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Recent International Developments in the Law of Negotiable Instruments and Payment and Settlement Systems

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Recent International Developments in the Law of Negotiable Instruments and Payment and Settlement Systems

BENJAMIN GEVA*

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I. OVERVIEW

This paper surveys four recent major developments worldwide in the areas of negotiable instruments and payment and settlement systems. Only private or

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commercial law aspects are considered; regulatory and public law issues are outside the scope of the present discussion. Topics covered are checks, payment cards, securities transfers, and payment transactions. A common theme is the adaptation by statute of the law to the world of electronic banking as it keeps evolving.

The first development, outlined in Part II, is concerned with the ongoing transformation of the check payment into an electronic funds transfer. The check has been characterized as the paper-based payment system par excellence. Recently, this view has been eroded in several ways. Principal developments outlined in this paper consist of the "electronic check" in the United States; the remotely created check in the United States and Canada; electronic presentment in the United States, UK, recent law reform in Sri Lanka and a proposal in Canada; and "electronic negotiation" under "Check 21 Act" in the United States. A procedure in which the physical movement of checks is curtailed or eliminated, being replaced, in whole or in part, by electronic transmission of information is called "check truncation." To a large extent, check truncation reflects a partial conversion of the check collection process to an electronic funds transfer.

The second development, covered by Part III, is the evolving legal framework applicable to payment cards. A fundamental distinction has been known to exist between access and stored-value payment cards. The recent emergence in the United States of payroll, remittance and gift cards has required their classification in that framework. A recent amendment in the United States placed the payroll card under Regulation E governing access device. Yet earlier parameters established by the Federal Reserve Board, to which no reference was made in connection with the recent amendment, but which are followed in the literature and banking parlance, would have suggested the payroll card is a stored-value card. With the view of eliminating future confusion, Part III endeavors to reconstruct these earlier parameters, to clarify the distinction between access and stored-value cards, and thus to facilitate an appropriate framework for future developments. Specifically, Part III is designed to justify the treatment of the payroll card as an access device as conceptually sound.

The third development, outlined in Part IV, is the acceleration in the modernization of the law of securities transfers. Recent Canadian legislation modeled on Article 8 of the American Uniform Commercial Code, passed in May 2006, provides for a comprehensive framework dealing with all modes of securities holdings and transfers. Particularly, it covers the indirect-tier holding, namely, the transfer and pledge of "security entitlements" credited and debited to "securities accounts" maintained with "securities intermediaries" such as brokerage firms which in turn maintain securities accounts with a Central Depository of Securities (CDS).

The fourth development, outlined in Part V, is the European march towards a Pan-European common payment law. With the view of creating a Single Payment Market where improved economies of scale and competition would help to reduce cost of the payment system, the Commission of the European Communities proposed in December 2005 to establish a common framework for the Community payments market creating the conditions for integration and rationalisation of national payment systems. Focusing on electronic payments, the Commission made a proposal for a Directive on payment services in the internal market, designed to provide for a harmonised legal framework. Intended to leave maximum room for self-regulation of industry, the Proposed Directive purports to harmonise only what is necessary to overcome legal barriers to a Single Euro Payment Area (SEPA).

II. THE CHECK PAYMENT AS AN ELECTRONIC FUNDS TRANSFER¹

A. Introduction

By its nature, a check is an order to pay given by a customer to a bank with which the customer maintains an account. It is a paper instrument, embodying an unconditional order in writing, signed by a drawer, instructing a drawee bank to make payment to or to the order of a designated payee, or to the bearer.² The person to whom a check is payable and who is in possession of the check is its holder.³ A check is issued when the drawer delivers it to the first holder.⁴ Once issued, a check may circulate from hand to hand, namely be negotiated, by delivery from one holder to another; in the case of a check payable to order, negotiation consists of delivery accompanied by the signature of the holder, called “indorsement.”⁵ To obtain payment, the last holder is to have the check physically presented to the drawee bank.⁶

Typically, a holder will not present the check to the drawee bank in person. Rather, the holder is likely to have the check deposited with and collected by a depositary bank, with which the holder maintains an account. The depositary bank will then either present the check directly to the drawee bank, or negotiate it to an intermediary bank. There may be one or more negotiations to one or more intermediary banks. The last intermediary bank will present the check for payment to the drawee. In that process, all banks other than the drawee, namely the depositary bank and each intermediary bank, are collecting banks, the drawee bank is the payor bank, and the collecting bank that presents the check for payment to the drawee bank is the presenting bank.⁷

The normal process thus entails a series of physical deliveries of the piece of paper embodying the check. First, the check is physically issued by the drawer to the first holder. Second, there may be one or more physical negotiations outside the banking system. Third, there is the physical delivery of the check by the holder to the depositary bank. Fourth, there may be one or more deliveries of the check to intermediary bank(s). Fifth, the process concludes with a physical presentment of the check to the drawee. Following payment, there is possibly a sixth and post-concluding stage, in which the cancelled check is delivered by the payor bank to the drawer, together with the periodic statement containing it. Conversely, where the drawee dishonors the check, the check is returned in a reversed itinerary.

1. See generally BENJAMIN GEVA, *THE LAW OF ELECTRONIC FUNDS TRANSFERS* § 1.07 (1992-2006) [hereinafter GEVA, *LAW OF EFT*].

2. U.C.C. § 3-104(f) (2006); Bills of Exchange Act, R.S.C., ch. B-4, §§ 165(1), 17(1) (1985) (Can.). Canadian Bills of Exchange Act provisions cited in footnotes 2-6 and 12 have parallels in all statutes modeled on the England's Bills of Exchange Act. Bills of Exchange Act, 1882, 45 & 46 Vict., c. 61 (Eng.).

3. U.C.C. § 1-201(b)(21)(B); Bills of Exchange Act, R.S.C., ch. B-4, § 2.

4. U.C.C. § 3-105; Bills of Exchange Act, R.S.C., ch. B-4, § 2.

5. U.C.C. §§ 3-201, -204; Bills of Exchange Act, R.S.C., ch. B-4, §§ 2, 59 (substituting “endorsement” for “indorsement”).

6. A point implied, though not specifically provided for, in the U.C.C., speaking of the exhibition of the check to, and its handling by, the drawee. U.C.C. § 3-501(b)(2). However, the Bills of Exchange Act is straightforward on this point. Bills of Exchange Act, R.S.C., ch. B-4, § 84(3).

7. See U.C.C. §§ 4-104 to -105 (providing applicable definitions).

Modern law facilitates variations by agreement; as may be necessary it may further provide for the position of third parties under the law of checks where such variations have been agreed. First, a check may be given as a source of information to be used to initiate a one-time electronic fund transfer, in which case it is often described as an “electronic check.” Second, a check may be remotely created. Third, a check may be negotiated to a collecting bank, whether by its customer the holder, or another collecting bank, by means of electronic transmission. Fourth, a check may be presented for payment electronically. At the same time, no practice of electronic negotiation to non-banks has developed so that no provision for such electronic transmission has been made.

As a source of information, a check may be given to the payee with the authority to convert it to an electronic image. A remotely created check is drawn by the payee, as an agent of the drawer, on the basis of information provided by the drawer to the payee, typically, over the telephone. Both electronic negotiation and presentment consist of the transmission of an electronic image instead of the physical transfer of the paper check. In the United States, inter-bank transmission of check images takes place over dedicated telecommunication channels, provided by both Federal Reserve Banks,⁸ and the private sector.⁹

All four procedures involve check truncation, namely a procedure in which the “physical movement of [checks] is curtailed or eliminated, being replaced, in whole or in part, by electronic [transmission of information].”¹⁰ Inasmuch as it constitutes the transmission of payment information other than by the delivery of paper check, each of the four procedures results in an electronic funds transfer for the pertinent stage of the check transaction. The ensuing discussion will outline proposed and existing legislative and regulatory frameworks to govern all four procedures. It will commence with the “electronic check,” discuss the remotely created check, move on to the electronic presentment, and conclude with the electronic negotiation, the latter being the most elaborate scheme.

To a large extent, these variations reflect a partial conversion of the check collection process to an electronic funds transfer. To that end, one may roughly describe the process as a whole as the “dematerialization” of the check, or perhaps better, as its immobilization,¹¹ namely the substitution of any stage in its physical transfer, by the transmission of its information or electronic image. By analogy then,

8. See FEDERAL RESERVE BANKS, GUIDE TO CONNECTIVITY OPTIONS FOR FEDFORWARD^{RM}, FEDRETURN^{RM}, AND FEDRECEIPT^{RM} SERVICES (VERSION 2) (2005), available at <http://www.frbsservices.org/Retail/pdf/C21ConnectivityGuide.pdf>.

9. A major player is SVPCO, which is the Check and Electronic Clearing Service of The Clearing House Payments Company. SVPCO, About Us, <http://www.svpco.com/about/000162f.php> (last visited May 10, 2007). The service covers electronic check presentment and check imaging. *Id.* Its “SVPCO Image Payments Network is an industry utility for all financial institutions [which] lets each participant transmit images directly to other participants.” SVPCO Image Payments Network, http://www.svpco.com/payment_services/check_image_exchange/000093.php (last visited May 10, 2007). “SVPCO Image Payments Network facilitates “peer-to-peer” exchanges without going through a central processing facility.” *Id.*

10. COMM. ON PAYMENT & SETTLEMENT SYS., BANK FOR INT’L SETTLEMENTS, A GLOSSARY OF TERMS USED IN PAYMENTS AND SETTLEMENT SYSTEMS 50 (2003), available at <http://www.bis.org/publ/cps00b.pdf> (stating one example of the definition of “truncation”).

11. These are terms borrowed from the law of securities transfers, which is discussed in Part III of this Paper. For the use of “dematerialization” in the present context, I am obliged to Bradley Crawford. My own preference to “immobilization” stems from the fact that as in the immobilization of securities, the process involves the conversion and not elimination of paper.

the entire transformation of the paper-based payment system into an electronic funds transfer may be viewed as the “decertification” of the check. In the process, the law of checks is being transformed into the law of electronic funds transfers. The ensuing discussion covers developments in the legal framework for each of the four variations outlined above; it does not go as far as to introduce an overall theory encompassing the entire transformation process.

B. The “Electronic Check”: Check as an EFT Authorization

On occasion, a check may not be “issued” so as to give the payee rights thereon to enforce payment in discharge of the underlying obligation;¹² rather, contrary to the usual presumption of conditional payment by check,¹³ a check may be given to the payee merely as a source of information to be used to initiate a one-time electronic fund transfer from the drawer’s account in payment of the obligation. The check is then used as a source document to collect the drawer’s routing number, account number, check’s serial number and the sum payable. In effect, the check is thus converted to a single debit entry which is then input to the ACH (Automated Clearing House) Network. This arrangement is particularly common in consumer transactions. Where the check is mailed to the payee-merchant, the check is converted to an ARC—Accounts Receivables Entry. Where the check is given to the payee-merchant in a face-to-face transaction the check is converted to a POP—Point-of-Purchase Entry. Once converted, the check itself is voided; in a face-to-face transaction it is typically returned to the consumer-drawer.¹⁴

The electronic image created by the merchant, usually at the point-of-sale, is often colloquially referred to as an “electronic check.” In fact this is a misnomer; what is generated on the basis of the information derived from the check is not a “check” but rather an ACH debit entry. Payment is then not governed by UCC Articles 3 and 4, but rather is brought into the ambit of Regulation E, issued by the Federal Reserve Board, governing consumer electronic fund transfers.¹⁵ Regulation E requires the merchant to “provide a notice that the transaction will or may be processed as an electronic fund transfer, and obtain a consumer’s authorization for each transfer.”¹⁶

12. See U.C.C. § 3-105(a) (2006) (defining “Issue” as “the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.”); Bills of Exchange Act, R.S.C., ch. B-4, § 2 (1985) (Can.) (to a similar effect, defining “issue” as the first delivery to a holder).

13. See U.C.C. § 3-310(b) (stating the presumption which states that “[u]nless otherwise agreed . . . if . . . an uncertified check is taken for an obligation, the obligation is suspended . . . until dishonor of the check or until [the check] is paid or certified.”); *In re Charge Card Services Ltd.*, [1988] 3 W.L.R. 764 (CA) (Eng.) (discussing the conditional payment presumption in the common law).

14. See NACHA, *ACH Operating Rules*, §§ 3.7-3.8 (2007). For bulk electronic payments processed through the ACH (Automated Clearing House) Network and for NACHA (National Automated Clearing House Association), as well as for NACHA Operating Rules and Guidelines, see GEVA, *LAW OF EFT*, *supra* note 1, ch. 5.

15. Regulation E excludes from the term “electronic fund transfers” “[a]ny transfer of funds originated by check . . .” 12 C.F.R. § 205.3(c)(1) (2006). However, the theory of the check conversion is that the transfer is initiated by the converted debit entry, rather than the check, that has been used as a mere source of information. *Id.* § 205.3(b)(2).

16. *Id.* § 205.3(b)(2) (codifying 71 Fed. Reg. 1638 (Jan. 10, 2006)). Briefly stated, the underlying

It should, however, be pointed out that in principle there is nothing to preclude the issue of a paper check by a drawer-buyer of goods or services in payment or discharge of the obligation to the payee-merchant¹⁷ and its subsequent electronic presentment to the drawee bank by the merchant through the depository bank. The banking operation involved may not be different than that of the current “electronic check” collection procedure as outlined above; and yet, it would be governed by the law of checks,¹⁸ in which case it is hard to rationalize any disclosure or authorization requirement as under Regulation E. Indeed, the check collection is a regular debit transfer; the “electronic check” collection scenario lends further support to the view that a separate law to govern check collection is outdated.

C. *A Remotely Created Check*

A remotely created check is typically generated when the drawer authorizes the payee to produce a check drawn on the drawer's account. The drawer does not sign the check, which generally bears either the drawer's printed or typed name or a statement as to the issue of the check under the drawer's authority. The check is deposited by the payee at a depository bank, under an agreement under which the payee warrants the drawer's authority. Authorization to the payee is typically given over the telephone; the remotely created check is thus a useful mechanism to make a one-shot “last minute” and yet a timely payment.

The issue or creation of the remotely created check is a matter between the drawer and the payee. Its deposit is a matter to be agreed between the payee and the depository bank. Obviously however, a customer will not authorize the drawee to honor any remotely created check that merely purports to emanate under that customer's authority; the customer is not to be charged with checks not actually issued under that customer's authority. Yet, inasmuch as remotely created checks do not bear signatures or other ready means to verify authority, they are vulnerable to fraud. In the absence of specific protection measures discussed immediately below, a drawee bank that pays a remotely created check thus pays it at its peril, bearing the risk of unauthorized payment out of a customer's account.

Regulatory and legal response providing protection to the drawee bank against the fraud risk dramatically varies between Canada and the United States. In Canada, the Canadian Payments Association (CPA)¹⁹ prohibits the clearing of remotely created checks, or “tele-cheques” in the Canadian terminology.²⁰ In the

theory of the requirement is that conversion may change the consumer's position, insofar as payment is likely to be speedier and the cancelled check will not prove payment.

17. As will be the normal procedure. See *supra* note 13 and accompanying text.

18. See discussion *infra* Part II.D-E (electronic presentment and negotiation under the law of checks).

19. Canadian Payments Act, R.S.C., ch. C-21 (1985), amended by 2001 S.C., ch. 9 (Can.) (establishing the Canadian Payments Association (CPA)). The CPA's membership consists of financial institutions and is mandated to “establish and operate national systems for the clearing and settlement of payments and other arrangements for the making or exchange of payments . . .” *Id.* § 5(1)(a). Its Board may make rules “respecting payment items acceptable for exchange, clearing or settlement . . .” *Id.* § 19(1)(a). CPA Rule A1 identifies payment items that are eligible for clearing. CPA, *Rule A1-General Rules Pertaining to Items Acceptable for Exchange, for the Purpose of Clearing and Settlement* (2004), available at http://www.cdnpay.ca/rules/pdfs_rules/rule_a1.pdf.

20. In fact, there is no explicit prohibition in a specific Rule. Rather, it is the CPA's Policy Statement that effectively prohibits tele-cheques. CPA Policy Statement, *Prohibition of Tele-cheques in the Clearing & Settlement System* (June 3, 2003), available at <http://www.cdnpay.ca/news/tele.asp>. Rule A4 outlines the

absence of a pre-existing written and signed authorization by the drawer, fraud, due to the inability of the drawee bank to verify the authority of its customer, is cited as the “key risk associated with a tele-cheque.”²¹ In short, protection is afforded to the drawee bank in the form of a ban on the practice.

In contrast, the remotely created check is an accepted practice in the United States. To protect the payor bank from the fraud risk, and still facilitate the use of the remotely created check, that otherwise may have not been honored by that bank, both the UCC²² and Regulation CC²³ create transfer and presentment warranties. Thereunder, the depository bank warrants that the remotely created check, which it is transferring or presenting, is authorized by the person on whose account the check is drawn. Loss caused by a check issued without proper authority of the person on whose account the check purports to be drawn thus falls on the depository bank, which is the bank that dealt directly with the payee, who is the party that created the check.²⁴ It is then up to that bank to shift by contract the risk to its customer, the payee, from whom the bank accepted the check for collection.

D. *Electronic Presentment*

Electronic presentment is provided for by UCC Section 4-110. Thereunder, the presentment of a check may be made pursuant to an agreement for presentment. “Agreement for electronic presentment” could be in the form of an agreement, clearing-house rule, or Federal Reserve regulation or operating circular.²⁵ The agreement is to provide “that presentment . . . may be made by the transmission of an image of [a check] or information describing [it] . . . rather than delivery of the [check] itself.”²⁶ The transmission of the image or information constitutes a “presentment notice”; its receipt is the actual presentment. Other elements that may be covered by the agreement for electronic presentment are “procedures governing retention, . . . payment, dishonor and other matters”²⁷ Arguably, return

return time-frame for tele-cheques, which “may be returned for the reason ‘Not Eligible for Clearing’ up to and including 90 days after being received by the Drawee.” CPA, *Rule A4-Returned and Redirected Items* § 6(g) (2005), available at http://www.cdnpay.ca/rules/pdfs_rules/rule_a4.pdf.

21. CPA Policy Statement, *supra* note 20.

22. U.C.C. §§ 3-416(a)(6), 3-417(a)(4), 4-207(a)(6), 4-208(a)(4) (2006).

23. 12 C.F.R. §§ 229.2(ff), 229.34(d) (2006) (having consequential amendments in sections 210.5, 210.6, 210.9). Federal law purports to mirror the aforesaid U.C.C. provisions and is designed to rectify the lack of their universal adoption throughout the entire country.

24. See Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire and Availability of Funds and Collection of Checks, 70 Fed. Reg. 71,218 (Nov. 28, 2005) (codified at 12 CFR pts. 210 & 229; 70 Fed. Reg. 10,509 (March 4, 2005) (codified at 12 C.F.R. pts. 210 & 229); Federal Reserve Bank of New York, Request for Comment on Proposed Rule Governing Remotely Created Checks - Regulation CC, Circular No. 11688 (Mar. 8, 2005), available at <http://www.newyorkfed.org/banking/circulars/11688.html>.

25. See, e.g., Regulation J, 12 C.F.R. § 210.2 (defining “item” in section 210.2(i) to include “electronic item,” such as an “electronic image” of a check or any other paper item); see also Federal Reserve Bank, Operating Circular No. 3: Collection of Cash Items and Returned Checks § 5 & apps. E, E-E3 (July 1, 2004), available at <http://www.frb services.org/OperatingCirculars/pdf/Oc3.pdf> (stating that electronic access to Reserve Bank’s Services is governed by Section 5 and Appendices E (MICR Presentment Services), E1 (Truncation Service), E2 (MICR Presentment Plus Service), and E3 (Basic MICR Presentment Service)).

26. U.C.C. § 4-110.

27. *Id.*

procedures fall in the ambit of the agreement. An interbank voluntary agreement may be either bilateral or multilateral.²⁸ In any event, per the language quoted above, “agreement for electronic presentment” under Section 4-110 may for example be constituted by means of a regulation or a circular issued by the Federal Reserve and thus may not be entirely consensual; this is however in line with UCC Section 4-103(b) under which “Federal Reserve regulations and operating circulars, clearing-house rules, and the like have the effect of agreements . . . , whether or not specifically assented to by all parties interested in items handled.”²⁹

At the same time, the scheme that was introduced in England in 1996 appears to have stronger compulsory features. Under Section 74B of the Bills of Exchange Act,³⁰ “a banker may present a cheque for payment to the banker on whom it is drawn by notifying him of its essential features by electronic means or otherwise, instead of by presenting the cheque itself.”³¹ However, in the final analysis, the option is not entirely in the hands of the presenting bank:

if, before the close of business on the next business day following presentment of a cheque under this section, the banker on whom the cheque is drawn requests the banker by whom the cheque was presented to present the cheque itself—(a) the presentment under this section shall be disregarded, and (b) this section shall not apply in relation to the subsequent presentment of the cheque.³²

The obligations of a banker making and receiving an electronic presentment that has not been timely rejected are stated to “be subject to the same duties in relation to the collection and payment of the cheque as if the cheque itself had been presented for payment,” except that “[an electronic] presentment need not be made at the proper place or at a reasonable hour on a business day.”³³

Along similar lines, a more detailed scheme was recently adopted in Sri Lanka.³⁴ It goes further in containing the following elements. First, it specifically

28. One such multilateral agreement is under the rules of the check truncation program of NACHA for electronic images of truncated checks input to the ACH Network. Check truncated items input to the ACH Network are TRC/TRX entries referred to as a category of Payment Applications in NACHA Operating Guidelines (as well as in the ACH Primer preceding NACHA Operating Rules), and are governed by the NACHA Operating Rules. NACHA, *ACH Operating Rules*, *supra* note 14, § 1(2)(c); NACHA, *ACH Rules Primer*, § (c)(3); NACHA, *Operating Rules of the National Association for Check Safekeeping* art. 10 (2007). For bulk electronic payments processed through the ACH Network and for NACHA, as well as for NACHA Operating Rules and Guidelines, see GEVA, *LAW OF EFT*, *supra* note 1, ch. 5.

29. U.C.C. § 4-103(b).

30. Bills of Exchange Act, 1882, 45 & 46 Vict., c. 61, § 74B (Eng.); Deregulation (Bills of Exchange) Order, 1996, S.I. 1996/2993, art. 4(1).

31. Bills of Exchange Act, 1882, 45 & 46 Vict., c. 61, § 74B (Eng.). “Essential features” are defined to consist of “(a) the serial number of the cheque, (b) the code which identifies the banker on whom the cheque is drawn, (c) the account number of the drawer of the cheque, and (d) the amount of the cheque is entered by the drawer of the cheque.” *Id.* § 74B(6).

32. *Id.* § 74B(3).

33. *Id.* §§ 74B(2), (5) (as otherwise required under section 45(3)). Also, physical exhibition of the check, otherwise required for a lawful presentment under section 52(4), is dispensed with under section 74C. *Id.* §§ 52(4), 74C.

34. Payment and Settlement Systems Act, No. 28 of 2005, §§ 33-37 (Sri Lanka), available at http://www.cbsl.gov.lk/pics_n_docs/09_lr_docs/acts/Paymt_&_setmt_sys_act.pdf. Under section 36(3): “The provisions of [Part III] shall, in so far as it is possible be read and construed as one with the Bills of

requires the electronic presentment of the check to consist of the transmission of its “image . . . along with . . . stipulated electronic payment information”³⁵ Second, it limits the right to decline electronic presentment and request a physical one only in the case of technical failure.³⁶ Third, it provides for an “image return document,” stated to “be deemed to be the cheque to which it relates,”³⁷ to be returned to the presenting bank in the case of the dishonor of the check. Fourth, it provides for warranties and indemnities made by the banker making an electronic presentment as well as the banker issuing an image return document.³⁸ Finally, and subject to “rules, directions or instructions issued by the Central Bank,” the scheme authorizes its implementation by means of interbank agreements, “including those in the form of clearing house rules.”³⁹

Electronic check presentment is now on the legislative agenda in Canada. A proposal of the Canadian Payments Association (CPA)⁴⁰ to amend the Bills of Exchange Act⁴¹ follows the English precedent⁴² and further clarifies⁴³ that electronic

Exchange Ordinance (Chapter 82).” *Id.* § 36(3).

35. *Id.* § 33(1). In comparison, the English provision requires the notification of the essential features of the check “by electronic means or otherwise” Bills of Exchange Act, 1882, 45 & 46 Vict, c. 61, § 74B (Eng.). On this point, in Sri Lanka, similarly as in the UK, the stipulated information consists of the serial number of the check, the code identification of the presenting bank, the drawer’s account number, the amount of the check, as well as (in departure from the English provision) “any other matter as may from time to time be prescribed by regulation.” Payment and Settlement Systems Act, No. 28 of 2005, § 33(8) (Sri Lanka).

36. Payment and Settlement Systems Act, No. 28 of 2005, §§ 33(3), (5) (Sri Lanka).

37. *Id.* § 34(2).

38. *Id.* § 35. Briefly stated, the presenting banker’s warranties relate to the accuracy of the image and the information. *Id.* § 35(1). “He shall also indemnify the drawer against any loss incurred due to the [electronic] presentment” *Id.* Loss is likely to be rare, as for example where the original check, needed as a piece of evidence to establish forgery that cannot be proved otherwise, cannot be retrieved. The issuer of an image return document warrants the accuracy of the document “and shall also indemnify the drawer against any loss in the event of the cheque itself being paid or sued on.” *Id.* § 35(2). All warranties and indemnities are in favor of the drawee bank, its customer, the holder who delivered the check for collection, and any other endorser. *Id.* § 35(3). The person stated to be the drawer may recover directly from the drawee banker, who is then subrogated to the claim against the warrantor or the person liable on the indemnity obligation. *Id.* § 35(4).

39. Payment and Settlement Systems Act, No. 28 of 2005, § 37 (Sri Lanka). Unlike under the U.C.C., interbank agreements are stated to be “binding [only] between the parties thereto.” *Id.* Conversely, legal pronouncements issued by the Central Bank “are deemed to bind and benefit [all] parties liable on and entitled to enforce a cheque” *Id.*

40. See CPA, *Submission to the Department of Finance in Response to the Call for Comments on “An Effective and Efficient Legislative Framework for the Canadian Financial Services Sector”* (May 26, 2005) [hereinafter CPA, *Submission to the Department of Finance*], available at http://www.cdnpay.ca/publications/pdfs_publications/2006%20Financial%20Legislative%20Review.pdf.

For the CPA and its mandate, see *supra* note 19.

41. Bills of Exchange Act, R.S.C., ch. B-4 (1985) (Can.).

42. For an effective electronic presentment under proposed section 165.1(3),

“the essential features of a cheque must be transmitted in a form that is intelligible or easily decipherable by the drawee bank and, at a minimum, must identify the sum ordered to be paid, the serial number of the cheque, the account against which it is drawn, and the code or number that identifies the bank on the which the cheque is drawn.”

Canadian Bankers Ass’n., *The 2006 Financial Services Legislation Review: Improving the Legislative Framework for Canadian Consumers*, app. C (June 1, 2005), available at <http://www.cba.ca/en/content/general/050617%20-%20BankActsFINALbookmarked%20-%20mckj.pdf>.

conversion does not trigger statutory provisions dealing with lost⁴⁴ or intentionally cancelled instruments.⁴⁵ There is however no provision dealing with a “fallback” to physical presentment upon the failure of an electronic presentment or otherwise. An innovative aspect of the Canadian approach is the amendment of the standard definition of a check⁴⁶ to include

digital data and a display, printout, or other output of that data, provided the digital data, display, printout or other output was created by or from digital imaging of such bill by or on behalf of a bank by a computer system conforming to bylaws, rules or standards of the Canadian Payments Association or from the application of another technology or process conforming to bylaws, rules or standards of the Canadian Payments Association.⁴⁷

It is submitted that the expansion of the definition of “cheque” is an unsatisfactory aspect of the Canadian proposal. Certainly it is not necessary to attach to the data or its output all the attributes of a “cheque.” And, while the proposed definition is limited to data or output created “by or on behalf of a bank,” it is not limited to its transmission within the interbank check clearing system. A real statutory vacuum will thus be created for the transmission of the data or its output outside the interbank check clearing system.⁴⁸ Furthermore, within the interbank check clearing system, there is nothing to preclude the use of such data or its output not for presentment, but rather for negotiation, for which there is no provision in the proposal. The treatment of electronic negotiation in the United States, discussed immediately below, is an indication to the further detail and complexity required for a fair statutory treatment of electronic negotiation.

E. Electronic Negotiation

The most elaborate statutory and regulatory scheme is that in the United States covering the electronic negotiation to a collecting bank. The scheme is governed by the Check Clearing for the 21st Century Act (Check 21 Act)⁴⁹ and implemented by Regulation CC subpart D.⁵⁰ In essence, the Check 21 Act authorizes a collecting bank to create a substitute check, being a paper reproduction of the original check, for further negotiation or presentment. Upon compliance with specified requirements, the substitute check is to become “the legal equivalent of the original

Electronic presentment must be made under the proposal “in accordance with the by-laws, rules and standards of the Canadian Payments Association.” *Id.*

43. *See id.*

44. Bills of Exchange Act, R.S.C., ch. B-4, §§ 155-56.

45. *Id.* § 142.

46. Check is presently defined in the Bills of Exchange Act as “a bill [of exchange] drawn on a bank, payable on demand.” *Id.* § 165(1).

47. *See CPA, Submission to the Department of Finance, supra* note 42 (internal quotation marks omitted).

48. Nor can this vacuum be filled by CPA pronouncements. For the jurisdiction of the CPA, see *supra* note 19.

49. Check 21 Act, 12 U.S.C. §§ 5001-5018 (2004).

50. 12 C.F.R. § 229 (2006).

check for all purposes.”⁵¹ The Check 21 Act further includes warranty and indemnity provisions, as well as expedited re-credit procedures, designed to protect substitute check recipient.⁵²

In practice, the creation of a substitute check by a collecting bank is predicated upon the existence of two preconditions. First, the creating bank must have received the transmission of an image of the original check instead of the check itself. Second, to receive the substitute check the bank must have not agreed to accept electronic transmission of an image.

The sender of the transmission of the original check image could be either a customer, the payee-holder of the check, or a collecting bank. Either way, the creating bank is a collecting bank; it is the depository bank where the sender is the customer, and an intermediary bank where the sender is a prior collecting bank. On its part, the bank to receive the substitute check is typically a small bank that does not have the required processing equipment. It could be either a subsequent intermediary bank or the drawee bank.⁵³

Stated differently, the Check 21 Act does not require banks to accept electronic transmission of check information or image. Rather, it requires a collecting bank that agreed to accept the electronic transmission, whether from its customer or a prior collecting bank, to issue a substitute check, to be processed onward as if it were the original check. A bank, either a subsequent collecting/intermediary bank or the drawee bank, must accept the substitute check as the equivalent of the original check. By the same token, a customer who received original checks with the periodic statement cannot object to receiving substitute checks in lieu of original checks that have been so truncated in the collection process.⁵⁴

In practice, by truncating the paper check, the Check 21 Act eliminates long-distance transport of physical checks, though effectively it does not eliminate or bypass intra-city or local transportation for paper. The following hypothetical example will demonstrate the circumstances governed by the Check 21 Act. Suppose Drawer has a bank account with a Payor (drawee) Bank in New York. Drawer sends a check drawn on that account to Payee in California who deposits the check in Payee’s account with a California Depository Bank. The latter is a large institution that has equipment for the transmission of the image of the check. At the same time, Payor (drawee) Bank is a small institution that does not have processing equipment capable of receiving the electronic transmission of a check. There is

51. Check 21 Act § 4(b), 12 U.S.C. § 5003(b); *see also* 12 C.F.R. § 229.51(a).

52. For a comprehensive overview, though written prior to the promulgation of the final text for Regulation CC Part D, *see* PAUL S. TURNER, ANALYSIS OF THE CHECK CLEARING FOR THE 21ST CENTURY ACT (“CHECK 21”) (2004). For more on the background to the Check 21 Act, *see* Availability of Funds and Collection of Checks, 69 Fed. Reg. 1470 (Jan. 8, 2004) (codified at 12 C.F.R. pt. 229) and 69 Fed. Reg. 47,290 (Aug. 4, 2004) (codified at 12 C.F.R. pt. 229). *See also* Press Release, Federal Reserve Board, *Final Amendments to Regulation CC and its Commentary to Implement Check 21 Act* (July 26, 2004), available at <http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040726/default.htm>; Press Release, Federal Reserve Board, *Board Announces Final Amendments to Regulation J* (October 22, 2004), available at <http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20041022/default.htm>.

53. For the various roles of banks in the check collection and payment system, *see supra* note 7 and accompanying text.

54. An agreement of the recipient is dispensed with for a substitute check deposited, presented, sent for collection, or returned, “so long as a bank has made the warranties in [section 5] with respect to such substitute check.” *See* Check 21 Act § 4(a), 12 U.S.C. § 5003(a).

nothing in the UCC, the Check 21 Act, or anywhere else, to force Payor (drawee) Bank to accept electronic transmission; hence, electronic presentment is not an option for Depository Bank. Rather, Depository Bank may transmit the image of the check to an Intermediary Bank in New York, which is capable of accepting such transmission.⁵⁵ In effect, this is an electronic negotiation of the check. Having agreed to accept the electronic transmission, the New York Intermediary Bank is now required under the Check 21 Act to create a paper substitute check. The Act further requires Payor (drawee) Bank to accept the presentment of the substitute check as if it were the original check. Finally, any requirement, either by statute or agreement, to provide the canceled check, as under the contract between Drawer and Payor (drawee) Bank, is to be satisfied, under the Check 21 Act, by providing the substitute check.

In that hypothetical example, coast-to-coast physical transportation was eliminated; only local delivery of the substitute check in New York was not avoided.

A substitute check is a paper production of the original check that contains the image of the front and back of the original check, bears a MICR line containing information appearing on the MICR line of the original check, conforms, particularly in paper stock and dimension, with generally applicable for substitute checks, and is suitable for automated processing in the same manner as the original check.⁵⁶ To be the legal equivalent of the original check, a substitute check must "accurately represent . . . all of the information on the front and back of the original check as of the time the original check was truncated" and bear the legend: "This is a legal copy of your check. You can use it the same way you would use the original check."⁵⁷

As in the example above, a substitute check is typically created by a collecting intermediary bank. It, however, can also be created by the depository bank, where it agreed to receive the deposit of the check from the payee by means of electronic transmission. Furthermore, a substitute check may be created even by the payee/holder; such would be the case for a large organization that receives checks in various locations but would rather deposit them in one place. The organization may then arrange for the electronic transmission of check images to one place where substitute checks will be created for deposit. In general, a check could be transformed from electronic form to substitute checks form several times in the course of the collection and return process.

In connection with a substitute check, the Check 21 Act provides for warranties and an indemnity. The warranties are, first, that the substitute check meets the requirements for legal equivalence, and second, against double payment on the original check or any other representation of it.⁵⁸ The indemnity is "to the extent of any loss incurred . . . due to the receipt of a substitute check instead of the original check." Other than for costs, expenses, and reasonable attorney's fees, the amount to be indemnified is to the extent of loss proximately caused by the breach of

55. Interbank settlement between California Depository Bank and New York Intermediary Bank may take various forms. For example, it may be either bilateral (on a correspondent account one bank has with the other), or part of multilateral clearing house settlement. If the check is collected through the Reserve Banks, settlement will take place on the books of the Reserve Banks. Check 21 Act does not deal with interbank settlement arrangements. See Check 21 Act, 12 U.S.C. §§ 5001-5018 (2004).

56. Check 21 Act § 3(16), 12 U.S.C. § 5002(16); 12 C.F.R. § 229.2(aaa) (2006).

57. Check 21 Act § 4(b)(2), 12 U.S.C. § 5003(b)(2); 12 C.F.R. § 229.51(a).

58. Check 21 Act § 5, 12 U.S.C. § 5004; 12 C.F.R. § 229.52(a).

warranty. In the absence of a breach of a warranty amount of indemnity is limited though to the amount of the substitute check. Either way, amount of loss to be indemnified is reduced by amount representing loss resulting “from the negligence or failure to act in good faith on the part of an indemnified party.”⁵⁹ An example of loss incurred notwithstanding the lack of any breach of warranty is the case where forgery, proof of which would have allowed a purported drawer to avoid liability, cannot be proved on the substitute check, but allegedly could have been proved on the original.

Substitute check warranties are given by each bank “that transfers, presents, or returns a substitute check and receives consideration for the check.”⁶⁰ In turn, indemnity liability is incurred by “[a] reconverting bank and each bank that subsequently transfers, presents, or returns a substitute check in any electronic or paper form, and receives consideration for such transfer, presentment, or return”⁶¹ A “reconverting bank” is defined as “the bank that creates a substitute check” or where “a substitute check is created by [the depositor], the first bank that transfers or presents [the] substitute check,” namely, the depository bank.⁶² Surprisingly, the reconverting bank is not listed as one of the warrantors; it can hardly be described as a “bank that transfers . . . a substitute check,” unless “transfer” is to include the first delivery or issue; this indeed appears to be the view of the Federal Reserve.⁶³ In any event, the reconverting bank is listed as one to become liable to indemnify for loss caused by the breach of warranty.

As indicated, a substitute check need not necessarily be created by a bank; rather it may be by a person other than a bank, typically a large organization-payee. In such a case warranties and indemnity liability emanate under the Check 21 Act not from the payee, the creator in fact of the substitute check, but rather from the first bank that transfers or presents such substitute check; such a bank, being the depository bank, is then considered to be the “reconverting bank” in the collection process.

Both substitute check warranties and the indemnity are stated to run to the benefit of the transferee, any subsequent collecting or returning bank, the depository bank, the drawee, the drawer, the payee, the depositor, and any endorser.⁶⁴ Since a check could be transformed from electronic form to substitute checks form several times in the course of the collection and return process, it is possible that there could be multiple substitute checks, and thus multiple reconverting banks, with respect to the same payment transaction. A subsequent participant may thus benefit from warranties and indemnity of more than one reconverting bank. As well, a collecting

59. Check 21 Act § 6(c), 12 U.S.C. § 5005(c); *see also* 12 C.F.R. § 229.53.

60. Check 21 Act § 5, 12 U.S.C. § 5004.

61. Check 21 Act §§ 5-6, 12 U.S.C. §§ 5004-5005 ; *see also* 12 C.F.R. §§ 229.52-.53.

62. Check 21 Act § 3(15), 12 U.S.C. § 5002(15); *see also* 12 C.F.R. § 229.2 (zz).

63. Check 21 Act § 3(15), 12 U.S.C. § 5002(15); *see also* 12 C.F.R. § 229.2 (zz). Regulation CC Commentary to section 229.52(a) states “the reconverting bank starts the flow of warranties when it transfers, presents, or returns a substitute check” 12 C.F.R. 229 App. E XXXI (2006). The reference in the Check 21 Act to “[a] bank that transfers” (section 5), as opposed to “each bank that subsequently transfers,” (section 6) (which does not purport to cover the reconverting bank which is separately referred to in section 6) re-enforces this interpretation; yet, generally speaking, for a check, “issue” and “transfer” are two distinct concepts and the Act would have been clearer had it distinguished between the original issue of a substitute check and its subsequent transfer. Check 21 Act § 5-6, 12 U.S.C. § 5004-5005.

64. Check 21 Act § 5-6, 12 U.S.C. § 5004-5005.

bank receiving an electronic representation of a substitute (rather than original) check will both receive and pass on the reconverting bank's Check 21 Act warranty and indemnity protections.

The Check 21 Act further contains provisions covering expedited re-credit for consumers⁶⁵ and banks. First, Section 7 permits a consumer to challenge a debit for a substitute check either where the check was not properly charged to the consumer's account or where the consumer has a warranty claim. In each case the consumer must have suffered a resulting loss and the production of the original check or a better copy of it is necessary to determine the validity of the challenge or claim. Second, Section 8, governs a claim by a bank that is obligated to provide an expedited re-credit to the consumer or that has otherwise suffered loss, in circumstances where "production of the original check . . . or a better copy of [it] is necessary to determine the validity of the charge to the customer account or any warranty claim connected with such substitute check."⁶⁶ The claim is a claim for indemnity from another bank that incurred the indemnity liability to the claimant bank under Section 8.⁶⁷

The Check 21 Act allocates losses only among banks that handle a substitute check. However, it is possible that the problem giving rise to liability under the Check 21 Act was created prior to the creation of a substitute check; for example, electronic information derived from the check may have consisted of a poor image of the original check, which would preclude the reconverting bank from creating a legally equivalent check, and thus caused it to be in breach of a substitute check warranty. Or else, a substitute check created by the payee and deposited at the depository bank may have been deficient in one way or another. At the same time, neither warranties nor indemnity liabilities are provided in the Check 21 Act in connection with the electronic transmission of check image or information. Similarly, no warranties or indemnity liability are fastened on a payee that creates a substitute check. Responsibilities of transmitters of electronic information and depositories of substitute checks are thus to be provided by their respective contracts with the immediate recipients of electronic information and substitute checks. This indeed is quite consistent with the overall position under the Check 21 Act, under which no bank is to be required to receive electronic transmission of check data and no depository bank is under an obligation to accept for deposit substitute checks. Having nevertheless agreed to accept such information or substitute checks, it is up for the collecting banks to do so under contractual arrangements that provide them with adequate protections.

However, contract is not the exclusive source of regulating responsibilities outside the Check 21 Act; under Regulation J, a sender of an electronic item derived directly from the original check makes two sets of warranties for the electronic item. First, the sender makes transfer warranties as if the item was a paper check governed by the UCC. Second, the sender makes warranties as if the item were a substitute check governed by the Check 21 Act.⁶⁸ For checks handled by Reserve Banks

65. "Consumer" is defined by reference to the meaning of "consumer account" in the Expedited Funds Availability Act. Check 21 Act § 3(8), 12 U.S.C. § 5002(8). A "consumer account" being "any account used primarily for personal, family, or household purposes." Expedited Funds Availability Act § 602(10), 12 U.S.C. § 4001(10).

66. Check 21 Act §§ 8, 12 U.S.C. §§ 5007.

67. See 12 C.F.R. §§ 229.54-.55 (2006) (implementing Check 21 Act §§ 7-8, 12 U.S.C. §§ 5006-07).

68. 12 C.F.R. § 210; See *id.* §§ 210.2-210.6, 210.12.

governed by Regulation J an end-to-end combined UCC and Check 21 liability structure is thus provided.⁶⁹

In the final analysis, however, by reconverting an electronic image to a new piece of paper, Check 21 Act is a step backward in the process of the “immobilization” of the check.⁷⁰ Rather, the Act implements the “materialization” or “certification” of the electronic image. The Act reflects a legislative policy of not forcing banks either to have their check processing facilities automated, or to outsource or contract out the function of automated processing, whether to a large bank, or a third-party processor. The result is a move away from an EFT payment, at the additional cost of a complex piece of legislation with no counterpart anywhere else in the world.

III. PAYMENT CARDS – THE PAYROLL CARD AS AN ACCESS DEVICE

Payment cards have been classified as either access devices or stored-value products (SVPs).⁷¹ Briefly stated, a payment by means of an access device is reflected in a debit to an account maintained with a financial institution. At the same time, a payment by means of an SVP is reflected in the reduction of value stored on the card, as recorded on the card itself. Value stored on an electronic device embodied in a stored-value card is often referred to as e-money.

In both access and stored-value systems, payment is initiated by having the card inserted to a terminal,⁷² usually with the payment details,⁷³ with or without a secret code such as a PIN, entered into the terminal. Information is then read at the terminal from either a magnetic stripe or a microchips processor embodied in the card. The former reflects a cheaper technology and is typically associated with either an access card, or a low-amount stored-value card. Conversely, the latter, turning “memory card” into a “smart-card,” is typically associated with the more sophisticated form of a stored-value card. The use of ‘smart card’ technology ‘only’ to enhance security features of an access card, without converting it to a store-value card, is possible, but not in use in Canada and the United States.⁷⁴

69. See generally Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire, 69 Fed. Reg. 62,553 (Oct. 27, 2004) (codified at 12 C.F.R. pt. 210); Federal Reserve Bank of New York, Final Amendment to Regulation J: Collection of Checks and Other Items, Circular No. 11653 (October 25, 2004).

70. For the borrowed use of “decertification,” “dematerialization,” and “immobilization” in this context, see *supra* note 11 and accompanying text.

71. For the basic distinction between access devices and stored-value products, see, e.g. COMM. ON PAYMENT & SETTLEMENT SYS., SECURITY OF ELECTRONIC MONEY 3 (1996). See generally, Benjamin Geva & Muharem Kianieff, *Reimagining E-Money: Its Conceptual Unity with Other Retail Payment Systems*, in 3 CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW 669 (2005).

72. A public access terminal can be either at a point of sale (POS) for the payment of goods or services purchased, or at an automated teller machine (ATM) for strictly cash withdrawals, with or without other banking operations. Where on the top of cash withdrawals additional banking operations are facilitated, the terminal may be referred to as an automated banking machine (ABM).

73. It is, however, possible, though not common, to have the terminal programmed to charge payment in a specified amount. This is the case for telephone and transit cards, and often for cards inserted to unattended terminals at parking lots.

74. See Benjamin Geva, *Consumer Liability in Unauthorized Electronic Funds Transfers*, 38 CAN. BUS. L. J. 207, 212-23 (2003) [hereinafter Geva, *Consumer Liability*] (detailing various methods of authorization and the evolution of retail card payment systems).

Where the card is an access device, information read from the card at the terminal is then transmitted from the terminal to a central facility of the financial institution where the account associated with the card is maintained; both card authentication and the debit to the account take place at such a central facility. Conversely, where the card is stored-value, no information is transmitted from the terminal to any central facility; both authentication and the posting of the debit occur at the terminal.

In the United States, access devices are either credit cards, governed by the Consumer Credit Protection Act⁷⁵ and implemented by Regulation Z,⁷⁶ or debit cards, governed by the Electronic Fund Transfer Act⁷⁷ and implemented by Regulation E.⁷⁸ While payment by credit card is to be debited to a credit account maintained with a financial institution,⁷⁹ payment by debit card is to be debited to an asset, such a deposit, account, maintained with a financial institution.⁸⁰ Payment recorded on an SVP is not debited to an account maintained at the financial institution; the SVP thus falls outside the ambit of an existing specific legislation.

In practice, multi-participant stored-value ("open") systems have not made a breakthrough in North America where the typical stored-value card is still associated with a "closed" system such as telephone or transit.⁸¹ On its part, the typical debit or credit card envisages access by the cardholder to his or her account maintained by the financial institution. In recent years, however, various systems have arisen in the United States under which a deposit account is specifically set up for an exclusive access by a card;⁸² in turn, the asset account may be held or set up at a financial institution by a person other than the cardholder. Such is the case with respect to a payroll, remittance, or gift cards, as well as reloadable general spending cards. Thus, a card provider or marketer establishes a "pooled" or master account with its financial institution. The financial institution issues cards and assumes fiduciary or trust obligations for the benefit of the cardholders, as designated or recruited by the card provider or marketer. A third-party service provider may be charged with transaction processing, program administration, and customer services. For example, a payroll cardholder is an employee whose wages are deposited by the employer, acting as the card provider, to a "pooled" or master account from which the employee can make payments up to the value associated with the card, as capped by his or her wages. A remittance or gift card gives access to value deposited in a master account held by a money transmitter. In each case, the account relationship

75. 15 U.S.C. § 1631 (approved in 1968).

76. Truth in Lending, 12 C.F.R. § 226 (2006).

77. 15 U.S.C. § 1693 (implemented in 1978).

78. 12 C.F.R. § 205.

79. Note that the issuer of a credit card need not necessarily be financial institution. See 12 C.F.R. §§ 226.2(a)(14)-(15) (defining "credit" and "credit card").

80. See 12 C.F.R. §§ 205.2(b)(1), 205.3 (defining "account" and "coverage").

81. For the distinction, as well as for development in the United States and a legal perspective, see Task Force on Stored-Value Cards, *A Commercial Lawyer's Take on the Electronic Purse: An Analysis of Commercial Law Issues Associated with Stored-Value Cards and Electronic Money*, 52 BUS. LAW. 653 (1997). In contrast, a multi-participant stored-value ("open") system has been successful for small-value transactions, for example, in Hong Kong. For a Canadian perspective, see Shameela Chinoy, *Electronic Money in Electronic Purses and Wallets*, 12 BANKING & FIN. L. REV. 15 (1996); Bradley Crawford, *Is Electronic Money Really Money?*, 12 BANKING & FIN. L. REV. 399 (1996).

82. As of 1996, "[s]o far as [the FDIC was] aware, the systems of this type [were] not currently being utilized by depository institutions." Notice of FDIC General Counsel's Opinion No. 8, 61 Fed. Reg. 40,490 n.1 (Aug. 2, 1996).

with the financial institution in which the master account is held envisages access only by means of the card, but the relationship is between the financial institution and the holder of the master account, the card provider or marketer, who is a person other than the cardholder; yet, it is each cardholder who is entitled, at least vis-à-vis the person who set up the master account, and as facilitated by the financial institution in which the master account is maintained, to the value attached to the card. Indeed, a direct relationship may be established between the financial institution and the cardholder as to the use of the card; at the same time, the overall account relationship is between the financial institution and the card provider or marketer who set it up, such as the money transmitter or employer. Stated otherwise, the cardholder is a sub-account holder; his or her sub-account relationship is, however, with the account holder, the card provider or marketer who is the employer or money transmitter in the previous examples, and not directly with the financial institution.⁸³

It is submitted that, fundamentally, such an arrangements is an access system; indeed, a recent amendment to Regulation E expands the scope of Regulation E to cover payroll cards,⁸⁴ subject only to some incidental modifications, reflecting the lack of direct account relationship between the cardholder and the financial institution.⁸⁵ Unfortunately, however, both in the literature and banking parlance, cards accessing non-cardholder master accounts, are referred to as prepaid or stored-value cards.⁸⁶ It is submitted that this is conceptually wrong, which may lead to confusion and misunderstandings.

It seems that the source of this misconception is a classification of the Federal Reserve Board under which stored-value systems may be offline accountable, offline unaccountable, and online stored value;⁸⁷ arguably, the third category, that of online stored value, could be referred to as online accountable. According to the Board, in an offline accountable system, payment does not involve an online authorization; transaction data is however periodically transmitted to the financial institution and recorded in an account maintained there for the cardholder. An offline

83. See, e.g., Sherrie L.W. Rhine & Sabrina Su, *Stored Value Cards as a Method of Electronic Payment for Unbanked Consumers*, 9-11 (2005), available at http://www.newyorkfed.org/regional/Stored_Value_Card_Paper_August_2005.pdf; see also Julia S. Cheney, *Payment Cards and the Unbanked: Prospects and Challenges* 11-12 (2005), available at <http://www.philadelphiafed.org/pcc/conferences/2005/PaymentCardsandtheUnbankedSummary.pdf>; James C. McGrath, *The Cost Effectiveness of Stored-Value Products for Unbanked Consumers* 4-11 (2005), available at <http://www.philadelphiafed.org/pcc/papers/2005/D2005MarchUnbankedCover.pdf>; Samuel Frumkin, William Reeves & Barry Wides, *Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked* 1-6 (June 2005), <http://www.occ.treas.gov/cdd/payrollcards.pdf>.

84. See 12 C.F.R. § 205.2(b)(2) (effective July 1, 2007) (defining "Account" to include "payroll card account" which is "an account that is directly or indirectly established through an employer and to which electronic fund transfers of the consumer's wages, salary, or other employee compensation . . . are made on a recurring basis . . . whether the account is operated or managed by the employer, a third-party payroll processor, [or] a depository institution . . ."); see also Final Rule, 71 Fed. Reg. 51,437, 51437-51,439 (Aug. 30, 2006) (codified at 12 C.F.R. pt. 205).

85. See 12 C.F.R. § 205.18 (effective July 1, 2007) (stating that financial institutions need not provide periodic statements under 12 C.F.R. § 205.9, if they make required information available to the consumer via telephone, the Internet, or in writing upon request).

86. See Geva, *Consumer Liability*, *supra* note 74.

87. See Electronic Funds Transfers, 61 Fed. Reg. 19,696, 19,699-19,703 (May 2, 1996) (codified at 12 C.F.R. pt. 205).

unaccountable system does not involve online authorization; record of value is maintained only on the card itself. Finally, an online stored value (or accountable) system involves both online authorization and transmission of data to a centralized account with no record of value being maintained on the card.

In my view, the Board's classification ought to apply to both access and store-value systems. Along these lines I disagree with the classification of the offline accountable and online accountable systems as stored-value. According to my revised classification, card payment systems may well be classified as offline unaccountable, offline accountable, or online accountable. The online/offline distinction addresses the existence or absence of communication between the terminal and a central facility with regard to authorization. In the former case the system is "online"; in the latter it is "offline." The accountable/unaccountable distinction addresses the debiting of either an account held by an institution (typically the issuer) or a "decentralized" account maintained on the card in the form of a decrease of the value "loaded" on it. In the former case the system is "accountable"; in the latter it is "unaccountable." Whether a product is an access or stored-value depends on whether it is accountable or unaccountable; it is an access product in the former and an SVP in the latter case.

Practically speaking, an online system is bound to be accountable. This is so even though the central facility for the online authorization may not be same as the central facility posting entries to the account; once communication to the central facility occurs, there is simply no incentive for bypassing "centralized" accountability. At the same time, bypassing altogether online authorization is only likely, but not bound, to lead to non-accountability; technological limitations inherent in the card, such as those associated with the magnetic stripe technology, may preclude or limit the bypassing of accountability. In this context, one source of confusion is what could be characterized as a "quasi accountable" system, in which value is both reduced from the card, at the time payment is made, but also from an account at a central facility, to which the information is subsequently transmitted periodically.

The proposed revised classification, covering access and stored-value cards, takes into account the above in making the following options available:

- 1) An "online accountable" system. This is the typical credit and debit card system, utilizing magnetic stripe cards; it is an access system in which each payment made from a terminal typically involves communication between the terminal and a central facility and results in a debit to an account held by a financial institution. In my view, also the payroll card (as well as the remittance and gift card) falls into this category; it is immaterial that the account maintained by the central facility at the financial institution and to be debited is a master account set up by the employer rather than the cardholder. The card is thus an access device; while I agree with the Board that the value attached to this card is limited to a specified amount and is to be accessed only by the card, I do not see this as a feature which changes the basic nature of the account containing the value as an asset account; limitations on the withdrawals facilities of an account have nothing to do with its fundamental nature. In effect, the Board's view to the contrary is fraught with inconsistencies; having classified the system as stored-value, the Board nevertheless concluded that the

account to be debited on an online stored-value system is an asset account “covered by Regulation E.”⁸⁸

2) An “offline unaccountable” system. This is e-money loaded on an SVP pure and simple. Typically, the card is a “smart card.” Authorization occurs at the terminal and value is reduced only from the card. There may be later “accountability” in the sense of ability to match value paid (by cardholder-payor) and value deposited (by payee) and attributed to a given card—but this is not part of the payment process; rather, this is a method to track down payments as may be required. Hence, this “accountability” is to be disregarded for our purposes.⁸⁹

3) An “offline-accountable” system. In my view, an example to the point may be that of the credit card authorized only at the terminal with subsequent off-line communication to the central facility that debits the cardholder’s (credit) account. The card is however an access device as no value is deducted in the process of the at-the-terminal authorization. Typically, the card utilizes the magnetic-stripe technology, which has only limited capacity to be “loaded” with value. As explained below, what is described by the Board as “offline accountable” is fact “offline quasi-accountable”; to the extent that value recorded on the card is available on its own the periodic transmission to the financial institution is only for verification.

4) An “offline quasi accountable” system. This is likely to be the case for telephone and transit cards; value is reduced at the terminal (as part of the offline authorization process); the process is however followed by an off-line communication in batches to a central facility that debits a “centralized” “shadow” account attached to the card. Typically, cards that fall into this category are not smart cards but rather those bearing “magnetic stripe.” This is so since the information they carry is limited: there is no PIN and value is rather low. But it is this “inferior” technology that results in enhanced opportunities for counterfeiters and hence the need for an ongoing verification of authenticity in the form of the offline communication to a central facility. In the final analysis, however, so far as the cardholder is concerned, available value was reduced at the terminal and the subsequent debit of the shadow account is to confirm authenticity; the system is thus to be classified as a sub-category of an “unaccountable” rather than “accountable” system. Stated otherwise, a “quasi accountable” system is not truly “accountable” and the system is an SVP.

5) Either an “online unaccountable” or “online quasi accountable” system exists only in theory; once online communication takes place, there is no point to bypass the posting of entries to the account held at the financial institution; stated otherwise, there is no business case for “unaccountability.”

On its part, the Federal Deposit Insurance Corporation (FDIC) proposes to “promulgate a regulation that would clarify the insurance coverage of funds subject to transfer or withdrawal through the use of stored value cards and other nontraditional access mechanisms.”⁹⁰ Covering “nontraditional access mechanisms,”

88. *Id.* at 19,699.

89. See Alan L. Tyree, *The Legal Nature of Electronic Money*, 10 *Journal Banking & Fin. L. & Prac.* 273, 276 (1999) (describing “accounts” maintained on devices which are under the control of the customer, such as cards, as “decentralized” or “distributed” so as to distinguish it from the centralized account run in a central facility in an access system).

90. See Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access

the proposed Regulation describes a card falling into this category as a mechanism providing "access to funds received and held by an insured depository institution for payment to others."⁹¹ Purporting to cover in section 330.5 (c)(2) of the proposed Regulation e-money purchased from and held at the issuer depository institution, the FDIC proposed that "funds placed at an insured depository institution by one party for transfer or withdrawal by same party. . . shall be deposits belonging to the same party."⁹² This appears to cover funds paid for the purchase of e-money loaded on a stored-value card, which remain at the institution available for redemption.

With respect to "funds placed at an insured depository institution by one party for withdrawal by other parties," the FDIC proposes in section 330.5(c)(3) that unless two conditions are to be satisfied, funds will be insurable to the party that places the funds and not the actual cardholders. These conditions are first, "the account records of the insured depository institution reflect the fact that the first party is not the owner of the funds," and second, either the party that places the funds or the depository institution "maintains records reflecting the identities of the persons holding the [cards] and the amount payable to each person."⁹³ Only when these conditions are fulfilled, insurance will benefit the cardholders.⁹⁴ Accordingly, insurance will benefit holders of payroll cards but not anonymous purchasers of gift cards; under the same logic, insurance will also not cover anonymous cardholders of remittance cards, and in fact merchants and other payees paid by cards governed by the proposed new regulation.⁹⁵

In effectively dealing separately with "true" stored value cards (under paragraph (c)(2)) and cards accessing funds placed by marketer or card provider (under paragraph (c)(3)), the FDIC did not fail to see that the two situations are distinct. Yet, it purports to promulgate one rule applicable to both situations. Furthermore, the language of paragraph (c)(2), covering "funds placed at an insured depository institution by one party for transfer or withdrawal by same party," appears to apply to not only to funds paid for the purchase of e-money loaded on a stored-value card, which remain at the institution available for redemption, but also to funds accessed by a debit card accessing the cardholder's account. Thus, the FDIC did not go far enough to highlight the nature of the stored-value card as distinct from the "traditional" access card, issued to an account holder. In the final

Mechanisms, 70 Fed. Reg. 45,578, 45,578-45,580 (Aug. 8, 2005) (proposing to amend 12 C.F.R. § 330.5 by adding a new paragraph in which "access" is used by reference to specific funds deposited as opposed to the account under which they are managed).

91. *Id.* at 45,580.

92. *But see* Notice of FDIC General Counsel's Opinion No. 8, 61 Fed. Reg. 40,490, 40,491-40,494 (Aug. 2, 1996). The Notice states that such funds are not insured for the benefit of the cardholder where they are placed in a reserve account rather than frozen in the cardholder's account. *Id.* The proposed rule does not seem to follow that distinction. *Id.*

93. *Id.*

94. *Id.*

95. *Cf.* 12 U.S.C. § 1822(c) (limiting protection to depositors whose name appears on bank records). *But cf.* 12 C.F.R. § 330.5(b)(4) (2006) (providing insurance coverage for deposits evidenced by a negotiable instrument such as "certificate of deposit, negotiable draft, negotiable cashier's or officer's check, negotiable certified check, [or] negotiable traveler's check" whose holder is not on bank records). Certainly, identifying cardholders of "low value" cards not on bank records may be a costly and labor-intensive task. The question is whether exclusion from insurance coverage on such grounds is nevertheless justified for anonymous cardholders and payees with "high value" claims as well as of anyone actually coming forward by presenting a valid claim for redemption. Payee's claim to insurance may arise where payment on the card, as opposed to the redemption of its value, could not have been stopped.

analysis, while being cognizant of the distinction, and yet in focusing on the communality, between the two “nontraditional access mechanisms” to be governed by the proposed Regulation, the FDIC may have inadvertently blurred the distinction between access to stored-value cards.

No comprehensive legislation regarding SVPs is forthcoming in the United States. The expansion of Regulation E to cover the payroll card is a laudable pragmatic step taken in the right direction; yet, in my view, it is important to recognize that action taken is not the application of debit card law to a stored-value card. Rather, it is a recognition that the payroll card is an access device. Similarly, lumping up stored-value and funds placed by a third party into one category of “nontraditional access mechanisms,” as was done by the FDIC, does not enhance clarity. In the long run it is important to either repudiate or reconstruct the conceptual framework set out by the Federal Reserve Board expanding the stored-value category to cover situations that do not belong to it.

IV. SECURITIES TRANSFERS IN THE INDIRECT HOLDING SYSTEM — LAW REFORM IN CANADA IN THE FOOTSTEPS OF UCC ARTICLE 8⁹⁶

Historically, securities⁹⁷ were issued solely directly, by their issuers to securities holders, in a form of bearer, order, or registrable certificate. A transfer of a registrable security was “perfected,” so as to confer on the transferee ownership and legal title to the security, by registration on the issuer’s books. A transfer by a holder of a registered security required the physical delivery of the certificate accompanied by an endorsement. It was completed by the following steps: (i) the surrender by the transferee of the transferor’s certificate to the issuer, (ii) the cancellation of the transferor’s certificate by the issuer, (iii) the replacement of the transferor’s name by that of the transferee on the books of the issuer, and (iv) the issue by the issuer of a new certificate to the transferee, in the transferee’s own name. Typically, the transferor would deliver the certificate and an indorsement in blank to his or her broker, who would deliver this documentation to the transferee’s broker, for further action.

In the original form of the direct holding system, possession and delivery of physical certificates were key elements.⁹⁸ One response to the resulting paper crisis was immobilization or uncertification. For immobilized or uncertificated securities, no certificate was to be issued to registrable securities holders, whose rights were thus to be evidenced solely by the registration on the issuer’s book. In any event, the new system did not supersede altogether, and in practice, hardly challenged, the

96. See generally Benjamin Geva, *Promoting Stability in International Finance—Legislative and Regulatory Reform of Payment and Settlement Systems*, in 18 *THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE* 247-81 (Rosa M. Lastra ed., Intern’l Banking, Fin. & Econ. Law Series No. 18, 2001).

97. See BLACK’S LAW DICTIONARY 1358 (7th ed. 1999) (broadly speaking, “security” denotes an obligation of or an equity in an issuer which is of a type dealt in or traded on financial or exchange markets or is otherwise a medium of investment).

98. See *Colonial Bank v. Cady*, (1890) 15 App. Cas. 267 (H.L.) (U.K.) (providing a classic common law case on the effect of possession of the endorsed certificate); see also ALBERTA LAW REFORM INST., *TRANSFERS OF INVESTMENT SECURITIES* 67 (1993) (giving the historical evolution of securities from a Canadian perspective).

traditional certificated one. Rather, in principle, both systems co-exist, and depending on the terms of the issue, new securities could be issued in either certificated or uncertificated/immobilized form. In practice, the certificated system has remained prevalent.⁹⁹

In any event, the uncertificated system has been a direct holding variant. In its framework, the transfer of a registrable security still contemplates registration on the book of the issuer, albeit on the basis of an instruction sent to the issuer, without the mechanism of delivering, surrendering and cancelling a certificate and the issue of a new one. Immobilization or uncertification has thus proved to be a mere partial solution which failed altogether to address the crux of the matter, that of the emergence of the indirect (or tiered) holding system. Thereunder, securities, whether in a certificated or uncertificated form, are issued to a clearing corporation or agency such as a central depository of securities (CDS) which then allocates rights in them to financial intermediaries, such as securities brokers and banks, as purchased by the intermediaries from the issuer. In turn, each financial intermediary then sells rights to investors. In such a system, the CDS remains the registered securities holder. Neither change in the registration on the books of the issuer, nor in the context of a certificated system, the issue of a new certificate, effectuates the subsequent transactions. Rather, the rights acquired by a purchaser are reflected as a credit or book-entry in an account held by that purchaser with an upper tier financial intermediary. To pursue our example, a brokerage firm purchasing a defined quantity of securities from the issuer will have its account with the CDS credited to that extent. Similarly, an investor, client of such a brokerage firm, will have his or her account with the brokerage firm credited, to the extent of the amount purchased. Transactions among brokers are effectuated on the books of CDS. Transactions among customers are effectuated on books held by brokers or other financial intermediaries. Interests in securities are thus held indirectly, through securities intermediaries.

A few important characteristics of this indirect holding system could be elaborated as follows:

1) The system does not preclude the registration of any interest on the books of the issuer. Stated otherwise, an interested holder can require, through the intermediary who maintains the interest holder's account, the establishment of a direct relationship with this intermediary's upper-tier institution, and ultimately, with the issuer. In fact, only a *direct* relationship with the issuer will secure to an investor a *direct* access to dividends or interest as well as the exercise of membership rights in the assembly or otherwise in management of the issuer, per the terms attached to the security. Yet, registration on the books of the issuer so as to establish such a direct relationship is a costly and timely process, in which most investors are not interested. This explains the popularity of the indirect holding system.

99. Thus, in both the United States and Canada, the uncertificated system has not made significant inroads. In the United States, the uncertificated system, though accommodated by the 1978 revision of U.C.C. Article 8, has not developed for most categories of securities. It was thus observed that "[m]utual funds shares have long been issued in uncertificated form, but virtually all other forms of publicly traded corporate securities are still issued in certificated form." U.C.C. revised art. 8, Prefatory Note I(B) (1994). In Canada, uncertificated securities have been even less widespread. Regardless, in both the United States and Canada, mutual funds securities are not transferable, only redeemable. Hence they do not raise any issue relating to transferability.

2) The pattern set out above should not mislead the reader to assume that the indirect holding system is necessarily exclusively a two-tiered one. In fact, further extensive financial intermediation may take place, particularly in the context of international finance.

3) Typically, in the indirect holding system, where a certificate is issued to the CDS, the original certificate so issued by the issuer to the CDS, is a “jumbo certificate,” reflecting the entire issue. In the normal course of events, that is, where no remote investor seeks to establish a direct relationship with the issuer, this certificate will remain stored with and untouched by the CDS. In this context, we speak of the “dematerialization of the security.” Unlike immobilization or uncertification which exclude the issue of a certificate in the first place, dematerialization contemplates the issue of an original certificate which is put out of use.

4) A holder of an interest has no entitlement to any specific security. Rather, the entitlement is to a specific quantity of a fungible asset as credited to the security holder’s security account. Inter-financial intermediary transactions are thus not cleared and settled individually, but rather, in a fashion similar to the clearing and settlement of money transfers.

Not surprisingly, the law governing securities transfers has been concerned with the direct holding system. This law is thus ill-fit to provide a comprehensive and clear framework for the indirect holding system. While the law relating to the direct holding system focuses on the relationship between the issuer and the security holder, the indirect holding system revolves around relationships involving intermediaries. Put another way, in the direct holding system the asset under discussion is the security itself. Conversely, in the indirect holding system, the asset under discussion is the entitlement to a security as reflected in an account maintained by a financial intermediary.

To accommodate the indirect holding system in the context of laws governing securities transfers Guynn set out four fundamental principles of law reform:¹⁰⁰

[1)] Interests in securities held through a financial intermediary should be defined . . . as [an] interest in a pro-rata portion of the pool of securities or interests in securities held by the intermediary with whom the interest holder has a direct contractual relationship The interest should exclusively be reflected as a credit to the interest holder’s account with the intermediary, and not as a traceable property right in individual securities or a mere contractual claim.

[2)] The pool of securities or interests in securities held by a financial intermediary to satisfy the interest of its interest holders should be protected against the claims of the intermediary’s general creditors This can be done either by defining the interest as a type of property or co-property right or by amending existing . . . laws governing the insolvencies of “financial intermediaries to give explicit effect to this policy.

100. Randall D. Guynn, *Modernizing Securities Ownership, Transfer and Pledging Laws: A Discussion Paper on the Need for International Harmonization* 33-37 (Capital Markets Forum, Intern’l Bar Assoc. 1996), available at <http://www.dpw.com/iba.modernization.pdf>.

[3)] Conflicts of laws rules should be interpreted or modernized to reflect the development of the [indirect holding] system [to accommodate] holding, transferring and pledging interests in securities by [means of] book-entry to accounts with financial intermediaries so that the selection of the law governing the [rights in such a system ought to be] determined by agreement, [and] in the absence of such agreement, by reference to where the office of the financial intermediary maintaining such accounts is located or otherwise by reference to the intermediary's jurisdiction.

[4)] Procedures for creating and enforcing a pledge of [or security] interests in securities credited to accounts with intermediaries should be simplified.¹⁰¹

Guynn enumerated three enactments that appear already to satisfy these four basic principles so as to be models for reform. One such enactment is Revised Article 8 (1994 Official Text) of the Uniform Commercial Code in the United States.¹⁰² An important update¹⁰³ is the adoption by the Canadian provinces of Alberta¹⁰⁴ and Ontario¹⁰⁵ of a Uniform Securities Transfers Act (USTA),¹⁰⁶ closely modelled on UCC Revised Article 8.

101. *Id.* at 33-34 (asserting that this principle is consistent with an informed application of the *lex situs* rule). Guynn goes on to elaborate several applications as follows:

[i] the substantive law governing the validity of securities and the rights and duties of issuers should be the law of the issuer's jurisdiction"; [(ii)] the law governing any contest between the rights of any person identified as the holder of an interest in dematerialized securities directly on the books of an issuer or its agent and the rights of any adverse claimant in such interest should be the law where the books are located (typically the issuer's jurisdiction"); [(iii)] "the law governing any contest between the rights of persons that have actual possession of physical securities and those of any adverse claimant in such physical securities should be the law where the physical securities are located"; [(iv)] "the law governing the rights and duties of an intermediary with respect to interests in securities credited to accounts with it, as well as any contest between the rights of any person identified as the holder of such an interest on the books of the intermediary and those of any adverse claimant in such interest, should be the law where the intermediary's office maintaining such accounts is located or otherwise by the law of the intermediary's jurisdiction.

Id. at 36.

102. *See id.* at 43-45 (explaining that the two other enactments are (i) "the Belgian Royal Decree No. 62 dated November 10, 1967 Facilitating the Circulation of Securities (as amended, April 7, 1995)"; and (ii) the Luxembourg Grand-Ducal Decrees of February 17, 1971, December 18, 1991 and June 8, 1994").

103. *See generally* UNIDROIT Study Group, *Harmonised Substantive Rules Regarding Indirectly Held Securities* (2003), available at <http://www.unidroit.org/english/publications/proceedings/2003/study/78/s-78-08-e.pdf> (discussing such issues from a more global perspective). For subsequent developments and comments, see generally UNIDROIT Web-site, *Intermediated Securities – Study LXXVIII*, <http://www.unidroit.org/english/workprogramme/study078/item1/main.htm> (last visited May 16, 2007).

104. Securities Transfer Act, S.A. 2006, ch. S-4.5 (Alberta), available at <http://www.canlii.org/ab/laws/sta/s-4.5/20070312/whole.html>.

105. Securities Transfer Act, S.O. 2006, ch. 8 (Ontario) [hereinafter Ontario Securities Transfer Act], available at <http://www.canlii.org/on/laws/sta/2006c.8/20070307/whole.html>.

106. *See generally* CANADIAN SECURITIES ADMINISTRATORS' UNIFORM SECURITIES ACT TASK FORCE, PROPOSAL FOR A MODERNIZED UNIFORM LAW IN CANADA GOVERNING THE HOLDING, TRANSFER AND PLEDGING OF SECURITIES (May 28, 2004), available at http://www.osc.gov.on.ca/MarketRegulation/SpecialProjects/usta/usta_20040528_consultation-paper.pdf;

Article 8 and USTA are not limited to indirect securities holding. Rather, they are comprehensive pieces of legislation covering also the direct holding of certificated and uncertificated securities. The ensuing discussion will outline the principal features of Article 8 and the Ontario Securities Transfer Act (OSTA) as a model for legislative reform.¹⁰⁷

Both Revised Article 8 and OSTA abandon any attempt to describe all of the complex relationships in the indirect holding system using the simple concepts of the traditional holding system. For example, the investors' interests are not described as co-ownership in securities held for their benefit by a broker. Instead, vis-à-vis a "securities intermediary" maintaining for him or her a "securities account," the "entitlement holder," such as an investor or another "securities intermediary," has a "security entitlement" to a "financial asset" held by that "securities intermediary." In turn, the "financial asset" held by the "securities intermediary" to meet its obligations to satisfy the "security entitlements" of its customers, namely those for whom it maintains "securities accounts," is itself a "security entitlement" to a "financial asset" held by another "securities intermediary." Only ultimately, the "financial asset" held by the clearing corporation (such as a CDS) to whom the security was originally issued, is the security itself.¹⁰⁸

The specific provisions of Part 5 of Revised UCC Article 8 and Part VI of OSTA, each bearing the title "security entitlement" and dealing with the indirect holding of securities, can be outlined as follows. In principle, the acquisition of a financial asset is to be reflected as a credit in a securities account.¹⁰⁹ An action based on an adverse claim to a financial asset may not be asserted against a person who acquires a security entitlement for value and without notice of the adverse claim.¹¹⁰ Financial assets held by a securities intermediary to satisfy securities entitlements "are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary."¹¹¹ Rather, entitlement holders share them pro rata.¹¹² A securities intermediary is required to maintain a financial asset in a

see also Eric T. Spink & Maxime A. Paré, *The Uniform Securities Transfer Act: Globalized Commercial Law for Canada*, 19 BANKING & FIN. L. REV. 321 (2004); Benjamin Geva, *Legislative Power in Relation to Transfers of Securities: The Case for Provincial Jurisdiction in Canada*, 19 BANKING & FIN. L. REV. 393 (2004).

107. See generally James Steven Rogers, *Policy Perspectives on Revised U.C.C. Article 8*, 43 UCLA L. REV. 1431 (1996) (providing detailed discussion on article 8 by the reporter to the revised article 8 drafting committee).

108. Pertinent definitions are set out in U.C.C. sections 8-102 and 8-501 as well as in OSTA section 1. Briefly stated, a "securities intermediary" is either "(i) a clearing corporation; or (ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others" U.C.C. § 8-102(a)(14) (2006); Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 1. A "securities account" is "an account to which a financial asset is or may be credited" U.C.C. § 8-501(a); Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 1. A "financial asset" is either "a security [or] property that is held by a securities intermediary for another person in a securities account" U.C.C. § 8-102(a)(9); Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 1. "Security entitlement" is the rights and property interest of an entitlement holder with respect to a financial asset. U.C.C. § 8-102(a)(17). An "entitlement holder" is "a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary." U.C.C. § 8-102(a)(7); Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 1.

109. U.C.C. § 8-501(b); Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 95.

110. U.C.C. § 8-502; Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 96.

111. U.C.C. § 8-503(a).

112. U.C.C. § 8-503(b); Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 97(2); see also U.C.C. § 8-

quantity corresponding to the aggregate of all security entitlements it has established in favour of its entitlement holders with respect to that financial asset.¹¹³ Stated otherwise, unlike a bank account, a securities account is backed by 100% reserve. A securities intermediary is responsible to its entitlement holders to obtain and distribute any payment made by the issuer of the financial asset and is further obliged to exercise rights with respect to a financial asset as directed by the entitlement holder.¹¹⁴ A securities intermediary is further required to comply with the entitlement holder's instructions as to the transfer or redemption of an underlying financial asset as well as to change entitlement holder's position to other form of security holding.¹¹⁵ Finally, a purchaser of a security entitlement, who obtains control of it for value and without notice of any adverse claim to the security entitlement or the underlying financial asset, takes that security entitlement free from the adverse claim.¹¹⁶

Both UCC Article 8 and OSTA further provide for coherent choice of law rules to apply to the indirect holding system. In the direct holding system, a key factor in determining the governing law of a transaction is the location of the security. This location is not always easy to determine.¹¹⁷ Furthermore, particularly in the context of globalization, the *lex situs* of the security may not fit the expectations of an entitlement holder and a securities intermediary located other than where the security is located. Indeed, as indicated, both Revised Article 8 and OSTA focus on the "security entitlement," and consequently, on the bilateral relationship between an entitlement holder and the securities intermediary. This, rather than the "security," or the link between an investor and the issuer, constitutes the foundation of the legal regime governing the indirect holding system. Consistently with this approach, the key factor in determining the governing law in the indirect holding system has been stated in UCC 8-110(b) and OSTA Section 45(1) to be the law of the securities intermediary's jurisdiction.¹¹⁸ Such law is stated to govern the acquisition of a security entitlement from the securities intermediary, the respective rights and duties arising from a security entitlement, and rights of an adverse claimant. In the absence of a specific agreement, a "securities intermediary's jurisdiction" is the jurisdiction where the securities account is maintained.¹¹⁹

Finally, in conjunction with corresponding amendments to UCC Article 9 and to the Ontario Personal Property Security Act (OPPSA)¹²⁰ governing secured

511; Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 105 (providing for the priority of entitlement holders over the securities intermediary's creditors, other than secured parties (of the securities intermediary) having "control" over the financial asset).

113. U.C.C. § 8-504; Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 98.

114. U.C.C. §§ 8-505 to 8-506; Ontario Securities Transfer Act, S.O. 2006, ch. 8, §§ 99-100.

115. U.C.C. §§ 8-507 to 8-508; Ontario Securities Transfer Act, S.O. 2006, ch. 8, §§ 101-02.

116. U.C.C. § 8-510; Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 104.

117. See Geva, *Consumer Liability*, *supra* note 74.

118. Cf. Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, July 5, 2006, http://hcch.e-vision.nl/index_en.php?act=conventions.pdf&cid=72; see also Bradley Crawford, *The Hague "PRIMA" Convention: Choice of Law to Govern Recognition of Dispositions of Book-Based Securities in Cross Border Transactions*, 38 Can. Bus. L.J. 157 (2003).

119. U.C.C. § 8-110(e). The Ontario Securities Transfer Act states that if the law is not agreed upon, it is the law of the jurisdiction where the securities intermediary's office maintaining the particular securities account is located, as such office is identified by contract, or otherwise, in an account statement. Ontario Securities Transfer Act, S.O. 2006, ch. 8, § 45(2). In the absence of any such identification, it is the law of the jurisdiction in which the chief executive office of the securities intermediary is located. *Id.*

120. See Personal Property Security Act, R.S.O. 1990, ch. P.10, c. 8, §§ 123-141 (coming into force Jan.

transactions, rules applying to security interests in investment securities have been provided for. In general, as for any other form of personal property, a security interest in securities is to be created by agreement between the debtor and the secured party. A new collateral category, "investment property," was introduced to cover securities, security entitlements and security accounts.¹²¹ Under UCC 9-314(a) and OPPSA Section 22.1, a security interest in investment property may be perfected¹²² by "control."

With respect to a security entitlement, "control" is achieved under UCC 8-106(d) and OSTA Section 25(1) by becoming an entitlement holder. Under both provisions, "control" may alternatively be achieved by the securities intermediary's agreement that it will comply with entitlement orders, namely, with directions to transfer or redeem the pertinent financial asset, originated by the secured party (or any other purchaser), without further consent of the entitlement holder. A third alternative under OSTA Section 25(1) as well as under a proposed addition to UCC 8-106(d) is by the control of another person on behalf of the purchaser. Both UCC 9-106(a) and OPPSA Section 1(2)(c) specifically incorporate UCC 8-106 and OSTA Section 25.

Perfection by control is in line with the broad principle underlying UCC 8-106 (as well as in effect OSTA Sections 23 to 26), under which "[o]btaining control" means that the purchaser [including a secured party] has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner."¹²³ Both Article 8 and OSTA do not preclude perfection of a security interest in investment property other than by control;¹²⁴ and yet, under UCC 9-328(1), "control" provides the utmost priority in investment property: "A security interest held by a secured party having control of investment property under Section 9-106 has priority over a security interest held by a secured party that does not have control of the investment property."¹²⁵ OPPSA Section 30.1 is to the same effect.

1, 2007 as the most recent amendment to the OPPSA) [hereinafter Ontario Personal Property Security Act].

121. U.C.C. § 9-102(a)(49) (encompassing "security[ies]," "security entitlement[s]," and "securities account[s]," as well as "commodity contract" and commodity account" under Article 8).

122. In general, under both U.C.C. Article 9 and OPPSA, a "security interest" is an interest in personal property, created by agreement, securing payment of a debt or the performance of an obligation. *Id.* § 1-201(b)(35) & art. 9; Ontario Personal Property Security Act, R.S.O. 1990, ch. P.10, c. 8, § 1. "Collateral" is the property subject to the security interest. U.C.C. § 9-102(a)(12); Ontario Personal Property Security Act, R.S.O. 1990, ch. P.10, § 1. The "secured party" is the holder of a security interest. U.C.C. § 9-102(a)(12); Ontario Personal Property Security Act, R.S.O. 1990, ch. P.10, c. 8, § 1. "Perfection" denotes the completion of all required steps designed to protect the secured party from claims of third parties such as buyers from and creditors of the debtor. U.C.C. § 9-308; Ontario Personal Property Security Act, R.S.O. 1990, ch. P.10, c. 8, § 19. For the perfection of security interests in investment property other than by "control," see generally *infra* note 123.

123. U.C.C. § 8-106, cmt. 1 (1994); Ontario Securities Transfer Act, S.O. 2006, ch. 8, §§ 23-26; see generally U.C.C. § 8-106(a)-(d) (2006) (offering various definitions of "control").

124. See also Ontario Personal Property Security Act, R.S.O. 1990, ch. P.10, § 23 ("Registration perfects a security interest in any type of collateral."); *id.* § 22(3) ("[A] security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs"; U.C.C. §§ 9-310(a), 9-313(a) (paralleling Ontario Personal Property Security Act §§ 23, 22(3)).

125. U.C.C. 9-328(1).

V. EU PROPOSED LEGAL FRAMEWORK FOR A SINGLE PAYMENT MARKET

A. Introduction

In its proposal for a Directive on payment services in the internal market (Proposed Directive), the Commission of the European Communities (the Commission) purported to provide for “a harmonised legal framework” designed to create “a Single Payment Market where improved economies of scale and competition would help to reduce the cost of the payment system.”¹²⁶ Being “complemented by industry’s initiative for a Single Euro Payment Area (SEPA), aimed at integrating national payment infrastructures and payment products for the euro-zone,” the Proposed Directive is designed to “establish a common framework for the Community payments market creating the conditions for integration and rationalisation of national payment systems.”¹²⁷ Focusing on electronic payments, and designed to “leave maximum room for self-regulation of industry,” the Proposed Directive purports to “only harmonise what is necessary to overcome legal barriers to a Single Market, avoiding regulating issues which would go beyond this matter.”¹²⁸ Stated otherwise, the measure will fall short of providing for a comprehensive payment law.

The scope of the Proposed Directive is stated in Article 2(1) to “apply . . . to business activities,” referred to as “payment services,” listed in the Annex, and “consisting in the execution of payment transactions on behalf of a natural or legal person . . . where at least one of the payment service providers is located in the Community.”¹²⁹ A “payment transaction” is defined to “consist in the act, initiated by the payer or the payee, of depositing, withdrawing or transferring funds¹³⁰ from a payer to a payee,¹³¹ irrespective of any underlying obligations between the payment service users.”¹³² “Payment services” listed in the Annex¹³³ are cash deposits and withdrawals in and from payment accounts;¹³⁴ execution of payment transactions in funds held on deposit in a payment account; execution of direct debits; execution of payment transactions through a payment card (or a similar device); execution of credit transfers (including standing orders); execution of payment transactions in funds covered by a credit line; execution of direct debits (including one-off direct

126. Commission of the European Communities, *Commission Proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market* 2 (Dec. 1, 2005) [hereinafter *Commission Proposal*], available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0603en01.pdf.

127. *Id.*

128. *Id.* at 8.

129. *Id.* art. 2(1).

130. *Id.* art. 4(8) (defining “funds” as “cash, scriptural money and electronic money . . .”).

131. *Id.* art. 4(4)-(5) (“[P]ayer” means a natural or legal person who has the right of disposal of funds and who allows them to be transferred to a payee [and] ‘payee’ means a natural or legal person who is the intended final recipient of funds which have been the subject of a payment transaction . . .”).

132. *Commission Proposal*, *supra* note 126, art. 2 (describing what constitutes a “payment transaction”); *id.* art. 4(6) (including payer and payee as payment service users).

133. The Annex is quite disorganized and repetitive. For example, the terms “payment card,” “direct debit,” and “credit transfer” are each enumerated at least twice. *Id.* at 54.

134. *Id.* art. 4(7) (“‘Payment account’ means an account held in the name of a payment service user which is used exclusively for payment transactions.”).

debits)¹³⁵; issuing of payment cards; execution of payment transactions in e-money; money remittance services in funds accepted for the sole purpose of carrying out the payment transaction; and execution of certain payment transactions by any means of communication at a distance such as mobile telephones or other digital or IT devices.¹³⁶

Article 3 deals with the outer limits of the Proposed Directive. Thereunder, cash payments, collections, delivery and transport, as well as certain cash refunds¹³⁷ are specifically excluded. Also excluded from the coverage of the Proposed Directive are change of foreign currency in the form of cash-to-cash operations; paper checks, vouchers, traveller's checks and promissory notes;¹³⁸ payment transactions carried out within a payment or security clearing and settlement system; payment processing services; payment by instruments which are not redeemable within a limited network or affiliated service providers; certain payment transactions executed by means of a mobile telephone or any other digital or IT device,¹³⁹ and payment transactions carried out between payment service providers as well as tied agents or subsidiaries.¹⁴⁰

Coverage of payment transactions by any means of communication at a distance requires further analysis. The "Execution of a payment transaction by any means of communication at a distance such as mobile telephones or other IT devices" is a payment service listed in the Annex and is thus covered by the Proposed Directive, "where the service provider operating the telecommunication or IT system or network,"

- "is facilitating the *payment of goods or services that are not digital goods or electronic communication services* and so are provided through the device itself"; or
- "simply arranges a transfer of funds for the *payment of digital goods or electronic communication services provided through the device*, without any other intervention in the service provided."¹⁴¹

Conversely, under Article 3(j), "Payment transactions executed by means of a mobile telephone or any other digital or IT device" is to be excluded from the Proposed Directive, "where all the following conditions are met":

135. "Direct debit," "credit transfers," and "payment card" are not defined in the Directive.

136. Although the "execution of payment transactions . . . at a distance" are generally covered by the Directive, an exception exists in Article 3(j), as discussed below. *Id.* ann. at 54.

137. *Id.* art. 3(d) (excluding "cash refunds provided by the payee to the payer after a payment transaction following an explicit request by the payment service user made just before the execution of a payment transaction through a payment card and completely independent of the cost of the good or services purchased . . .").

138. *See id.* at 13 ("This [proposed] Directive should not apply to payment transactions made in cash or to those based on paper cheques since, by their nature, they cannot be processed as efficiently as other means of payment, in particular electronic payments."). In light of Part I of this Paper, the reasoning underlying this statement ought to be taken with a grain of salt, at least insofar as checks are concerned.

139. For the conditions under which payment transactions executed by mobile phone or digital or other IT devices are covered under the Annex and excluded under Article 3(j), see next paragraph.

140. *Commission Proposal, supra* note 126, art. 4(16) ("['T]ied agent' means a natural or legal person which acts on behalf of a payment institution in carrying out payment services . . .").

141. Emphasis added

- (i) “the service provider operating the telecommunication or IT system or network is closely involved in the development of the digital goods or electronic communication services provided”; and
- (ii) “the goods and service cannot be delivered in the absence of the service provider.”

These provisions distinguish between “digital goods or electronic communication services” (digital products) and other goods and services (non-digital products). Language and rationale of these provisions are not entirely clear. For example, for the Proposed Directive to apply, why does the language quoted in the first bullet limited to non-digital products provided “through the device itself”? And if they are not provided “through the device itself,” can they still be covered under another more general “payment service”? Second, exclusion under Article 3(j) is limited to digital products covered under the second bulleted quoted language. Yet, the rationale of this exception is not self explanatory; moreover, there is a gray area between the second bulleted quoted language (under which service is covered) and the exclusion under Article 3(j); thus, any “intervention in the service provided,” beyond the arrangement of the funds transfer, will exempt the transaction from coverage under the second bulleted quoted language; at the same time, to fall within the exclusion under Article 3(j), the service provider’s involvement must exceed mere intervention; he must be “closely involved in the development of the digital goods or electronic communication services provided.”

Title I of the Proposed Directive provides for subject matter, scope and definitions. It is followed by three substantive components. First, Title II covers payment service providers. Second, Title III deals with transparency of conditions for payment services. Third, Title IV governs rights and obligations in relation to the provision and use of payment services. Under Article 2, both Titles III and IV are limited to payment transactions of up to EUR 50,000; stated otherwise, they provide for payment law for retail funds transfers. While large-value payments are thus excluded, payments of up to EUR 50,000 taking place on wholesale transfer systems, particularly targeted at large-value payments, remain nevertheless covered.¹⁴² The three substantive components are followed by Titles V and VI dealing with amendments, Payment Committee, and final provisions.

The ensuing discussion outlines the statutory scheme set out in the three substantive parts, namely Titles II, III and IV, covering licensing, transparency, and transaction rights and obligations.

*B. Licensing of Non-Bank Payment Service Providers*¹⁴³

Title II establishes a legal framework for a single license for all providers of payment services which are not connected to taking deposits or issuing e-money, and regulated under existing EU directives.¹⁴⁴ Payment service providers falling into this residuary category are referred to in the Preamble and the head-note to Chapter 1 of

142. *Id.* at 13 (“[P]ayment[s] above this amount are not generally processed [in] the same way, are often channelled through different networks and are submitted to different technical and legal procedures that should be maintained.”).

143. *Cf.* UNIF. MONEY SERVICES ACT art. 2 (2001).

144. *See generally* Council Directive 2000/12, 2000 O.J. (L 126) 1; Council Directive 2000/46, 2000 O.J. (L 275) 39.

Title II as “payment institutions,” which otherwise, are not defined in the Proposed Directive. Title II is designed to “create a level-playing field, instil more competition in national markets and reflect market developments in recent years, triggering market entry of a new generation of providers.”¹⁴⁵ To that end it is further designed to harmonize market access, also with the view of facilitating “the gradual migration of . . . providers from the unofficial economy to the official sector.”¹⁴⁶ In the language of Paragraph 9 of the Preamble:

The conditions for the granting and maintenance of authorisation of payment institutions should include prudential requirements proportionate to the operational and financial risks faced by such bodies in the course of their business. Those requirements should reflect the fact that payment institutions engage in more specialised and restricted activities, thus generating risks that are much narrower and easier to monitor and control than those that arise across the spectrum [or deposit-taking] credit institutions. In particular, payment institutions should be prohibited from accepting deposits from users and permitted to use only funds accepted from users for rendering payment services.¹⁴⁷ Provision should be made for client funds to be kept separate from the payment institution’s funds for other business activities.¹⁴⁸ Payment institutions should also be made subject to effective anti-money laundering and anti-terrorist financing requirements.¹⁴⁹

Authorization is to be valid in all Member States.¹⁵⁰ However, to prevent the forcing out into the “black economy” of those unable “to meet the full range of conditions for authorisation as payment institutions,” provision is made for the registration “of payment institutions while not applying all of the conditions for authorisation,” but only as long as derogation is limited to the provision of payment services within the Member State of registration and is “subject . . . to strict requirements relating to volume of transactions and importance for the public interest.”¹⁵¹

Activities permitted to payment institutions are enumerated in Article 10(1). They consist of (i) the provision of payment services; (ii) the provision of operational and related ancillary services such as the guaranteeing of the execution of payment transactions, foreign exchange services, safekeeping activities, and storage and processing of data; and (iii) accessing and operating payment systems¹⁵² for the

145. *Commission Proposal*, *supra* note 126, at 7.

146. *Id.*

147. “[F]unds received by payment institutions from payment service users with a view to the provision of payment services shall not constitute a deposit or other repayable funds within the meaning of Article 3 of Directive 2000/12/EC, or electronic money within the meaning of Directive 2000/46/EC.” *Id.* art. 10(1). The former Directive governs deposit-taking by credit institutions and the latter governs electronic money institutions. *See supra* note 144.

148. Article 10 codifies the separation of payment service users funds from non-payment service funds. *Commission Proposal*, *supra* note 126, art. 10(2).

149. *Id.* at 12.

150. *Id.* art. 6.

151. *Id.* at 12-13; *see infra* note 160.

152. *See Commission Proposal*, *supra* note 126, art. 4(3) (“‘[P]ayment system’ means a funds transfer system with formal and standardised arrangements and common rules for the processing, clearing and/or

purpose of transferring, clearing and settling funds, including any instruments and procedures relating to the systems. Under Article 10(3), all such activities “shall be non-exclusive and shall not be restricted to payment services, having regard to the applicable national and Community law.”¹⁵³

Specific provisions deal with the authorization process;¹⁵⁴ govern the use of third-parties by payment institutions;¹⁵⁵ require record-keeping,¹⁵⁶ registration of head office¹⁵⁷ and professional secrecy;¹⁵⁸ provide for supervision,¹⁵⁹ and regulate the derogation from authorization and its substitution by registration requirements.¹⁶⁰ Finally, equality of treatment throughout the Community between the different categories of payment service providers is provided for.¹⁶¹

C. Transparency of Conditions for Payment Services

Title III governs transparency of conditions for payment services for payment transactions throughout the Community that do not exceed EUR 50,000.¹⁶² It is stated to aim at providing users with standardized “high level of clear information” enabling them “to make well-informed choices and be able to shop around within the EU” and yet to ensure that “[m]icro payments should be a cheap and easy-to-use alternative in the case of low-priced goods and services and should not be overburdened by excessive requirements.”¹⁶³

Title III has separate rules for single payment transactions (Articles 24-28) and for framework contracts (Articles 29-38). Common provisions (Articles 39-40) cover the selection of currency. A “framework contract” is defined in Article 29 to refer to an agreement which “commits a payment service provider to execute in the future successive payment transactions or individual payment transactions on the order of the payer if the agreed conditions are met.”¹⁶⁴ No requirements are laid out as to

settlement of payment transactions . . .”).

153. *Id.* art. 10(3).

154. *Id.* arts. 5-9.

155. *Id.* arts. 11-12.

156. *Id.* art. 13.

157. *Id.* art. 14.

158. *Commission Proposal, supra* note 126, art. 17.

159. *Id.* arts. 15-16.

160. *Id.* arts. 21-22. Derogation is where registration is necessary for the effective implementation of anti-money laundering and terrorist financing rules and mechanisms, for an institution whose business activity generates “a total amount of funds outstanding which were accepted for the provision of payment services and which does not exceed EUR 5 million on average over a month and EUR 6 million at any given point in time,” and which plays a vital role in financial intermediation, providing access to payment services for underprivileged social groups. *Id.* art. 21(1). A person benefiting from the exception shall be treated as a payment institution but may provide payment services only within the Member State of registration and may be permitted to engage only in certain of the activities listed in Article 10. *Id.* art. 21(2).

161. *Id.* art. 23 (“[R]ules on access to and operation of payment systems shall be objective and proportionate and shall not inhibit access more than is necessary to safeguard against specific risks and to protect the financial safety of the payment system.”).

162. *Commission Proposal, supra* note 126, arts. 2, 24-40; *see also id.* art. 84 (providing for the repeal of Council Directive 97/5, 1997 O.J. (L 43) 25).

163. *Id.* at 13-14; *see also id.* art. 38(1) (defining “micro payment” as one not exceeding 50 Euro).

164. *Id.* art. 29.

either the medium in which such a contract is to be contained or as to whether the contract must be express.

There is some overlap in disclosure requirements for both single payment transactions and framework contracts. For both, conditions are to be “set out in easily understandable words and in a clear and readable form,” “on paper or on another durable medium,”¹⁶⁵ and “in good time before the payment service user is bound”¹⁶⁶ In each case,¹⁶⁷ conditions consist of description of respective obligations and liabilities which include information or unique identifier¹⁶⁸ to be provided by user in order for a payment order¹⁶⁹ to be properly executed; execution time; and where applicable or appropriate, conditions such as safekeeping requirements for and risks associated with a payment verification instrument,¹⁷⁰ and how to notify the service provider in case of loss or theft of the instrument. Conditions to be disclosed further consist of a clear reference to the point of time of acceptance of a payment order;¹⁷¹ pertinent charges and “where applicable,” relevant exchange rate; indication as to the governing law and competent court; indication of the redress and complaint procedure; and “an indication of where any other information may be made available and be consulted.”

In addition to such common disclosures for both categories, for a single payment transaction specific disclosure requirements are set out in Article 26(1).¹⁷² They address liability for the execution of the payment transaction, “information to be provided in accordance with Directive 2005/. . ./EC,”¹⁷³ and the availability of appropriate funds.¹⁷⁴ By the same token, and in addition to the common disclosures

165. “[D]urable medium’ means any instrument which enables information addressed personally to the payment service user to be stored in a manner accessible for future reference for a period of time adequate to the purposes of the information and which allows the unchanged reproduction of the information stored; in particular, durable medium covers printouts by account printers, floppy disks, CD-ROMs, DVDs and hard drives of personal computers on which electronic mail is stored but excludes internet sites, unless such sites meet the criteria specified in the first sentence of this point.” *Id.* art. 4(19).

166. *Id.* arts. 25(1), 26; *see also id.* arts. 30(1), 32 (describing the communication of conditions to the payment service user with regard to framework contracts).

167. *See Commission Proposal, supra* note 126, art. 26(1), 31(1).

168. *Id.* art. 4(15) (“[U]nique identifier’ means the information specified by the payment service provider and to be provided by the payment service user to identify unambiguously the other payment service user involved in a payment transaction, and consisting of the IBAN (International Bank Account Number), the BIC (Bank Identifier Code), a bank account number, a card number or a name . . .”).

169. *Id.* art. 4(10) (“[P]ayment order’ means any instruction by a payer or payee to his payment service provider requesting the execution of a payment transaction . . .”).

170. *Id.* art. 4(17) (“[P]ayment verification instrument’ means any personalised device(s) and/or set of procedures used by the payment service user in order to enable the payment service provider to authenticate a payment order. If it is not provided by the payment service provider, the payment service provider and the payment service user may agree on the use of any other instrument for the authentication of payment orders which may also serve other purposes . . .”); *id.* art. 4(13) (“[A]uthentication’ means a procedure which allows the payment service provider to verify that the user issuing the payment order is authorised to do so . . .”).

171. *Id.* art. 54 (time of acceptance is established only after the payment service provider has received, authenticated, and explicitly or implicitly accepted the obligation to execute the payment order).

172. *Commission Proposal, supra* note 126, art. 26(1).

173. *See id.* art. 26(1)(a)(v) (the blank reference ought to be taken as referring to a directive in preparation).

174. *Id.* art. 4(9) (“[A]vailability of funds’ means that the funds on a payment account may be used by the payment service user without fees being charged . . .”).

set out above, for a framework contract specific disclosure obligations are set out in Article 31(1).¹⁷⁵ They relate to the technical requirements with respect to user's equipment, termination rights, blocking of a payment verification instrument in case of suspicion of fraud, and spending ceilings. For a framework contract, explicit information on execution time and charges is to be disclosed before the execution of each payment transaction.¹⁷⁶

For each payment transaction, whether it is single or pursuant to a framework contract, subsequent to the acceptance of payment order for execution, the payment service provider is mandated¹⁷⁷ to make available to the payer a reference enabling the identification of the payment transaction, "where appropriate" information relating to the payee, amount of payment as well as of fees and charges, and "where relevant" exchange rate. Subsequent to making funds, received for the payee, available to him, the payment service provider is required¹⁷⁸ to make a similar disclosure to the payee,¹⁷⁹ though obviously with information as to the payer replacing information as to the payee. For a framework contract specific provisions are made in Articles 33 and 34 to govern changes in contractual provisions and termination.

Under Article 38, disclosure requirements are substantially reduced in connection with "a [framework] contract concerning payments where no individual payment can exceed EUR 50"¹⁸⁰ In a case of a contract for such "micro payments," "the payment service provider shall communicate to the payment service user . . . only the main characteristics of the payment service to be provided, the way in which it can be used and all charges applicable."¹⁸¹ Further required information is to be provided "in an easily accessible manner."¹⁸² Subsequent to the execution of such a payment transaction, a service provider is to communicate "at least a reference enabling the . . . user to identify the payment transaction, the amount . . . and the fees"¹⁸³

D. Rights and Obligations of Users and Providers of Payment Services

Title IV provides for substantive law for major aspects of payment transactions not exceeding EUR 50,000. It covers the authorization of payment transactions, the execution of payment transactions, data protection, and penalties and procedures for settlement disputes.

Authorization of payment transactions is governed by Chapter 1 consisting of Articles 41-53. Article 2(1) defines a "payment transaction" to "consist in the act, initiated by the payer or the payee, of depositing, withdrawing or transferring funds

175. *Id.* art. 31(1).

176. *See id.* art. 35.

177. *See id.* art. 27 (single payment transaction); *see also id.* art. 36 (payment transaction executed pursuant to a framework contract).

178. *See Commission Proposal, supra* note 126, art. 28 (single payment transaction); *see also id.* art. 37 (payment transaction executed pursuant to a framework contract).

179. *See id.* arts. 25(1), 26(2), 30(1), 31(2) (disclosure requirements).

180. *Id.* art. 38.

181. *Id.*

182. *Id.*

183. *Id.* *Quare* as to whether these requirements are specific enough to guide payment service providers as to what they ought to do.

from a payer to a payee . . .”; this includes both payer-initiated “credit-push” and payee-initiated “debit-pull” transfers.¹⁸⁴ Article 41 however equates authorization only with the payer’s consent, which is obviously required also for “debit-pull” withdrawals by the payee from the payer’s account. Arguably, then, Chapter 1 is concerned only with the payer’s authorization, for payment transactions initiated by either the payer or the payee.

Article 42 envisages that an authorization for a payment transaction is to be subject to a procedure agreed between the payer and the payer’s payment service provider, that it may be communicated directly to the payer’s payment service provider or indirectly via the payee, and that it may (though not must) be transmitted by means of a “payment verification instrument.”¹⁸⁵ As well, authorization must specify the exact amount and identify the payee; it also must be in an amount expected from a reasonable payer in that position.¹⁸⁶

The following summary outlines the exposure to payment transactions purported to emanate under the authority of a payment service user as a payer:

1.) Under Article 41, a payer is bound only for payment transactions explicitly authorized by him.¹⁸⁷ Otherwise, “a payment transaction shall be considered to be unauthorised.” Curiously, there is no provision for implied or apparent authority.¹⁸⁸ Authorization may be given either prior or subsequent to the execution of the payment transaction. Under Article 43, where it is transmitted by means of a payment verification instrument it may vary with respect to prescribed spending limits.

2.) A payment service user may further be liable under Article 50(1) for the loss up to EUR 150 “resulting from the use of a lost or stolen payment verification instrument¹⁸⁹ and occurring before he has fulfilled his obligation to notify his

184. In a credit transfer, such as a direct payroll, benefit deposit, or a wire transfer, the payer’s instructions are communicated to the payer’s bank directly, so as to ‘push’ funds to the payee’s account. Conversely, in a debit transfer, such as the deposit of a check for collection or the collection of insurance premiums, loan installments, or taxes, the payee, acting under the payer’s authority, instructs the payee’s bank to ‘pull’ or collect funds from the payer’s account. In a credit transfer, the banking operation commences with a debit to the payer’s account. In contrast, in a debit transfer, the banking operation typically commences with a credit, albeit temporary and provisional (pending collection from the payer), to the payee’s account. See, e.g., Benjamin Geva, *International Funds Transfers: Mechanisms and Laws*, in *CROSS-BORDER ELECTRONIC BANKING: CHALLENGES AND OPPORTUNITIES* 1, 2-3 (Chris Reed, Ian Walden & Laura Edgar eds., 2nd ed. 2000).

185. *Commission Proposal*, *supra* note 126, art. 4(17) (“‘[P]ayment verification instrument’ means any personalised device(s) and/or set of procedures used by the payment service user in order to enable the payment service provider to authenticate a payment order. If it is not provided by the payment service provider, the payment service provider and the payment service user may agree on the use of any other instrument for the authentication of payment orders which may also serve other purposes . . .”).

186. *Id.* arts. 52-53 (governing refund for authorized payments that do not meet these requirements, for other than large enterprises). Per Preamble paragraph 23, “refund rights should not affect the liability of the payer vis-à-vis the payee . . .” *Id.* at 14.

187. I follow the language of the Proposed Directive which uses “he” and “him” to include “she” or “her.”

188. As a matter of agency law, authority can be actual or apparent. Actual authority may be express or implied. See, e.g., *BLACK’S LAW DICTIONARY*, *supra* note 97, at 67, 142.

189. A Member State may reduce that maximum amount for payment service providers authorized by it. *Id.*

payment service provider” of the loss or theft.¹⁹⁰ Under Article 46(b), the obligation is “to notify . . . without undue delay on becoming aware of loss, theft or misappropriation of the payment verification instrument or of its unauthorised use.”¹⁹¹ Presumably then, the payer is not liable for loss occurring prior to learning the loss or theft since until then he has not been in breach of his notification obligation.

3.) Notwithstanding no. 2 above, the payment service user “shall bear all the losses on unauthorised transactions if he incurred them by acting fraudulently or with gross negligence with regard to his obligations under Article 46.”¹⁹² It is noteworthy that Article 45 requires the user to keep safe security features of a payment verification instrument and use it in accordance with the terms governing its issuing and use, and to give timely notification of loss or theft. It is however not explicitly stated that loss caused by breach of such duties, other than that of the duty to promptly notify covered by Article 46(b), is to be allocated to the payment service user.

4.) Under Article 49, the payment service provider is to refund the payment service user “forthwith” the amount of an unauthorized payment transaction; presumably this applies to any amount for which the user is not responsible under no. 2 and 3 above. The provision goes on to state: “Further financial compensation may be determined in accordance with the law applicable to the contract concluded between the payment service provider and the payment service user.”¹⁹³

5.) Where a payment service user disputes an alleged authorization, under Article 48(1), “the payment service provider is to provide at least evidence that the payment transaction was authenticated,¹⁹⁴ accurately recorded, entered in the accounts and not affected by a technical breakdown or some other deficiency.”¹⁹⁵ Presumably, such facts give rise to a presumption of authorization. Arguably, in this context, the payment service provider is to prove compliance with obligations fastened on him with respect to the payment verification instrument under Article 47. These obligations are to protect the security features of a payment verification instrument, to refrain from sending unsolicited payment verification instruments, and to ensure that appropriate means are available to enable users to make notification.

6.) To rebut this presumption, the payment transaction user is required under Article 48(2), to “provide factual information or elements to allow the presumption that he could not have authorised the payment transaction and that he did not act fraudulently or with gross negligence with regard to the obligations incumbent upon him”¹⁹⁶

7.) In any event, under Article 48(3), “the use of a payment verification instrument recorded by the payment service provider shall not, of itself, be sufficient

190. *Commission Proposal, supra* note 126, art. 50(1).

191. *Id.* arts. 45(1), 46(b). However, under Article 50(4), the payment service user who has not acted fraudulently is dissolved of any responsibility if the payment service provider “does not provide adequate means for the notification” *Id.* art. 50(4). For the payment service provider’s record-keeping obligations, see *id.* art. 44.

192. *Id.* art. 50(2); see also *id.* art. 50(3).

193. *Id.* art. 49.

194. For the definition of “Authentication,” see *supra* note 170.

195. *Commission Proposal, supra* note 126, art. 48(1).

196. *Id.* art. 48(2).

to establish either that the payment was authorised by the payment service user or that the payment service user acted fraudulently or with gross negligence”¹⁹⁷

Two exemptions are provided for in Article 51. First, under Article 51(2), protections against unauthorized use are limited in the case of e-money. Particularly, responsibility for unauthorized use continues notwithstanding of giving notice of theft or loss, as long as payment service provider is technically incapable to freeze or prevent further spending of the e-money stored on the electronic device. Second, Article 51(1) exempts large enterprises¹⁹⁸ from Articles 49-50, dealing with respective liabilities of provider and user for losses in respect of unauthorized payment transactions. The exemption is however unclear and not self-explanatory. So far as Article 49 is concerned, does the exemption mean that large enterprises are not entitled to a refund for unauthorized payments? This is absurd. Does it only mean they are not entitled to refund “forthwith”? Exemption from Article 50 is even more enigmatic; does it mean that large enterprise is released from the EUR 150 minimum liability for no-fault unauthorized use? Presumably, per Preamble Paragraph 22, the intent has been to exempt large enterprises from the entire unauthorized use loss allocation scheme, “since such enterprises are normally in a position to assess the risk of fraud and take countervailing measures.”¹⁹⁹ Arguably, the theory may also be that large enterprises are in a position to bargain with payment institutions for a favorable loss allocation scheme.

Chapter 2 of Title IV, consisting of Articles 54-74 deals with various aspects relating to the execution of a payment transaction. It is divided to three Sections. Section 1, consisting of Articles 54-58, deals with payment orders, fees, and amount transferred. Section 2, consisting of Articles 59-64, deals with execution time. Section 3, consisting of Articles 65-70, deals with availability of funds and liability.

For all these stages and aspects, the point of acceptance is of fundamental importance. Section 1 identifies for a payment order, the point of both the loss of its revocability by the payment service user,²⁰⁰ as well as arguably, of the loss the refusal right by the payment service provider.²⁰¹ Either loss occurs upon the acceptance by the payment service provider. As well, as will be seen further below, under Section 2, permissible execution time is as of the acceptance of the payment order. Finally, under Section 3, upon acceptance, a payment service provider incurs strict liability for non-execution or defective execution.

“Acceptance” is, however, not defined; presumably it denotes the binding agreement of the payment service provider to carry out the payment order, which, in turn, is defined in Article 4(10) to mean “any instruction by a payer or payee to his payment service provider requesting the execution of a payment transaction.” Under Article 54, acceptance of a payment order covered by a payer’s authorization

197. *Id.* art. 48(3).

198. Defined by reference to Articles 1 and 2(1) and (3) of Title I of the Annex to Recommendation 2003/361/EC. *Id.* art. 51(1).

199. *Id.* at 14.

200. *See id.* art. 56 (“[T]he payment service provider and the payment service user may agree on a date of irrevocability that falls within the three working days preceding the point in time of acceptance for the order.”).

201. *See Commission Proposal, supra* note 126, art. 55 (providing some limits and requiring prompt advice “in any case, within three working days” of the refusal and related information). Unlike Article 56, Article 55 is not explicit as to the loss of the right of refusal upon the acceptance of the payment order.

may not occur prior to its receipt, complete authentication,²⁰² and the explicit or implicit acceptance of the obligation to execute the payment transaction ordered, by the payment service provider. Making acceptance contingent in part on the occurrence of explicit or implicit acceptance is however an awkward way to state that acceptance may be either explicit or implicit; the provision thus goes on to state that acceptance (whether explicit or implicit) may not occur prior to the receipt of the payment order and its authentication. Article 54(1) further states that acceptance “shall not be later than the point in time when the payment service provider starts to execute the payment transaction”; presumably then, the commencement of “execution” is the mode par excellence for an implicit acceptance.

Further under Article 54(2), where the payment transaction is “electronically initiated,”²⁰³ the payment service provider is to inform the payment service user of the acceptance, “without undue delay and, in any case, before the end of the next working day after the point in time of acceptance”²⁰⁴ Such notice is however to be given after the acceptance, and is not part of the acceptance itself.

For an intra-Community transfer, and in the absence of currency exchange, fees are to be charged to each payment service user only by his payment service provider; intermediaries are precluded from deducting fees from the amount transferred.²⁰⁵

Section 2, consisting of Article 60-64, deals with execution time. Article 59 states that the Section applies “only if the payment service providers of both the payer and the payee are located in the Community” and not to apply to micro payments, presumably, those of EUR 50 and below.²⁰⁶ Limits are set for both payer and payee initiated payment transactions; per Article 64 such limits may be shortened for “purely national payment transactions.”²⁰⁷

For both payment transactions initiated by the payer and payment transactions initiated by or through the payee, under both Articles 61 and 62, execution is to be completed not later than at the end of the first working day following the point of time acceptance. Execution is completed typically by having the amount credited to the payee’s account,²⁰⁸ and in the case of a payment transaction initiated by or through the payee, also by having the funds made available to the payee.²⁰⁹ Unfortunately, there is no provision explicitly linking the completion of the execution of a payment transaction initiated by or through the payee with the posting of an irrevocable and final debit to the payer’s account.

In any event, this one-day time limit for the execution of a payment transaction, rationalized on the need “to improve the efficiency of payments throughout the Community,”²¹⁰ is, however, partially compromised as follows:

202. For the definition of “Authentication,” see *supra* note 170.

203. Neither execution nor electronic initiation is defined.

204. *Commission Proposal, supra* note 126, art. 54(2).

205. *See id.* arts. 57-58.

206. *Id.* art. 59; *see supra* notes 154, 183-183 and accompanying text.

207. *Commission Proposal, supra* note 126, art. 64.

208. Though, per Article 62, the deadlines remain effective even in the absence of payee’s payment account with the payment service provider. Per Article 63, the one-day execution deadline also applies to credit given for cash deposits by the payment service user to his own account.

209. Stated otherwise, provisional credit will not satisfy the deadline requirement.

210. *Id.* at 15.

For payment transactions initiated by the payer, “up to 1 January 2010, a payer and his payment service provider may agree on a period no longer than three days.”²¹¹

For payment transactions initiated by the payer, and for all payment transactions initiated by or through the payee, an explicit agreement between the initiator and his payment service provider may agree on a longer (or in theory, shorter) execution period.

For a payment transaction initiated by or through the payee, his payment service provider has the option of refusing to release the funds to the payee, but is to inform the payee of the refusal within the time for execution. Presumably, this is designed to provide for the case of dishonor by the payer’s payment service provider.

Section 3, consisting of Articles 65-70, deals with funds availability and liability. So far as liability is concerned, it covers misdescription of payee and liability for non-execution or defective execution.

In principle, under Article 65, funds are to become available to the payee, at no additional fees, as soon as they are credited to the payee’s account. No provision is made for provisional credit to the payee’s account in connection with debit-pull transfers initiated by the payee. Similarly, funds cease to become available to the payer once they are debited to the payer’s account. The point in time at which an account is debited or credited is respectively the debit value date for the payer’s payment account and the credit value date for the payee’s payment account.²¹²

Article 66(1) appears to protect a payee’s payment service provider that executed a payment order “in accordance with the unique identifier²¹³ provided by the user.”²¹⁴ An account number, or more specifically an IBAN,²¹⁵ specified as the unique identifier “take[s] precedence over the name of the payee if it is provided additionally.”²¹⁶ These absolute statements are however immediately qualified, since the payment service provider is required “where possible” to verify the consistency of the account number with the name. Certainly, the provision is not to be taken to protect a service provider that either neglected that duty or that credited an account knowing it does not belong to the named payee.²¹⁷

Under Article 66(2), “If the unique identifier provided by the payment service user is incorrect, the payment service provider shall not be liable for the non-execution or defective execution of the transaction.” It is not clear however whether “incorrect” includes “inconsistent” under Article 66(1) and if so what effect has the verification duty as well as its fulfillment on the defense available to the service provider under Article 66(2). In any event, notwithstanding this defense, a payment service provider that misdirected payments on the basis of an incorrect unique identifier is required to “make a bona fide effort to recover the funds involved in the

211. *Id.* art. 60(1).

212. *Id.* art. 65.

213. See *supra* note 168 and accompanying text (defining “unique identifier”).

214. *Commission Proposal*, *supra* note 126, art. 66.

215. IBAN is an acronym for the International Bank Account Number. *Id.* art. 4(15).

216. *Id.* art. 66(1).

217. *Id.* art. 66.

payment transaction.”²¹⁸ No provision is made for errors in the amount of a payment transaction.

Subject to that, under Article 67, upon acceptance, a payment service provider incurs strict liability “for the non-execution or defective execution of a payment transaction” that cover also additional fees and interest charges. Per Article 69, additional compensation under national law applicable to the contract between the payment service provider and user is not precluded. There is, however, no provision for privity nor for its dispensation; no chain of liability is provided for so that it is not clear who is liable to whom. There is also no express provision for money-back guarantee, namely, for the refund obligation of the payer’s payment service provider, in case execution has not been properly completed. At the same time, liability is excused under Article 70 in case of force majeure or “where a payment service provider is bound by other legal obligations expressly covered by national or Community legislation, such as money laundering and anti-terrorist financing provisions.”²¹⁹ Under Article 68, where the payment service provider of the payee is not located in a Member State, “the payment service provider of the payer shall be liable for the execution of the payment transactions only until the funds reach the payee’s payment service provider.”²²⁰ *Quare* as to the scope of the responsibility of the payer’s payment service provider beyond that point, in the case in which the payee’s payment service provider is located in a Member State. It may also not be clear as to whether in any event the payer’s payment service provider’s responsibility under Article 67 amounts to a money-back guarantee. At least so far as the second question is concerned, the language appears to be broad enough to cover an unlimited money-back guarantee obligation of the payment service provider of the payer.²²¹

Chapter 3 of Title IV dealing with data protection consists exclusively of Article 71 which permits the processing of personal data by payment systems and payment service providers “when this is necessary to safeguard the prevention, investigation, detection and prosecution of payment fraud.”²²² The effect is to provide for an exemption from rules governing data protection.²²³

Finally, Chapter 5 of Title IV, consisting of Articles 72-75, deals with penalties and dispute settlement. It provides a framework for setting up complaint procedures, penalties for violations, enforcement by competent authorities, and out-of-court redress.

218. *Id.* art. 66(2)

219. *Id.* art. 70.

220. *Id.* art. 68.

221. This is to be contrasted with the 12,500 limit to the qualified money-back guarantee obligation under Council Directive 97/5, art. 8, 1997 O.J. (L 43) 25. On its treatment of the money-back guarantee, see Benjamin Geva, *Cross-Border Credit Transfers in Euros: Legal and Operational Aspects*, in YEARBOOK OF INTERNATIONAL FINANCIAL AND ECONOMIC LAW 173, 173-98 (Joseph J. Norton ed., 1999).

222. *Commission Proposal*, *supra* note 126, art. 71.

223. The provision goes on to require processing to be carried out according to Directive 95/46. Council Directive 95/46, 1995 O.J. (L 281) 31.

E. Final Remarks

Purporting to facilitate the establishment of a Single Payment Market where improved economies of scale and competition would help to reduce costs of the payment system, the Commission proposed to establish a common framework for the Community payments market, creating the conditions for integration and rationalisation of national payment systems. Focusing on electronic payments, the Commission made a proposal for a Directive on payment services in the internal market, designed to provide for a harmonised legal framework. Intended to leave maximum room for self-regulation of industry, the Proposed Directive purports to harmonise only what is necessary to overcome legal barriers to a Single Euro Payment Area (SEPA).

However, in the final analysis, steps taken towards Pan-European common legal principles are quite modest. Payment amount ceilings and a narrow range of selected topics, primarily focusing on the payer-bank and payee-bank relationships, resulted in a scheme whose scope and contents cannot be compared for example to of UCC Article 4A. Arguably, too much room was left for national general laws to fill in blanks. Nevertheless, the proposal goes beyond consumer aspects. As for payment transactions covered, besides credit transfers, the proposal covers debit transfers. Its solutions are reasonable in meeting the needs of the various participants. Hence, the proposal is a noteworthy milestone in the march to a comprehensive payment law. There is however still a long way to go to such a final destination. It remains to be seen how much will and determination exist to go further, and if so, how far.

VI. CONCLUSION

The four topics covered in this survey are the transformation of the check payment into an electronic funds transfer, the payroll card as an access and not stored-value device, the emergence of indirect holding for securities and the ensuing evolution of “security entitlement” as a principal form of investment property, and the march towards a Pan-European common payment law covering electronic retail funds transfers. A common theme is the adaptation of the law by statute to accommodate the world of electronic banking as it keeps evolving.

Regarding the electronic presentment of checks, Canada did not proceed to adopt the proposal of the Canadian Payments Association discussed in Part II.D. Rather, it amended the Bills of Exchange Act²²⁴ to permit²²⁵ a bank to present for payment an “official image” of an “eligible bill”,²²⁶ including a check, “electronically in accordance with by-laws, rules or standards made under the *Canadian Payments*

224. Section 398 of An Act to amend the law governing financial institutions and to provide for related and consequential matters S.C. 2007, c. 6, which received Royal assent on March 29, 2007. Section 398 came into force April 20, 2007. It adds Sections 163.1-163.6 to the Bills of Exchange Act, note 41, *supra*. Unless indicated otherwise, statutory references in this Addendum are to the Bills of Exchange Act as amended.

225. New Section 163.3.

226. Defined in New Section 163.1 as: “a bill that is of a class specified by a by-law, a rule or a standard made under the *Canadian Payments Act*.”

Act” in which case the requirements of the Bills of Exchange Act respecting the presentment for payment of the check “are deemed to have been complied with.”

An “official image” is defined in New Section 163.1 as:

“an image of [an] eligible bill created by or on behalf of a bank in accordance with bylaws, rules or standards made under the *Canadian Payments Act*, together with any data in relation to the eligible bill prepared in accordance with those by-laws, rules and standards, and includes a display, a printout, a copy or any other output of that image and that data created by or on behalf of a bank in accordance with those by-laws, rules and standards. “

An official image of a check “may be dealt with and used for all purposes as though it were the [check]”;²²⁷ together with the check it is discharged “if payment in due course is made by or on behalf of the drawee after the electronic presentment for payment of the official image...”²²⁸ An official image further benefits from presumptions of authenticity²²⁹ and of being a true and complete copy of the original check;²³⁰ it is also admissible in evidence.²³¹ A properly destroyed check, for which there is an official image, is not considered lost, materially altered or intentionally cancelled; its lawful destruction does not affect the rights, powers, duties and liabilities of any person, by virtue of lack of possession or otherwise.²³²

Finally, a bank that creates an official image warrants its authenticity, accuracy, and compliance with all requirements and is liable for damages suffered by any person as a result of the breach of this warranty.²³³

The new provisions do not cover electronic presentment made outside the check clearing system operated by the Canadian Payments Association.

227. New Section 163.2.

228. New Section 163.3(2).

229. New Sections 163.4(1)

230. New Section 163.4(3).

231. New Section 163.4(2)

232. New Section 163.5.

233. New Section 163.6.