unclear why this rule is being proposed. There is no abuse that we are aware of that needs attention, no other state has implemented a similar rule, and federal law expressly permits current practice. The only beneficiaries are, perhaps, traditional debt collectors or NACHA, the private trade group whose internal regulations DFI wishes to transform into Wisconsin law.

- One important point is that although DFI purports to be regulating debt collectors like CybrCollect, the practical effect of the rule will be to regulate small businesses and merchants. This fact was obviously lost on the Department when it ignored its statutory responsibility, under Chapter 227, to conduct a review of the rule's impact on small business. In a bit of circular logic the Department blithely states, "because the rule codifies existing practices and statutory

requirements of which licensees should already be in compliance, the rule will not have an effect on small business." This rule does not codify existing practice; rather it outlaws an existing practice, as evidenced by the thousands of small businesses in Wisconsin that electronically debit bad check fees. Moreover, there is no statute that bans this practice, not in Wisconsin, not in any other state and not in federal law. What the Department may mean is that NACHA, which processes these transactions, has its own private rules that banks **may** observe. However NACHA's rules are not state law and they are not binding on merchants. I have rarely seen a rule that will have more immediate and negative impact on small business, yet the Department has flat out refused to obey the law that requires a review of those impacts and consideration of ways to mitigate harmful effects.

- This state should not be erecting barriers to electronic commerce. It is ironic that an agency charged with promoting the health of financial institutions and protecting consumers is pushing a rule that will obliterate a low cost, low impact, efficient model of debt collection that will certainly – not maybe – but certainly be harmful to both consumers and small businesses.

- Thank you for your time, we would be happy to answer any questions.

RCK RETURN ENTRY FEES

Mary Schnell AAP
President
262-796-0252
Mschnell@wacha.org

WACHA
The Premier Payments Resource

NACHA's Mission is to promote the development of electronic solutions that improve the payments system for the benefit of its members and their customers.

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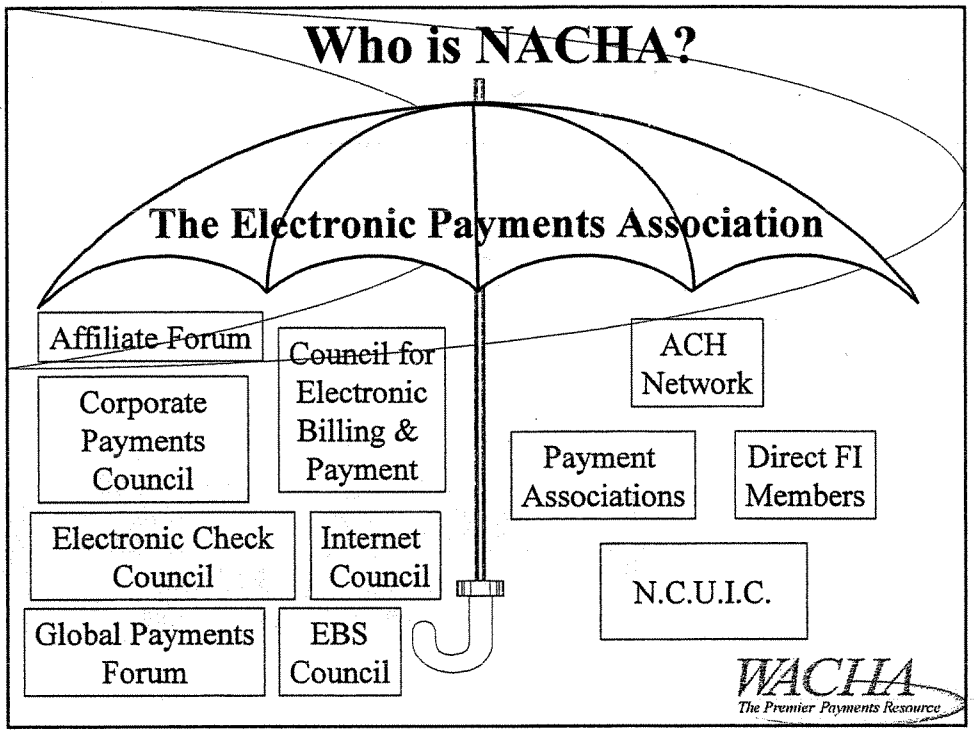
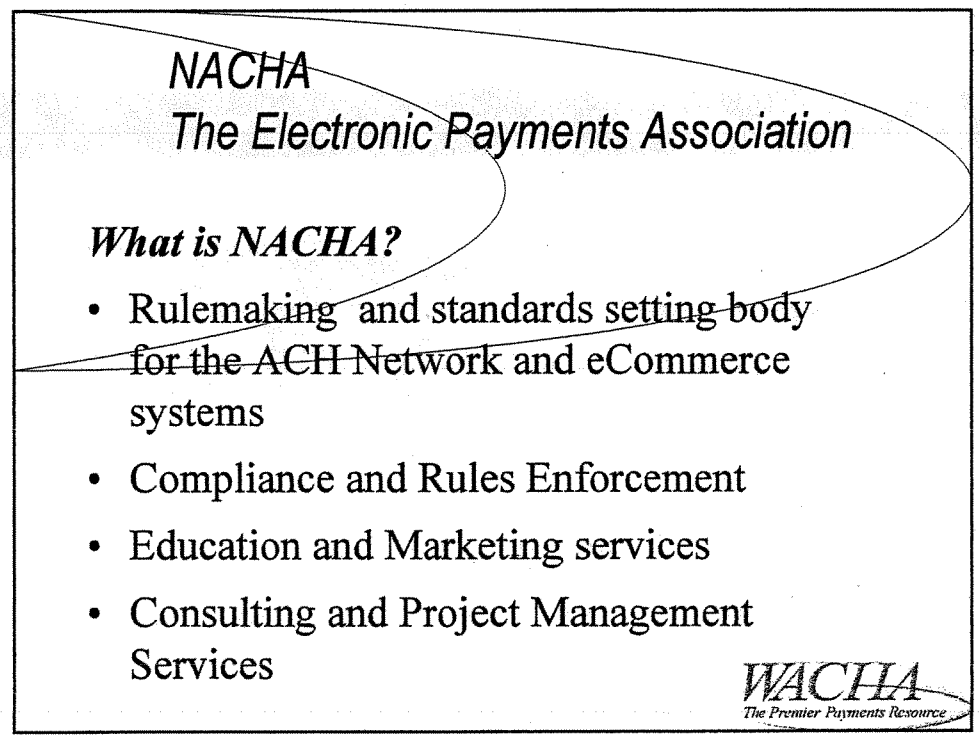
The Premier Payments Resource


Who is NACHA?
The Electronic Payments Association
Affiliate Forum
Council for Electronic Billing & Payment
ACH Network
Corporate Payments Council
Payment Associations
Direct FI Members
Electronic Check Council
Internet Council
N.C.U.I.C.
Global Payments Forum
EBS Council
WACHA
The Premier Payments Resource


NACHA
The Electronic Payments Association
What is NACHA?
• Rulemaking and standards setting body for the ACH Network and eCommerce systems
• Compliance and Rules Enforcement
• Education and Marketing services
• Consulting and Project Management Services
WACHA
The Premier Payments Resource

What is WACHA

- WACHA is a Regional Payment Association serving financial institutions in the 7th Federal Reserve District.
  - Over 350 members

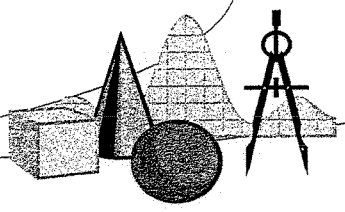
WACHA
The Premier Payments Resource

WACHA's Mission Statement

- To be the Premier Payments Resource for members and clients by providing high value, comprehensive solutions through quality products, education and services.

WACHA
The Premier Payments Resource

ACH Facts - 2002



Volume	8.9 billion
Value	$24 trillion
Number of Companies	3.5 million
Consumer Participation	115 million

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NACHA Operating Rules

What are the NACHA Operating Rules?

- Multi-lateral contract between participating depository financial institutions
- Rules set out the rights and responsibilities of parties to ACH transactions
- Adopted by the FRB Operating Circular

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What are ACH Payments?

- Electronic method for transferring credits and debits between financial institutions
- Debits and credits are exchanged between depository financial institutions (DFIs) with clearing provided electronically rather then through the physical movement of checks or cash

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Originator

- Initiate ACH entries
- Relationship with Receiver
- Usually company, may be consumer
- Transfers funds
- Can be Federal, state or local government agency

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Originating Depository Financial Institution (ODFI)

- Depository Financial Institution
- Receives payment instructions from Originator
- Forwards payment entries to the ACH Operator
- ODFI must act also as an RDFI

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ACH Operator

- Central clearing facility for ACH entries
- Electronic Payments Network or Federal Reserve Bank
- Operates on behalf of Depository Financial Institutions (DFIs)
- Establish processing and exchange schedules for FIs
- Complete transmission

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Receiving Depository Financial Institution (RDFI)

- Depository Financial Institution
- Receives entries from the ACH Operator
- Posts entries to accounts of Receivers

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Receiver

- Natural person or an organization
- Authorizes the Originator to initiate the entry
- Receiver is account holder at the RDFI

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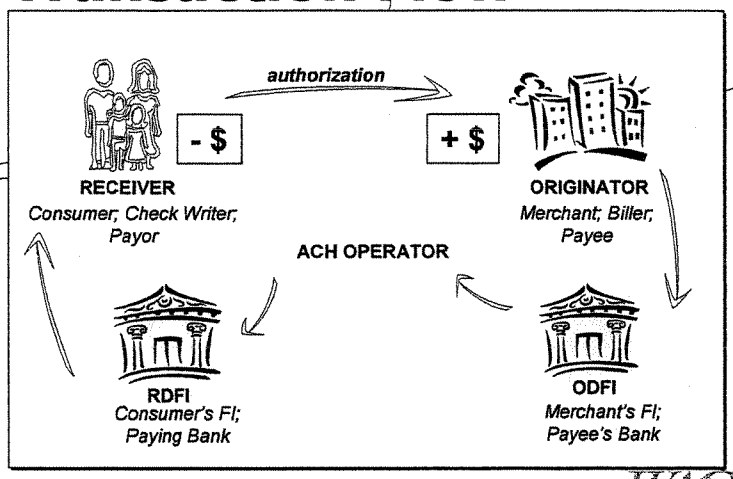
The Premier Payments Resource

ACH Debit Parties / Transaction Flow



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Re-Presented Check Entries (RCK)

- Used to transmit ACH debit entries in place of a paper check after the paper check has been returned for insufficient (NSF) or uncollected funds

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RCK by the Numbers . . .

- Final Rule: Effective September 15, 2000
- Average Transaction Amount: $159
- 2002 Statistics:
  - Transactions: 25.99 million
  - Dollars: $4.13 billion
  - Overall Return Rate: 57.63%
- September 30, 2003, YTD Statistics:
  - Transactions: 16.75 million
  - Dollars: $2.6 billion
  - Overall Return Rate: 54.3%
- Typically used by bill collectors, retailers, consumer billers, credit card issuers

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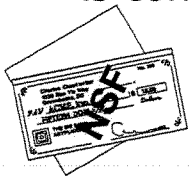
RCK – How It Works

- Paper check is received for payment and processed in the usual manner
- If the paper check is returned for NSF or uncollected funds, the paper check is converted to an ACH entry



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RCK – Benefits

- More effective way for merchants to handle bounced checks
- Increases merchant's cash flow
- Financial institutions have fewer paper checks to handle, sort, and mail
- Reduces check collection expenses

WACHA
The Premier Payments Resource

RCK – Eligible Items

- Negotiable demand draft item with pre-printed check serial number
- Drawn on a consumer account
- Dated 180 days or less from the date the ACH entry is transmitted to the RDFI
- Less than $2,500
- Returned for NSF or uncollected funds
- Presented no more than allowable re-presentments

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The Premier Payments Resource

RCK – Number of Presentments

- An RCK entry can be transmitted after the physical check has been presented one or two times, as defined below:
  - If there was only one previous physical presentment, an RCK entry can be transmitted twice
  - If there were two physical presentments, the RCK entry can be sent only once

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The Premier Payments Resource

RCK – Authorization

- Originator must provide notice of the RCK policy to the check writer before receiving the check
- The notice must clearly and conspicuously state the terms of the RCK policy
- Notice plus receipt of the consumer's check constitutes authorization
- Copy of check must be retained for 7 years

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RCK – ODFI Warranties

- ODFI has good title to the returned item
- Signatures on the item are authentic and authorized
- Item has not been altered
- Item is not subject to a defense or claim
- ODFI has no knowledge of any insolvency
- RCK entry accurately reflects the item
- Item will not be presented
- Encoding is correct
- Restrictive endorsement is void or ineffective
- ODFI will provide copy of item, if requested

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RCK – Collection Fees

- Re-Presented Check entries must be for the face amount of the check
- No collection fee may be added to the RCK entry
- If a fee is to be collected, a separate Prearranged Payment/Deposit (PPD) entry may be initiated
  - Receiver's written authorization is required or similarly authenticated

WACHA
The Premier Payments Resource

FOLEY

FOLEY & LARDNER LLP
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MILWAUKEE, WI 53202-5306
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July 15, 2004

CLIENT/MATTER NUMBER
999999-9999

VIA FACSIMILE AND U.S. MAIL

Attorney Mark Schlei
State of Wisconsin Department of Financial Institutions
P.O. Box 8861
Madison, WI 53708-8861

Re: Clearing House Rule 04-041
(Proposed Rule Creating ss. DFI-Bkg 74.14(16) and (17)) ("Proposed Rule")

Dear Mr. Schlei:

Our firm represents CybrCollect, Inc. We have received a copy of the letter, dated May 26th 2004, from Ms. Mary Schnell, President of WACHA and Mr. Fred Laing, President of UMACHA, to Ms. Jean Plale (the "Letter"), together with the accompanying Memorandum from Mr. Oliver Ireland to Ms. Jane Larimar (the "Memorandum"). With due respect to Mr. Ireland, we believe that his Memorandum omits critical information. As a result, the Memorandum does not accurately describe the role of the rules of the National Automated Clearinghouse Association (the "NACHA Rules") in the collection of fees for returned checks by merchants and their agents. We would like to take this opportunity to address the inaccuracies.

1. ***The Memorandum fails to acknowledge that, unlike the Electronic Fund Transfer Act ("EFTA")[1] and Regulation E[2], the NACHA Rules have limited applicability. The NACHA Rules bind participating financial institutions, not private citizens.***

The Memorandum's assertion that "[E]ntries to collect fees for returned checks must meet the requirements of both Regulation E and the NACHA Rules" is true with respect to the financial institutions that are bound by those rules. However, the NACHA Rules do not bind merchants or their agents who initiate electronic debits from consumer accounts. Attempts to require debt collectors to comply with the authorization requirements set forth in the NACHA Rules have failed in Wisconsin and North Dakota. *See,* CybrCollect v. Wis. Dept. of Fin. Inst., Case No. O3-CV-0572, Order entered June 13, 2003; *see also,* CybrCollect Inc. v. N.D. Dept. of Fin. Inst. et

[1] 15 U.S.C. 1693-1693t

[2] 12 C.F.R. Part 205

al., Case No. 03-C-3271, Order entered June 15, 2004 (copy attached). Indeed, if the Memorandum's assertion were true, the Proposed Rule would be not be necessary.

2. ***The Memorandum asserts that "Regulation E does not contain express requirements for determining what constitutes appropriate authorization for individual transfers" (emphasis added). Yet it inexplicably fails to mention that the Federal Reserve Board provides express guidance regarding such authorization in its Commentary to Regulation E.***

The Federal Reserve Board, in its Commentary to Regulation E, provides clear guidance regarding the form that authorization may take:

> *Re-presented checks.* The electronic representment of a returned check is not covered by Regulation E because the transaction originated by check. Regulation E does apply, however, to any fee authorized by the consumer to be debited electronically from the consumer's account because the check was returned for insufficient funds. ***Authorization occurs where the consumer has received notice that a fee imposed for returned checks will be debited electronically from the consumer's account.***
>
> Commentary to 12 C.F.R. § 205.3(c), para. 1. (Emphasis added)

Authorization by notice therefore meets the Board's expectation, quoted in the Memorandum, that "merchants or other payees . . . [will] obtain a consumer's authorization to initiate an EFT from the consumer's account." Indeed, Congress placed so much faith in the Federal Reserve Board's ability to protect consumers that it provided immunity under EFTA to any person who acts in conformity with the Commentary. *See,* 15 U.S.C. § 1693m(d)) (providing that there is no civil or criminal liability for "any act done or omitted in good faith in conformity with any rule, regulation or interpretation thereof by the [Federal Reserve] Board...").

3. ***The assertion that the NACHA Rules provide the terms of an agreement between a merchant or other payee and a consumer is simply not true, and highlights a fundamental weakness in the Proposed Rule.***

The NACHA Rules do not automatically become part of an agreement between a merchant (or its agent) and a consumer.[3] Like any other terms, the NACHA Rules would have to be

[3] On the contrary, only "Participating Depository Financial Institutions" ("Participating DFIs") agree to comply with the NACHA Rules. (*See,* NACHA Rule 1.2). According to NACHA, each Participating DFI should enter into agreements with originators of electronic fund transfers which bind "the originating compan[ies] to the NACHA Operating Rules" (2003 NACHA Rules at OG 8). Therefore, although the Memorandum implies that an "originator" is bound by the NACHA Rules under Rule 2.1.1, the cited Rule merely formalizes NACHA's instruction to Participating DFIs to incorporate the NACHA Rules by reference into their contracts with their own customers. The contracts between Participating DFIs and originators of electronic fund transfers do not extend to the payors of those transfers, however. Nor do Participating DFIs

agreed upon by the parties in order to become part of their contract. Indeed, the assertion in the Memorandum highlights a fundamental weakness of the Proposed Rule: it attempts to regulate debt collectors, but it actually regulates the way *merchants* conduct business in Wisconsin.

Section 402.204 of the Wisconsin statutes provides that "a contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." A conspicuous notice stating that, in the event of a dishonored check, the face amount and a collection fee may be collected electronically, is a term of sale offered by a merchant. A customer who does not wish to enter into a contract which may be subject to an electronically collected fee may pay cash for the goods or services, may pay by credit card, or may simply refuse to make a purchase. The Department of Financial Institutions has neither the express nor the implied authority to impose terms on contracts between merchants and their customers.

Moreover, the Proposed Rule would force merchants to obtain advance written authorization from all check writing customers, or else forfeit their ability later to forward returned checks to debt collectors for electronic collection. Merchants themselves, outside the scope of the Proposed Rule, could originate electronic fund transfers for the fees upon notice to their customers in compliance with EFTA and Regulation E. Yet this double standard would create even greater confusion: consumers who wrote checks to merchants would sometimes be required to provide written authorization (if a merchant planned to send returned checks to a debt collector), and would sometimes only receive notice of electronic collection (if a merchant planned to submit returned checks itself and keep the fees, or the merchant otherwise failed to obtain the authorization necessary and decided on a case-by-case basis to submit entries itself). Indeed, a consumer could be subject to authorization by notice ***and*** written authorization in different transactions with the same merchant.

****

We would also like to take this opportunity to address the assertion in the Letter that "the bill being considered will . . . provide more consumer protection and less consumer confusion." We respectfully ask the Department of Financial Institutions to consider which consumers would be protected, and from what harm.

States generally agree as a matter of policy that it is unfair and unreasonable for an individual to issue a check for which he or she knows there are insufficient funds in the account.[4] Indeed, section 403.414(7) of the Wisconsin Statutes provides that a person who issues a check that is not honored upon presentment, because there are not sufficient funds in his or her account, "***is***

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that debit their customers' accounts have contractual relationships with the recipients of the electronic fund transfers. Moreover, the binding nature of contractually incorporated NACHA Rules is questionable, inasmuch as "in some circumstances the agreements [binding originators] . . . may be superseded by applicable federal or state law (e.g. . . . the Electronic Fund Transfer Act) (NACHA Rules at OG 8).

[4] *See,* Larry Lawrence ad Bryan D. Hull, *Payment Systems*, § 6:40 ("Virtually every state has specific statutes prohibiting the issuing and/or passing of bad checks", with list of statutory cites attached).

liable for all reasonable costs and expenses in connection with the collection of the amount for which the check or draft was written. . . ." (Emphasis added).

Consumers who issue checks for insufficient funds in Wisconsin do not have a choice about whether to pay a returned check fee. Section 403.414(7) imposes *unconditional liability* on a check writer for the costs and expenses. A consumer therefore cannot be "protected" against a merchant's legal right to the fee. Just as a check, as a negotiable instrument, creates an "unconditional . . . order to pay a fixed amount of money" (Wis. Stat. 403.104(1)), in the same way section 403.414(7) creates an unconditional obligation to pay costs and expenses incurred in collecting that money.

For both a returned check and the related collection fee, the recipient has an underlying *right* to the funds that does not depend on the means of collection. Therefore, the risk of fraud in collecting a returned check fee electronically is no greater than the risk of fraud in collecting the returned check itself. Yet (ironically) the NACHA Rules permit authorization by notice at the point-of-sale for a returned check (RCK) entry.[5] If authorization by notice does not necessitate "greater protection and less confusion" for consumers with respect to the electronic collection of returned checks, it should not pose a problem for the collection of related fees. Indeed, the benefits to both businesses and consumers of collection through RCK entries have been heralded by NACHA.[6]

Furthermore, the Federal Trade Commission, charged with protecting consumers under the Fair Debt Collection Practices Act, acknowledges that *notice alone* may be sufficient to authorize the collection of a fee:

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[5] "The authorization for RCK entries consist of a **notice** meeting the requirements of subsection 2.1.4 and the receipt of the item to which the RCK entry relates . . .", (2003 ACH Rules OR 2) (emphasis added) ("Originators of RCK entries must provide ***notice*** to the check writer. . . informing the check writer that his returned check may be collected electronically if the check is returned for insufficient or uncollected funds. The manner in which the Originator provides notice to the check writer is not prescribed by the *NACHA Operating Rules*. However, the notice must clearly and conspicuously state the terms of the Re-Presented Check Entry policy. ***It is recommended that notice provided at the point-of-sale be clearly displayed on a sign at the point-of- sale*** ...."(2003 NACHA Rules, OG 159-OG 161).

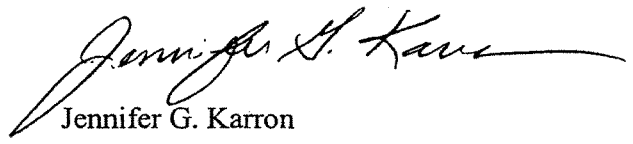
[6] According to the leader of the NACHA Work Group that developed the RCK rule, "'The collection of returned checks through the ACH Network can bring substantial cost and time savings to businesses, consumers and financial institutions. Respondents to the group's request for comments estimate that costs associated with representing an NSF check can be reduced by up to 50 cents per check for businesses, and one dollar per check for financial institutions. Lower costs also make the collection of small-value checks more cost-effective.' In addition, NACHA projects that the rate of successful collection could increase by 25 to 50 percent. Consumers will benefit from the new provision, too.... [The] Chairman of NACHA said, 'Use of the new ACH check collection transaction will result in quicker removal of negative information from check verification databases, which many merchants use to screen out bad check writers. This means that consumers will be able to write checks again sooner.'" March 10, 1998 NACHA press release. *See also,* http://www.electronicprocessor.com/nacha.html, which contains a brochure explaining to consumers the benefits of RCK entries.

> 4. Agreement Not in Writing. A debt collector may establish an "agreement" without a written contract. For example, he may collect a service charge on a dishonored check based on a posted sign on the merchant's premises allowing such a charge, if he can demonstrate that the consumer knew of the charge.[7]
>
> Comment 4 to section 808(1).

In light of the Federal Trade Commission's recognition that notice may give rise to a right to collect a fee, it should not be an unfair and deceptive practice to use the same means to authorize the electronic collection of that fee.

If you have any questions, please call me at (414) 297-5610.

Very truly yours,



Jennifer G. Karron

Attachment

cc: Senator Dale W. Schultz
Representative Phil Montgomery
Mr. Gary Doherty
Mr. Tom Knothe

[7] Courts have held that a conspicuous sign at a point of sale at least raises a presumption that the consumer has seen it. See, *Merrel v. Research & Data, Inc.*, 589 P.2d 120, 122 (Ct. App. Kan. 1979) (holding that circumstances where "all the signs were so placed that a person cashing a check or giving a check for merchandise 'could not help but see the sign' . . . raised a presumption of fact that plaintiff saw the signs when he presented his checks."); *see also , Tuttle v. Equifax Check*, 190 F.3d 9 (2nd Cir. 1999).

STATE OF NORTH DAKOTA

COUNTY OF BURLEIGH

IN DISTRICT COURT

Case No. 03-C-3271

CybrCollect, Inc.,

Appellant,

vs.

North Dakota Department of Financial Institutions and Timothy J. Karsky, Commissioner of the North Dakota Department of Financial Institutions,

Appellees.

ORDER

SUMMARY OF THE FACTS

The North Dakota Department of Financial Institutions (DFI) is charged with the regulation of debt collection agencies. CybrCollect, a Wisconsin corporation, has been a licensed debt collection agency in North Dakota since April 2003. This is an appeal from an administrative decision by the DFI, which affirmed a cease and desist order issued by Commissioner Timothy Karsky, and determined that the electronic collection of NSF fees, without a debtor's signed authorization, violates Chapter 13-05 of the North Dakota Century Code. This appeal was taken under the provisions of Section 28-32-42.

A check issued without sufficient funds is subject to collection costs in an amount not to exceed $25.00. ***Section 6-08-16(2) of the North Dakota Century Code.*** The $25.00 collection fee is recoverable by the holder of the check, its agent, or representative. ***Id.*** CybrCollect contracts with North Dakota merchants to

electronically collect checks which have been returned for non-sufficient or "held" funds (NSF checks). On behalf of the merchant, CybrCollect collects the amount of the NSF check, as well as the statutory fee of $25.00. CybrCollect's contract with its merchant customers requires the merchants to post a conspicuous sign explaining the collection procedures, notifying the customer that if a check does not clear because of insufficient funds, the check and the $25.00 fee will be collected electronically.

When CybrCollect receives a NSF check from the contracting merchant's bank, it scans the check into its own computer system. The system converts the information into electronic data in the form of two debits: one for the face value of the check, and another for the amount of the merchant's collection fee. When sufficient funds become available in the check writer's account, the two electronic records are transmitted to the check writer's bank through the Automatic Clearing House (ACH) and the check writer's account is debited for both amounts. If re-presentment is attempted twice and there are still insufficient funds in a consumer's account, CybrCollect sends the check to a traditional collection agency for collection. The DFI claims that CybrCollect's electronic collection of NSF check fees without written authorization from the debtor is a violation of North Dakota law.

On June 24, 2003, Administrative Law Judge Hoberg issued his Recommended Findings of Fact, Conclusions of Law, and Order in this matter. He determined the greater weight of the evidence showed CybrCollect had not engaged in practices in violation of Chapter 13-05, was not engaged in acts, practices, or transactions under Chapter 13-05 that required relief, and had not specifically violated Chapter 13-05, or any rule adopted by Chapter 13-05.

A second hearing took place on September 29, 2003, before North Dakota DFI

Commissioner Timothy Karsky. On November 13, 2003, as a result of that hearing, Commissioner Karsky issued his own Findings of Fact, Conclusions of Law, and Order, disregarding Judge Hoberg's Recommended Findings of Fact, Conclusions of Law, and Order.

STANDARD OF REVIEW

A district court must affirm the agency's order unless it finds any of the following are present:

> 1. The order is not in accordance with the law.
> 2. The order is in violation of the constitutional rights of the appellant.
> 3. The provisions of this chapter have not been complied with in the proceedings before the agency.
> 4. The rules or procedure of the agency have not afforded the appellant a fair hearing.
> 5. The findings of fact made by the agency are not supported by a preponderance of the evidence.
> 6. The conclusions of law and order of the agency are not supported by its findings of fact.
> 7. The findings of fact made by the agency do not sufficiently address the evidence presented to the agency by the appellant.
> 8. The conclusions of law and order of the agency do not sufficiently explain the agency's rationale for not adopting any contrary recommendations by a hearing officer or an administrative law judge. ***Section 28-32-46(1)-(8), North Dakota Century Code.***

ANALYSIS

The Electronic Funds Transfer Act (EFTA) (15 U.S.C. § 1693 *et seq.*) is the federal law governing electronic fund transfers. Regulation E (12 C.F.R. Part 205), issued by the Federal Reserve Board (FRB) carries out the purpose of the EFTA, which is the protection of individual consumer rights. In North Dakota, consumer electronic fund transfers are subject to the EFTA and Regulation E. The FRB, in the official commentary to Regulation E, has taken the position that the electronic re-

presentment of an NSF check is the "continuation of the transaction originated by check," and is outside of the scope of the EFTA and Regulation E.

However, the electronic debit of the statutory $25.00 collection fee is defined as an "electronic fund transfer" under section 205.3(b) of Regulation E. Thus, the FRB in the Official Commentary to Regulation E, concluded that Regulation E applies to fees electronically debited from the consumer's account when the check is returned for insufficient funds. ***12 C.F.R. 205.3(c)(1), Comment 1.*** Authorization for an electronic debit of an NSF check fee "occurs where the consumer has received notice that a fee imposed for returned checks will be debited electronically from the consumer's account." ***12 C.F.R. 205.3(c)(1), Comment 1.***

Under Regulation E, an electronic funds transfer must be authorized, in writing, if it is to recur at substantially regular intervals. ***12 C.F.R. § 205.2(k); 12 C.F.R. § 205.10.*** However, no written authorization is required for non-recurring debits, such as the non-recurring $25.00 NSF check fee involved in the instant litigation. CybrCollect's contracts require merchants to post at each point-of-sale location a conspicuous notice that NSF fees will be collected electronically. The notice informs the consumer that if a check is returned for insufficient funds, the consumer's checking account will be debited electronically for both the face amount of the check and the NSF fee. CybrCollect's activities are permissible under the EFTA, Regulation E, and North Dakota law.

In North Dakota, an administrative hearing may not be held unless the parties have been served with "a written specification of issues for hearing or other document indicating the issues to be considered and determined at the hearing." ***Section 28-32-21(3)(c), North Dakota Century Code.*** In the Notice of Hearing and Specification

of Issues provided to CybrCollect, the issues were described as follows: "Whether CybrCollect has engaged in acts, practices, or transactions in violation of N.D.C.C. Ch. 13-05 such that the Commissioner may impose a cease and desist order against CybrCollect under the provisions of N.D.C.C. Ch. 13-05, and whether such acts, practices, or transactions require further relief beyond the imposition of a cease and desist order." Based on the specification of issues, the hearing judge could only decide whether Cybrcollect had violated Chapter 13-05, and whether relief beyond the cease and desist order was required.

On those issues, the administrative law judge determined "by the greater weight of the evidence, the evidence does not show that CybrCollect has engaged in acts, practices, or transactions in violation of N.D.C.C. ch. 13-05, or rules adopted under ch. 13-05, such that the Commissioner may impose a cease and desist order against CybrCollect under the provisions of N.D.C.C. ch. 13-05, or rules adopted under ch. 13-05." ***See Appellant's Appendix,*** p. 176-77. Judge Hoberg correctly decided the issues before him, and the administrative agency should have accepted his findings rather than substituting its own.

Commissioner Karsky had no basis for substituting his own findings in place of Judge Hoberg's. "When the director of an agency rejects the recommendations of the hearing officer in favor of a contrary decision, the findings, conclusions, and decision should be sufficient to explain the Director's rationale for doing so." ***Steen v. North Dakota Dep't of Human Servs.,*** 1997 ND 52, ¶ 10, 562 N.W.2d 83 (citations omitted). Timothy Karsky, the DFI Commissioner, rejected Judge Hoberg's recommended findings, conclusions, and order, without providing a sufficient explanation regarding his rationale for doing so. For this and all of the reasons given above, the order of the

DFI must be reversed, and the case should be remanded. ***Section 28-32-46(8).***

State law or regulation could prohibit check collectors' ability to electronically collect NSF fees from a debtor's bank account without a debtor's signed authorization. However, current law does not prohibit CybrCollect from electronically collecting NSF check fees from a debtor's bank account without written authorization.

CONCLUSION

The Agency's order is reversed, and the case is remanded to the DFI for disposition in accordance with this order.

Dated June 15, 2004.

BY THE COURT:

Gail Hagerty
District Judge