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# Developments in the Laws Affecting Electronic Payments and Stored-Value Products: A Year of Stored-Value Bankruptcies, Significant Legislative Proposals, and Federal Enforcement Actions

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# Developments in the Laws Affecting Electronic Payments and Stored-Value Products: A Year of Stored-Value Bankruptcies, Significant Legislative Proposals, and Federal Enforcement Actions

*By Patricia Allouise, Sarah Jane Hughes, and Stephen T. Middlebrook\**

## INTRODUCTION

Electronic payment products are eclipsing traditional check-based payments in the United States. A study by the Federal Reserve System released in November 2007 reports that check payments are decreasing and more than two thirds

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\* Members of the Electronic Payments Working Group, Committee on Cyberspace Law, ABA Section of Business Law. The Working Group thanks the Indiana University School of Law-Bloomington for research support and Mario K. Castillo, Destiny M. Wenning, Michelle V. McCrory, and Kevin M. Dent for their assistance with this Survey.

Patricia Allouise is Assistant Vice President and Assistant General Counsel, Federal Reserve Bank of Boston. Ms. Allouise's research is current through June 3, 2008. She prepared the parts of this year's Survey that discuss Regulation E, gift cards and bankruptcy, and truncation of receipts. The views expressed in this Survey do not necessarily reflect the views of the Federal Reserve Bank of Boston or any other component of the Federal Reserve System.

Sarah Jane Hughes is the University Scholar and Fellow in Commercial Law at the Indiana University School of Law-Bloomington. She is the author of the parts of this Survey on state gift and payroll card laws, the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA"), and federal enforcement actions. She serves as co-chair of the Joint Subcommittee on Electronic Payments and Financial Services, ABA Section of Business Law, and was co-chair of the Electronic Payments Working Group (2006–2008). Her research is current through June 13, 2008. Professor Hughes is the author of numerous articles about payments and U.S. policy on the deterrence of money laundering; she also contributes to the *Hawklund Series on the Uniform Commercial Code* on the subject of electronic payments products. Prior to joining the Indiana University School of Law faculty in 1989, Professor Hughes was with the Federal Trade Commission's Bureau of Consumer Protection. The views expressed in this Survey are those of Professor Hughes alone and do not necessarily reflect the views of Indiana University.

Stephen T. Middlebrook is Senior Counsel, U.S. Department of the Treasury; he is co-chair of the Joint Subcommittee on Electronic Payments and Financial Services, ABA Section of Business Law, and was co-chair of the Electronic Payments Working Group (2006–2008). He is responsible for the parts of this Survey covering legislation on interchange fees, the government's prosecution of *e-gold Ltd.*, and various other regulatory and enforcement developments. His research is current through June 13, 2008. The views expressed in this Survey are those of Mr. Middlebrook alone and do not necessarily reflect the views of the U.S. Department of the Treasury.

The authors invite readers to direct questions on each part of this Survey to the individual author who is named above as primarily responsible for its content. Copies of many of the documents cited in the Survey may be found on the Electronic Payments Working Group's web page at <http://www.abanet.org/dch/committee.cfm?com=CL320040>.

of all U.S. noncash payments in 2006 were made electronically.<sup>1</sup> The report noted that:

Within the industry, various providers and analysts have published differing estimates both for current prepaid volumes and also for future projections of volume. Sometimes these estimates vary substantially from one source to the next, ranging from \$95.4 billion in spend[ing] for all prepaid in 2006 to \$50 billion for closed loop gift card sales in 2006 to \$160 billion in just open loop, branded prepaid spen[t] in 2007.<sup>2</sup>

With so much volume, legal issues arise. These include questions about what law, if any, governs a particular payment product or dispute about a payment, whether provision of certain payments services or issuance of certain products constitutes “money transmission” or the “sale of stored value” for purposes of federal Bank Secrecy Act reporting requirements, and who should bear losses associated with breaches of data security in payments systems.

This is the third Survey on laws pertaining to stored-value and other electronic payment products by the Working Group on Electronic Payments Systems. Our 2007 Survey covered subjects such as preemption of state regulation of gift-card terms and marketing under federal bank regulatory authority,<sup>3</sup> the increase in the number of states directly regulating both gift and payroll cards,<sup>4</sup> significant federal statutory and regulatory developments including the Unlawful Internet Gambling Enforcement Act of 2006 (“UIGEA”),<sup>5</sup> and significant federal enforcement actions.<sup>6</sup>

Part I of this Survey covers developments pertaining to gift and payroll cards, including new state laws and the proper disposition of gift-card value when the retailer issuing the card files for bankruptcy. Part II discusses recent federal legislation and regulations pertaining to the UIGEA and resulting compensation

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1. FED. RESERVE SYS., THE 2007 FEDERAL RESERVE PAYMENTS STUDY: NONCASH PAYMENT TRENDS IN THE UNITED STATES: 2003–2006 14 (2007), available at [http://www.frb.services.org/files/communications/pdf/research/2007\\_payments\\_study.pdf](http://www.frb.services.org/files/communications/pdf/research/2007_payments_study.pdf).

2. FED. RESERVE SYS., THE ELECTRONIC PAYMENTS STUDY: A SURVEY OF ELECTRONIC PAYMENTS FOR THE 2007 FEDERAL RESERVE PAYMENTS STUDY 28 (2008), available at [http://www.frb.services.org/files/communications/pdf/research/2007\\_electronic\\_payments\\_study.pdf](http://www.frb.services.org/files/communications/pdf/research/2007_electronic_payments_study.pdf).

3. Sarah Jane Hughes, Stephen T. Middlebrook & Broox W. Peterson, *Developments in the Law Concerning Stored-Value Cards and Other Electronic Payments Products*, 63 BUS. LAW. 237, 247–51 (2007) [hereinafter “2007 Survey”]. Consistent with the decisions described in the 2007 Survey, the U.S. Court of Appeals for the Second Circuit in December 2007 upheld a district court decision that the Office of the Comptroller of the Currency was the sole enforcer of national banks’ compliance with federal and state laws. The court thus ended the efforts by the State of New York begun in 2005 to gain access to records of several national banks to determine compliance with state anti-discrimination laws. The court wrote: “Congress has already expressed its intent to limit the role of the states in regulating national banks . . . We do not perceive the need for any further statement of intent to achieve the limitation at issue here.” *Clearing House Ass’n, L.L.C. v. Cuomo*, 510 F.3d 105, 114 (2d Cir. 2007). For reactions to the decision, see Cheyenne Hopkins, *OCC Wins Appeal in New York Preemption Case*, AM. BANKER, Dec. 5, 2007, at 1.

4. 2007 Survey, *supra* note 3, at 251–53.

5. *Id.* at 266–68.

6. *Id.* at 255–64.

claims against the United States before the World Trade Organization (“WTO”). Part III covers the card and expiration date truncation requirements of the Fair and Accurate Credit Transactions Act (“FACT Act”), the Credit and Debit Card Receipt Clarification Act of 2007, and, very briefly, a clarification to Regulation E on electronic disclosures and the E-Sign Act. Part IV discusses the legal fallout from two spectacularly large breaches of data security at TJX Corporation and Hannaford Brothers. Part V covers other federal legislation introduced pertaining to electronic payments. Part VI discusses major new federal enforcement actions pertaining to electronic payments and updates the status of the United States’ prosecution of e-gold Ltd.

## I. DEVELOPMENTS IN THE LAW PERTAINING TO GIFT CARDS AND PAYROLL CARDS: A BANKRUPTCY LESSON FOR GIFT CARD HOLDERS AND A FEW NEW STATE LAWS

### A. GIFT CARDS AND RETAILER-ISSUER BANKRUPTCY

The bankruptcy of a gift-card issuer-retailer is a significant risk of gift-card programs. The recent bankruptcy filing of Shaper Image Corporation (“Sharper Image”) illustrates those risks.

When a debtor files a bankruptcy petition, the automatic stay prevents creditors from taking action to obtain possession of property of the estate or to recover on a claim against the debtor that arose before the commencement of the petition.<sup>7</sup> A debtor-retailer may, however, sometimes seek permission from the court to continue to honor gift cards that were issued prior to the filing of the bankruptcy petition.<sup>8</sup> On February 19, 2008, retailer Sharper Image filed a chapter 11 bankruptcy petition.<sup>9</sup> The retailer filed a motion with the court on February 20, 2008, to honor certain prepetition customer programs.<sup>10</sup> Although on the date of the bankruptcy filing the face value of outstanding gift cards and online gift certificates was \$19,589,253, Sharper Image was not seeking interim authority to honor the gift cards and gift certificates but only other customer programs such as massage chair merchandise certificates.<sup>11</sup>

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7. See 11 U.S.C. § 362(a) (2006).

8. Bankruptcy cases involving retailers Kmart and Linens n’ Things are examples. See Motion for an Order Pursuant to 11 U.S.C. §§ 105(a), 365 and 507(a)(6) Authorizing Continuation of Certain Customer Practices at 1–2, *In re Kmart Corp.*, No. 02-B02474 (Bankr. E.D. Ill. Jan. 22, 2002); Motion of the Debtors and Debtors in Possession for an Order Authorizing the Debtors to Honor Certain Prepetition Customer Programs at 1, *In re Linens Holdings Co.*, No. 08-10832 (Bankr. D. Del. May 2, 2008).

9. See Chapter 11 Voluntary Petition, *In re Sharper Image Corp.*, No. 08-10322 (Bankr. D. Del. Feb. 19, 2008).

10. See Motion of Debtor Pursuant to Section 105(a), 363(b), and 503(b)(1) of the Bankruptcy Code for Authorization to Honor Certain Prepetition Customer Programs, *In re Sharper Image Corp.*, No. 08-10322 (Bankr. D. Del. Feb. 20, 2008).

11. *Id.* at 5, 9. Seven days after Sharper Image filed for bankruptcy, a competitor, Brookstone, announced that it would provide customers holding a Sharper Image gift card a one-time 25 percent discount off of a Brookstone purchase. See Press Release, Brookstone, Brookstone Converts Sharper

On March 3, 2008, Sharper Image also sought authority to honor the outstanding gift cards and online gift certificates.<sup>12</sup> In its supplemental motion, Sharper Image stated that customers had complained that Sharper Image was unwilling to honor the gift cards; such inability to honor gift cards had negatively impacted sales; and a competitor had sought to capitalize on the inability of Sharper Image to honor its gift cards.<sup>13</sup> However, Sharper Image sought to honor the gift cards with the restriction that a customer using a gift card had to purchase an item that cost double the value of the gift card.<sup>14</sup>

California, Connecticut, Kentucky, Michigan, New York, Ohio, Oregon, and Tennessee filed a limited objection to Sharper Image's supplemental motion.<sup>15</sup> The states objected to Sharper Image's motion, in part because the debtor had not given "adequate *accurate* information to the press and the public" to give the states an adequate opportunity to respond.<sup>16</sup> The states also argued that the two-for-one program violated state consumer protection laws, such as unfair or deceptive acts or practices ("UDAP") statutes,<sup>17</sup> which are not preempted by the Bankruptcy Code.<sup>18</sup> American Express Travel Related Services Company, Inc. ("American Express"), also filed an objection contending that the modified gift-card policy Sharper Image proposed was forbidden by the reward participation agreement between American Express and Sharper Image.<sup>19</sup>

Despite the objections filed by the states and American Express, the court approved Sharper Image's modified certificate program.<sup>20</sup> The State of California, however, had filed in state court a request for a temporary order to enjoin Sharper Image from violating California laws related to business practices through

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Image Gift Cards and Gift Certificates to 25 Percent Off Store Purchase (Feb. 27, 2008), [http://www.brookstone.com/bs\\_assets/files/pdf/corporate/BrookstoneRelease022708.pdf](http://www.brookstone.com/bs_assets/files/pdf/corporate/BrookstoneRelease022708.pdf). Another retailer, Aerus, formerly Electrolux, announced a similar offer. See Press Release, Aerus LLC, Sharper Image Gift Cards Redeemable at Aerus (Mar. 10, 2008), <http://www.prweb.com/releases/2008/03/prweb752824.htm>.

12. Supplement to Motion of Debtor Pursuant to Section 105(a), 363(b), and 503(b)(1) of the Bankruptcy Code for Authorization to Honor Certain Prepetition Customer Programs at 4, *In re Sharper Image Corp.*, No. 08-10322 (Bankr. D. Del. Mar. 3, 2008).

13. *Id.* at 3.

14. *Id.* at 4. For example, if a customer held a \$50 gift card, the customer would get the full value of the \$50 gift card only if he or she purchased at least \$100 worth of goods. See *id.*

15. Limited Objection of the [States] to the Supplement to Motion of Debtor Pursuant to Section 105(a), 363(b), and 503(b)(1) of the Bankruptcy Code for Authorization to Honor Certain Prepetition Customer Programs, *In re Sharper Image Corp.*, No. 08-10322 (Bankr. D. Del. Mar. 6, 2008) [hereinafter "State Limited Objection"].

16. *Id.* at 5.

17. See *id.* at 6, 9.

18. See *id.* at 8.

19. (I) Preliminary Objection of American Express Travel Related Services Company, Inc. to Supplement to Motion of Debtor Pursuant to Section 105(a), 363(b), and 503(b)(1) of the Bankruptcy Code for Authorization to Honor Certain Prepetition Customer Programs and (II) Joinder of American Express Travel Related Services Company, Inc. to the Motion For Extension of Time to Object and Limited Objection Filed by the States at 1-2, *In re Sharper Image Corp.*, No. 08-10322 (Bankr. D. Del. Mar. 6, 2008).

20. *In re Sharper Image Corp.*, No. 08-10322, slip op. at 2 (Bankr. D. Del. Mar. 7, 2008) ("Supplemental Order Pursuant to Sections 105(a), 363(b), and 503(b)(1) of the Bankruptcy Code Authorizing Debtor to Honor Certain Prepetition Customer Programs").

its modified certificate program.<sup>21</sup> The State alleged that Sharper Image violated “California’s gift certificate statute by failing to honor gift certificates or exchange them for cash as required by law, and . . . California’s Consumer Legal Remedies Act by advising their customers that their gift certificates cannot be used, or can only be used if customers comply with additional requirements not part of the gift certificate transaction, including the requirement to purchase additional merchandise.”<sup>22</sup> In a memorandum accompanying the application for the temporary restraining order, the Office of the California Attorney General also contended that under California law, the value of a store’s gift certificate is the property of the beneficiary of the certificate, not property of the issuer of the card, and that the issuer merely holds the value in trust on behalf of the beneficiary.<sup>23</sup> The Superior Court of California denied the request for an injunction, stating, “Notwithstanding the lack of showing of irremedi[able] harm and the fact that Plaintiff is seeking mandatory injunctive relief, it appears this lawsuit is directed at pre-petition debt of the debtor, and this Court is without jurisdiction, in light of the automatic stay provisions of the United States Bankruptcy Code, to make any ruling.”<sup>24</sup>

A holder of a gift card faces uncertainty if the card issuer files for bankruptcy. If the retailer closes shop completely, the only option for the gift-card holder may be to file a proof of claim with the bankruptcy court.<sup>25</sup> If the retailer seeks to reorganize, the court may approve a motion that allows the retailer-debtor to honor the gift card under the original terms. Last, other retailer-debtors could follow the example set by Sharper Image and try to modify the terms of its gift card program, leaving card holders with a choice between using the card as modified or filing a claim with the bankruptcy court,<sup>26</sup> or even using the card elsewhere if another company offers a promotion that allows the gift-card holder to use the gift card as a coupon.

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21. Plaintiff’s Ex Parte Application for Temporary Restraining Order and Order to Show Cause Re Preliminary Injunction, *People v. Sharper Image Corp.*, No. RG 08-374889 (Cal. Super. Ct. Mar. 6, 2008).

22. *Id.* at 2.

23. See Memorandum of Points and Authorities at 8, *People v. Sharper Image Corp.*, No. RG 08-374889 (Cal. Super. Ct. Mar. 6, 2008). California, Montana, Oklahoma, and Washington are states with gift-card laws that maintain that the gift card is held in trust by the gift-card issuer on behalf of the gift-card beneficiary and that, in the case of the issuer’s bankruptcy, the issuer shall continue to honor the card. See CAL. CIV. CODE § 1749.6 (West Supp. 2007); MONT. CODE ANN. § 30-14-102 (2007); OKLA. STAT. ANN. tit. 15, § 798 (West Supp. 2007); WASH. REV. CODE ANN. § 19.240.090 (West 2007).

24. *People v. Sharper Image Corp.*, No. RG 08-374889, slip op. at 1 (Cal. Super. Ct. Mar. 6, 2008) (“Application Re: Temporary Restraining Order & OSC re Preliminary Injunction Denied”).

25. See 11 U.S.C. § 507(a)(7) (2006). Section 507 of the Bankruptcy Code sets forth a list of expenses and claims that have priority. A gift-card holder may claim priority under section 507(a)(7), which states: “Seventh, allowed unsecured claims of individuals, to the extent of \$2,425 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.” *Id.* (footnote omitted). However, there is no guaranty that there will be money left in a debtor’s estate for the payout of a gift-card holder’s claim.

26. For example, the states asked the court that, if it allowed the modified Sharper Image program, it order the retailer “to adopt certain safeguards to ensure that consumers are not unwittingly forced to buy added merchandise when they have the option of filing a priority expense claim and having their consumer priority recognized and fully protected in the form of a cash payment at confirmation.” State Limited Objection, *supra* note 15, at 6.

## B. MAINE ENACTS LEGISLATION ON GIFT CARDS

The State of Maine was the only state to enact new legislation on gift cards since our 2007 Survey. Maine's new law, signed on April 24, 2008, requires a merchant redeeming a gift obligation or stored-value card to refund any balance on the card less than \$5 as long as the holder redeems the card in person.<sup>27</sup> It explicitly does not cover "prefunded" bank cards.<sup>28</sup>

Gift-card legislation was introduced in seven states since our 2007 Survey.<sup>29</sup> As of May 27, 2008, none of these bills had been enacted. As of now, state laws govern only those cards that are not issued by national banks or federal savings banks.<sup>30</sup>

## C. PAYROLL CARDS: TWO STATES ENACT NEW PAYROLL CARD LEGISLATION

Since the 2007 Survey,<sup>31</sup> two states have enacted new laws on payroll cards. Minnesota extended its existing payroll card statute beyond its original May 31, 2008, expiration date.<sup>32</sup> West Virginia's new payroll card law allows businesses to pay wages through use of electronic payment cards or other electronic transfers if the employee consents to payment by electronic method.<sup>33</sup>

## II. THE UNLAWFUL INTERNET GAMBLING ENFORCEMENT ACT OF 2006: PROPOSED FEDERAL REGULATIONS AND THE UNITED STATES' RESPONSE TO WTO COMPENSATION CLAIMS BY ANTIGUA AND OTHER COUNTRIES

Our 2007 Survey discussed the enactment of the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA" or "Act")<sup>34</sup> and the successful prosecution

27. 2007 Me. Legis. Serv. 696 (West) (to be codified at ME. REV. STAT. ANN. tit. 33, § 1953(G)).

28. See *id.*

29. See H.B. 2591, 24th Leg., 2008 Sess. (Haw. 2008); H.S.B. 201, 82d Gen. Assem., 2d Sess. (Iowa 2008); A.B. 2603, 213th Leg., 2008 Sess. (N.J. 2008); A.B. 2751, 213th Leg., 2008 Sess. (N.J. 2008); A.B. 2477, 213th Leg., 2008 Sess. (N.J. 2008); A.B. 2449, 213th Leg., 2008 Sess. (N.J. 2008); A.B. 1261, 213th Leg., 2008 Sess. (N.J. 2008); A. 11034, 2008 Leg., 231st Sess. (N.Y. 2008); H.B. 7398, 2008 Leg., Jan. Sess. (R.I. 2008); S.B. 4038, 105th Gen. Assem., 2d Sess. (Tenn. 2008); H.B. 3897, 105th Gen. Assem., 2d Sess. (Tenn. 2008); A.B. 471, 98th Leg., Reg. Sess. (Wis. 2008).

30. See 2007 Survey, *supra* note 3, at 248–51. See also *Watters v. Wachovia Bank, N.A.*, 127 S. Ct. 1559, 1567 (2007); *SPGCC, LLC v. Ayotte*, 488 F.3d 525, 534–35 (1st Cir. 2007), *cert. denied*, 128 S. Ct. 1258 (2008).

31. See 2007 Survey, *supra* note 3, at 242–45; Sarah Jane Hughes, Stephen T. Middlebrook & Brook W. Peterson, *Developments in the Law Concerning Stored Value and Other Prepaid Payments Products*, 62 BUS. LAW. 229, 241–43 (2006) [hereinafter "2006 Survey"].

32. 2008 Minn. Sess. Law Serv. 168 (West) (repealing the sunset provision in MINN. STAT. ANN. § 177.255).

33. 2008 W. Va. Acts ch. 129 (H.B. 4032) (Mar. 31, 2008) (to be codified at W. VA. CODE § 21-5-3).

34. Pub. L. No. 109-347, 120 Stat. 1952 (codified at 31 U.S.C.A. §§ 5361–67 (West Supp. 2008)). The Act generally defines "unlawful Internet gambling" as "to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use ... of the Internet where such bet or

by Antigua and Barbuda of related claims against the United States before the WTO.<sup>35</sup> The UIGEA makes it unlawful to take payments for debts incurred in jurisdictions in which online gambling is illegal.<sup>36</sup> Since our 2007 Survey, the U.S. Department of the Treasury (“Treasury”) and Federal Reserve Board (“FRB”) have published long-anticipated regulations to implement the Act,<sup>37</sup> Congress has considered proposals to legalize and tax Internet gambling,<sup>38</sup> and Congress has held hearings on the UIGEA regulations.<sup>39</sup> In addition, other governments have filed compensation claims with the WTO based on its decision in the Antigua proceeding.<sup>40</sup>

### A. PROPOSED JOINT FRB/TREASURY REGULATIONS TO IMPLEMENT THE UIGEA

On October 1, 2007, the FRB and Treasury announced proposed joint UIGEA regulations, to be known as Regulation GG.<sup>41</sup> The primary provisions (1) designate “certain payments systems that could be used in connection with unlawful Internet gambling,” (2) require participants in such systems “to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit transactions in connection with unlawful Internet gambling,” (3) exempt certain participants in designated payments systems from the requirements of the regulations, (4) describe the “types of policies and procedures that non-exempt participants in the designated payments systems may adopt to comply with the Act and include[] non-exclusive examples of policies and procedures” that the agencies deem “to be reasonably designed to prevent or prohibit unlawful Internet gambling transactions restricted by the Act,” and (5) explain the regulatory

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wager is unlawful under any applicable Federal or State law in the State . . . in which the bet is . . . made.” UIGEA § 802(a), 31 U.S.C.A. § 5362(10) (West Supp. 2008). The Act exempts three types of transactions: (1) certain intrastate bets or wagers, (2) intratribal transactions, and (3) interstate horseracing transactions allowed under the Interstate Horseracing Act of 1978. *See id.*

35. *See 2007 Survey, supra* note 3, at 266–68; *see also* Recourse to Article 22.6 Arbitration Report, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/ARB (Dec. 21, 2007).

36. UIGEA § 802(a), 31 U.S.C.A. § 5363 (West Supp. 2008).

37. Prohibition of Funding of Unlawful Internet Gambling, 72 Fed. Reg. 56680 (proposed Oct. 4, 2007) (to be codified at 12 C.F.R. pt. 233 & 31 C.F.R. pt. 132).

38. *See, e.g.*, Internet Gambling Regulation and Enforcement Act of 2007, H.R. 2046, 110th Cong. (2007); Internet Gambling Regulation and Tax Enforcement Act of 2008, H.R. 5523, 110th Cong. (2008).

39. *See, e.g.*, *Proposed UIGEA Regulations: Burden Without Benefit? Hearing Before the Subcomm. on Domestic and International Monetary Policy, Trade, and Technology of the H. Comm. on Financial Servs.*, 110th Cong. (Apr. 2, 2008), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/hr040208.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr040208.shtml); *Hearing on Establishing Consistent Enforcement Policies in the Context of Online Wagers Before the H. Comm. on the Judiciary*, 110th Cong. (Nov. 14, 2007), available at [http://judiciary.house.gov/hearings/hear\\_111407.html](http://judiciary.house.gov/hearings/hear_111407.html); *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System? Hearing Before the H. Comm. on Financial Servs.*, 110th Cong. (June 8, 2007), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/ht060807.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/ht060807.shtml).

40. *See infra* note 69 and accompanying text.

41. *See* Prohibition on Funding of Unlawful Internet Gambling, 72 Fed. Reg. 56680.



enforcement “framework.”<sup>42</sup> The FRB and Treasury have proposed that the regulations take effect six months following publication of the joint final rules.<sup>43</sup>

The proposed rules define common payments terminology, including “automated clearing house system,” “card system,” “check collection system,” “money transmitting business,” “money transmitting service,” and “wire transfer system,” which may cause concern for providers, their lawyers, and courts because the definitions differ significantly from those in prior Board guidance.<sup>44</sup> The Board maintains that the proposed definitions “are intended to be consistent with how those terms are used in [the payment] systems [defined].”<sup>45</sup> The definition of “card systems” is especially significant; it includes “credit cards, debit cards, pre-paid cards, [and] stored-value products . . . used to purchase goods or services or to obtain a cash advance.”<sup>46</sup> Drawing upon existing definitions in FRB regulations, the proposed rules define the scope of the Act, designating, for example, in the case of check collection systems, “[t]he first banking office located in the United States that receives a check from outside the United States for forward collection inside the United States . . . as the depository bank for that check.”<sup>47</sup>

The proposed rules exempt participants in ACH systems, check collection systems, and wire transfer systems, except for participants that “possess[] the customer relationship with the Internet gambling business (and certain participants that receive certain cross-border transactions from, or send certain such transactions to, foreign payment service providers . . .).”<sup>48</sup> The reasoning behind this exemption is the relative inability of these payments providers to identify the line of business in which the payee engages (gambling or not) and how the transfer was initiated (e.g., via the Internet) as compared to other systems that can identify both.<sup>49</sup>

The proposed regulations require that payment systems establish policies and procedures reasonably designed to prevent or prohibit unlawful Internet gambling, including (1) due diligence—“flexible, risk-based” policies “consistent with [participants’] regular account-opening policies”;<sup>50</sup> (2) remedial action, including imposing fines, restricting access, and closing a customer’s account, to enable the participant to follow up after it “becomes aware that one of its customer relationships was being used to process restricted transactions”;<sup>51</sup> (3) monitoring of web sites and payment patterns to particular recipients to detect possible restricted transactions and suspicious patterns;<sup>52</sup> and (4) coding—in card systems

42. *Id.* at 56680–81.

43. *Id.* at 56682.

44. *See id.* at 56683–85.

45. *Id.*

46. *See id.* at 56684.

47. *See id.* (citing, *inter alia*, 12 C.F.R. § 229.2(e) & (o) (2008)).

48. *Id.* at 56685.

49. *See id.*

50. *Id.* at 56688.

51. *Id.* at 56689.

52. *Id.*

especially—to enable identification and denial of restricted transactions.<sup>53</sup> In addition, participants must pay attention to cross-border relationships because “most unlawful Internet gambling businesses do not have direct account relationships with U.S. financial institutions.”<sup>54</sup> Accordingly, at least “[i]n the case of incoming cross-border ACH debit and check collection transactions, the proposed rule places responsibility on the first participant in the United States that receives the incoming transaction directly from a foreign institution . . . to take reasonable steps to ensure that [its] cross-border relationship is not used to facilitate restricted transactions.”<sup>55</sup> In other systems, payments providers that do not have a direct relationship with a gambling business are exempt.<sup>56</sup> Last, the proposed rules request comment on the desirability and feasibility of publishing a list of unlawful Internet gambling businesses, such as that administered by the Office of Foreign Assets Control (“OFAC”), to enable payments providers to block restricted transactions.<sup>57</sup>

The agencies received more than 200 comments on the proposed regulations.<sup>58</sup> In its comment, for example, the Credit Union National Association called for a moratorium on enforcement of the UIGEA until the scope of illegal conduct could be better defined and the safe harbor could be enlarged.<sup>59</sup> As of June 13, 2008, there had been no further action on the proposed rules.

## B. WTO COMPENSATION CLAIMS AND RETALIATORY ACTION

In answer to complaints Antigua and Barbuda filed in 2003 after the United States prosecuted the operator of an online gambling site in Antigua,<sup>60</sup> the WTO found that several U.S. federal and state statutes violated the “market access” rules in Article XVI of the General Agreement on Trade in Services (“GATS”) and were not justified under GATS Article XIV(a) as “necessary to protect public morals or to maintain public order.”<sup>61</sup> Following an appeal, the WTO required the United States to reform laws, primarily the Interstate Horseracing Act, to come into compliance with GATS.<sup>62</sup> On May 4, 2007, the United States announced it would

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53. *Id.*

54. *Id.* at 56690.

55. *Id.*

56. *Id.*

57. *Id.* The agencies give detailed reasons for and against creation of such a list. For a summary of the discussion of this proposal, see H. REP. NO. 109-412, pt. 1, at 11 (2006).

58. See Fed. Reserve Bd., Comments on Prohibition of Funding of Unlawful Internet Gambling [R-1298], [http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc\\_id=R%2D1298&doc\\_ver=1](http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=R%2D1298&doc_ver=1) (last visited Oct. 24, 2008).

59. See Letter from Mary Michelle Dunn, Senior Vice President & Gen. Counsel, Credit Union Nat'l Ass'n, to Jennifer J. Johnson, Bd. of Governors of the Fed. Reserve Sys. & Dept of the Treasury (Dec. 12, 2007), [http://www.cuna.org/reg\\_advocacy/comment\\_letters/cl\\_121207.html](http://www.cuna.org/reg_advocacy/comment_letters/cl_121207.html) (“Prohibition of Funding on Unlawful Internet Gambling”).

60. See *United States v. Cohen*, 260 F3d 68 (2d Cir. 2001), cert. denied, 536 U.S. 922 (2002).

61. See Joost Pauwelyn, *WTO Softens Earlier Condemnation of U.S. Bank on Internet Gambling, but Confirms Broad Reach into Sensitive Domestic Regulation*, A.S.I.L. INSIGHTS, Apr. 12, 2005, <http://www.asil.org/insights050412.cfm> [hereinafter “Pauwelyn, WTO Softens”].

62. See *id.*

withdraw its commitments to GATS on gambling services.<sup>63</sup> Subsequently, a WTO dispute resolution panel on May 22, 2007,<sup>64</sup> allowed Antigua and Barbuda to “retaliate” for the United States’ conduct. On June 22, 2007, Antigua requested sanctions against the United States in the amount of \$3.443 billion for lost gambling revenues.<sup>65</sup> Antigua also requested authority to suspend its commitments under the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS”) because the Antiguan economy was not large enough “to allow for effective sanctions in the area of trade in services.”<sup>66</sup>

The United States responded with various proposals, including limiting Antigua’s damages to a figure corresponding to the percentage of gambling related to horseracing—7 percent of the gambling market or \$3.3 million in 2007—and argued it was inappropriate to suspend Antigua’s intellectual property obligations under TRIPS.<sup>67</sup> On December 21, 2007, WTO arbitrators found, among other things, that the annual impairment of benefits to Antigua from the U.S. action was \$21 million and Antigua could proceed with trying to suspend its TRIPS Agreement responsibilities vis-à-vis the United States.<sup>68</sup> On January 28, 2008, Antigua requested arbitration regarding the amount of compensation and the dispute has now generated a firestorm of new compensation claims against the United States by the European Union, Japan, Canada, Australia, India, Macau, and Costa Rica.<sup>69</sup> The United States and the European Union reached an agreement over their dispute in December 2007,<sup>70</sup> but the London-based Remote Gambling Association continues to press for a more aggressive resolution.<sup>71</sup> Readers should continue

63. *Id.* (citing Press Release, Office of the U.S. Trade Representative, Statement of Deputy United States Trade Representative John K. Veroneau Regarding U.S. Actions Under GATS Article XXXI (May 4, 2007), [http://www.ustr.gov/Document\\_Library/Press\\_Releases/2007/May/Statement\\_of\\_Deputy\\_United\\_States\\_Trade\\_Representative\\_John\\_K\\_Veroneau\\_Regarding\\_US\\_Actions\\_under\\_GATS\\_Article\\_XXI.html](http://www.ustr.gov/Document_Library/Press_Releases/2007/May/Statement_of_Deputy_United_States_Trade_Representative_John_K_Veroneau_Regarding_US_Actions_under_GATS_Article_XXI.html)). The United States decided to “[r]ewrite] its trade rules to remove Internet gambling from the WTO’s jurisdiction.” Josh Catone, *US, EU Reach Internet Gambling Agreement*, READWRITEWEB.COM, Dec. 17, 2007, [http://www.readwriteweb.com/archives/us\\_eu\\_reach\\_internet\\_gambling\\_agreement.php](http://www.readwriteweb.com/archives/us_eu_reach_internet_gambling_agreement.php). For more discussion of the U.S. action, see Joost Pauwelyn, *WTO Condemnation of U.S. Bank on Internet Gambling Pits Free Trade Against Moral Values*, A.S.I.L. INSIGHTS, Nov. 2004, <http://www.asil.org/insight041117.cfm>; Pauwelyn, *WTO Softens*, *supra* note 61.

64. *See 2007 Survey*, *supra* note 3, at 268 n.247.

65. *Id.* For more analysis of this award, see *Antigua Gambling Dispute: Major Economies Demand Compensation from US*, BRIDGES WEEKLY TRADE NEWS DIGEST, July 4, 2007, [http://ictsd.net/i/news/bridges\\_weekly/6527/](http://ictsd.net/i/news/bridges_weekly/6527/) (citing Mark Mendel, Antigua’s chief counsel, who describes his position that Antigua’s compensation claim was “conservative”).

66. Simon Lester, *The WTO Gambling Dispute: Antigua Mulls Retaliation as the U.S. Negotiates Withdrawal of Its GATS Commitments*, 12 A.S.I.L. INSIGHTS—INT’L ECON. LAW EDITION, Apr. 8, 2008, <http://www.asil.org/insights/2008/04/insights080408.html>.

67. *See id.*

68. Press Release, Office of the U.S. Trade Representative, Statement on Internet Gambling (Dec. 21, 2007), [http://www.ustr.gov/Document\\_Library/Press\\_Releases/2007/December/Statement\\_on\\_Internet\\_Gambling.html](http://www.ustr.gov/Document_Library/Press_Releases/2007/December/Statement_on_Internet_Gambling.html).

69. *See Lester*, *supra* note 66.

70. *See, e.g.*, Press Release, European Comm’n, Trade Barriers Regulation: EU Opens Investigation into US Internet Gambling Laws (Mar. 10, 2008), [http://ec.europa.eu/trade/issues/respectsrules/tbr/pr100308\\_en.htm](http://ec.europa.eu/trade/issues/respectsrules/tbr/pr100308_en.htm).

71. *See, e.g.*, Winter Casey, *WTO Issues Decision on Internet Gambling Case*, NATIONALJOURNAL.COM, Dec. 21, 2007, [http://thegate.nationaljournal.com/2007/12/wto\\_issues\\_decision\\_on\\_interne.php](http://thegate.nationaljournal.com/2007/12/wto_issues_decision_on_interne.php); Press

to follow these disputes because of their implications for electronic payments, as well as for intellectual property rights and other obligations under GATS and TRIPS.

**C. A BANKRUPTCY COURT DECLARES THAT ILLEGAL  
CREDIT CARD DEBTS INCURRED IN ONLINE GAMBLING  
AFTER UIGEA EFFECTIVE DATE ARE UNENFORCEABLE**

A very important development regarding UIGEA since our 2007 Survey pertains to the enforceability of electronic payment obligations for online gambling. In *In re Baum*, the court held that online gambling debts incurred after October 13, 2006, were unenforceable in bankruptcy if they violated the UIGEA.<sup>72</sup> If the holding of the U.S. Bankruptcy Court for the Northern District of Ohio stands, post-October 13, 2006, debts for gambling obligations incurred in violation of the UIGEA are unenforceable under federal law, just as pre-October 13, 2006, debts for gambling obligations that violated state laws already were.

**III. OTHER FEDERAL LEGISLATIVE AND REGULATORY  
DEVELOPMENTS SIGNIFICANTLY AFFECTING  
THE OPERATION OF ELECTRONIC PAYMENTS**

This part of the Survey covers the Credit and Debit Card Receipt Clarification Act of 2007, regulations implementing the Fair and Accurate Credit Transactions Act, Federal Reserve Board action pertaining to Regulation E, e-disclosures, and the E-Sign Act, and two recent FinCEN administrative rulings on the scope of “money transmission.”

**A. FACT ACT RECEIPT TRUNCATION REQUIREMENTS  
AND THE CREDIT AND DEBIT CARD RECEIPT  
CLARIFICATION ACT OF 2007**

The Fair and Accurate Credit Transactions Act amended the Fair Credit Reporting Act (“FCRA”) to, among other things, protect consumers from identity theft.<sup>73</sup> Section 113 of the FACT Act added a new subsection to section 605 of the FCRA prohibiting a merchant from printing a receipt that contains more than the last five digits of a credit or debit card number or the card’s expiration date.<sup>74</sup> The provision also provides: “This subsection shall apply only to receipts that are electronically printed, and shall not apply to transactions in which the sole means of recording

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Release, Remote Gambling Ass’n, Gaming Industry Urges UK Government to Join Fight Against Blatant U.S. Protectionism (Oct. 30, 2007), <http://www.rga.eu.com/shopping/images/Press%20Release%20-%20EU-US%20Trade%20Dispute.pdf>.

72. See *In re Baum*, 386 B.R. 649, 656, 659 (Bankr. N.D. Ohio 2008).

73. Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159, 117 Stat. 1952, 1952 (preamble).

74. *Id.* § 113, 117 Stat. at 1959 (codified at 15 U.S.C. § 1681c(g) (2006)).

a credit card or debit card account number is by handwriting or by an imprint or copy of the card.”<sup>75</sup>

### **1. Scope of Damages for Receipt Truncation Violations**

A consumer who establishes that a person acted negligently under 15 U.S.C. section 1681c(g) may recover actual damages, as well as reasonable attorney’s fees and costs.<sup>76</sup> Furthermore, the consumer can recover for a willful violation without having to prove actual damages.<sup>77</sup> 15 U.S.C. section 1681n(a) provides, in relevant part:

Any person who willfully fails to comply with any requirement imposed under this subchapter with respect to any consumer is liable to that consumer in an amount equal to the sum of—

(1)(A) any actual damages sustained by the consumer as a result of the failure or damages of not less than \$100 and not more than \$1,000 . . . .<sup>78</sup>

### **2. Receipt Truncation Lawsuits Against Merchants Led to Passage of the Credit and Debit Card Receipt Clarification Act of 2007**

15 U.S.C. section 1681c(g) gained the attention of plaintiff class action lawyers, and reports indicate that more than 300 complaints were filed under this provision.<sup>79</sup> On June 3, 2008, President Bush signed the Credit and Debit Card Receipt Clarification Act of 2007 into law.<sup>80</sup> As part of its findings in passing the Act, Congress noted that merchants understood the truncation requirements set forth in 15 U.S.C. section 1681c(g) to be “satisfied by truncating the account number down to the last 5 digits based in part on the language of the provision as well as the publicity in the aftermath of the passage of the law.”<sup>81</sup> Congress further observed that “[a]lmost immediately after the deadline for compliance passed, hundreds of lawsuits were filed alleging that the failure to remove the expiration date was a willful violation of the Fair Credit Reporting Act even where the account number was properly truncated.”<sup>82</sup> This new addition to the

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75. *Id.*

76. See 15 U.S.C. § 1681o (2006).

77. See 15 U.S.C.A. § 1681n (West Supp. 2008).

78. *Id.*

79. Correy E. Stephenson, *FACTA Litigation Heats Up*, LAWYERSUSA, May 5, 2008, <http://lawyersusa-online.com/index.cfm/archive/view/id/430648>; Posting of Dan Slater to Wall Street Journal Law Blog, <http://blogs.wsj.com/law/2008/04/08/are-credit-card-receipt-class-actions-annihilating-corporate-america> (Apr. 8, 2008, 14:29 EST) (“Are Credit Card Receipt Class Actions Annihilating Corporate America?”); Richard M. Hoffman, Justine Young Gottshall & Katherine K. Ivers, *FACTA: Online Retailers Beware—The New Class Action Threat*, WILDMAN HARROLD CLIENT BULLETIN, Nov. 6, 2007, <http://www.wildman.com/index.cfm?fa=news.bulletin&aid=20780F4B-CDFC-74EC-199080E8FB23E8BD>.

80. Credit and Debit Card Receipt Clarification Act of 2007, Pub. L. No. 110-241, § 2(a)(3), 122 Stat. 1565.

81. *Id.*

82. *Id.* § 2(a)(4). Congress further acknowledged that “[n]one of these lawsuits contained an allegation of harm to any consumer’s identity,” and “[e]xperts in the field agree that proper truncation

FCRA states that for purposes of determining *willful noncompliance*, “any person who printed an expiration date on any receipt provided to a consumer cardholder at a point of sale or transaction between December 4, 2004, and June 3, 2008, but otherwise complied with the requirements of section 1681c(g) of this title for such receipt shall not be in willful noncompliance with section 1681c(g) by reason of printing such expiration date on the receipt.”<sup>83</sup> The Credit and Debit Card Receipt Clarification Act of 2007 contained further language in which Congress expressly stated that the clarification applies retroactively to pending lawsuits.<sup>84</sup>

### 3. Courts Split on Application of 15 U.S.C. Section 1681c(g) to Internet Transactions

A review of several district court decisions shows that uncertainty exists as to whether 15 U.S.C. section 1681c(g) applies to a merchant doing business over the Internet. This part of the Survey addresses Internet transactions, not those done in person at “brick-and-mortar” locations.

The plaintiff in *Grabein v. 1-800-Flowers.com, Inc.*, purchased flowers online from the defendant (“1-800-Flowers”).<sup>85</sup> The plaintiff printed a confirmation of an online order that included the expiration date of the plaintiff’s credit card.<sup>86</sup> 1-800-Flowers moved to dismiss the case by arguing that 15 U.S.C. section 1681c(g) applies only to transactions where the seller, not the consumer, “prints” the receipt for the consumer at the location of the transaction—for example, an over-the-counter exchange of money for goods.<sup>87</sup> In addition, 1-800-Flowers argued that Congress intended for the statute to cover only receipts printed at a specific point of sale—like a retail establishment—and not receipts transmitted electronically.<sup>88</sup> The plaintiff relied on *Merriam-Webster’s Collegiate Dictionary* to argue that “print” is defined as “to display on a surface (as a computer screen) for viewing.”<sup>89</sup> In finding against 1-800-Flowers, the court found that 1-800-Flowers “mark[ed]” the plaintiff’s computer screen “with printed characters” when 1-800-Flowers transmitted an electronic receipt with the plaintiff’s credit card expiration date.<sup>90</sup> The court further noted that “[e]liminating electronically transmitted receipts from coverage of FACTA would undercut Congress’s ability to stamp out

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of the card number, by itself as required by the amendment made by the Fair and Accurate Credit Transactions Act, regardless of the inclusion of the expiration date, prevents a potential fraudster from perpetrating identity theft or credit card fraud.” *Id.* § 2(a)(5), (6).

83. *Id.* § 3(a) (codified at 15 U.S.C.A. § 1681n(d) (West Supp. 2008)).

84. *See id.* § 3(b). “The amendment made by subsection (a) shall apply to any action, other than an action which has become final, that is brought for a violation of 605(g) of the Fair Credit Reporting Act to which such amendment applies without regard to whether such action is brought before or after the date of the enactment of this Act.” *Id.*

85. No. 07-22235–CIV–HUCK, 2008 U.S. Dist. LEXIS 11757, at \*2 (S.D. Fla. Jan. 29, 2008).

86. *Id.*

87. *Id.* at \*4.

88. *Id.*

89. *Id.* at \*7–8 (quoting *MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY* 924 (10th ed. 2002)).

90. *Id.* at \*8.

identity theft in its various and rapidly changing forms, especially considering the volume of transactions that now take place online.”<sup>91</sup> However, as a result of the enactment of the Credit and Debit Card Receipt Clarification Act of 2007, the parties in the action stipulated to a notice of voluntary dismissal that rendered moot their appeal pending before the U.S. Court of Appeals for the Eleventh Circuit.<sup>92</sup>

The court in *King v. MovieTickets.com* took the opposite view and held that order receipts or confirmations provided over the Internet do not fall within the scope of the FACT Act provision on credit card truncation.<sup>93</sup> Edwin King ordered movie tickets online from MovieTickets.com.<sup>94</sup> The receipt King received included the expiration date of his credit card, and he alleged that including the expiration date on his receipt was a violation of 15 U.S.C. section 1681c(g).<sup>95</sup> The U.S. District Court for the Southern District of Florida granted MovieTickets.com’s motion to dismiss.<sup>96</sup> The court looked to the plain language of section 1681c(g), consulted the dictionary, and reviewed the word “print” within the context of the provision.<sup>97</sup> The court held that “it is clear that in the context of subsection (g) and particularly in light of the ‘cash register or other machine or device’ language, the word ‘print’ refers to the act of imprinting something on paper or another tangible surface.”<sup>98</sup> The court went on to conclude that:

the term “print” must be construed in light of the use in § 1681c(g) of the word “receipt” and the requirement that such receipts be “provided at the point of sale or transaction.” When § 1681c(g) is looked at as a whole, it is clear that this subsection focuses on paper receipts electronically printed by a cash register or other machine and provided to consumers at the point of sale or transaction.<sup>99</sup>

The court specifically declined to follow the *Vasquez* and *1-800-Flowers* courts “because neither considered the plain meaning of the word ‘printed,’ within the

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91. *Id.* at \*9.

92. Stipulated Notice of Voluntary Dismissal, *Grabein v. 1-800-Flowers.com*, No. CV 07-22235 (S.D. Fla. June 5, 2008). For other district court decisions allowing cases to proceed upon facts in which a consumer printed a receipt or order confirmation from a purchase made over the Internet, see *Harris v. Best Buy Co., Inc.*, No. 07 C 2559, 2008 U.S. Dist. LEXIS 22166, at \*24 (N.D. Ill. Mar. 20, 2008); *Harris v. Circuit City Stores, Inc.*, No. 07 C 2512, 2008 U.S. Dist. LEXIS 12596, at \*34 (N.D. Ill. Feb. 7, 2008); *Vasquez-Torres v. Stubhub, Inc.*, No. CV 07-1328 PSG (SSx), 2008 U.S. Dist. LEXIS 63719, at \*10 (C.D. Cal. July 2, 2007); *Harris v. Wal-Mart Stores*, No. 07-2561, slip op. at 5 (N.D. Ill. Oct. 10, 2007) (memorandum order and opinion).

93. *King v. MovieTickets.com*, No. 07-22119, slip op. at 14 (S.D. Fla. Feb. 13, 2008) (“Order Granting Motion to Dismiss”) [hereinafter “King Order”]. See also *Narson v. GoDaddy.Com, Inc.*, No. 08-0177, slip op. at 7 (D. Ariz. May 5, 2008) (order) (holding that the word “to print” is to transfer information to a tangible medium); *Haslam v. Federated Dep’t Stores, Inc.*, No. 07-61871, slip op. at 7 (S.D. Fla. May 8, 2008) (holding that the word “print” commonly refers to a tangible, paper receipt and not an on-screen computer display).

94. *King Order*, *supra* note 93, at 2.

95. *Id.* at 2–3.

96. *Id.* at 14.

97. *Id.* at 8–9.

98. *Id.* at 10.

99. *Id.*

context of the entire § 1681c(g).<sup>100</sup> The court also stated that in cases where the consumer printed the paper copy of the e-mail, the paper copy was not provided by the merchant.<sup>101</sup> The court noted that “[t]he plain language of the statute expressly requires that the person accepting such credit cards be the party both printing and providing the receipt.”<sup>102</sup> After the court dismissed his action, King filed an amended complaint but that action was also dismissed by the court.<sup>103</sup>

## B. REGULATION E, ELECTRONIC DISCLOSURES, AND THE E-SIGN ACT

In the 2007 Survey, we discussed an amendment to Regulation E to exempt issuers in low-dollar debit card transactions of \$15 or less from Regulation E’s paper receipt requirements.<sup>104</sup> In the only Regulation E development since the 2007 Survey, the Board of Governors of the Federal Reserve System (“Board”) on November 9, 2007, adopted a final rule to clarify the requirements for providing consumer disclosures in electronic form under Regulation E.<sup>105</sup> This final rule withdrew parts of an interim final rule for the electronic delivery of disclosures issued March 30, 2001.<sup>106</sup> The interim final rule restated or cross-referenced the Electronic Signatures in Global and National Commerce Act (“E-Sign Act”) regarding electronic disclosures and electronic signatures, and that rule was unnecessary because the E-Sign Act is a self-effectuating statute.<sup>107</sup> The Board also withdrew provisions related to the specific timing and delivery requirements for electronic disclosures under Regulation E, such as the requirement to send disclosures to a consumer’s e-mail address or post the disclosures on a web site and send a notice alerting the consumer to the disclosures.<sup>108</sup> In issuing the final rule, the Board reconsidered disclosure by e-mail because electronic disclosures have evolved since 2001 as industry and consumers have gained experience with them, and concerns exist related to e-mail due to data security, identity theft, and phishing.<sup>109</sup>

## C. FINCEN’S 2008 ADMINISTRATIVE RULINGS ON “MONEY TRANSMISSION”—ONE PROGRAM IS, THE OTHER IS NOT

In March and May 2008, respectively, the U.S. Department of the Treasury’s Financial Crimes Enforcement Network—colloquially known as “FinCEN”—announced

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100. *Id.* at 11.

101. *Id.* at 12.

102. *Id.*

103. *King v. MovieTickets.com*, No. 07-22119, slip op. at 8 (S.D. Fla. May 19, 2008) (“Order Granting Motion to Dismiss; Dismissing Case with Prejudice; Closing Case”).

104. See 2007 Survey, *supra* note 3, at 265–66.

105. Electronic Fund Transfer, 72 Fed. Reg. 63452 (Nov. 9, 2007) (to be codified at 12 C.F.R. pt. 205).

106. *Id.* at 63452.

107. *Id.* at 63453.

108. *Id.* at 63454.

109. *Id.*



administrative rulings on the scope of the term “money transmission” and its effect on who qualifies as a “money services business” for purposes of compliance obligations under the Bank Secrecy Act.

FinCEN regulations implementing provisions of the anti-money laundering laws require that “money services businesses” register with FinCEN. FinCEN defines the term “money services business” to include, among others, persons doing business as a seller or redeemer of stored value or as a money transmitter.<sup>110</sup> Thus, persons serving as “money transmitters,” which FinCEN defines as “any person . . . who engages as a business in accepting currency, or funds denominated in currency, and transmits the currency or funds or the value of currency or funds, by any means through a financial agency or institution,”<sup>111</sup> are “money services businesses” and must register with FinCEN and comply with its Bank Secrecy Act regulations.<sup>112</sup>

### 1. Is Offering a One-Time-Only, Virtual Replacement Credit Card “Money Transmission”?

FinCEN’s first ruling answers a question from a limited liability company about whether offering a one-time-only virtual replacement credit card with a credit limit equal to the full price of goods or services involved in a single online transaction constitutes “money transmission.” Each “virtual card” expires upon use and cannot be reloaded.<sup>113</sup> FinCEN determined that the answer is “yes”—the issuer qualifies as a “money transmitter”<sup>114</sup> and, accordingly, has to register with FinCEN as a “money services business.”<sup>115</sup>

To use this virtual credit card, consumers have to provide personal financial information.<sup>116</sup> They also choose whether to bill funds loaded onto the card to an existing credit or debit card, or to authorize an ACH debit from a bank account.<sup>117</sup> To obtain the specific virtual card, the consumer accesses the virtual card issuer’s web site and enters the amount of the purchase.<sup>118</sup> The “card” issues after the pre-authorization comes through or the debit is “processed satisfactorily” and the issuer has instructed its U.S. partner bank to issue the card to the consumer.<sup>119</sup>

A key feature of the card is the issuer’s commitment to protect the identity and financial account information of the consumer involved,<sup>120</sup> in much the same way

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110. 31 C.F.R. § 103.11(uu) (2007) (definition of “money service business”).

111. *Id.* § 103.11(uu)(5)(i)(A).

112. *Id.* pt. 103.

113. Whether a Certain Operation Protecting On-line Personal Financial Information Is a Money Transmitter, FIN-2008-R007 (May 27, 2008), [http://www.fincen.gov/statutes\\_regs/guidance/html/fin-2008-r007.html](http://www.fincen.gov/statutes_regs/guidance/html/fin-2008-r007.html) [hereinafter “FIN-2008-R007”].

114. *Id.*

115. *See id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. *See id.*

that PayPal does.<sup>121</sup> The issuer's "partner bank" handles debiting the issuer's account and paying the online merchant, and the issuer is protected from any credit risk in the transaction.<sup>122</sup> Nevertheless, FinCEN concluded that the issuer is required to register with FinCEN as a "money services business."<sup>123</sup> Additionally, the issuer also will have to comply with state regulations and licensing requirements for a "money services business."<sup>124</sup>

PayPal, whose payments platform also protects the identity and financial account information of a consumer unless the consumer discloses its name and address to the person to whom the on-line purchase is provided, is registered as a "money services business" with FinCEN<sup>125</sup> and also has "money transmitter" or "money services business" licenses in many jurisdictions.<sup>126</sup> To hold that this limited liability company requesting FinCEN's guidance was *not* a "money transmitter" would have required some rethinking of the earlier insistence of FinCEN and some states that PayPal was a "money transmitter."<sup>127</sup> However, there is an unanswered question of whether the contemporary virtual credit card offered by Visa and MasterCard<sup>128</sup> also involves "money transmission."

## 2. Is a Reloadable Prepaid Card Program "Money Transmission" or the "Sale of Stored Value"?

FinCEN concluded in its March 10, 2008, ruling that a prepaid card reload program offered by 5,700 depository institutions through merchants and retail operators of automated teller machines ("ATMs") is not "money transmission" or the "sale of stored value."<sup>129</sup> Participants in this service, therefore, are not "money services businesses."<sup>130</sup> The provider group has 140 million cards in circulation; holders can use cards at more than 1.9 million ATM and point-of-sale locations.<sup>131</sup> Customers can withdraw cash, make purchases, check account balances, and do other transactions at ATMs and merchant point-of-sale locations sponsored by

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121. See PayPal, Privacy to Fight Identity Theft, <https://www.paypal.com/us/cgi-bin/webscr?cmd=xpt/cps/securitycenter/buy/Privacy-outside> (last visited June 17, 2008).

122. FIN-2008-R007, *supra* note 113.

123. *Id.*

124. See, e.g., WASH. REV. CODE ANN. §§ 19.230.05–19.230.905 (West 2007); VA. CODE ANN. §§ 6.1-370–6.1-378.4 (West 1999 & Supp. 2008).

125. See FinCEN, MSB State Selector, <http://www.msb.gov/guidance/msbstateselector.php> (last visited Sept. 28, 2008) (California).

126. See PayPal, State Licenses, <https://www.paypal.com/us/cgi-bin/webscr?cmd=p/ir/licenses-outside> (last visited June 17, 2008).

127. See *id.*

128. See, e.g., Posting of Janet Meiners to WebProNews, <http://www.webpronews.com/topnews/2007/11/19/paypal-unveils-virtual-credit-card> (Nov. 19, 2007, 17:09 EST), ("PayPal Unveils Virtual Credit Card"); <http://www.11card.com/> (last visited Oct. 24, 2008).

129. Whether Certain Reloadable Card Operations Are Money Services Businesses, FIN-2008-R-005, at 1 (Mar. 10, 2008), available at [http://www.fincen.gov/statutes\\_regs/guidance/pdf/fin-2008-r005.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2008-r005.pdf).

130. *Id.*

131. *Id.*

bank members of this consortium.<sup>132</sup> Members that sponsor ATMs and merchants are “fully responsible for the transactions” at those terminals as if they “owned and operated them.”<sup>133</sup> Following verification, the depository institution provider signals approval of the reload to the merchant or ATM and the intermediary credits the card after any fee charged is deducted.<sup>134</sup>

Cardholders can add value in one of three ways: through in-branch payments, ACH direct deposits, or receipt of transfers of value by *competing* reload networks. The provider plans to expand to handle the reload value transfers themselves.<sup>135</sup> Plans for expanding services involve the forwarding of funds collected by the ATM or merchant to the provider and verification by the provider of the good standing of the account underlying the prepaid card and the customer’s management of the account.<sup>136</sup>

Six factors appear to have influenced FinCEN’s ruling. In addition to the three mentioned above—the above-described verification process, use of the intermediary, and assignment of the risk to the provider,<sup>137</sup> FinCEN also emphasized that the “money transmitter” definition provides that “the acceptance and transmission of funds as an integral part of the execution and settlement of a transaction *other than the funds transmission itself* . . . will not cause a person to be a money transmitter.”<sup>138</sup> The last two factors were that the provider’s members are banks who control how their ATMs and sponsored merchants add value,<sup>139</sup> and that the ATMs and sponsored merchants operate “only as a conduit” between the member bank and the member customers.<sup>140</sup> Because of their limited roles in the reload transactions, the sponsored merchants and ATMs did not qualify as sellers of stored value.<sup>141</sup> Given the central role that banks play in this particular reloading operation, it is unclear whether non-bank providers of reloadable prepaid cards would have received a similarly favorable response from FinCEN.

#### IV. DATA SECURITY: CONSUMERS PURSUE CLASS ACTIONS AS BREACHES CONTINUE

Since our 2007 Survey, new data security breaches have occurred in the United States, including at the Hannaford Brothers grocery store chain<sup>142</sup> and at smaller retailers, such as Dave & Buster’s, a national restaurant chain.<sup>143</sup> There has been

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132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.* at 2.

138. *Id.* (quoting 31 C.F.R. § 103.11(uu)(5)(ii) (2008) (emphasis added)) (omission in original).

139. *Id.*

140. *Id.*

141. *Id.* at 3.

142. See *infra* notes 146–49 and accompanying text.

143. See Superseding Indictment at 3–5, *United States v. Yastremskiy*, No. 08-CR-160 (S-1) (SJF) (E.D.N.Y. May 14, 2008). The indictment charged that hackers installed electronic collection software

class action litigation against Hannaford Brothers<sup>144</sup> and settlement of a Federal Trade Commission action against TJX Companies, Inc., the parent of TJMaxx, pertaining to its sizeable security breach.<sup>145</sup>

On March 17, 2008, Hannaford Brothers, a Maine-based grocery store chain, announced that “data intrusion into [our] computer network . . . resulted in the theft of consumer credit and debit card numbers.”<sup>146</sup> 4.2 million credit and debit card numbers apparently were compromised in the breach and 1,800 cases of reported credit and debit card fraud allegedly have arisen.<sup>147</sup> Although Hannaford Brothers confirmed that its security systems had been deemed PCI-compliant in February 2008,<sup>148</sup> it still faces class action litigation by customers as well as the costs of remediating customer and bank losses associated with the breach.<sup>149</sup>

Congress is considering numerous proposals for notice and remediation of data security breaches<sup>150</sup>—at least one, H.R. 4175, was first introduced after our 2007 Survey. In addition, on June 10, 2008, Governor M. Jodi Rell of Connecticut signed into law SB 5658, which subjects individuals to civil fines up to \$500,000 for an “intentional failure” to safeguard personal information whether in paper or electronic form.<sup>151</sup>

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onto cash-register systems in order to steal debit and credit card data during payment authorization. *See id.* The defendants allegedly hacked into data while cash registers were processing authorizations. *See id.*

144. Trevor Maxwell, *Lawyers Vie to Lead Suit over Breach: Hannaford Likely Will Face One Class-Action Lawsuit over the Exposure of Customers' Data*, PORTLAND PRESS HERALD, June 2, 2008, at A1.

145. Press Release, Fed. Trade Comm'n, Agency Announces Settlement of Separate Actions Against Retailer TJX, and Data Brokers Reed Elsevier and Seisint for Failing to Provide Adequate Security for Consumers' Data (Mar. 27, 2008), <http://www.ftc.gov/opa/2008/03/datasec.shtm>.

146. *See Consumers of Hannaford Brothers Co. Supermarkets File Class Action Suit for Loss of Credit Card and Debit Card Data*, PR NEWswire, Mar. 19, 2008 (online) (internal quotation marks omitted).

147. *Id.* Reports suggest that the breach began in early December 2007 and was not contained until March 10, 2008; Hannaford Brothers admits it knew of the breach by late February 2008. *See id.* Apparently, hackers installed malware on the Hannaford Brothers cash registers and stole credit and debit card information along with approval codes. They then manufactured cards using that information and successfully used those cards in transactions in the original consumers' names with other merchants. The data breach was revealed when consumers started reporting unauthorized debits from bank accounts and unauthorized credit card charges. *See, e.g.*, Ross Kerber, *Advanced Tactic Targeted Grocer: "Malware" Stole Hannaford Data*, BOSTON GLOBE, Mar. 28, 2008, at 1A.

148. *See, e.g.*, Michael Garry, *Retailers Call for More Flexible, Secure POS*, SUPERMARKET NEWS, May 19, 2008, at 35; Christina Veiders, *Standards Not Enough in Hannaford Brothers Data Breach*, SUPERMARKET NEWS, Apr. 14, 2008, at 12.

149. *See, e.g.*, Press Release, Berger & Montague, P.C., *Consumers of Hannaford Brothers Co. Supermarkets File Class Action Suit for Loss of Credit Card and Debit Card Data* (Mar. 19, 2008), <http://www.bergermontague.com/case-summary.cfm?id=178>. Other entities had sizeable data security breaches during the past year. *See, e.g.*, Robert Lemos, *Bank of NY Mellon Breaches Keep Growing*, SECURITYFOCUS, Mar. 9, 2008, <http://www.securityfocus.com/brief/811>; Linda McGlasson, *Bank of New York Mellon Investigated for Lost Data Tape*, BANK INFO SECURITY, May 27, 2008, [http://www.bankinfosecurity.com/articles.php?art\\_id=862](http://www.bankinfosecurity.com/articles.php?art_id=862).

150. *See, e.g.*, Piracy and Cybercrime Enforcement Act of 2007, H.R. 4175, 110th Cong. (2007); Data Accountability and Trust Act, H.R. 958, 110th Cong. (2007); Notification of Risk to Personal Data Act of 2007, S. 239, 110th Cong. (2007).

151. M. Peter Adler, Pepper Hamilton LLP, *New Connecticut Data Protection Law Imposes a Maximum Fine of \$500,000 for Willful Violations*, PRIVACY & SECURITY CLIENT ALERT, June 19, 2008, [http://www.pepperlaw.com/pepper/publications\\_update.cfm?rid=1449.0](http://www.pepperlaw.com/pepper/publications_update.cfm?rid=1449.0).

## V. OTHER SIGNIFICANT FEDERAL LEGISLATION—THE CREDIT CARD FAIR FEE ACT OF 2008

### A. BACKGROUND AND LEGISLATIVE HISTORY

On March 6, 2008, Rep. John Conyers, Jr. (D-MI), introduced the Credit Card Fair Fee Act of 2008 into the U.S. House of Representatives.<sup>152</sup> The stated purpose of the bill is “to ensure competitive market-based rates and terms for merchants’ access to electronic payment systems.”<sup>153</sup> Conyers is Chairman of the Judiciary Committee and also heads the Antitrust Task Force and Competition Policy Subcommittee, to which the bill was referred.<sup>154</sup> The bill creates an exemption to current antitrust laws to allow groups of merchants to band together to negotiate interchange rates with Visa and MasterCard.<sup>155</sup> If, after a period of negotiations, they cannot reach agreement, the matter is referred to a panel of Electronic Payment System Judges (“EPSJ”). Each side presents its best proposal for rates and fees to the judges who are required to pick one of the two plans which becomes binding on the participants for the next three years.<sup>156</sup> According to Chairman Conyers:

This legislation is intended to give merchants a seat at the table in the determination of these fees. It is not an attempt at regulating the industry and does not mandate any particular outcome. This legislation simply enhances competition by allowing merchants to negotiate with the dominant banks for the terms and rates of the fees.<sup>157</sup>

The bill received bipartisan support in the House, attracting forty-five cosponsors with a fairly even split between parties.<sup>158</sup> The proposal has its opponents also, including Rep. F. James Sensenbrenner (R-WI) who said, “This is a very ill-advised bill. It is going to have a lot of unintended consequences.”<sup>159</sup> Rep. Lamar Smith (R-TX) focused his concerns on the effect of the legislation on consumers. He asked, “Will the consumer pay less in goods and services if the interchange fees are reduced for merchants? Will those lower prices be offset by reduced credit card benefits and higher charges and fees on credit cards?”<sup>160</sup>

The Antitrust Task Force of the House Judiciary Committee held hearings on the bill on May 15, 2008.<sup>161</sup> Stephen Cannon testified in favor of the bill on

152. Credit Card Fair Fee Act of 2008, H.R. 5546, 110th Cong. (2008) [hereinafter “H.R. 5546”].

153. *Id.* (preamble).

154. See U.S. House of Representatives, Committee on the Judiciary, <http://judiciary.house.gov/> (last visited Oct. 24, 2008) (regarding Chairman Conyers); U.S. House of Representatives, Committee on the Judiciary, Antitrust Task Force and Competition Policy Subcommittee, <http://judiciary.house.gov/about/subantitrust.html> (last visited Oct. 24, 2008).

155. H.R. 5546, *supra* note 152, § 2(c).

156. *Id.* § 2(d)(2)(A).

157. 154 Cong. Rec. E318, E319 (daily ed. Mar. 6, 2008) (statement of Rep. Conyers).

158. See Library of Congress, Thomas, Bills, Resolutions, <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:h.r.05546>: (last visited Sept. 21, 2008).

159. Cheyene Hopkins, *Lawmaker Views Color Palette on Interchange Bill*, AM. BANKER, May 16, 2008, at 3, 3.

160. *Id.*

161. *Hearing on H.R. 5546, The “Credit Card Fair Fee Act of 2008,” Before the Antitrust Task Force and Competition Policy Subcomm. of the H. Comm. on the Judiciary*, 110th Cong. (May 15, 2008), available at [http://judiciary.house.gov/hearings/hear\\_051508.html](http://judiciary.house.gov/hearings/hear_051508.html) [hereinafter “Credit Card Hearing”].

behalf of the Merchants Payment Coalition, a coalition of twenty-three trade associations representing retailers, restaurants, supermarkets, convenience stores, gasoline stations, and other merchants who accept debit and credit cards for payment.<sup>162</sup> Cannon testified that because Visa and MasterCard control approximately 75 percent of all card payment transactions, merchants have no choice but to accept their cards.<sup>163</sup> By accepting the cards, merchants must abide by the card association rules and pay the interchange fees which are set not through a competitive process but rather unilaterally by the banks that are members of the card associations.<sup>164</sup> Cannon stated that interchange rates are seven times the actual cost of processing a payment and, as a result, American consumers indirectly paid \$42 billion in interchange fees in 2007.<sup>165</sup> The Merchants Payment Coalition supports the bill because it would foster negotiations and voluntary agreements and would impose judicially determined solutions only when negotiations fail.<sup>166</sup>

Representatives from both Visa and MasterCard testified against the bill, asserting that ultimately the legislation would increase costs for retailers. Joshua Floum, General Counsel for Visa Inc., explained that a payment card system is an example of a “two-sided market,” or one in which there are two distinct groups of customers and the level of participation within one group determines the value of the product to the other. He testified:

The demand for payment cards by cardholders and retailers is interdependent—the greater the number of consumers who use payment cards, the more valuable the network is to retailers, and the greater the number of retailers that accept payment cards, the more cardholders value those cards. Payment networks use interchange to balance demand between the two sides of the market, promoting growth of the total system.<sup>167</sup>

Visa contended that it sets interchange rates with an understanding of this two-sided market and a goal of maximizing transaction volume.<sup>168</sup> If interchange is not sufficient to provide cardholders with rewards programs and other benefits, they switch to other payment card brands that offer them a better deal.<sup>169</sup> Likewise, if Visa interchange rates are set at too high a rate, then retailers will stop accepting Visa cards or will exhibit less preference for Visa products.<sup>170</sup> Given

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162. *Id.* (statement of W. Stephen Cannon, Chairman, Constantine Cannon, LLP, on behalf of the Merchant Payments Coalition).

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.* (statement of Joshua Floum, General Counsel, Visa Inc.). For a more detailed explanation of payment card systems as a two-sided market, see Stuart E. Weiner & Julian Wright, *Interchange Fees in Various Countries: Developments and Determinants*, 4 REV. NETWORK ECON. 290, 292–93 (2005).

168. *Credit Card Hearing*, *supra* note 161 (statement of Joshua Floum, General Counsel, Visa Inc.).

169. *Id.*

170. *Id.*

that both the number of Visa cards issued and the number of retailers that accept the brand have increased significantly over the last decade, Visa asserts that it has succeeded in setting interchange rates at an optimal rate and there is no need for change.<sup>171</sup>

Joshua Peirez, a senior officer from MasterCard, questioned whether the goal of the merchants backing this legislation was really to win the opportunity to negotiate payment card fees, or to force a reduction in such fees through government regulation.<sup>172</sup> He noted that merchants who wish to accept American Express payment cards currently negotiate the discount fees they pay to American Express:

Yet the merchant discount fees that merchants agree to pay when they choose to accept American Express cards are higher on average than the fees they pay when they choose to accept MasterCard cards. . . . [I]f merchants are willing to pay more for American Express when they readily admit that they do not have to accept the American Express card, how can they claim that our system which involves interchange fees and results in average merchant discount fees that are lower raises an issue that must be addressed by Congress.<sup>173</sup>

From the card associations' perspective, their interchange rates are optimized to benefit both merchants and consumers as is demonstrated by the wide and growing acceptance of the Mastercard and Visa brands by both constituencies.<sup>174</sup>

On June 5, 2008, Senator Richard J. Durbin introduced a companion bill in the Senate and stated that “[h]igher interchange fees for businesses means higher costs for retailers and consumers.”<sup>175</sup> Durbin asserted that “[e]very time you make a purchase with plastic, the bank that issued your credit card gets a cut of the sale amount. American businesses and consumers are getting nickled and dimed by the big banks, who end up making billions from these hidden fees.”<sup>176</sup> The Senate bill, also named the Credit Card Fair Fee Act of 2008, is substantively quite similar to the House version, but the Senate restructured, expanded, and rewrote

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171. *Id.*

172. *Id.* (statement of Joshua Peirez, Chief Payment System Integrity Officer, MasterCard Worldwide).

173. *Id.*

174. The interchange issue has received significant attention in the business press, beginning with an editorial in the *Wall Street Journal* which said the bill's administrative process “sounds like a price-control regime.” Editorial, *Credit-Card Wars*, WALL ST. J., Mar. 29, 2008, at A8. The editorial went on to state that a strong case could be made that Visa and MasterCard attained their market share and profitability by offering a superior product and no one “should want the precedent of punishing a business for winning huge numbers of voluntary customers by outcompeting rivals.” *Id.* Representatives John Conyers, Jr., and Chris Cannon, sponsors of the bill, responded with a letter noting that Americans pay on average three times the amount in interchange fees as Europeans do and concluded that market forces would not correct this inequity “unless there are negotiations and proceedings as set forth in our legislation.” John Conyers, Jr. & Chris Cannon, *The Credit-Card Fee Market Isn't Working*, WALL ST. J., Apr. 8, 2008, at A18.

175. Press Release, U.S. Sen. Dick Durbin, Durbin Moves to Bring Down Credit Card Costs (June 5, 2008), <http://durbin.senate.gov/showRelease.cfm?releaseId=298800>.

176. *Id.* (internal quotation marks omitted).

certain provisions of the House Bill.<sup>177</sup> As was the case in the House, because the bill ostensibly deals with an antitrust issue, it was assigned to the Judiciary Committee.<sup>178</sup>

## B. AN OVERVIEW OF THE LEGISLATION

The Credit Card Fair Fee Act of 2008<sup>179</sup> creates an exemption to current anti-trust law to allow merchants<sup>180</sup> and providers of a “covered electronic payment system”<sup>181</sup> to negotiate and agree upon the terms and fees for access to the system’s payment products.<sup>182</sup> The only networks that currently meet the market share requirement of “covered electronic payment system” are Visa and MasterCard.<sup>183</sup> If the distribution of market share were to change, however, other payment networks could come under the bill’s jurisdiction and Visa or MasterCard could drop out.

Interestingly, the bill never uses the term “interchange” but rather asserts “[a]ccess by a merchant to any covered electronic payment system and the fees and terms of such access shall be subject to this Act.”<sup>184</sup> “Access” is defined as permission to conduct transactions—including authorization, clearance, and settlement—involving the acceptance of credit or debit cards from consumers for the payment for goods or services and the receipt of payment for such goods

177. See Credit Card Fair Fee Act of 2008, S. 3086, 110th Cong. (2008), available at <http://www.govtrack.us/congress/billtext.xpd?bill=s110-3086> [hereinafter “S. 3086”]. Because the Senate version of the bill is more detailed, we refer to it when discussing the terms of the legislation.

178. 154 CONG. REC. S5208 (daily ed. June 5, 2008) (statement of Sen. Durbin).

179. The legislation’s title—Credit Card Fair Fee Act of 2008—is a bit of a misnomer because the bill covers fees for accepting debit as well as credit cards.

180. “Merchant” refers to “any person who accepts or seeks to accept debit or credit cards in payment for goods and services.” S. 3086, *supra* note 177, § 2(a)(19).

181. “Covered electronic payment system” is defined as “an electronic payment system that routes information and data to facilitate transaction authorization, clearance, and settlement for not less than 20 percent of the combined dollar value of credit card and debit card payments processed in the United States in the most recent full calendar year.” *Id.* § 2(a)(10).

182. See *id.* § 2(c)(1). The specific terms of the exemption read:

Notwithstanding any provision of the antitrust laws—

- (1) in negotiating fees and terms and participating in any proceedings under subsection (d), any providers of a covered electronic payment system and any merchants who have access to or who are seeking access to that covered electronic payment system may jointly negotiate and agree upon the fees and terms for access to the covered electronic payment system, including through the use of common agents that represent the providers of the covered electronic payment system or the merchants on a nonexclusive basis; and
- (2) any providers of a single covered electronic payment system also may jointly determine the proportionate division among such providers of paid fees.

*Id.* § 2(c).

183. Editorial, *Credit-Card Wars*, *supra* note 174, at A8 (stating that Visa has approximately 50 percent of the credit and debit card market while MasterCard controls approximately 25 percent).

184. S. 3086, *supra* note 177, § 2(b).



or services.<sup>185</sup> "Credit card" refers to a general purpose card or other device issued or approved by a financial institution that allows the cardholder to obtain goods or services on credit terms specified by the financial institution.<sup>186</sup> The bill defines "debit card" to mean a card or device "approved for use by a financial institution for use in debiting the account of a cardholder for the purpose of that cardholder obtaining goods or services, whether authorization is signature-based or PIN-based."<sup>187</sup>

In its operative sections, the bill immunizes merchants and covered electronic payment system providers from any liability under the antitrust laws that might arise from negotiations or other proceedings which are authorized by the Act.<sup>188</sup> Protected under the bill is the voluntary negotiation of an access agreement between one or more providers of a covered electronic payment system and one or more merchants.<sup>189</sup> If the parties reach an agreement, they are required to file a copy with a court of specially created EPSJs<sup>190</sup> who will then make the document publicly available.<sup>191</sup> If the parties cannot reach a mutually acceptable agreement, mandatory "proceedings" are to begin before the EPSJs, including a three-month period of negotiation between the parties.<sup>192</sup> If voluntary negotiations fail, it appears that the Act mandates that the EPSJs set the interchange fees and terms.<sup>193</sup>

## VI. FEDERAL ENFORCEMENT ACTIONS

Since our 2007 Survey, federal bank regulatory agencies and the Federal Trade Commission ("FTC") have brought enforcement actions seeking sizeable monetary damages from companies for engaging in "unsafe and unsound practices" under the federal banking statutes<sup>194</sup> or in "unfair or deceptive acts or practices" in violation of section 5(a) of the Federal Trade Commission Act.<sup>195</sup> These actions

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185. *Id.* § 2(a)(1).

186. *Id.* § 2(a)(11).

187. *Id.* § 2(a)(12). Under this definition, a number of payroll cards and other prepaid debit products are not covered by the bill. Most payroll and prepaid debit card programs do not provide for a separate bank account for each cardholder, but rather place all of the funds backing the cards in a single "funds pool" typically held in the name of the employer or program sponsor. For a more detailed explanation, see 2006 Survey, *supra* note 31, at 232. Because the use of such cards does not involve "debiting the account of a cardholder," these cards do not qualify as debit cards for purposes of the legislation.

188. S. 3086, *supra* note 177, § 2(c).

189. *Id.* § 2(d)(1)(A).

190. Section 3 of the bill details the process for the selection and appointment of EPSJs and sets forth their powers and duties. *Id.* § 3.

191. *Id.* § 2(d)(1)(B), (C).

192. See *id.* §§ 2(d)(2), (3) & 4(b)(2)(A), (B).

193. *Id.* Section 2(d)(3) states that the EPSJs "shall conduct proceedings under this Act to establish fees and terms for access to a covered electronic payment system." Section 5(a)(1) of the bill, titled "Institution of Proceedings Before Electronic Payment System Judges," does not address who may initiate a proceeding, but rather simply says "[p]roceedings under this Act shall be commenced as soon as practicable after the date of enactment."

194. See *infra* Part VI.A.1.

195. See *infra* Part VI.A.2.

include the April 2008 settlement of allegations of unsound practices brought by the Office of the Comptroller of the Currency (“OCC”) against Wachovia Bank, N.A., as well as the June 2008 actions by the Federal Deposit Insurance Corporation (“FDIC”) against three banks for engaging in “unfair or deceptive acts or practices” related to marketing subprime credit cards and against CompuCredit Corporation under the FDIC’s “institution-affiliated party” authority.<sup>196</sup> Collectively, these enforcement actions seek more than \$150 million in restitution, sizeable additional payments for consumer education and compliance programs, and civil penalties. They also signal a move toward increased government oversight of the third-party partners with whom financial services providers work.

In our 2007 Survey we reported on developments in the federal prosecution of e-gold Ltd. for failing to register as a “money services business” or comply with certain Bank Secrecy Act requirements.<sup>197</sup> Since then, the defendants in this prosecution challenged the application of the Bank Secrecy Act to their operations. The U.S. District Court ruled against e-gold and the defendants have subsequently entered into plea agreements.

## A. FEDERAL ENFORCEMENT ACTIONS UNDER THE GOVERNMENT’S AUTHORITY TO REGULATE “UNSAFE AND UNSOUND PRACTICES” AND “UNFAIR OR DECEPTIVE ACTS OR PRACTICES”

### 1. Bank Regulators Use Their Authority

#### a. *The OCC Gets \$144 Million from Wachovia*

In the 2007 Survey, we discussed the DOJ’s prosecution of Payments Processing Center, LLC, which processed “remotely created checks” payable to certain telemarketers through commercial banks.<sup>198</sup> Since then, the OCC settled charges against Wachovia Bank, N.A., that Wachovia had engaged in various “unsafe and unsound” banking practices in managing its account relationship with Payments Processing Center.<sup>199</sup> Among its findings, the OCC concluded that Wachovia:

- “failed to conduct suitable due diligence on the [Payments Processors’] accounts even though Wachovia had reason to know that their payments processor and direct telemarketers . . . posed significant legal, reputational and monetary risks to the Bank and monetary risk to consumers;”<sup>200</sup>
- “fail[ed] to recognize and properly address the risks posed by the activities of the [non-bank] payments processors and direct telemarketers” who generate remotely created checks (“RCCs”) which Wachovia accepts for deposit;<sup>201</sup>

196. See 12 U.S.C. § 1813(u) (2006).

197. See 2007 Survey, *supra* note 3, at 254–62.

198. See *id.* at 263–65. As explained in last year’s Survey, Professor Hughes briefly served as an expert in the criminal case against Payments Processing Center, LLC. See *id.* at 264 n.220.

199. *In re Wachovia Bank, N.A.*, No. 2008-027 (OCC Apr. 24, 2008) (“Consent Order for a Civil Monetary Penalty”), available at <http://www.occ.treas.gov/ftp/release/2008-48a.pdf>.

200. *Id.* at 2.

201. *Id.*

- “fail[ed] to monitor the rates of [charge-backs] on the RCCs deposited into the accounts and to respond to allegations of consumer fraud from other banks and consumers”,<sup>202</sup> and
- “fail[ed] to follow the Bank’s normal procedures for handling returned RCCs” and to create procedures to “minimize consumer complaints and scrutiny of the Bank’s relationships with the payments processors and direct telemarketers.”<sup>203</sup>

The settlement requires the payment by Wachovia Bank of roughly \$144 million. The breakdown of this sum is a \$10 million civil penalty,<sup>204</sup> \$125 million in restitution to consumers,<sup>205</sup> and \$8.9 million for consumer education programs.<sup>206</sup>

Wachovia also is named in a civil action filed in Pennsylvania in which the plaintiff alleges that the bank knowingly processed fraudulent checks and unauthorized demand drafts for telemarketing companies.<sup>207</sup>

### *b. The FDIC Sues Banks and CompuCredit Corporation*

As the subprime mortgage crisis hit in 2007, Chairman Barney Frank of the House Financial Services Committee warned bank regulators that they should use their statutory “unfair or deceptive acts or practices” authority under section 5(a) of the Federal Trade Commission Act<sup>208</sup>—or risk losing it.<sup>209</sup> After Chairman Frank’s plea, the Board of Governors of the Federal Reserve System proposed regulations of unfair or deceptive acts or practices.<sup>210</sup> At the same time, the Board proposed similar revisions to Regulation Z<sup>211</sup> and Regulation DD.<sup>212</sup>

202. *Id.* at 3.

203. *Id.*

204. *Id.*

205. Agreement by and Between Wachovia Bank, National Association, Charlotte, North Carolina, and the Office of the Comptroller of the Currency at 4, *In re Wachovia Bank, N.A.*, No. 2008-027 (OCC Apr. 24, 2008), available at <http://www.occ.treas.gov/ftp/release/2008-48b.pdf> [hereinafter “Wachovia Agreement”]. Restitution will be paid to consumers who file an appropriate claim in *United States v. Payments Processing Center, LLC*, No. 06-725 (E.D. Pa. July 6, 2006) (filing of amended verified complaint). The settlement has been criticized by Rep. Markey (D-MA) and others for not providing a simpler method for consumers to get their money back. See Charles Duhigg, *Big Fine Set for Wachovia to End Case*, N.Y. TIMES, Apr. 26, 2008, at C1.

206. Wachovia Agreement, *supra* note 205, at 8.

207. See Complaint/Class Action at 19–21, *Faloney v. Wachovia Bank, N.A.*, No. 07-1455 (E.D. Pa. Apr. 12, 2007).

208. Federal Trade Commission Act § 5(a), 15 U.S.C. § 45(a) (2006).

209. See Jesse Westbrook & Craig Torres, *U.S. Regulators Tell Lenders to Toughen Standards*, BLOOMBERG.COM, June 29, 2007, <http://www.bloomberg.com/apps/news?pid=20601103&ssid=aM75RhUR34Sg> (commenting on how U.S. banking regulators were telling mortgage lenders to tighten their standards in extending credit on subprime loans, and how Chairman Frank and others thought that regulators were shirking their rulemaking authority with regard to subprime loans).

210. Unfair or Deceptive Acts or Practices, 73 Fed. Reg. 28904 (proposed May 19, 2008) (to be codified at 12 C.F.R. pts. 227, 535 & 706) (joint proposal of the Federal Reserve System, Office of Thrift Supervision, and the National Credit Union Administration).

211. Truth in Lending, 73 Fed. Reg. 28866 (proposed May 19, 2008) (to be codified at 12 C.F.R. pt. 226).

212. Truth in Savings, 73 Fed. Reg. 28739 (proposed May 19, 2008) (to be codified at 12 C.F.R. pt. 230).

On June 10, 2008, the FDIC announced it was seeking \$200 million from First Bank of Delaware, First Bank & Trust of Brookings, South Dakota, and CompuCredit Corporation for engaging in deceptive marketing of Visa and MasterCard branded credit card products to consumers with low credit scores.<sup>213</sup> While each of the targets engaged in different marketing practices, the FDIC faulted each for failure to “disclose significant upfront fees.”<sup>214</sup> For example, the FDIC charged that First Bank & Trust offered a credit card with “up to \$3250” in available credit to some consumers, but failed to tell applicants that only half of the credit limit would be available for the first ninety days.<sup>215</sup> Similarly, CompuCredit allegedly failed to disclose that it would monitor cardholders’ purchases and reduce available credit based on undisclosed “behavioral” scoring models.<sup>216</sup> In other cases, CompuCredit offered consumers a Visa credit card to which they could transfer charged-off debt which would then be reported to consumer credit reporting agencies as having been paid in full.<sup>217</sup> In fact, CompuCredit enrolled some of those consumers in a debt repayment plan operated by its subsidiary, Jefferson Capital, and did not issue the promised credit card until the consumer had repaid 25 percent to 50 percent of the charged-off debt.<sup>218</sup> Also, consumers who paid the sums required discovered that their Visa cards had only nominal available credit limits.<sup>219</sup>

The FDIC settled similar charges involving CompuCredit with a third financial institution, Columbus Bank, which had agreed to a cease-and-desist order,<sup>220</sup> a \$2.4 million civil penalty, and to maintain a fund of \$7.5 million to guarantee payment of the restitution that the FDIC is seeking from CompuCredit.<sup>221</sup> The cease-and-desist order requires that all future card solicitations contain clear and “prominent” upfront disclosures of all fees and restrictions on the cardholder’s initial available credit, prohibits material misrepresentations related to credit cards, and requires maintenance of adequate systems and controls especially for supervision of third-party partners.<sup>222</sup>

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213. Press Release, Fed. Deposit Ins. Corp., FDIC Seeks in Excess of \$200 Million Against Credit Card Company and Two Banks for Deceptive Credit Card Marketing (June 10, 2008) (PR-47-2008), available at <http://www.fdic.gov/news/news/press/2008/pr08047.html> [hereinafter “FDIC Press Release”].

214. *Id.*

215. *Id.*

216. *Id.*

217. *Id.*

218. *Id.*

219. *Id.*

220. *In re Columbus Bank & Trust Co.*, FDIC-08-033b, FDIC-08-034k (June 9, 2008) (“Order to Cease and Desist and Order to Pay”), available at [http://www.fdic.gov/news/news/press/2008/CBT\\_CD\\_and\\_Order\\_to\\_Pay.pdf](http://www.fdic.gov/news/news/press/2008/CBT_CD_and_Order_to_Pay.pdf) [hereinafter “Cease-and-Desist-Order”].

221. *In re Columbus Bank & Trust Co.*, FDIC-08-033b, FDIC-08-034k, slip op. at 2 (June 9, 2008) (“Order for Restitution”), available at [http://www.fdic.gov/news/news/press/2008/CBT\\_Restitution\\_Order.pdf](http://www.fdic.gov/news/news/press/2008/CBT_Restitution_Order.pdf).

The bank’s obligation to pay restitution is contingent on the success of the FDIC’s litigation against CompuCredit and apparently is intended to fund cash refunds for consumers in the event CompuCredit is unable to do so. See *id.* at 2–3. The bank also agreed to cooperate with the FDIC and FTC in their actions against CompuCredit. See *id.*

222. Cease-and-Desist-Order, *supra* note 220, at 4–13.

In addition to the actions taken against the banks, the FDIC sued CompuCredit seeking more than \$4.8 million in civil penalties as well as consumer redress of as much as \$200 million.<sup>223</sup> This action names CompuCredit as an “institution-affiliated” party of Columbus Bank which enables the FDIC to pursue restitution and other remedies against the non-bank entity.<sup>224</sup>

In all of the matters, the FDIC has held financial institutions accountable for the activities of its affiliate. FDIC Board member Thomas J. Curry expressed the message quite directly: “[A]n institution’s board of directors and senior management are ultimately responsible for managing activities conducted through third-party relationships, and identifying and controlling risks arising from such relationships, to the same extent as if the activity were handled within the institution.”<sup>225</sup> Mr. Curry also cited the FDIC’s new Guidance for Managing Third-Party Risk, issued on June 4, 2008.<sup>226</sup>

## 2. The Federal Trade Commission Polices Electronic Payments Products and Services

In a parallel action to the FDIC proceedings, the FTC sued CompuCredit Corporation and its subsidiary, Jefferson Capital Systems, LLC.<sup>227</sup> The FTC alleges violations of section 5(a) of the Federal Trade Commission Act and sections 806, 807, and 814 of the Fair Debt Collection Practices Act, and seeks rescission and reformation of contracts, restitution, and disgorgement.<sup>228</sup> In addition to behavior alleged in conjunction with the FDIC’s suit,<sup>229</sup> the FTC alleged that Jefferson played an “integral role in collecting charged-off receivables (often including

223. Notice of Charges for an Order to Cease and Desist and for Restitution; Notice of Assessment of Civil Money Penalties; Findings of Fact and Conclusions of Law; Order to Pay; and Notice of Hearing at 19, *In re CompuCredit Corp.*, FDIC-08-139b, FDIC-08-140k (June 18, 2008), available at [http://www.fdic.gov/news/news/press/2008/CompuCredit\\_Notice\\_of\\_Charges.pdf](http://www.fdic.gov/news/news/press/2008/CompuCredit_Notice_of_Charges.pdf) (describing the civil penalty of more than \$4.8 million); FDIC Press Release, *supra* note 213 (estimating that restitution to consumers will exceed \$200 million and that the civil penalty assessed against CompuCredit would be \$6.2 million).

224. See *supra* note 223; see also 12 U.S.C. § 1813(u) (2006) (definition of “institution-affiliated” party). For a discussion of this authority and its use in previous enforcement actions, see generally James O. Johnston, Jr. & Daniel Schott Schecter, *Introduction: Kaye, Scholer and the OTS—Did Anyone Go Too Far?*, 66 S. CAL. L. REV. 977 (1993); Jonathan R. Macey & Geoffrey P. Miller, *Kaye, Scholer, FIRREA, and the Desirability of Early Closure: A View of the Kaye, Scholer Case from the Perspective of Bank Regulatory Policy*, 66 S. CAL. L. REV. 1115 (1993).

225. FDIC Press Release, *supra* note 213.

226. See *id.* (citing Guidance for Managing Third-Party Risk, FIL-44-2008 (Fed. Deposit Ins. Corp. June 4, 2008), available at <http://www.fdic.gov/news/news/financial/2008/fil08044a.htm>).

227. Press Release, Fed. Trade Comm’n, FTC Sues Subprime Credit Card Marketing Company and Debt Collector for Deceptive Credit Card Marketing (June 10, 2008) (No. 0623212), available at <http://www.ftc.gov/opa/2008/06/compucredit.shtm>.

228. Complaint for Permanent Injunction and Other Equitable Relief at 1–2, *FTC v. CompuCredit Corp.*, No. 08 Civ. 1976 (N.D. Ga. June 10, 2008) [hereinafter “CompuCredit Complaint”]. Section 5(a) of the Federal Trade Commission Act is codified at 15 U.S.C. section 45(a) (2006); sections 806, 807, and 814 of the Fair Debt Collection Practices Act are codified at 15 U.S.C. sections 1692d, 1692e & 1692f (2006).

229. See *supra* notes 213–19 and accompanying text.

assessed fees) that CompuCredit generated through its Aspire Visa cards,<sup>230</sup> and that CompuCredit

has had the sole and exclusive right to solicit applications for certain credit cards; has created, designed, and distributed the marketing materials; established the credit cards' terms and conditions; developed the underwriting and credit criteria; administered the card programs; maintained customer service functions; and purchased all account receivables (except for a one-time sum that has been retained by the bank, e.g., in the case of CB&T, \$1 million), including fees, finance charges and principal balances on purchases and cash advances.<sup>231</sup>

In addition, the FTC charges that, among other things, CompuCredit "misrepresented the credit limits on its credit cards, failed to disclose the up-front fees charged for some of its credit cards, and failed to disclose how certain transactions could adversely affect the available credit on its credit cards."<sup>232</sup>

In addition to the CompuCredit action, the FTC has in the last year taken action against other card issuers and processors for unfair or deceptive practices. It obtained injunctive relief and more than \$26.4 million in damages from a group of card processing companies for failure to deliver promised savings on credit card interchange fees to merchants.<sup>233</sup> It sued EdebitPay, LLC, which markets prepaid debit cards to subprime consumers through Internet sites, pop-up advertising, and e-mail advertising.<sup>234</sup> The EdebitPay defendants agreed to change their marketing practices, pay \$2,258,258 in consumer redress, and, in a highly unusual provision for an FTC settlement, \$667,228 in back taxes.<sup>235</sup> The FTC obtained a \$10 million judgment against Centurion Financial Benefits and a group of affiliated corporations and individuals who operated a massive telemarketing scheme in which consumers were promised, for a fee of \$249 each, a credit card with a \$2,000 line of credit but received only an application for a prepaid cash card.<sup>236</sup> An interesting twist to the case was that all of the defendants were based in Canada, the telemarketing calls originated in Canada, and the FTC alleged that much of the illegal activity occurred outside of the United States.<sup>237</sup> In another cross-border credit card marketing prosecution, the FTC won a judgment of \$5 million

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230. CompuCredit Complaint, *supra* note 228, at 4.

231. *Id.* at 6.

232. *Id.* at 7-8.

233. See *FTC v. Merchant Processing, Inc.*, No. CV07-0533BR, slip op. at 9 (D. Or. May 5, 2008) ("Stipulated Final Judgment and Order for Permanent Injunction and Other Equitable Relief"), available at <http://www.ftc.gov/os/caselist/0523162/080515mpipi.pdf>.

234. Press Release, Fed. Trade Comm'n, Online Marketers of Prepaid Debit Cards to Subprime Consumers Will Pay More than \$2.2 Million to Settle FTC Charges (Jan. 24, 2008), <http://www.ftc.gov/opa/2008/01/cards.shtm>.

235. *FTC v. EdebitPay, LLC*, No. CV07-4880-ODW (AJWx), slip op. at 9 (C.D. Cal. Jan. 17, 2008) ("Stipulated Final Order for Permanent Injunction and Monetary Relief"), available at <http://www.ftc.gov/os/caselist/0623125/080117edebitpayfinalorder.pdf>.

236. Press Release, Fed. Trade Comm'n, Court Enters Final Orders and \$10 Million Judgment Against Last Centurion Defendants (Oct. 25, 2007), <http://www.ftc.gov/opa/2007/10/centurion.shtm>.

237. *Id.*

from a group of Canadian-based defendants known as the Pacific Liberty Group who charged people \$319 each for a credit card and “complimentary gifts” which were never received.<sup>238</sup>

Finally, the FTC won a victory before the U.S. Court of Appeals for the Eleventh Circuit, which upheld a judgment against Peoples Credit First, a company that collected over \$11 million from consumers who were “guaranteed” but never received a platinum credit card with a \$5,000 limit.<sup>239</sup>

## B. DISTRICT COURT HOLDS E-GOLD LTD. IS A “MONEY TRANSMITTING BUSINESS”

Our 2007 Survey provided an in-depth analysis of the criminal prosecution of e-gold Ltd.—the company that issued the Internet-based international currency backed by deposits of gold and other precious metals—on charges of money laundering.<sup>240</sup> Since then, the district court has held that e-gold is a “money transmitting business” subject to federal law.<sup>241</sup> Shortly thereafter, e-gold entered into a plea agreement resolving the charges against it.<sup>242</sup>

The events that led to the conclusion of the case began on February 11, 2008, when the defendants filed a motion to dismiss three of the four counts against them. They argued that the government had failed to allege adequate facts to support the charges.<sup>243</sup> The defendants were charged under 18 U.S.C. section 1960, which applies only to a “money transmitting business.”<sup>244</sup> In order to be a “money transmitting business,” an entity must engage in cash transactions.<sup>245</sup> The defendants argued that because the government failed to allege that they had handled cash (and, in fact, the defendants had not handled cash), the indictment must be dismissed.<sup>246</sup> The court rejected the defendants’ argument, concluding:

Section 1960 defines what it means to be unlicensed and what it means to engage in money transmitting. By those definitions, a business can clearly engage in money transmitting without limiting its transactions to cash or currency and would commit a crime if it did so without being licensed.<sup>247</sup>

238. Press Release, Fed. Trade Comm’n, Court Orders Cross-Border Telemarketers to Pay Nearly \$5 Million (May 1, 2008), <http://www.ftc.gov/opa/2008/05/pacliberty.shtm>.

239. *FTC v. Peoples Credit First, LLC*, 244 F. App’x 942 (11th Cir. 2007), *aff’g* No. 8:03-CV-2353-T, 2005 WL 3468588 (M.D. Fla. Dec. 18, 2005).

240. See 2007 Survey, *supra* note 3, at 254–62.

241. *United States v. E-gold, Ltd.*, 550 F. Supp. 2d 82, 97 (D.D.C. 2008).

242. See Letter from Bernard S. Grimm, Esq., Cozen O’Connor, to Jeffrey A. Taylor, U.S. Attorney (July 18, 2008) (plea agreement).

243. Memorandum of Law in Support of Defendants’ Motion to Dismiss Counts Two, Three and Four of the Indictment at 5, *United States v. E-gold, Ltd.*, 550 F. Supp. 2d 82 (D.D.C. 2008) [hereinafter “E-gold Motion to Dismiss”].

244. *Id.* at 6–7.

245. See 18 U.S.C. § 1960 (2006).

246. E-gold Motion to Dismiss, *supra* note 243, at 5.

247. *E-gold*, 550 F. Supp. 2d at 84.

The court read section 1960 as providing an expansive definition of money transmission: “Section 1960 defines ‘money transmitting’ broadly to including transferring ‘funds,’ not just currency, ‘by any and all means[’];[] it is not limited to cash transactions.”<sup>248</sup>

The defendants had argued that under federal law, the term “money transmitting business” is only defined in 31 U.S.C. section 5330, which provides that a business can be considered a “money transmitting business” only if it is required to file cash transaction reports under 31 U.S.C. section 5313.<sup>249</sup> Section 5313, in turn, places a reporting requirement only upon domestic financial institutions involved in transactions of “United States coins and currency (or other monetary instruments the Secretary of Treasury prescribes).”<sup>250</sup> Accordingly, e-gold argued that because section 5330 applies only if section 5313 is triggered, section 5330 must also require the handling of cash or coin.<sup>251</sup> The court was not persuaded, concluding that in fashioning section 1960, Congress did not borrow from section 5330, but rather relied upon 18 U.S.C. section 1955, which makes it a federal crime to operate a gambling business in violation of state law.<sup>252</sup> Looking at the legislative history of section 1955, the court found that Congress used the term “gambling business” to indicate that it sought to criminalize only large-scale illegal gambling operations:

Because Section 1960 was modeled from Section 1955, it can be inferred that Congress employed the term “business” after “money transmitting” in subsections (a) and (b)(1) of Section 1960 to indicate that Section 1960 was designed to tackle large-scale operations as opposed to small-scale or individual money transmitters.<sup>253</sup>

The day before oral argument was held on the defendants’ motion to dismiss,<sup>254</sup> the government filed a superseding indictment that buttressed the “business” aspect of “money transmitting business” by alleging e-gold maintained “a cadre of employees” and had transferred “approximately \$145,535,374.26” in funds.<sup>255</sup> With these facts included in the indictment, the court concluded that e-gold was a “money transmitter” and a “business” and thus was also a “money transmitter business.”<sup>256</sup> Anticipating that its reliance on the legislative history of 18 U.S.C. section 1955—a statute not at issue in the case—might trouble some readers, the court preemptively defended its analysis:

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248. *Id.* at 88 (quoting 18 U.S.C. § 1960(b)(2) (2006)).

249. E-gold Motion to Dismiss, *supra* note 243, at 7.

250. 31 U.S.C. § 5313(a) (2000).

251. E-gold Motion to Dismiss, *supra* note 243, at 7.

252. *E-gold*, 550 F. Supp. 2d at 88–89.

253. *Id.* at 89.

254. *Id.* at 85 n.1.

255. *Id.* at 89.

256. *Id.*



The Court recognizes that reliance on the legislative history of a separate, albeit historically related, statute may not by itself eliminate all ambiguity from the phrase “money transmitting business” in Section 1960 (assuming *arguendo* that any ambiguity existed at the outset). The structure of the statute as well as the relevant canons of statutory construction, however, guide the Court to the same conclusion.<sup>257</sup>

The defendants also had argued that they could not be a “money transmitting business” under section 5330 because they were not required to file currency transaction reports under section 5313.<sup>258</sup> The court rejected that argument, concluding that even though e-gold had never handled currency or coin, it was still subject to the currency reporting requirements:

A money transmitting business is no less a transmitter of money just because it does not deal in currency. Rather, Section 5313 comes into force and will require a report if, when, and as the transmitter does engage in currency transactions.<sup>259</sup>

In conclusion, the court was very clear in its view that handling cash is not the touchstone of being a “money transmitting business” under federal law.

The term “money transmitting business” as used in Section 5330 includes all financial institutions that fall outside of the conventional financial system (and that are not a “depository institution”), not just those that engage in cash transactions.<sup>260</sup>

The court’s decision, however, raises as many questions as it answers. If all entities could theoretically handle cash at some time in the future and thus be subject to section 5313, how could being subject to section 5313 possibly serve as a limiting factor in the application of section 1960(a)? What limitations, if any, are there on the application of money transmitter business laws? If e-gold—an Internet-based system that allows users to transfer among themselves electronic warehouse receipts for precious metals—must comply with federal money transmitter laws, then do other similar Internet systems also need to come into compliance? Under the e-gold decision, money transmitters do not have to handle cash, and transactions do not have to be denominated in dollars. Does this mean that the various “virtual world” games in which players trade elfin gold, magic potions, and valuable weapons are now subject to money transmitter statutes? Is Coca-Cola running a money transmitting business when it redeems codes found under bottle caps for prizes on [www.mycokerewards.com](http://www.mycokerewards.com)? Could executives of Mattel, along with Barbie and Ken, be indicted for conspiracy to operate an unlicensed “money transmitting business” because of the exchange of “B-Bucks” on [www.barbiegirls.com](http://www.barbiegirls.com)? Unfortunately, the e-gold decision only makes these types of questions more difficult to answer. Given the plea agreement, the law of this case is not going to be refined upon appeal—leaving business lawyers who work in this area to wander in dim light.

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257. *Id.*

258. E-gold Motion to Dismiss, *supra* note 243, at 7.

259. E-gold, 550 F. Supp. 2d at 95.

260. *Id.* at 93.

## CONCLUSION

Change is the touchstone of electronic payments and the law that governs them here and abroad, whether payments are made through established and regulated payments systems such as debit cards, credit cards, automated clearinghouse debits or credits, or wire transfers, or through newer payments products such as virtual currencies, mobile payments, or “remote deposit capture.”<sup>261</sup> Electronic payments continue to generate legal controversies, such as how to classify products such as e-gold.

While we see the current proliferation of payments systems with different rules in the United States, recent European developments suggest that it is possible to harmonize the law of electronic payments. For example, the March 2007 Payment Services Directive adopted by the European Union and European Parliament<sup>262</sup> has the goal of creating single, cross-border deposit accounts and harmonizing payment obligations and laws for credit transfers, direct debits, and payment cards across borders and payment instruments,<sup>263</sup> to be completed by 2010.<sup>264</sup> As of January 28, 2008, “every credit transfer carried out in euros is processed in the same way across Europe, with identical procedures and the same timeframe,” although pricing will differ among banks for a while longer.<sup>265</sup> Before December 31, 2010, European Union nations will have a Single Euro Payment Area (“SEPA”) payment instrument for direct debits, while all current credit cards will be replaced by interoperable, SEPA-compliant cards.<sup>266</sup> Plans also call for coverage of Internet payments (currently governed by the European Union’s eMoney Directive adopted in 2000)<sup>267</sup> and for amendment of the eMoney Directive and its integration into the Payment Services Directive.<sup>268</sup>

261. Remote deposit capture allows consumers and businesses who are not in close proximity to a branch of their depository bank or who lack access to more sophisticated equipment for image processing to use a commercial computer scanner to send images of the check they wish their bank to collect on their behalf. The only access consumers in the United States currently have to remote deposit capture is through USAA, the giant financial institution that serves individuals connected with the military services. USAA’s web site includes a video explaining how to use remote deposit capture. USAA, USAA Deposit@Home, [https://www.usaa.com/inet/ent\\_utils/McStaticPages?key=bank\\_deposit](https://www.usaa.com/inet/ent_utils/McStaticPages?key=bank_deposit) (last visited June 11, 2008).

262. See *Payment Services Directive Pushed Through by Parliament*, EURACTIV.COM, Apr. 27, 2007, <http://www.euractiv.com/en/financial-services/payment-services-directive-pushed-parliament/article-163368>.

263. See *Payment Services Directive: The End of the Cash Era?*, EURACTIV.COM, July 11, 2008, <http://www.euractiv.com/en/financial-services/payment-services-directive-cash-era/article-171979>.

264. See *Payment Services Directive Pushed Through by Parliament*, *supra* note 262.

265. *SEPA: Easier Credit Transfers but Uncertain Cost Cuts*, EURACTIV.COM, Jan. 29, 2008, <http://www.euractiv.com/en/financial-services/sepa-easier-credit-transfers-uncertain-cost-cuts/article-169907>.

266. *Id.*

267. See *Payment Services Directive: The End of the Cash Era?*, *supra* note 263.

268. See *id.* For more information on the Single Euro Payments Area, see EUROPEAN PAYMENTS COUNCIL, MAKING SEPA A REALITY: IMPLEMENTING THE SINGLE EURO PAYMENTS AREA (Apr. 16, 2007), [http://www.europeanpaymentscouncil.eu/documents/EPC066\\_06%20SEPA%20Overview%20v1.4.pdf](http://www.europeanpaymentscouncil.eu/documents/EPC066_06%20SEPA%20Overview%20v1.4.pdf) (last visited June 15, 2008).

Although the Directive technically does not change the law of payments in the United States, progress toward the SEPA should encourage us to think about pursuing the harmonization of payments laws and regulations that was the subject of the “Rethinking Payments Law” symposium in April 2007.<sup>269</sup> Especially following e-gold and other actions discussed in this Survey, financial services providers and consumers in the United States need to be able to predict their rights and responsibilities in payments generally and to avoid the expense of litigation over which laws apply to which payment transactions.

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269. See Federal Reserve Bank of New York, *Rethinking Payments Law*, <https://www.newyorkfed.org/registration/legal/paylaw/form.cfm> (last visited June 18, 2008). For papers presented at the symposium, see *Symposium: Rethinking Payments Law*, 83 CHI.-KENT L. REV. 475 (2008).