

**AUTOMATED CLEARING HOUSE CONTRACTS
INVOLVING THE ODFI, ORIGINATOR, AND THIRD PARTY SENDER**

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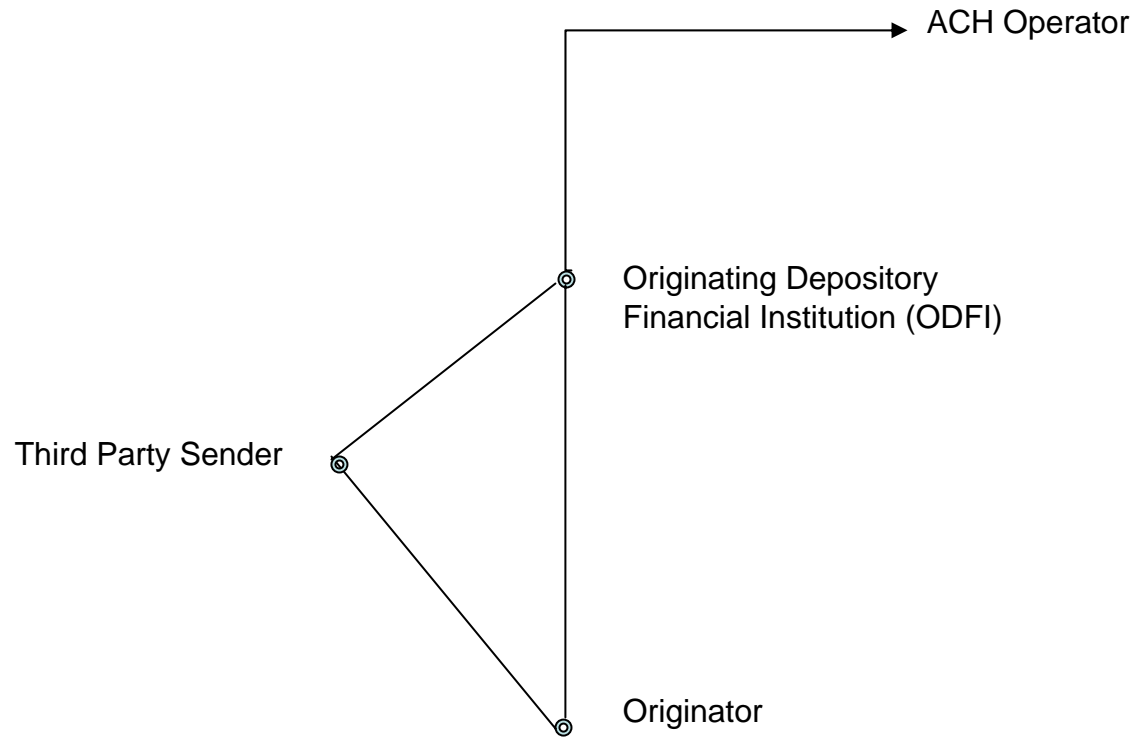
ELECTRONIC PAYMENTS LAW SUMMIT

Alliance for Payment Systems Education

Hyatt Regency O'Hare

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LEGAL FRAMEWORK

- ***NACHA Operating Rules* govern interregional ACH transactions and intraregional ACH transactions unless a regional ACH association has implemented a local rule to supersede a provision of the Rules.**
- **Federal government payments are controlled by Title 31, Code of Federal Regulations, Part 210. The *NACHA Operating Rules* were adopted in 1999 to govern the transmission and receipt of federal government ACH entries with certain exemptions.**
- **UCC Article 4 (check transactions) – state statutory law**
- **UCC Article 4A (wholesale wire transfers) – state statutory law**
- **Federal Electronic Fund Transfer Act (implemented by Federal Reserve Board Regulation E) – applicable to consumer payments**

LEGAL FRAMEWORK

(Continued)

- **Federal Right to Financial Privacy Act**
- **Federal Reserve Regulation D (reserve requirements for banks)**
- **Federal Reserve Regulation CC (funds availability)**
- **Contracts between ACH participants (state common law)**
- **“There is no such thing as a standard form contract for ACH services”**

ODFI- ORIGINATOR CONTRACT

- ***NACHA Operating Rules*** require that an Originator (the individual, corporation or entity that initiates credit or debit entries into the ACH Network) must enter into a contract with the Originating Depository Financial Institution (“ODFI”) unless the Originator has contracted directly with a Third Party Sender.
- ***NACHA Operating Rules*** require the ODFI-Originator contract to contain provisions that (a) bind the Originator to the *NACHA Operating Rules*, and (b) require the Originator to acknowledge that entries may not be initiated in violation of U.S. laws.
- Other provisions in the contract should (a) define the parameters of the relationship between the two parties, (b) identify processing requirements for specific payment applications, (c) establish liability and accountability for certain procedures related to the selected payment applications.
- The ODFI-Originator contract should inform the Originator that its liabilities may include such things as the amount of fines assessed against the ODFI for a rules violation caused by the Originator.

ODFI- ORIGINATOR CONTRACT

(Continued)

- **In some instances, provisions of the agreement may be superseded by certain federal or state laws, such as Uniform Commercial Code Article 4A (wholesale wire transfers) or the Electronic Fund Transfer Act (as implemented by Federal Reserve Board Regulation E).**
- **Originators should be made aware that they are subject to certain US laws when they initiate ACH transactions (e.g., that they are not violating Office of Foreign Assets Control sanctions).**
- **The *NACHA Operating Guidelines*, pages OG 10 through OG 13, include a table of issues that “should” be defined in the agreement between an Originator and ODFI. The table identifies issues in the context of consumer debt and credit transactions and corporate debit and credit transactions. This table is followed by a sample ODFI-Originator Agreement on pages OG 14 through OG 20.**

DISTINCTION BETWEEN THIRD PARTY SERVICE PROVIDERS AND THIRD PARTY SENDERS

- **A Third Party Service Provider is an entity other than an Originator, ODFI, or Receiving Depository Financial Institution (“RDFI”) that performs any functions on behalf of the Originator, ODFI, or RDFI with respect to processing ACH entries (e.g., creation of ACH files on behalf of an Originator or ODFI, or acting as a Sending Point or Receiving Point on behalf of an ODFI or RDFI, respectively).**
- **A Third Party Sender is a Third Party Service Provider that acts on behalf of an Originator as an intermediary between the Originator and an ODFI when there is no contractual agreement between the ODFI and Originator for ACH origination services. Even though ACH entries are settled against the Third Party Sender’s account at its ODFI, the Third Party Sender is not an Originator of ACH transactions when it acts in this capacity.**
- **An ACH transaction may involve multiple Third Party Senders.**

- **When a Third Party Sender is utilized, there must be a contract between the Third Party Sender and the ODFI, and a contract between the Third Party Sender and the Originator.**
- **If multiple Third Party Senders are involved, there must also be separate contracts between each Third Party Sender.**

THIRD PARTY SENDER - ORIGINATOR CONTRACT

- **The Third Party Sender – Originator contract will, in most instances, include provisions that are similar to the ODFI – Originator agreement.**
- **The Originator must agree to assume the responsibility of an Originator under *NACHA Operating Rules*.**
- **Both parties should agree to be bound by the *NACHA Operating Rules* and acknowledge that entries may not be initiated in violation of US laws.**
- **The Third Party Sender is ultimately responsible to the ODFI for the Originator’s compliance with the *NACHA Operating Rules*. Consequently, the agreement should clearly specify each party’s responsibilities.**
- ***NACHA Operating Rules* require the Originator to make payment to the ODFI for credit entries originated or debit entries returned, to the extent that the ODFI does not receive payments from the Third Party Sender as contracted.**

THIRD PARTY SENDER - ORIGINATOR CONTRACT

(continued)

- ***NACHA Operating Guidelines*** do not include a sample Third Party Sender – Originator Agreement, but instead reference, “for illustrative purposes,” the sample ODFI-Originator Agreement and ODFI-Third Party Sender Agreement.

THIRD PARTY SENDER - ODFI AGREEMENT

- **The ODFI-Third Party Sender contract must bind the Third Party Sender to the *NACHA Operating Rules* and require the Third Party Sender to acknowledge that entries may not be initiated in violation of US laws.**
- **The ODFI must assume responsibility and liability (including indemnification of the ACH Operator and RDFI) for all entries it transmits into the ACH Network and warrants that that all entries are properly authorized. The Third Party Sender is required by the Rules to assume these liabilities and make the warranties imposed on the ODFI. These responsibilities apply even when the Originator fails to perform its obligations as an Originator. Thus, the ODFI assumes the responsibilities of the Third Party Sender and the Originator, and the Third Party Sender assumes the responsibilities of the Originator and the ODFI.**
- **The Third Party Sender is required to give a warranty to the ODFI that the Originator has agreed to assume the responsibilities of an Originator under the *NACHA Operating Rules*.**
- **The Third Party Sender is obligated to make payment to the ODFI for any credit entries originated and for any debit entries returned by the RDFI.**

THIRD PARTY SENDER - ODFI AGREEMENT

(continued)

- **The Third Party Sender is required to provide the ODFI with any information the ODFI reasonably deems necessary to identify each Originator for which it transmits entries. This obligation must be satisfied within two business days after receiving the ODFI's request.**
- **The Third Party Sender must make all representations of a Third Party Sender under the *NACHA Operating Rules*.**
- **The Third Party Sender may itself act as an Originator. In this situation it may be advisable for the ODFI and Third Party Sender to enter into a separate agreement focusing on origination of ACH entries by the "Third Party Sender."**
- **UCC Article 4A disclosures and other issues relating to Article 4A may need to be addressed in the ODFI-Third Party Sender agreement.**

THIRD PARTY SENDER - ODFI AGREEMENT

(continued)

- **There are certain issues standard to any ACH agreement that should also be addressed in the ODFI-Third Party Sender Agreement. For example, processing procedures and security requirements.**
- **Special agreements and warranties should be addressed if the Third Party Sender intends to transmit ARC, POP, TEL and WEB entries on behalf of an Originator.**
- **ODFIs are required to impose exposure limits on Third Party Senders and establish effective policies and procedures to actively measure exposure limits when processing ACH entries on behalf of customers.**
- **ODFIs should consider imposing requirements on the Third Party Sender to minimize credit risk. For example, prohibitions on certain Originators that engage in businesses that could result in excessive returns or cause reputation problems.**

AGREEMENTS BETWEEN MULTIPLE THIRD PARTY SENDERS

- **When multiple Third Party Senders are utilized in the origination of ACH payments, the *NACHA Operating Rules* require execution of appropriate agreements between each Third Party Sender.**
- **These agreements should allocate responsibility for specific functions and assign liabilities accordingly.**
- **Complications in drafting these agreements can arise because one Third Party Sender will have a contract with the Originator, and the other Third Party Sender will have a contract with the ODFI. Any special obligations imposed by the ODFI on the Third Party Sender in privity with the ODFI should be considered in drafting the contract between the two Third Party Senders.**

OTHER CONTRACT PROVISIONS

- The *NACHA Operating Rules* do not address many critical contractual issues that should be considered by the parties to ACH contracts
- Authorization to enter into the contract
- Existence and good standing of the legal entity counterparty
- Representations and warranties concerning the counterparty's legal status and business operations
- How the contract will be amended
- How and where notices will be delivered
- Force majeure
- Data retention requirements
- Cooperation in loss recovery efforts

OTHER CONTRACT PROVISIONS

(continued)

- **The terms under which the contract may terminate and the consequences of termination.**
- **Entirety clause to ensure that there are no oral agreements binding on the parties.**
- **Prohibition (or allowance) of assignment of rights and obligations.**
- **Governing law. Preferable to insert the law of of the ODFI's jurisdiction. NACHA rules impose the law of New York in contracts between the ODFI and RDFI with respect to entries subject to UCC Article 4A.**
- **ODFI (or Third Party Sender) responsibilities, liability, and limitation of liability should be inserted in the contract**
- **Intellectual property rights**

OTHER CONTRACT PROVISIONS

(continued)

- **In ODFI-Third Party Sender contracts, the ODFI may want to consider mandating special provisions that must be included in the contracts entered into between the Third Party Sender and its Originators, including a clause making the ODFI a third party beneficiary of those contracts.**
- **Confidentiality provisions**
- **Directors and Officers insurance or other insurance**
- **Arbitration**

NACHA arbitration rules only apply between depository financial institutions, but there is nothing in the rules that prohibit contract parties in other situations from using the same procedures
- **Venue, Submission to Jurisdiction, and Waiver of Jury Trials**

ANNUAL AUDIT REQUIREMENTS

- ***The NACHA Operating Rules*** require all ODFIs and any Third Party Service Providers performing a function of ACH processing on behalf of those ODFIs to conduct an annual audit to determine their compliance with the rules regarding the origination of ACH entries.
- The ODFI and Third Party Service Provider are obligated to retain (and produce to NACHA if requested) documentation supporting the completion of an ACH audit for six years from the date of the audit.
- All contracts between ODFIs and Originators, ODFIs and Third Party Senders, and Third Party Senders and Originators should be examined during the audit. Although required contract audits are intended to ensure compliance with the NACHA Operating Rules, the audit is also an opportunity to update other contract provisions that are not necessarily affected by the rules.

Jeffrey D. Dunn

Jeff Dunn is an attorney and shareholder with the law firm of Munsch Hardt Kopf & Harr, PC in Dallas, Texas. He is a native Texan with a B.A. degree in economics from Texas A&M University, a masters degree in public affairs from the University of Texas at Austin, and a law degree from SMU (Southern Methodist University) law school where he served as Leading Articles editor for the Southwestern Law Journal, now known as the SMU Law Review.

Mr. Dunn's practice area is focused on representing financial institutions engaged in commercial lending and consumer finance as well as general banking law. He has represented clients in negotiating automated clearing house contracts from the perspective of the originating depository financial institution, the third party sender, and the merchant originator. He is currently a member of NACHA's national arbitration board and his law firm is an affiliate member of SWACHA. Mr. Dunn has published articles in the Banking Law Journal, Texas Journal of Business Law, the Journal of Corporate Counsel review, the ABF Journal for commercial finance professionals, and the Dallas Business Journal, and is a frequent speaker at continuing legal education seminars in Texas. He is a former member of the Board of Directors of the Texas Association of Bank Counsel and currently a member of the governing council for the State Bar of Texas Business Law Section. He is listed in the 2006 and 2007 editions of "Best Lawyers in America" legal guide under the category of banking law.

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