

CHECK 21 LAW

The Check 21 Act (Check Clearing for the 21st Century Act) is found at 12 U.S.C. §§ 5001 to - 5017. Its purpose is to facilitate the use of current and future technology by financial institutions when processing checks to improve overall efficiency of the nation's payments system. The new law takes effect October 28, 2004.

The law provides that banks may choose to truncate (and ultimately destroy) original paper checks, process and deliver checks electronically, and then print substitute checks at a location near the paying financial institution for presentment.

Definitions:

- Truncate means to remove an original paper check from the check collection or return process and sent to a recipient, in lieu of such original check, a substitute check or, by agreement, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check), whether with or without subsequent delivery of the original paper check. All this language means that the bank scans the original check and makes an electronic image of it.
- MICR line (magnetic ink character recognition line) means the numbers, which may include the bank routing number, account number, check number, check amount, and other information, that are printed near the bottom of a check in magnetic ink in accordance with generally accepted industry standards.

Under the Check 21 law the banks may produce a substitute check, which is a paper reproduction of the original check. The substitute check is the legal equivalent of the original check for all purposes if the substitute check accurately represents all of the information on the front and back of the original check as of the time the original check was truncated; and bears the legend: "This is a legal copy of your check. You can use it the same way you would use the original check."

To meet legal requirements the substitute must:

- Contain an image of the front and back of the original check
- Bear a legend that states: "This is a legal copy of your check. You can use it the same way you would use the original check."
- Display a MIRC line containing all the information appearing on the MIRC line of the original check
- Conform in paper stock, dimension, and otherwise, with generally applicable industry standards for substitute checks
- Be suitable for automated processing in the same manner as the original check

A substitute check is subject to any provision of the Uniform Commercial Code and any other law as if such substitute check were the original check, to the extent the provision of the law is not inconsistent with the Check 21 law.

To see copies of what a substitute check will look like, go to the following web site: <http://www.frb services.org/Retail/Check21.html>. On the right hand side you will see something that says "See Also"; click on "About the Check 21 Act"; then click on "Anatomy of a Substitute Check" under the heading "About Check 21."

The following example of the effect of the Act on a worthless check prosecution was prepared by Matt Osborne, Assistant Counsel, Administrative Office of the Courts, who has generously agreed to let me use it.

- * A customer writes a bad check to a merchant.
- * The merchant accepts the check and submits it to the merchant's financial institution.
- * The merchant's financial institution truncates the original check, destroys the original check, and sends the electronic image of the check to the customer's financial institution.
- * When the customer's financial institution dishonors the check, it prints a substitute check from the electronic image. The substitute check essentially is a paper reproduction of the original check that contains all of the essential information from the original check, including the reason for dishonor.
- * The customer's financial institution sends the substitute check back to the merchant's financial institution.
- * The merchant's financial institution sends the substitute check to the merchant so that the merchant can attempt to collect on the bad check.
- * The substitute check is the equivalent of the original check, and the magistrate can issue criminal process based on the substitute check.

Notes:

1. Truncation of the check can take place at any point in the process. Any one of the players in the process (the merchant, the merchant's financial institution, or the customer's financial institution) might be the one truncating the check and any one of the players in the process might be the one printing the substitute check from the electronic image.
2. The Act is permissible so it is possible that some merchants may continue to receive original dishonored checks.