INTRODUCTION TO RETHINKING PAYMENTS LAW

STEVEN L. HARRIS*

A payment may be made by any one of a number of mechanisms, including a check, wire transfer, credit card, and debit card. The rights and duties of those involved in a payment transaction depend on the mechanism chosen by the paying party and, in some cases, by the payee and the financial institutions processing the payment. Depending on the mechanism chosen, any given payment may be governed by an amalgam of one or more state or federal statutes or regulations, one or more private contracts, and the common law. The Symposium on Rethinking Payments Law grew out of a paper, prepared by Stephanie Heller, Counsel and Vice President of the Federal Reserve Bank of New York, suggesting that "society would be best served by a unified payments code that sets forth a coherent and principled payments law that recognizes differences in payment types where appropriate and harmonizes disparities that have arisen over time but can no longer be justified" and asking The American Law Institute (ALI) to consider leading "an effort to consider the desirability for such a unified payments law."[1] With the encouragement of the late Donald Rapson, Ms. Heller, Linda Rusch, and I organized the Symposium as a vehicle for considering whether contemporary payments law reflects the appropriate level of uniformity and for exploring the contours of what a unified payments law might encompass. We were indeed fortunate to secure the financial sponsorship of the Federal Reserve Bank of New York and five New York City law schools for a live symposium in April 2007[2] and the agreement of the *Chicago-Kent Law Review* to publish the papers.

The live symposium was a great success. In a series of six panels, more than two dozen individuals—including lawyers who represent financial institutions, consumer advocates, regulators, and law profes-

* Professor, Chicago-Kent College of Law.

1. An updated version of this proposal appears as an Appendix to this introduction. Stephanie Heller, *A Proposal for Consideration of a Unified Payments Law*, *infra* at 485.

2. The sponsoring law schools were Brooklyn Law School, Columbia University School of Law, Hofstra University School of Law, New York University School of Law, and St. John's University School of Law.

sors—presented their views on a broad range of topics. Many of the more than 180 registrants, whose affiliated organizations likewise reflect diverse perspectives on, and interests in, the law governing payment systems, participated in the ensuing discussions. The discussion has continued apace within financial institutions and at the Fed. The New York Fed has established a listserv for these issues, and NACHA's 2008 payments conference features a panel on the how the legal environment might respond to the convergence of payment pathways.[3] The publication of the articles in this issue no doubt will stimulate more and deeper thought.

As Ms. Heller's proposal acknowledges, the idea that society might benefit from greater uniformity in payments law is not new.[4] Thirty years ago, Hal Scott submitted a report to a committee of the Permanent Editorial Board, in which he concluded that the then-existing Articles 3 and 4 of the Uniform Commercial Code "needed to be amended or replaced in order to establish a legal framework for all payment systems except for cash."[5] As Professor Scott explained:

> The guiding philosophy of such an effort, as put forward by the Report, was that the new legal framework should not distort user choices among different payment systems, whether they be paper or card based, or electronic. This was to be accomplished by having the same legal consequences attach to all kinds of transactions, where technology and the nature of the transaction permitted.[6]

Scott's report led to a series of drafts of what became known as the Uniform New Payments Code (UNPC).[7] After considerable controversy and extensive debate over the desirability of uniformity in this area, the sponsors decided to stop work on the UNPC. Ms. Heller argues, however, that "today's payment environment has sufficiently and significantly changed from the payments environment of the 1980s so as to warrant a re-examination of the need for a unified payments law covering both retail and wholesale payments and both debit and credit transfers for payment systems that rely on intermediaries."[8]

3. *See* NACHA, Payments 2008, http://www.nacha.org/conferences/Payments2008/Pay08Bro chure.pdf (last visited Apr. 5, 2008). For an example of one possible road towards convergence, see NACHA, Deposited Check Truncation (DCT) Pilot, http://dct.nacha.org (last visited Apr. 5, 2008) (describing the anticipated launch of a pilot project to use automated clearing houses to collect low-value checks).

4. Heller, *supra* note 1, at 489.

5. *See* Memorandum from Hal S. Scott to the Nat'l Conference of Comm'rs on Uniform State Laws 1 (June 15, 1983) (on file with the Chicago-Kent Law Review).

6. *Id.*

7. *Id.* at 2–3.

8. Heller, *supra* note 1, at 489.

In their contribution to this Symposium, Clayton Gillette and Steven Walt largely disagree.[9] If most parties would agree to the same allocation of the risks arising from the initiation and processing of a payment, they argue, then the law might do well to adopt this "majoritarian" rule. However, they believe that different parties or classes of parties may have different preferences about the best way to allocate these risks and that different transactional structures likewise may warrant that these risks be treated differently. A menu consisting of a limited number of payments options, each accompanied by its own default rules, might afford parties the opportunity to make a low-cost selection of a payment device that allocates risks in a manner consistent with their particular transaction. They reach this conclusion despite the fact that, today, a given payment (e.g., by check) may be processed through several different payment systems.

Gillette and Walt suggest that "uniformity must be argued for rule by rule."[10] To this end, they examine the current legal rules applicable to three payment-related risks: the risk that a payment is unauthorized, the risk that a transaction proves defective such that the paying party seeks to reverse the payment, and the risk that a bank's customer fails to report an unauthorized charge to its account. Although they remain dubious that uniform loss-allocation rules are desirable, they conclude that "current law in these areas does not reflect an optimal standardization in rules across payment systems."[11]

A number of the other contributions to this Symposium argue for uniformity risk-by-risk, if not rule-by-rule. Linda Rusch, like Gillette and Walt, addresses the problems raised by unauthorized payments; however, she is more favorably inclined towards uniformity.[12] After explicating the various legal rules that allocate the loss arising from an unauthorized debit to a deposit account, Rusch stakes out a path towards reaching uniformity. Her first step would be to identify the policies that underlie the allocation of loss. Among the policies she identifies and analyzes are allocating the loss to the person in the best position to spread it, insuring certainty of result and finality of payment, and allocating the loss to the person in the best position to prevent it. Once these policies are identified, she suggests, legal rules can

9. Clayton P. Gillette & Steven D. Walt, *Uniformity and Diversity in Payments Systems*, 83 CHI.-KENT L. REV. 499 (2008).

10. *Id.* at 501.

11. *Id.* at 504.

12. Linda J. Rusch, *Reimagining Payment Systems: Allocation of Risk for Unauthorized Payment Inception*, 83 CHI.-KENT L. REV. 561 (2008).

be crafted to advance them and rulemakers can determine whether the implementation of the policies is feasible under the existing technology. Rusch herself offers tentative uniform formulations that promote the various policies she discusses.

Francis Facciolo suggests a different approach to achieving uniformity.[13] His examination of the issue of unauthorized payments focuses on the ways in which technological developments have increased the risk of fraud. He argues that the financial institutions that participate in the payment systems are in the best position to police these systems and that the default rule for unauthorized payments should be modeled on the Truth in Lending Act's credit-card provisions and "squarely place the burden upon financial institutions to deal with unauthorized transactions."[14]

Benjamin Geva and Andrew Kull examine different aspects of finality of payment. Geva's article emphasizes the connection between two points in time: the point where the banking process ends and the payee acquires an irreversible right against its bank ("payment finality"), and the related point where the payor's obligation to the payee is discharged.[15] Although he finds that, "[c]ompared to legislation elsewhere, the U.C.C. treatment of each of the various aspects of these topics is commendable," Geva advocates the development of "a general statutory framework . . . to replace piecemeal treatment."[16] In an effort to bridge payment finality and discharge, he proposes consideration of a procedure under which a bank check is to be paid over a wire-transfer system.

Andrew Kull's article starts where Geva's leaves off: the banking process has reached the point where the payee has an irreversible right against its bank for the amount of the payment; i.e., "final payment" (or "payment finality") has occurred.[17] Kull emphasizes the importance of distinguishing clearly between this event and the common-law right of restitution, which under some circumstances permits a payor to recover even a "final payment." Although the possibility of using the law of restitution to recover a final payment makes the payment less certain, Kull argues that affording this possibility in a very

13. Francis J. Facciolo, *Unauthorized Payment Transactions and Who Should Bear the Losses*, 83 CHI.-KENT L. REV. 605 (2008).

14. *Id.* at 631.

15. Benjamin Geva, *Payment Finality and Discharge in Funds Transfers*, 83 CHI.-KENT L. REV. 633 (2008).

16. *Id.* at 669.

17. Andrew Kull, *Restitution and Final Payment*, 83 CHI.-KENT L. REV. 677 (2008).

limited number of cases—those in which recovery is necessary to prevent the unjust enrichment of someone other than a bona fide creditor or a person who in good faith changed position in reliance on the payment—improves the functioning of the payment system by making it possible to speed up the moment of final payment.

As James Rogers observes, payment finality determines who bears the loss if a financial institution becomes insolvent: "[B]efore any payment transaction, Debtor takes the risk of the solvency of Debtor's Bank. After the completion of the payment transaction, Creditor takes the risk of the solvency of Creditor's Bank."[18] Rogers' article examines how to allocate the risk that the insolvency of a financial institution prevents completion of the payment transaction and concludes that "it seems entirely feasible to adopt a general principle that the risk of intermediary provider insolvency is borne by the providers of the payment system, not by the users of the payment system."[19]

The increasing difficulty of defining duties that financial institutions that process payments owe to one another and to payment-system users is the subject of Sarah Jane Hughes's article.[20] After examining a variety of duty issues that may arise with respect to check processing, Hughes argues that the traditional legal doctrines of ordinary care and good faith have become an increasingly less helpful tool for assigning liability. She concludes that "new parameters for duties in payments processing are required,"[21] and, in an environment where the initiator of a payment does not have control over how the payment will be processed, emphasizes the importance of enabling payors to determine whether the processing institutions have fulfilled their duties.

Joseph Sommer's commentary focuses on the appropriate tools for analyzing payments law.[22] Seeking an explanation for the fact that very few of the contributions to this Symposium rely on economic analysis, Sommer concludes that economic analysis "simply does not work" on what he considers the core of payments law, the clearing and settlement rules of the payment system.[23] The law governing "the legal

18. James Steven Rogers, *Unification of Payments Law and the Problem of Insolvency Risk in Payment Systems*, 83 CHI.-KENT L. REV. 689, 705 (2008).

19. *Id.*

20. Sarah Jane Hughes, *Duty Issues in the Ever-Changing World of Payments Processing: Is It Time for New Rules?*, 83 CHI.-KENT L. REV. 721 (2008).

21. *Id.* at 747.

22. Joseph H. Sommer, Commentary, *Where is the Economic Analysis of Payment Law?*, 83 CHI.-KENT L. REV. 751 (2008).

23. *Id.* at 767.

plumbing of payments," he argues, has much more to do with the "engineering design principles" of privity and nominalism than with economics.[24] And although economics may have more explanatory power with respect to the risk-allocation rules for inauthentic messages (an issue discussed by Gillette and Walt, Rusch, and Facciolo), sociology explains the precision of the core legal doctrine as well as the tremendous importance of bank operational integrity.

The special needs of consumers garner considerable attention in this Symposium. Indeed, even those who are generally dubious about the need for uniformity are open to the possibility that uniformity in the governing law may be justified with respect to consumer-initiated payments.[25] Putting consumer protection foremost, Gail Hillebrand advances ten principles to which all new payments law and payment products should conform.[26] Given the uncertainty that consumers confront in deciding which payment mechanism to use, she argues, "[c]onsumers cannot afford to wait for the law to be sorted out in payments."[27] She also advocates five specific changes to existing payments law that would immediately afford consumers a clear, simple set of protections regardless of the mechanism by which a payment is made.

Anita Ramasastry shares Hillbrand's concern that the convergence and blending of payment methods may cause uncertainty over which rules govern any given payment.[28] She analyzes in detail a variety of issues surrounding the process of resolving claims that a charge or debit to a consumer's account resulted from a processing error and should be reversed. Concluding that a market failure exists with respect to error resolution in payments, Ramasastry proceeds to examine various means by which the law might provide greater certainty and predictability with respect to error resolution for a greater number of payment mechanisms, including possible changes to Federal Reserve Regulation E.

24. *Id.* at 752, 754.

25. *See* Gillette & Walt, *supra* note 9, at 501–02; *see also* Robert G. Ballen & Thomas A. Fox, *The Role of Private Sector Payment Rules and a Proposed Approach for Evaluating Future Changes to Payments Law*, 83 CHI.-KENT L. REV. 937 (2008) (arguing that the rules of private-sector payment organizations should be primary, provided that they are consistent with consumer protections established under state and federal law).

26. Gail Hillebrand, *Before the Grand Rethinking: Five Things To Do Today with Payments Law and Ten Principles to Guide New Payments Products and New Payments Law*, 83 CHI.-KENT L. REV. 769 (2008).

27. *Id.* at 811.

28. Anita Ramasastry, *Confusion and Convergence in Consumer Payments: Is Coherence in Error Resolution Appropriate?*, 83 CHI.-KENT L. REV. 813 (2008).

Norman Silber's article examines another area in which uniformity may be desirable for consumers, the legal treatment of late payments.[29] Silber argues that the practices of creditors in setting billing cycles and charging late fees exploit the cognitive limitations of consumers and thereby cause a significant number of unwittingly late payments. Adoption of his draft Late Payment Act, he argues, would alleviate these cognitive limitations and permit consumers to act more rationally in making recurring payments.

To a considerable extent, the law governing payment systems can be varied by agreement.[30] In their article, Peter Alces and Jason Hopkins argue that form deposit agreements do not reflect a real agreement between banks and their consumer customers and so do not promote the policies underlying freedom of contract.[31] The market, they claim, fails to weed out terms that have a pernicious effect on consumers, and so another mechanism must do so. Believing that the greatest difficulty facing bank customers is lack of information, Alces and Hopkins suggest that the Federal Reserve Board maintain a readily accessible database that would provide the terms of bank-customer agreements in a manner that would allow customers to compare among financial institutions.

Mark Budnitz comments on the articles in this Symposium dealing with consumer payments.[32] He places particular emphasis on the role that technology has played in shaping the payments world in which consumers find themselves and argues that "consumer protection should not be sacrificed in order to gain the maximum 'efficiencies' that technology may be able to achieve."[33] He concludes by recommending that the law guarantee all consumers several basic minimum rights regardless of the payment mechanism or system used.

The last two articles in the Symposium focus on the financial institutions that process payments. With respect to most payment mechanisms, statutory or regulatory law provides the default rules governing the relative rights of these financial institutions; private agreements serve to supplement and vary these default rules. With respect to some

29. Norman I. Silber, *Late Charges, Regular Billing, and Reasonable Consumers: A Rationale for a Late Payment Act*, 83 CHI.-KENT L. REV. 855 (2008).

30. *See, e.g.*, U.C.C. § 4–103(a) (2005).

31. Peter A. Alces & Jason M. Hopkins, *Carrying a Good Joke Too Far*, 83 CHI.-KENT L. REV. 879 (2008).

32. Mark E. Budnitz, Commentary, *Technology as the Driver of Payment System Rules: Will Consumers Be Provided Seatbelts and Air Bags?*, 83 CHI.-KENT L. REV. 909 (2008).

33. *Id.* at 911.

payment systems, however, private agreements, often sponsored by payment organizations such as ECCHO and NACHA, are the primary source of the rights of financial institutions among themselves. In their contribution to this Symposium, Robert Ballen and Thomas Fox argue that "private sector payment organizations should continue to play the primary role in establishing rights and responsibilities for payment transactions between their participating financial institutions, provided that their rules are consistent with customer protections established by federal and state governmental authorities for the customer-financial institution relationship."[34] Reform of the law governing payment systems should be commenced only as a last resort—when the objective cannot be reached through private sector rules or changes to consumer regulations—and only when there is general consensus among the participants in the payment system as to the scope and application of the proposed legislation. In their view, any legislative effort to unify current payments law fails both tests.

Ronald Mann suggests that one might have more confidence that rules developed in the market provide satisfactory answers to payment-system problems if competition among financial institutions were greater and barriers to entry lower.[35] He argues that "a revision of the regulatory framework designed to foster competition and lower barriers to entry is a valuable part of an effort to design coherent rules," and that greater competition will foster innovation and a convergence that responds most effectively to the needs of commerce.[36]

The articles in this Symposium address a wide array of issues concerning payments law, including the extent to which society would benefit from the law becoming more uniform and the best way in which to create uniformity. I hope you find them valuable.

34. Ballen & Fox, *supra* note 25, at 937.
35. Ronald J. Mann, *A Requiem for Sam's Bank*, 83 CHI.-KENT L. REV. 953 (2008).
36. *Id.* at 972.

APPENDIX

A PROPOSAL FOR CONSIDERATION OF A UNIFIED PAYMENTS LAW

STEPHANIE HELLER*

I. BACKGROUND

For around one hundred years, the payment system in the United States was static. It had three significant components: currency, negotiable instruments, and the operationally important but then obscure wire transfer system (telegraph). But the past fifty years has been amazingly innovative: the microline adjunct to the check system in the 1950s, the introduction of credit cards in the 1960s, the automated clearing house networks in the 1970s, automated teller machine and debit cards in the 1980s, and just about everything the imagination could gin up beginning in the 1990s. As a result, the current payment system is not really a system at all, but rather a collection of different systems that are increasingly interconnected.

The legal rules for each payment system have not been adapted to the current multiplication of payment devices resulting in increasingly arbitrary legal rules. The law of checks is still locked into nineteenth-century concepts such as negotiability. The law of currency has been a quaint relic since the United States went off the gold standard in 1934. Wire transfers, it is true, are governed by a modern statute: U.C.C. Article 4A. But the last half-century of innovation is governed by a hodgepodge of consumer protection statutes, bilateral contracts, and system rules. As a result, payment law ranges from detailed statutory rules (check collection), to unfettered contracting (wholesale debit transfers) to a hybrid approach of system rules and statutory consumer protections.

The different approaches to payments law can be explained in part by the point in time when the particular payment system in ques-

* Counsel and Vice President, Federal Reserve Bank of New York. This Proposal was made to The American Law Institute on September 16, 2005. No substantive changes have been made; the Proposal has been edited slightly for inclusion herein. The views expressed in this Proposal are those of the author and do not necessarily reflect the views of the Federal Reserve Bank of New York or any other component of the Federal Reserve System.

tion was introduced and in part by the relative importance (or lack of importance) of the transfer mechanism. So, for example, debit transfers are not commonly used for business-to-business payments, which may explain the absence of a statutory law in this area. The question arises, however, as to whether this disparity best serves the interests of the users of these payment instruments and the providers of payment services. I believe the answer to this question is clearly no.

Convergence of payment processing methodology over the past decade without changing the legal rules to account for that convergence has led to a lack of transparency to all users of the payment mechanisms, which in turn has created inefficient markets for processing those mechanisms at the lowest cost. The increasing reliance on "private" rules created by agreement instead of "public" rules created in a more open process has and will continue to lead to the absence of representation of the interests of many of the users of the payment system (consumer and business) and to an unbalanced allocation of risk. Finally, the increasing use of nonbank payment intermediaries coupled with the uneven regulatory treatment of payment intermediaries in regard to allocation of risk in the processing of payments may be creating unacceptable systemic risk to the soundness and reliability of the various payment mechanisms.

Given this backdrop, I suggest that society would be best served by a unified payments code that sets forth a coherent and principled payments law that recognizes differences in payment types where appropriate and harmonizes disparities that have arisen over time but can no longer be justified. I respectfully submit that The American Law Institute (ALI) is uniquely suited to lead an effort to consider the desirability for such a unified payments law and request that the ALI consider sponsoring this project.

II. THE TAXONOMY OF PAYMENTS

Payment systems can be used to make *credit transfers*, *debit transfers*, or both. A credit transfer is one in which the instruction to pay is given by the person making the payment. A debit transfer is one in which the instruction to pay is given by the person being paid. (The line between the two may be blurry at times, as with point-of-sale systems that involve a payor swiping a debit card in a payee's card reader.) Credit and debit transfers can be used to make *wholesale payments* (i.e., a payment that does not involve a consumer) or *retail payments* (i.e., a transfer involving at least one consumer). Under current payments law there is no distinction between a payment involving a sophisticated corporate customer and one involving a mom and pop business—all nonconsumer payments are wholesale.

A. Wholesale Transfer Systems

The laws that govern wholesale transfers primarily vary depending on whether the transfers are credit transfer or debit transfers. There are two major competing systems for large dollar wholesale credit transfers: the Fedwire® Funds Service (which is owned and operated by the Federal Reserve Banks), and the Clearing House Interbank Payments System (CHIPS), (which is owned and operated by the Clearing House Payments Company, L.L.C.). Payments over these systems are generally governed by Article 4A of the U.C.C. (Fedwire is governed by Regulation J of the Board of Governors of the Federal Reserve System under 12 C.F.R. Part 210, Subpart B. However, Regulation J incorporates Article 4A as federal law). Both of these systems have issued system rules that mostly govern the details of how settlement between the system's members is achieved and largely leave the Article 4A default rules intact.

FedACH (the automated clearing house (ACH) network owned and operated by the Federal Reserve Banks) and the Electronic Payments Network (EPN, the automated clearinghouse network owned and operated by the Clearing House Payments Company, L.L.C.) can also be used for wholesale credit transfers, especially low to medium-value transfers. Wholesale credit transfers made over these systems are governed by Article 4A as amended by the ACH operating rules. Finally, Article 4A also governs wholesale credit transfers that take place outside of these systems, for example through correspondent banking relationships, provided that the transfer is accomplished through the use of banks.

In contrast to wholesale credit funds transfers, there is currently no codified state or federal law that governs wholesale debit funds transfers. Wholesale debit transfers over FedACH and EPN are governed exclusively by ACH system rules and bilateral contracts. Wholesale debit transfers through correspondent banking channels would be governed by bilateral agreements.

Wholesale check transactions (which can be thought of as debit transfers), on the other hand, are governed by a robust set of statutes

® Fedwire is a registered service mark of the Federal Reserve Banks.

and regulations; namely Articles 3 and 4 of the U.C.C., the Expedited Funds Availability Act (EFAA), the Check Clearing for the 21st Century Act (Check 21), and Regulations J (if collected through the Reserve Banks) and CC of the Board of Governors of the Federal Reserve System (12 C.F.R. Part 229).

Wholesale credit card (including purchasing card), debit card, and automated teller machine (ATM) transactions, on the other hand, are governed by the various private card network rules and card issuer contracts.

B. Retail Transfer Systems

Largely because of consumer protection statutes and the inability of consumers to demand the right to use credit transfers (as opposed to debit transfers) as a primary payment method, a discussion of governing law is somewhat more complicated in the world of retail payments. First and foremost electronic funds transfers (EFTs) that authorize a financial institution to debit or credit a consumer account (defined as a demand deposit, savings, or other consumer asset account) are governed by the Electronic Fund Transfer Act (EFT) and Regulation E. The term EFT includes but is not limited to debit card transactions, ATM transactions, and check-to-ACH conversions. EFTs accomplished over networks (ACH network, ATM network, debit card network) are also governed by the network's rules (for example the ACH operating rules) and bilateral agreements.

EFT is defined to exclude any transfer of funds originated by check or any payment made by check at an electronic terminal. Instead, U.C.C. Articles 3 and 4, the EFAA, Check 21, and Regulations J (if collected through the Reserve Banks) and CC apply to check transactions. These check laws also govern transactions where checks are collected electronically through electronic check presentment agreements and where returned checks are "represented" through the ACH network as a returned check entry.

For consumer credit card transactions, in addition to the system rules and issuer contracts, the Truth in Lending Act and Regulation Z of the Board of Governors of the Federal Reserve System will apply.

Then there are all of the emerging payment products. While most of these payment systems are consumer systems, at least one (and perhaps the most successful one), PayPal, can be used for business-to-business transfers as well. The law governing emerging payment systems, which include prepaid single purpose or multipurpose cards, payroll cards, stored-value cards, gift cards, online micro payment services, wireless systems (such as Cingular DirectBill), and contactless products (such as Mobil Speedpass), is far from clear. Until recently, many assumed that the only law that would apply to these products was EFTA and Regulation E and only to the extent that consumers were involved. This assumption played out in many of the system contracts, which often took verbatim the safe harbor language in Regulation E. However, recent proposed rule-makings by the Board of Governors reveal that even the application of the EFTA and Regulation E is uncertain.

III. A CHALLENGE TO BE ANSWERED

In the early 1980s in light of a perceived need for harmonization across payment systems and products, NCCUSL and the ALI, through the Permanent Editorial Board of the U.C.C., attempted to draft a set of rules to govern the operation of all payment systems except cash—the New Payments Code. Work on the New Payments Code quickly became controversial, resulting in a debate between those who believed that a comprehensive code might be necessary to eliminate artificial, legally imposed advantages of one payment system over another and those who felt that it is inappropriate to force essentially disparate systems under the umbrella of one comprehensive code. Ultimately those who opposed the New Payments Code persuaded the majority that: (1) while the issues that had to be addressed are very similar, each system works very differently and the law should reflect those differences, (2) there were no practical problems that justified the undertaking, and (3) development was still progressing in the various systems and premature rulemaking might arrest or artificially channel that development or alternatively cause a need to revise the statute shortly after its initial promulgation.

I believe that today's payment environment has sufficiently and significantly changed from the payments environment of the 1980s so as to warrant a re-examination of the need for a unified payments law covering both retail and wholesale payments and both debit and credit transfers for payment systems that rely on intermediaries (as opposed to direct payment systems, such as currency or some of the proposed person-to-person stored-value products).

It would be disingenuous not to acknowledge up front that many of the arguments made in the early 1980s against this type of initiative are arguments that the banking industry in particular is quick to raise even today. But there are several things that have changed or are likely to change in the near term that might justify the proposed exercise. What follows is a brief description of some of these environmental changes.

A. The Retail-Wholesale Distinction

Payment systems were never strictly wholesale or strictly retail; checks always straddled the divide. This distinction only became useful with the onset of consumer legislation in the 1960s. It is less useful today. We increasingly see consumer payments going over systems such as Fedwire and CHIPS and wholesale payments going over ACH. For example, the Federal Reserve Bank of New York did a survey of Fedwire data in 2002 and discovered that consumers originate approximately 15% of all Fedwire transfers and are the beneficiaries of approximately 20% of all Fedwire transfers. According to the Federal Reserve 2004 Electronic Payments Study, business-to-business transactions represented 16.5% of the *volume* of ACH transactions but 71.7% of the *value* of ACH transactions in 2003.

Under current law, the increasing number of consumer transfers over Fedwire and similar wholesale systems has legal significance. Because the drafters of Article 4A believed that covering consumer transactions would inhibit the Article's enactment, they excluded any transfer involving a consumer account to which the EFTA applies. If the EFTA applies to a funds transfer to which Article 4A otherwise would apply, the entire transfer is outside of the scope of Article 4A. Thus, Article 4A and the EFTA are mutually exclusive.

As noted above, the EFTA and Regulation E apply generally to any electronic fund transfer that authorizes a financial institution to debit or credit a consumer's account. The EFTA and Regulation E, however, both exclude from their coverage "[a]ny transfer of funds through Fedwire or through a similar wire transfer system that is used primarily for transfers between financial institutions or between businesses." This means that if a consumer payment is made directly over Fedwire, the consumer is not afforded the consumer protections in the EFTA. If, however, the same payment is made over an ACH network, the consumer is entitled to all of the EFTA rights. I suspect that when these laws were drafted, this disparity was of little concern as there was a sense that "wholesale" systems were not used to make retail payments or that at the very least retail payments were an oddity on these systems. This assumption is no longer valid.

The EFTA exclusion also implies that if and when a majority of transfers over "wholesale" systems shifts to being retail in nature, the exclusion will no longer apply and the EFTA (as opposed to Article 4A) will apply to consumer payments made over "wholesale" systems. The reverse is also true. As we see "retail" payment systems such as ACH shift to being business-to-business payment systems, the consumer payments made over these systems could lose the protections of the EFTA. I believe this is wholly contrary to public policy.

The dichotomy between wholesale and retail payments also came with a belief that wholesale payment systems support large dollar time critical payments and, as a result, the rules that govern those systems had to satisfy different needs than those governing the low value retail systems. What we see today, however, is that approximately half of the payments made over the Fedwire system are valued at less than $20,000. Anecdotal evidence suggests a similar trend in CHIPS. On the other hand, payments over the ACH networks can be extremely large in value with the only limit being the limitation in the size of the dollar amount field in an ACH message. Currently ACH messages sent over FedACH can be as large as $99,999,999.99.

B. Payment Processing Convergence

Another "fact" that may no longer carry the same weight as it did in the 1980s is that payment processing occurs in silos—the check business is wholly separate from the ACH business, which is wholly separate from the debit card business, and so on. Over the last decade we have seen a significant convergence in check and ACH processing. The first change was the overwhelmingly successful introduction of one-time consumer ACH debit items—generally referred to in this paper as check conversion. An ACH check conversion is an ACH debit to a consumer's checking account initiated at the POP (point-of-purchase), over the Internet, by telephone, or via bill remittance (lockbox). It also includes paper *checks* that were presented a second time through the ACH network (after being returned for not-sufficient funds, or NSF). In the second quarter of 2005 there were 383,642,279 one-time ACH debit transactions related to lockbox, 41,897,563 one-time ACH debit transactions at the point of sale, 57,245,265 one-time ACH debits initiated by telephone, and 236,020,723 one-time ACH debit transactions initiated over the Internet. These numbers reflect an 83.72%, 0.38%, 25.27%, and 38.44% respective increase since the second quarter of 2004.

Check conversion transactions by definition involve the use of a paper check although, with the exception of represented check entries, the paper check is serving as a source document for initiating an ACH debit transfer and is not intended to be used as a payment instrument. ACH check conversions are the ACH industry's attempt to move traditional check payments to the ACH networks. The point of purchase and lockbox conversions replace the use of checks at the point of purchase (like supermarkets) and as a method for paying bills. The Internet and telephone initiated check conversions replace what is commonly referred to as "demand drafts"—paper checks created by the payee based on information supplied by the payor and "authorized" by phone or other means.

Despite some initial attempts to view ACH check conversions and paper checks as two separate universes, the reality is that ACH check conversions are not always successful. If the ACH check convergence is not successful for some reason (e.g., the consumer's bank does not participate in the ACH network or the check that was converted was not eligible to be converted), the merchant or merchant's bank will often initiate collection of the paper check through the check collection channel. In some instances this entails use of the original paper check and in others it involves the "creation" of the paper check from information stored in the merchant's or merchant's bank's data base. Currently neither check law nor ACH law adequately addresses the rights and obligations of banks that encounter this scenario, and as a result banks experience both operational and legal uncertainty.

The second area of convergence in processing between ACH and check payments involves the increased use of electronics in check processing. Since the 1990 revisions to Article 4, the U.C.C. (and Regulation CC for that matter) has authorized the use of electronic check presentment (ECP). ECP requires an agreement between the parties that exchange electronic data and the electronic data is treated as items for certain purposes under Article 4. With the introduction of Check 21, the banking industry is now looking to use electronics not only for presentment but for the entire check collection process.

Although the file formats are different, both electronic check collection and ACH transactions rely on the same set of electronic data—account numbers, bank routing numbers, and dollar amounts. They are both batch processing systems. And although with the advent of Check 21 processing a payor bank will have electronic information that would not be present in an ACH file (an image of the check), that information is not easily integrated into the actual check processing stream. What this suggests is that arguments against a unified payments code based on differences in payments processing may have less strength today than they did in the 1980s.

C. Payor's Ability To Know What Payment Rules Govern

A payee can always choose which payment instruments it is willing to accept. Until recently, the correlative proposition was also true: a payor would always control the means of payment it tendered. This second proposition is no longer true as a result of check conversion to ACH and the increased use of electronic bill payment. Merchants and other payees who have chosen to use check conversions to ACH at a lockbox routinely include language in their billing statements indicating that if a payor tenders a check, the check can be used as a source document for an ACH transaction, as a negotiable instrument to be collected through traditional check collection channels, or both. It is not until the payor receives an account statement that the payor knows which payment system was used and therefore what legal rights the payor has.

Similarly, with most bill payment services the user of the service agrees that the service provider (the entity initiating the payment on the payor's behalf) can make payment in one of several ways—through the issuance of a check drawn on the payor's account, through the initiation of an ACH debit or credit, or through the issuance of a check drawn on the service provider's account aggregating the payment obligations of multiple payors to a single payee. Again, the payor typically will not know (and may never know) how the payment was accomplished until the time that the payment is made.

The result is that in today's payment environment a consumer payor often will be unable to ascertain, let alone exercise, his or her legal rights in connection with payments that the payor makes. I say consumer payor because presently the ACH check conversion products are intended to be limited to checks drawn on consumer accounts and bill payment is primarily a consumer service. Anecdotal evidence reveals, however, that business checks are also being converted to ACH transactions despite being ineligible for conversion under the NACHA rules. Moreover, there is significant pressure by NACHA to expand the check conversion product to business checks as well.

The loss of the payor's ability to know how the payor is making a payment was not an issue in the 1980s. The existence of this problem today, however, certainly challenges the notion that disparities in the payments laws with respect to payor rights and obligations are acceptable.

D. Increasing Confusion and Legal and Regulatory Arbitrage

Current payment law allows users, especially payees, to choose the set of legal rules that the user believes is most advantageous. The various payment systems do not work that differently, in any fundamental sense. The different rules governing these systems are often arbitrary (try to explain to a consumer why he or she has different rights depending on whether the debit to his or her checking account was caused by a paper check, a substitute check, a check converted to an ACH, or an ACH debit unrelated to a check conversion). This is not in and of itself a bad thing as long as there is adequate transparency and choice in the payments market place and the disparate legal rules do not introduce an unacceptable level of risk to society overall.

Today there is a lack of transparency concerning payments law. The current legal environment is complex and confusing, not only for consumers, but for banks and businesses as well. This problem will likely only increase if regulatory treatment of similar transactions remains inconsistent and as the industry continues to evolve and to create hybrid products that cross traditional boundaries.

This gives rise to a level of operational complexity at financial institutions that could add unnecessary costs to bank operations, either by requiring banks to implement significant customer service training programs and separate dispute resolution paths, or by having banks implement procedures and processes that satisfy a single standard that is most advantageous to its customers. A simple example of this dilemma is seen with dispute resolution procedures related to the EFTA and those related to Check 21—although similar, these two rules contain different timeframes for timely submissions of recredit requests and the timing of recredits.

There is also regulatory arbitrage in the payments world. Payments intermediaries are sometimes highly regulated (banks) and sometimes not (PayPal). The varying level of regulation and oversight should in theory be directly related to the risk of intermediary failure and interruption in the payment clearance and settlement process. As we see the profile of the use of various payment systems converge, the need for a more unified approach to addressing the risk posed to system users by intermediaries becomes clear.

E. Governance Questions

Currently, negotiable instruments and check collection are governed by a highly detailed set of statutory and regulatory rules the development of which are subject to a robust public debate (the U.C.C. drafting process, Federal Register notices, congressional hearings and the like). ACH payments, on the other hand, are supported almost entirely through system rules promulgated by an association of banks with a fairly opaque rulemaking process. The potential inequities of the ACH rulemaking process in part gave rise to the enactment of the consumer protection in the EFTA.

The introduction of Check 21 marks a pivotal moment in the law of negotiable instruments and check collection because of what Check 21 does not do. Check 21 does not establish a set of detailed rules to govern the transmission, collection, and presentment of electronic check information—despite the fact that the creation and transmission of such electronic information is presumed by Check 21. Instead, the rules governing electronic check exchange are left completely to private contracts or system rules. Currently, these rules are being developed by the Reserve Banks for exchange of electronic items with their customers, check clearing houses (relying mostly on a set of rules developed by ECCHO), and bilateral arrangements.

It is clear from the data that the use of paper checks is declining significantly. If the check is to survive as a payment instrument, most in the banking industry agree that it will require check collection (at least among banks) to become wholly electronic. In essence, the banking industry is looking to create a new electronic batch debit transfer system that will compete with the ACH networks. Absent some change in the law, Article 4 of the U.C.C. and most of Regulation CC will become irrelevant as check collection moves to electronics, and the application of Article 3 will become increasingly strained. At the same time, the need for a uniform rule set to govern electronic check exchange will increase as more and more banks want to engage in this business. In the absence of legislation addressing electronic check collection, we are likely to see one of the current rule sets emerging as the winner. In fact, ECCHO is already touting itself in the payments press as the next NACHA. As system rules take the place of carefully crafted statutory rules in the check area, we cannot take comfort in the safety net of the EFTA or Check 21 for consumer protections, as neither will apply. In this way, Check 21 is really an interim law.

The current situation with check law is fundamentally different from what existed in the 1980s. In the 1980s it was beyond the realm of possibilities that what we know as traditional check law (the U.C.C. and Regulation CC) would lose all relevance and be replaced by a banking association's system rules. Instead, the 1980 proposal would have replaced one payments code (U.C.C. Articles 3 and 4) with another payments code. Today the question is whether any payments code will survive in the check world absent affirmative action.

Many more financial institutions are involved in check collection than in the processing of ACH transactions. The difference in number is even greater if you think about the number of banks involved in ACH transactions when the ACH system and the NACHA framework were put in place. It may well be that the banking industry would not uniformly welcome the introduction of a NACHA-type legal regime for check collection. Moreover, as the ACH networks expand to include more and more institutions and affect an ever increasing class of one-time payments (now consumer debits, but soon perhaps business debits) the rule making process for ACH may rightly be questioned.

IV. POSSIBLE SCOPE OF THE PROJECT

For all of the reasons set forth above, I believe a unified payments law is ripe for consideration. It is impossible to lay down the scope of any project before a study has commenced, but there must be some tentative scope in order to provide sufficient guidance as to what this project might entail.

One possibility would be to look at this issue in two chunks: rules that govern interbank payments, and rules that govern consumer (or customer) rights. At first blush, the consumer rights part seems like the most logical candidate for a new law that rationalizes and makes consistent all the consumer disclosure, error resolution, and other protections. Theoretically, this can be done without changing the current mish-mash of interbank rules. And the arguments made against the last unified payment code effort are arguably stronger when applied to an inter-bank payments code than they are to a universal consumer (or perhaps a broader concept of "customer") payments code. I do not recommend this approach as I believe that focusing on end-user rules without considering the impact on the interbank rules could lead to unintended costs and disruptions in the interbank payment systems and will not address the current disparity in treatment of intermediaries across payment systems.

Another approach would be to develop basic principles that would apply to all payment systems and payment system users with the possibility of tailoring certain of the rules where important differences exist. At a minimum, this rule set would need to address risk allocation for errors and wrong-doings (unauthorized payments, intermediary failure, errors in processing, interloper interference, and the payor's need to stop payment), payment finality and dispute resolution, enforcement of obligations to pay when a payment fails to be cleared in the system, security and privacy of system users, national security concerns, transparency of legal rights and obligations, and antitrust or anticompetitive concerns.

V. WHY THE ALI?

The need for uniformity in payments law across state lines is uncontroversial. In the past, the state uniform law process has been extremely successful in satisfying this need. However, recent efforts to make even the most modest changes to payments law through the state uniform law process have faced significant obstacles. Many believe that if changes are needed in the current legal regime for payments the only way to achieve the desired uniformity is through federal legislation.

At the same time there is a general view that those charged with enacting federal laws, lacking both the expertise and perhaps the drafting precision that would be needed, are not best suited to drafting a federal payments law. In the past, Congress has looked to the Board of Governors of the Federal Reserve System to help craft payments law. There are differing views as to the success of this approach.

If the ALI were to entertain this project the initial phase would be one of exploration, but ultimately, if it is determined that there is a need for a new uniform law of payments, the ALI may be best suited to draft proposed federal legislation or at least to set forth the principles for such legislation. The ALI has a robust process in place for drafting legal doctrine, enjoys high credibility and reputation for nonpartisan analysis, and has a history of success in its law-reform projects. And its members—individuals who are professionally recognized and have a record of outstanding achievement—have joined the ALI in order to promote the clarification and simplification of the law and its better adaptation to social needs, to secure the better administration of justice, and to encourage and carry on scholarly and scientific legal work.