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CONSUMER PAYMENT PRODUCTS AND SYSTEMS: THE NEED FOR UNIFORMITY AND THE RISK OF POLITICAL DEFEAT

MARK E. BUDNITZ*

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I. Introduction

Consumers are usually in conflict with the payments industry over government regulation. They may find common ground, however, in the need for uniformity. As this article demonstrates, the development of new payment systems and recent proliferation of new payment products¹ have created a complex and confusing marketplace in which consumers cannot adequately understand their rights and responsibilities. This article examines the need for a uniform federal law that would mandate minimum consumer protection standards in statutes governing payment products and systems.

Part II outlines the various payments systems triggered by use of an old payment product, the check. Part III then examines two payment products that are especially popular among consumers, the telephone check and stored value card, and compares them to older products in terms of risks and benefits to consumers. Part III also examines the different laws and regulations that govern each payment product and system as well as rules issued by the National Automated Clearinghouse ("NACHA"), a private rule-making association. This part demonstrates that, as a consequence of piecemeal legislation, there are vast discrepancies in the responsibilities placed upon and the protections offered to consumers resulting in tremendous confusion for consumers.

Part IV proposes enactment of a uniform federal law to impose minimum standards for payment products and systems to ensure essential rights for consumers. This article takes the position that a uniform law should require meaningful disclosures of rights, risks, and responsibilities. Serious issues arise, however, in drafting and defining such standards. How minimal should the requirements be? If the standards are too low, they will not provide meaningful protection. But if they are too high and unduly detailed, there will be many complicated operational problems for financial institutions because of

¹ "Payment products" refer to devices used to authorize and enable a payment to be made. Examples include checks, credit cards, debit cards, and stored value cards such as prepaid gift and phone cards. "Payment systems" refer to the various systems used to process the payments, such as the check processing system and the Automated Clearing House Network that processes most electronic fund transfers.

the great variety of products and systems that are currently in place or will be developed in the future. Furthermore, to what extent should a uniform federal law preempt state law? Should states be free to enact protective legislation that goes beyond what the federal law requires? Doing so would impose heavy burdens upon financial institutions and be inconsistent with uniformity. On the other hand, there are many benefits to permitting states to bestow additional protection upon the consumers within their borders. For one, states can better take account of the special characteristics of their population, such as numerous immigrants or elderly residents. State experimentation also can help determine which approaches might be worth legislating at a federal level. Finally, any push for a uniform law should consider the risk of doing further harm to consumer welfare. Faced with competing interests, Congress could enact a uniform law which provides inadequate substantive protections. The proposed recommendations in Part IV attempt to weigh and balance these considerations.

II. A Case Study of the Need for Uniformity: Check 21

The recently enacted Check Clearing for the 21st Century Act² (“Check 21”) illustrates the need for uniformity at the federal level. This statute does not regulate a new payment product; rather, it is new legislation to regulate an old product, the ordinary paper check. It has long been a policy of the Federal Reserve Board (“FRB”) to establish a payment system that is entirely electronic.³ However, since consumers still use checks extensively,⁴ Congress and the FRB decided to use the check processing system as a transitional step to facilitate electronic transfer of payments.⁵ Check 21 does this by establishing

² Check Clearing for the 21st Century Act, Pub. L. No. 108-100, 117 Stat. 1177 (2003) (codified as amended at 12 U.S.C. §§ 5001–5018 (2000) [hereinafter Check 21].

³ See Alan Greenspan, Remarks by Chairman Alan Greenspan at the Fed. Reserve Payments Sys. Dev. Comm., 2003 Conference (Oct. 29, 2003), available at www.federalreserve.gov/boarddocs/speeches/2003/20031029/default.htm (“[T]he U.S. government is actively working on new technologies and services to increase the use of electronics in both its payments and collections.”); Andrea S. Klein, *Putting All Payment Data in One Place*, AM. BANKER, Apr. 23, 2004, at 11 (“The Check 21 Act, enacted by Congress and the Federal Reserve, begins the process of moving to a paperless environment.”).

⁴ In the year 2000, consumers wrote checks in 26% of all transactions in which consumers did not pay with cash. RONALD J. MANN, PAYMENT SYSTEMS AND OTHER FINANCIAL TRANSACTIONS 5 (2d ed. 2003). This amounted to 43% of all dollars spent by consumer. *Id.*

⁵ See Availability of Funds and Collection of Checks, 69 Fed. Reg. 47,290, 47,290

legal rules that encourage banks to use electronic image exchange resulting in quicker and more efficient processing.⁶

For purposes of understanding Check 21, consumers can be divided into two groups.⁷ In one group are consumers who have agreed not to have their checks returned with their monthly statements.⁸ Their checks are “truncated” — that is, stored by a financial institution, usually their own bank. Instead of receiving original paper cancelled checks, these consumers will have a record of their check either in a carbonized copy that is produced when they write the original, or in an image of the check that is returned with the monthly statement. The second group consists of consumers who have not agreed to truncation of their checks and, until Check 21, whose original checks were returned with their statement. Under Check 21, these customers will not receive an original check with their statement if, in the course of processing that check, a financial institution has converted the paper original into an electronic image. Instead, these consumers have a right to be provided a “substitute check,” a new instrument mandated by Check 21.⁹ Financial institutions are required to give these consumers a consumer awareness notice explaining the new law and the substitute check.¹⁰

Pursuant to Check 21, an original paper check could be changed to a digital image, which in turn could be converted to a paper substitute check.¹¹ Because Congress recognized that errors could occur when checks are processed in this manner,¹² the law grants those

(August 4, 2004) (to be codified at 12 C.F.R. pt. 229) (describing the need for Check 21 in order to increase the efficiency of check processing) [hereinafter Check 21 Final Rule].

⁶ See Availability of Funds and Collection of Checks, 12 C.F.R. § 229 (2005). See generally Check 21 Final Rule, *supra* note 5.

⁷ Check 21 applies generally to both consumers and non-consumers. This article discusses Check 21 only in regard to those provisions that pertain to consumers.

⁸ Check truncation is authorized under U.C.C. §§ 4-406(a), (b) (2002). An estimated 59% of bank customers received their canceled checks with their bank statements; the remaining 41% have agreed to truncation. *Banks Prepared for Check 21, but What About Their Customers?*, ITEM PROCESSING REP. No. 15-18, July 1, 2004 (reporting on a 2003 Global Concepts study).

⁹ Consumers who have agreed to truncation have no right to receive substitute checks. See 12 C.F.R. §§ 229.51, 229.52; Check 21 Final Rule, *supra* note 5, at 47,301.

¹⁰ 12 U.S.C. § 5011 (2000).

¹¹ See 12 C.F.R. §§ 229.51, 229.52; Check 21 Final Rule, *supra* note 5, at 47,323.

¹² Errors include multiple debits generated from one original paper check because

consumers who have been provided with a substitute check the right to submit a claim to the bank and require it to investigate the claim.¹³ If the bank cannot determine the validity of the claim within ten days, it must recredit the consumer's account.¹⁴ Consumers who have agreed to have their checks truncated have no right to be provided a substitute check. Therefore, if the bank does not voluntarily give them a substitute check, they have no recredit right.¹⁵

Until Check 21, the law regulating check transactions consisted primarily of state-enacted versions of the Uniform Commercial Code (the "UCC").¹⁶ Unlike Check 21, the UCC contains no required investigation and recredit. In fact, except in two very narrow recent amendments not yet fully adopted by any state, the UCC check provisions contain no provisions that apply explicitly to consumers.¹⁷ In contrast, Check 21 includes some important, although very limited consumer protections, including the recredit right discussed briefly above.¹⁸ The Check 21 recredit right is similar to that provided in the Electronic Fund Transfers Act (the "EFTA").¹⁹ This is a promising

of the existence of the original, electronic images, and substitute checks. The FRB has acknowledged the potential for such errors. See Check 21 Final Rule, *supra* note 5, at 47,323–24; Availability of Funds and Collection of Checks, 69 Fed. Reg. 1470, 1496–97, 1498 (proposed Jan. 8, 2004) [hereinafter Check 21 Proposed Rule].

¹³ 12 U.S.C. § 5006.

¹⁴ The financial institution is required to recredit the consumer's account only if the institution cannot resolve the consumer's complaint within ten days, and only for certain types of problems related to creation of the substitute check. See 12 U.S.C. § 5007. The maximum amount of the recredit is \$2500 or the amount of the substitute check, whichever is less, unless the financial institution still cannot resolve the complaint after forty-five calendar days, at which any balance over the initial \$2500 must be recredited. Check 21 Final Rule, *supra* note 5, at 47,313.

¹⁵ See Mark E. Budnitz, *The Check 21 Challenge: Will Banks Take Advantage of Consumers?*, 58 Consumer Finance Law Quarterly Rep. 369 (2004) (describing how Check 21 provides opportunities for banks to provide consumers more protection than the Act requires).

¹⁶ An exception is the Expedited Funds Availability Act and Regulation CC, ensuring that depositors have relatively prompt access to funds from checks. See discussion *infra* Part III.A.2. One provision of Check 21 requires the FRB to issue a report recommending whether funds can be made available more promptly as a result of the speedier check processing that should result from Check 21. *Id.* § 5015.

¹⁷ See U.C.C. § 3-305(e) (2002) (extends the effect of the FTC Holder Rule, 16 C.F.R. pt. 433 (2005), to promissory notes that do not include the required FTC legend). See discussion *infra* Part III.B.1 (describing telephone checks).

¹⁸ 12 U.S.C. § 5006.

¹⁹ See 15 U.S.C. § 1693f. An importance difference between Check 21 and the

development for consumers. Despite the UCC's almost universal refusal to include consumer protection,²⁰ consumers are gaining some protection in certain check transactions through Regulation CC ("Reg. CC") and Check 21.²¹ One might call this creeping limited consumer protection. Incremental protectionist developments should make it easier in the future for consumer advocates to successfully demand that prospective legislation in the payments area include consumer protection, in contrast to the UCC model. Any other approach would be a step backwards.

While the inclusion of consumer protection in Check 21 bodes well for consumers, it also undoubtedly will result in consumer confusion.²² For example, consumers who discover errors in check transactions involving substitute checks have a right to an investigation and a recredit; however, this right applies only to consumers who have not agreed to truncation.²³ Others do not have the right to a recredit of funds even though their accounts may be debited erroneously in transactions involving substitute checks.²⁴ In addition, consumers'

EFTA is that under Check 21 the recredit right only applies to a maximum of \$2500 per substitute check if the bank cannot determine within ten days whether the consumer's claim for a recredit is valid. The balance over \$2500 is credited only after forty-five days if the bank's investigation is still pending. 12 U.S.C. § 5006(c)(2)(B). The EFTA includes no maximum cap on the amount the bank must recredit if the bank cannot determine the validity of the consumer's claim within ten days. 15 U.S.C. § 1693f(c).

²⁰ Fred H. Miller, *U.C.C. Articles 3, 4 and 4A: A Study in Process and Scope*, 42 ALA. L. REV. 405, 412-16 (1991) (explaining why the UCC drafters decided not to include consumer protection in Articles 3 and 4).

²¹ For example, as discussed *infra* Part III.A.2, Expedited Availability Act and Regulation CC provide that depositors should be given relatively prompt access to funds from checks. Check 21's grant of the right to a recredit, however, came at the cost of losing the right to the original check. Also, the ten-day recredit right only applies up to \$2500. The Consumers Union urged that the consumer recredit guarantee in Check 21 be extended to all check transactions involving consumer accounts. *Facilitating Electronic Check Processing: Hearing on H.R. 1474 Before the Comm. on House Fin. Serv. Subcomm. on Fin. Inst. and Consumer Credit* (Apr. 8, 2003) (statement of Janell Mayo Duncan, Leg. and Reg. Counsel, Consumers Union).

²² The FRB has acknowledged consumers will be confused. *See* Check 21 Final Rule, *supra* note 5, at 47,292.

²³ A consumer has a right to the recredit only if a substitute check is provided by the bank, the consumer never agreed to truncation, and the consumer satisfies the requirements for submitting a claim. 12 U.S.C. § 5006.

²⁴ The recredit applies only to consumers who are provided a substitute check. *Id.* § 5006(a)(1)(A). Consumers who have not agreed to truncation are entitled to receive either the original checks or substitute checks along with their monthly statements.

disputes that do not involve substitute checks are subject to the UCC. The UCC contains no error resolution procedure, much less a recredit right. The UCC only gives the consumer the option of suing the financial institution for violating the UCC.²⁵ Consumers will be confused by the protections created by Check 21 and the UCC because some consumers will have error resolution and recredit rights, while others will not.

The consumer protection provisions of Check 21 illustrate Congress's acknowledgment that payment systems must contain some basic protections for consumers; even older payment systems, such as checks, need revisiting now and then. However, Check 21 illustrates how unsatisfactory it is to provide protection in piecemeal fashion.

III. Many Sources of Consumer Confusion: The Murky World of Payment Systems and Payment Products

A. Payment Systems

1. Electronic Fund Transfers

Check 21 is not the only source of consumer confusion. A consumer's checking account is like an airline company's hub city. Just as many of the airliner's flights stop at the hub even though they have another destination, many payment transfers pass through the consumer's checking account even though the funds may be going elsewhere.²⁶ Consumers may be confused because increasing numbers of

Check 21 Final Rule, *supra* note 5, at 47,322. Consumers who agreed to truncation have a recredit right only if their bank voluntarily provides a substitute check. *Id.* at 47,325.

²⁵ See Edward L. Rubin, *The Code, the Consumer, and the Institutional Structure of the Common Law*, 75 WASH. U. L.Q. 11 (1997) (arguing that numerous factors deter consumers from obtaining remedies for violations of the UCC); Robert D. Cooter & Edward L. Rubin, *A Theory of Loss Allocation for Consumer Payments*, 66 TEX. L. REV. 63, 79-82 (1987) (comparing the costs of consumers and financial institutions litigating a UCC dispute). See Cynthia Lee Starnes, *Bad News Should Travel Fast: Hot Checks, Tardy Banks, and the Uniform Commercial Code's Rude Surprise*, 25 N.Y.U. REV. L. & SOC. CHANGE 539 (1999) (stating that consumers are unlikely to challenge a bank's failure to exercise charge-back in a timely fashion because of the litigation costs and the small amount of consumer checks).

²⁶ The hub analogy may be illustrated by typical payment transfers. The airline hub has many arriving and departing flights. Once they arrive at the hub, they take off for other destinations. Similarly, the consumer's checking account has arriving payments (credits) such as direct deposit of payroll (an electronic transfer) and deposits (cash and checks with the consumer as payee) the consumer makes at the teller or

these transactions do not involve the consumer writing checks, but nevertheless appear on the consumer's monthly checking account statement. These transactions appear on the statement because they involve debits and credits to the consumer's checking account. Some of the debits and credits which appear consist of electronic transfers that are subject to the EFTA.²⁷ Under the EFTA, all consumers have the right to error resolution and a recredit. However, the EFTA provides the consumer with sixty days to report an error to the bank,²⁸ whereas under Check 21 the consumer has only forty days to make a claim.²⁹ Other items appearing on the monthly statement that do not involve the consumer writing a check are paper instruments in the form of preauthorized drafts sent by a creditor to the consumer's bank (rather than electronic transfers). These often consist of "telephone checks," and are subject to the UCC, which contains no error resolution or recredit right.³⁰

In recent years, a method of processing payments called electronic check conversion ("ECC") that involves both checks and electronic fund transfers has become increasingly popular,³¹ but also a source

through an ATM. The consumer's account also has departing payments (debits) such as checks written by the consumer, cash withdrawals at ATMs, preauthorized drafts (telephone checks discussed *infra* Part III.B.1), and electronic transfers such as preauthorized transfers of recurring obligations such as mortgage payments and online bill paying.

²⁷ For the first time in U.S. history, in 2003, the number of electronic payments surpassed the number of payments by check, 44.5 billion compared to 36.7 billion. *E-Payments Surpass Check Payments for the First Time, Federal Reserve Says*, BNA BANKING DAILY, Dec. 7, 2004.

²⁸ 15 U.S.C. § 1693f(a) (2000).

²⁹ *Id.* § 5006(a)(2). The consumer must make a claim before the end of a forty-day period beginning on the later of either the date the financial institution mails or delivers a periodic statement, or the date on which a substitute check is made available to the consumer. Several of those submitting comments to the FRB on its proposed Check 21 regulations suggested extending the Check 21 time period to sixty days to avoid confusion and achieve uniformity with the EFTA. The FRB rejected that recommendation, opining that the forty-day period was mandated by the statute. Check 21 Final Rule, *supra* note 5, at 46,302.

³⁰ See discussion *infra* Part III.B.1.

³¹ Richard Mitchell, *Merchant Acquiring: What's Next for Electronic Checks?*, CREDIT CARD MGMT., Nov. 1, 2004 (there were over 200 million electronic check conversions in 2003, and NACHA predicts that there will be over 1 billion in 2004. See generally www.checkconversioneducation.org (last visited March 26, 2005); Steven Bills, *Conversion Education Group Wrapping It Up*, AM. BANKER, Feb. 27, 2004 (explaining why industry groups established check conversion education website).

of consumer confusion. ECC takes place in two situations: (1) when a consumer hands the cashier a check to pay for goods³² and (2) when the consumer mails a creditor a check to pay a bill.³³ In both cases, the business does not process the check for collection. Rather, it uses the check as a "source document," scanning information from the MICR line in order to process the payment as an electronic fund transfer.³⁴ Because the payment is not processed as a check transaction, the consumer does not receive the check with the monthly statement.³⁵

Accordingly, when consumers tender a check in payment and do not receive that original check in their bank statements, it may be due to three reasons. First, they may have agreed to have their checks truncated. These consumers should not be confused by the failure to receive the original check.³⁶ Second, they may not receive the original because, pursuant to Check 21, a substitute check was produced in processing the check. Third, the merchant may have processed the check by utilizing electronic check conversion. In the latter situation, consumers probably do not understand that they have not received the original check because it was processed by means of ECC.³⁷

Although Regulation E ("Reg. E") requires notice of electronic check conversion, it is unlikely consumers see or understand the ECC

³² Major merchants using this type of electronic check conversion include Home Depot, Target and Wal-Mart. Loretta Kalb, *Banks Must Take Advantage of Emerging Technology To Survive, Say Experts*, SACRAMENTO BEE, Aug. 17, 2004.

³³ This second situation is called "lockbox ECC." See David Brietkopf, *Cards: Bankers, Merchants Criticize Check Conversion Proposal*, AM. BANKER, Nov. 29, 2004. ECC has been characterized as "just an interim technology, designed to convert paper payments into electronic ones. The endgame is to persuade consumers and corporations to issue electronic payments instead of writing checks." Will Wade, *Outgoing NACHA Chief Ponders Next Step for Payments Industry*, AM. BANKER, Dec. 1, 2004 (reporting comments by the NACHA chairman).

³⁴ MARK E. BUDNITZ, CONSUMER BANKING AND PAYMENTS LAW 41 (2d ed. 2002 & Supp. 2004).

³⁵ Where the consumer tenders a check to the cashier, the cashier may return the check marked void. In that situation, the consumer should not be surprised when no cancelled check is returned. In the second situation, where the check is mailed to a "lockbox," the consumer may well be surprised.

³⁶ However, that transaction may have resulted in a substitute check. Although the consumer may not be confused by not receiving the original checks with the bank statement, if there is an error on the statement, the consumer may not realize that it may be due to the production of a substitute check.

³⁷ Shannon Buggs, *The Float Will Soon Be History*, HOUSTON CHRON., Aug. 2, 2004.

notice.³⁸ Through the media and brochures that banks have sent their customers, many consumers have learned that there is a new law that permits banks to stop returning original checks. These consumers, if they have not agreed to truncation, may assume Check 21 applies to all transactions in which they do not receive the original. Such consumer confusion would be reduced to some extent if the law required a degree of uniformity between notices regarding transactions involving substitute checks and ECC.

The current disclosure system does little to alleviate consumer confusion and, in many cases, does more harm than good. Under certain circumstances, Check 21 requires financial institutions to provide consumers with a consumer awareness notice.³⁹ This requirement is critical to an effective protection regime; it does consumers little good for Congress to enact laws for their protection unless consumers are informed of those rights and how to take advantage of them. At the same time, however, this notice must be considered in the context of the numerous other notices consumers receive regarding their checking accounts. In addition to Check 21 notices, the customer may receive notices and disclosures about electronic fund transfers such as direct deposit, electronic check conversion, debit card and ATM transactions, and pre-authorized bill paying and online bill paying.⁴⁰ The end result of these disclosures may be "notice overload." From a consumer protection standpoint, the best solution to this problem is not to repeal laws requiring notices, but to change the statutes to ensure greater uniformity. For example, if there were a uniform rule for unauthorized use of the customer's account, consumers could receive one notice that informs them of that rule, rather than

³⁸ See Electronic Fund Transfers, 69 Fed. Reg. 55,996 (proposed Sept. 17, 2004) (to be codified at 12 C.F.R. pt. 205) [hereinafter Reg. E Proposed Amendment] (stating that the notices currently required "are not readily noticeable to consumers").

³⁹ See 12 C.F.R. 229.57(a) (2005). "A bank must provide [the consumer awareness disclosure] under two circumstances. First, each bank must provide the disclosure to each of its consumer customers who receives paid checks with his or her account statement. This requirement does not apply [if the consumer agreed to truncation]. . . . Second, a bank also must provide the disclosure when it (a) provides a substitute check to a consumer in response to that consumer's request for a check or check copy or (b) returns a substitute check to a consumer depositor." Check 21 Final Rule, *supra* note 5, at 47,328.

⁴⁰ 15 U.S.C. § 1693c (2000). See generally Todd Davenport, *Everyone at Fault for Disclosure Mess: Williams*, AM BANKER, Jan. 13, 2005, at 3 (according to Acting Comptroller of the Currency Julie Williams, banks do not provide their customers with the information they need to make informed decisions and "the process that produces disclosure requirements virtually guarantees failure").

several notices that inform consumers of several different rules, depending upon what payment device is used.

The absence of uniform notice is only part of the problem. Consumers also need uniform error resolution procedures to prevent undue confusion from the many different types of consumer payments that involve the consumer's checking account. Although both Check 21 and the EFTA require the financial institution to investigate and recredit when the consumer alleges an error occurred, the consumer's actual rights differ substantially depending on which statute applies. If the consumer pays by check, but the error is not related to a substitute check, the consumer has no right to an investigation and recredit because Check 21's recredit procedure does not apply and because there is no error resolution procedure under the UCC. Even if the error is related to a substitute check, the consumer may not have a right to a recredit and investigation if the consumer agreed to truncation and the financial institution does not provide a substitute check.⁴¹ Most consumers pay their credit cards by check, but have very different rights when they refuse to pay because of a dispute involving the card.⁴²

In order for consumers to be able to understand and properly invoke an error resolution procedure, the law should require banks to investigate errors and recredit the consumers' account regardless of whether a check is processed as a check or an ECC, and regardless of whether the consumer is provided a substitute check.

2. Check 21 and the Expedited Funds Availability Act

Check 21 represents the second major federal incursion into what had been exclusively a state regulated commercial activity. The first federal development was the Expedited Funds Availability Act (the "EFAA")⁴³ and Reg. CC.⁴⁴ The EFAA applies both to commercial and consumer checking accounts and requires the depository bank to make the customer's funds available promptly after a check is deposited.⁴⁵ Its enactment was a dramatic acknowledgment by the

⁴¹ See *supra* note 24 and accompanying text.

⁴² See 12 C.F.R. § 226.21(b)-(c) (Reg. Z).

⁴³ 12 U.S.C. §§ 4001-4010 (2000).

⁴⁴ 12 C.F.R. pt. 229. See generally Edward L. Rubin, *Uniformity, Regulation, and the Federalization of State Law: Lessons from the Payment System*, 49 OHIO ST. L.J. 1251 (1989); Robert G. Ballen, *The Federalization of Articles 3 and 4*, 19 UCC L.J. 34 (1986).

⁴⁵ 12 U.S.C. §§ 4002

legislature that the UCC could not be relied on to protect depositors.⁴⁶ The EFAA also demonstrates Congress' belief that federal intervention into the traditionally state-regulated realm of checks was appropriate.⁴⁷

Congress' motivation in enacting Check 21 was very different than what prompted Congress to pass the EFAA. The EFAA resulted from years of customer complaints that their banks unreasonably delayed access to their funds after they deposited checks.⁴⁸ Check 21, in contrast, is not the result of consumer demand. Rather, it furthers the FRB's objective of moving towards an all-electronic system and the banks' desire for legislation to facilitate check imaging.⁴⁹ While granting consumers certain very narrowly circumscribed rights, its main impact is to deprive customers of their ability to demand return of their original checks.

Nevertheless, Check 21 may benefit consumers by prompting changes to Reg. CC that would require banks to provide funds to depositors more quickly than they do presently. The current availability schedules are based on the time that banks need to process checks under the paper presentment system. Check 21 is expected to result in faster processing, which in turn would enable banks to make funds available to customers sooner. Check 21 requires the FRB to examine whether Reg. CC should be amended to require this result.⁵⁰ Legislation has been introduced in Congress to require depository banks to make funds available sooner than provided in Reg. CC.⁵¹

Despite the different factors that drove the enactment of the EFAA and Check 21, both laws represent significant federal law incursions into an area that had previously been under state regulation. Given the establishment of new payment products, policymakers should

⁴⁶ See Rubin, *supra* note 44, at 1261 (stating that Reg. CC preempts the UCC and was the beginning of the federalization of check processing law).

⁴⁷ *Id.*

⁴⁸ *Id.* at 1257 (the EFAA resulted from consumer complaints about banks' policies of placing lengthy holds on consumer funds).

⁴⁹ See Check 21 Final Rule, *supra* note 5, at 47,290.

⁵⁰ 12 U.S.C. § 5015.

⁵¹ Linda Micco, *Legislation Would Require Faster Clearance of Checks Deposited by Consumers*, BNA BANKING DAILY, Dec. 2, 2004 (anticipating faster check processing as a result of Check 21, H.R. 5410 would reduce the time banks can put a hold on deposited funds). See also Government Press Release, Federal Document Clearing House, *Committee Monitors Check 21 To Ensure Quick Turnaround for All Checks*, Dec. 7, 2004.

confront the issue of whether additional aspects of consumer payments law involving checks should be federal law rather than governed by the UCC.

B. Payment Products

However, the problem is more complex than merely whether check law should be federal or state law. The previous discussion of ECC illustrates that the same transaction may involve more than one type of payment product. ECC, for example, involves both a check and an electronic fund transfer. Nonetheless, only federal law, Reg. E, applies to the ECC transaction.⁵² This subpart provides a brief overview of the various payment products available to consumers today and the non-uniform laws governing their transfers.

1. Telephone Checks

Consumers often deal with telemarketers, debt collectors, and others in ways that result in preauthorized drafts, often called “telephone checks.” For example, when consumers order goods over the phone, sellers frequently request their checking account information. The sellers may use that data to prepare a draft to present to the consumer’s bank, resulting in the withdrawal of funds from the consumer’s account. That draft is referred to as a telephone check.⁵³ Many consumers have alleged that phone transactions result in unauthorized withdrawals.⁵⁴ Consumers complain that sellers and debt collectors obtain withdrawals when consumers have never authorized any, obtain multiple withdrawals when they authorized only one, or obtain more than the authorized amount.⁵⁵

To respond to this problem, the UCC was amended in 2002 to create a new type of negotiable instrument, the “remotely-created consumer item,” and to change the warranty rules to encourage the consumer’s bank (the payor bank) to recredit the consumer’s account when the

⁵² Notably, in both ECC and transactions involving substitute checks, consumers whose deposit agreements provide they will receive their original checks nevertheless do not receive them. Despite this similarity, the applicable federal laws regulating these transactions differ in significant respects.

⁵³ MANN, *supra* note 4, at 64.

⁵⁴ Caroline Mayer, *Checking Account Fraud Is Increasing*, WASHINGTON POST, July 19, 2004, at A1.

⁵⁵ MANN, *supra* note 4, at 79.

consumer complains that an unauthorized withdrawal was made pursuant to a telephone check.⁵⁶

As a general rule, if the consumer's bank pays a check that the consumer did not authorize, the loss is on the bank unless it can recover from the wrongdoer.⁵⁷ Amended UCC Articles 3 and 4, however, include special warranty rules for telephone checks that enable the consumer's bank to push liability back to the depository bank.⁵⁸ Although the consumer's bank is not required to take advantage of the new warranty rules, the expectation is that the consumer's bank will be more willing to recredit the consumer's account if it can avoid liability by passing it on to another bank.

However, in practice, the consumer's bank may not often meet this expectation. The consumer's bank may prefer not to enter into a dispute with the depository bank. Instead, the bank may refuse to recredit the consumer's account, assuming that the burden and expense of litigation will deter consumers from bringing suit. The banks may assume that the affected consumers likely will terminate their accounts with that bank. The prospect of losing a few low profit consumer accounts, however, may not be enough to motivate banks to exercise their new warranty rights against depository banks.

As of April 2004, only one state, Minnesota, had adopted any of the 2002 amendments to UCC Articles 3 and 4 issued by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. However, instead of enacting the uniform provision on telephone checks, it adopted a non-uniform amendment.⁵⁹ Minnesota's non-uniform amendment tracks the language of several other states' "demand draft" statutes.⁶⁰ These jurisdictions have passed statutes that are similar to the UCC's provisions on

⁵⁶ U.C.C. § 3-103(a)(16) (2002). The "remotely-created consumer item" is an item "not created by a payor bank and does not bear a handwritten signature purporting to be the signature of the drawer [the consumer]." An "item" is an instrument handled by a bank for collection or payment. *Id.* § 4-104(a)(9).

⁵⁷ JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* 552-53 (4th ed. 1995).

⁵⁸ U.C.C. §§ 3-416(a)(6), 3-417(a)(4), 4-207(a)(6), 4-208(a)(4).

⁵⁹ MINN. STAT. ANN. §§ 336.3-103(a)(16), 336.3-416(a)(6), 336-417(a)(4), 336.4-207(a)(6), 336.4-208(a)(4) (2002).

⁶⁰ *E.g.*, CAL. COM. CODE §§ 3104(k), 3416(a)(6), 3417(a)(4), 4207(a)(6), 4208(a)(4) (2002). States with demand draft statutes in addition to California include Colorado, Hawaii, Idaho, Nebraska, New Hampshire, North Dakota, Oregon, Tennessee, Texas, Utah, and West Virginia.

remotely-created consumer items, except they apply both to consumer and non-consumer drafts that do not contain the drawer's signature.⁶¹ These statutes also include a "reciprocity provision" under which the favorable warranty rules that permit the payor bank to pass liability to another bank apply only if the state where the other bank is located has reciprocated by also adopting the special warranty rules.⁶²

Meanwhile, the FRB solicited comments on the merits of incorporating the UCC's rules on remotely created items into Reg. CC.⁶³ As discussed above, if the UCC's rules are incorporated, depository banks in all states would be subject to the rules permitting payor banks to shift the loss to those depository banks in consumer transactions. Only in demand draft states, however, would depository banks be subjected to those rules in non-consumer transactions.

Banks favor the demand draft approach because under that system they do not have to distinguish between consumer and non-consumer checks, a task which they claim is operationally difficult.⁶⁴ In contrast, amended Articles 3 and 4 apply only to consumer telephone checks, forcing banks to determine which checks fall into the consumer category. The American Bankers Association has opposed the adoption of amended Articles 3 and 4 because of the alleged operational difficulties the telephone check provision requires.⁶⁵ The ABA's objection illustrates a potential impediment to uniform rules. Operational problems may arise that make implementation difficult and

⁶¹ *E.g.*, *id.* § 3104(k) (2002) (defining "demand draft" as a writing under the purported authority of a "customer," thereby not distinguishing between commercial and consumer customers as the uniform version does.)

⁶² *E.g.*, *id.* § 4208(h) (West 2004).

⁶³ Check 21 Final Rule, *supra* note 5, at 47,306. The FRB subsequently issued a proposed rule regarding incorporation of the UCC's rules. Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire and Availability of Funds and Collection of Checks, 70 Fed. Reg. 10,509 (proposed March 4, 2005) (to be codified at 12 C.F.R. pts. 210 and 229).

⁶⁴ *See, e.g.*, Letter from Rebecca S. Henderson, Senior Vice President and Deputy General Counsel, Wachovia Corporation, to Jennifer J. Johnson, Secretary, the Board of Governors of the Federal Reserve System (May 3, 2005), *available at* www.federalreserve.gov/SECRS/2005/May/20050505/R-1226/R-1226_235_1.pdf.

⁶⁵ Memorandum from L.H. Wilson, General Counsel, American Bankers Association, to State Association Executives and Counsel and Interested Persons (Sept. 27, 2002) (on file with author). It is unclear how much of a burden the telephone check amendment would impose. Under Check 21 banks will have to differentiate between consumer and non-consumer accounts because consumers are accorded special protections under that Act. *See supra* Part II.

expensive. On the other hand, one should not assume that there will be significant operational problems. For example, despite the ABA's objections, banks may not encounter undue difficulties differentiating between consumer and non-consumer accounts in most transactions, since banks already have to distinguish the two types of accounts for many purposes.⁶⁶

Further complicating matters, certain persons who do business with consumers over the phone are subject to the Telemarketing Sales Rule, a federal regulation issued by the Federal Trade Commission (the "FTC").⁶⁷ Consequently, payment to telemarketers with telephone checks is potentially subject to both the UCC and the FTC's rule. The Telemarketing Sales Rule requires telemarketers to follow strict requirements for obtaining the consumer's "verifiable authorization" in telemarketing transactions.⁶⁸ If the consumer pays by means of an electronic fund transfer other than a debit card, the FTC authorization requirements apply; accordingly, the authorization requirements apply with respect to consumers who pay with telephone checks, but not to those who pay with credit or debit cards.⁶⁹

In addition to federal and state law governing payments, most electronic transfers are subject to private rulemaking. Telephone sales in which payments are removed from the consumer's account electronically are governed not only by Reg. E, but also by the rules established by NACHA (the "NACHA Rules").⁷⁰ Parties that process electronic

⁶⁶ For example, under Reg. E, consumers with electronic fund transfers that debit and credit checking accounts receive notices and have rights that business accounts do not have. See 12 C.F.R. § 205.4 (2005) (disclosure requirements); *id.* § 205.11 (error resolution).

⁶⁷ Telemarketing Sales Rule, 68 Fed. Reg. 4580 (Jan. 29, 2003); 16 C.F.R. § 310.3(a)(3) (2005)

⁶⁸ *Id.* See also, e.g., VT. STAT. ANN. tit. 9 § 2464 (2004) (state law governing the authorization of payment instruments in telemarketing transactions), noted in UCC § 3-416, Official Cmt. 8 (2002). See generally *Payment Processor Barred From Helping Telemarketers*, BNA Banking Rep., April 19, 2004, at 703 (FTC filed proposed consent judgment against company that processed electronic debit to consumer accounts on behalf of fraudulent telemarketers, in violation of the Telemarketing Sales Rule).

⁶⁹ Telemarketing Sales Rule, 16 C.F.R. § 310 (2005).

Reg. Z and Reg. E do not include rules comparable to the FTC's Telemarketing Sales Rule. See 12 C.F.R. §§ 226.5–226.16 (governing credit cards) 12 C.F.R. pt. 205 (governing debit cards).

⁷⁰ See NACHA RULES 2.1.5 (obtaining the consumer's authorization); NACHA RULES 3.9.1 (employing commercially reasonable procedures to verify the consumer's

payments through the Automated Clearing House (“ACH”) Network are required as a condition of using the network to comply with NACHA’s Rules,⁷¹ which govern various matters such as direct deposit, electronic check conversion, bill payment, ATM transfers, debit card transactions, online payments, and debits authorized over the phone. Some of the rules are very favorable to consumers, going beyond anything required by Reg. E.⁷² In addition, NACHA can act faster than legislatures and federal agencies to respond to changing products and market conditions.⁷³

identity); MARK E. BUDNITZ & MARGOT FREEMAN SAUNDERS, *CONSUMER BANKING AND PAYMENTS LAW* 53–54 (2d ed. Supp. 2004). NACHA is a not-for-profit membership organization. The membership consists of approximately forty regional associations. These associations represent more than 13,000 financial institutions. Those financial institutions provide automated clearinghouse services to over 20,000 financial institutions, 3.5 million businesses, and 115 million individuals. *The NACHA Homepage*, at www.nacha.org/About/default.htm.

⁷¹ UNDERSTANDING THE ACH NETWORK: AN ACH PRIMER, 2004 ACH RULES, A COMPLETE GUIDE TO RULES & REGULATIONS GOVERNING THE ACH NETWORK, ACH PRIMER 12 (2004). The NACHA Rules apply to ACH transfers through ACH operators. The rules do not apply to a direct send whereby one bank makes an electronic transfer directly to another bank without using a clearinghouse. In addition, the Rules do not apply to an “on-us” electronic transfer in which both the business and the consumer are customers of the same bank and the bank makes an intra-bank transfer. NACHA also has issued operating guidelines, which supplement, but do not supercede, the NACHA Rules. BENJAMIN GEVA, *THE LAW OF ELECTRONIC FUNDS TRANSFERS* 5-4 (LexisNexis 2002).

⁷² NACHA’s rules for electronic check conversion provide greater protection for consumers than Reg. E provides. For example, under the NACHA Rules consumers have the opportunity to opt out of lockbox ECC. Disclosure, F.N.B. Corporation, Notice of Amendment to the 2004 ACH Rules (Apr. 6, 2004), at www.fnbcorporation.com/generalDisclosures/2004_ACH_Rules_Supplement_2_Summary.pdf. The biller is prohibited from returning the check; it must destroy the check within fourteen days. NACHA RULES, 2.9.3.3. This procedure prevents the original check from being put into the processing system, resulting in a double debit from the consumer’s account. The consumer can stop payment on a lockbox ECC. NACHA RULES, 7.4. The consumer has a right to a recredit under certain circumstances. NACHA RULES, 7.6.5.1.

⁷³ See e.g., NACHA’s 2004 rule permitting consumers to opt out of lockbox ECC. Disclosure, F.N.B. Corporation, Notice of Amendment to the 2004 ACH Rules (Apr. 6, 2004), at www.fnbcorporation.com/generalDisclosures/2004_ACH_Rules_Supplement_2_Summary.pdf. The NACHA Rules are developed by a Rules Work Group which, after consultation with others, submits a proposal to the Rules and Operations Committee of NACHA. If the committee approves the proposal, they submit it to the NACHA Board for adoption. PAUL S. TURNER, *LAW OF PAYMENT SYSTEMS AND EFT* 11-6 (2002).

NACHA Rules are deficient in several respects, however. For example, almost none of the NACHA Rules require disclosure to consumers. Consequently, few consumers are aware of their enhanced rights. Even if consumers know a company has not complied with the NACHA Rules, the rules do not explicitly grant consumers a direct cause of action; nothing in the rules provides that if another party to a transaction violates the rules, the consumer can use that as the basis of a lawsuit against that party.⁷⁴ In addition, some NACHA Rules, while granting more protection to consumers than statutes and regulations, add to the complexity of the piecemeal approach that legislatures have taken with respect to certain payment products. For example, as discussed above, a morass of federal and state regulations currently governs telephone transactions.

A more fundamental problem stems from the fact that the NACHA Rules are the product of private rulemaking. There are three problems inherent in the process of drafting and issuing such private rules from the consumer perspective. First, consumers have no role in drafting the rules. Second, while NACHA has a rulemaking process that can respond quickly to adjust rules to changing payment products and systems, it also can revoke rules at any time and for any reason, again without any consumer participation in the process, much less notice to them.

Third, and most problematic, NACHA is subject to no government oversight, much less supervision. In contrast, the UCC is subject to government oversight. The UCC is also drafted by private entities, namely the American Law Institute (“ALI”) and the National Conference of Commissioners on Uniform State Laws (“NCCUSL”).⁷⁵ However, NCCUSL has a quasi-governmental appearance in that its Commissioners are appointed by each state’s governor. More importantly, amendments to the UCC must be enacted by each state’s

⁷⁴ See *FTC v. Electronic Financial Group, Inc.*, No. W-03-CA-211 (W.D. Tex. July 8, 2003). The FTC obtained a temporary restraining order against a company accused of engaging in unfair practices in violation of section 5 of the Federal Trade Commission Act (the “FTC Act”) by systematically breaching its agreement with its bank to comply with NACHA rules. Although there is no private cause of action under the FTC Act, consumers arguably could draw support from this case to contend that violating the NACHA rules is an unfair practice under state unfair and deceptive practice laws that do include a private cause of action. See BUDNITZ & FREEMAN SAUNDERS, *supra* note 70, at 62–63.

⁷⁵ FRANCIS J. MOOTZ III ET AL., *COMMERCIAL CONTRACTING: SALES, LEASES, AND COMPUTER INFORMATION 1* (2004) (ALI and NCCUSL are the sponsors and drafters of the UCC).

legislature. An amendment to the UCC approved by ALI and NCCUSL therefore is nothing more than a proposal to those legislatures. Furthermore, legislatures often disagree with the proposals and adopt their own non-uniform amendments, including those guaranteeing consumer rights where the ALI-NCCUSL approved amendment provided none.⁷⁶ No analogous procedures check NACHA's rulemaking authority. It is arguably troublesome that a private entity should be allowed to wield such unimpeded influence over crucial economic issues.

Delegation of payment processing rules to private bodies is not unprecedented, of course. The UCC explicitly recognizes and incorporates the rules of check clearinghouses, as long as their rules do not conflict with the UCC.⁷⁷ Check clearinghouse rules, however, only regulate check processing among banks. In contrast, the NACHA Rules have a direct impact on consumer rights when something goes wrong. The NACHA Rules play an important role in ensuring that consumers have vital protections when erroneous electronic transfers occur. Because millions of Americans live paycheck to paycheck, the consequences can be devastating when there is a problem such as a multiple debit. A multiple debit can drain assets out of an account resulting in missed car payments that lead to repossession or missed rent that leads to eviction. This is a matter that is particularly appropriate for public law; it should not be left exclusively to private rulemaking.⁷⁸

2. Stored Value Cards: New Products, Little Law

Over the last few years, financial institutions have developed several new payment products, such as gift cards, phone cards, and payroll cards.⁷⁹ Each product and service has its own consumer benefits and risks. Moreover, consumers' legal rights and responsibilities vary dramatically depending upon which payment product they use.

Stored value cards, also called prepaid cards, are payment products in which the consumer pays first and purchases goods or services later,

⁷⁶ For example, several states have adopted non-uniform amendments to U.C.C. § 4-406 (2002). See generally BUDNITZ & FREEMAN SAUNDERS, *supra* note 70.

⁷⁷ U.C.C. § 4-103(b).

⁷⁸ See David G. Oedel, *Private Interbank Discipline* 16 HARV. J.L. & PUB. POL'Y 327, 402-407 (1993) (acknowledging that consumers need government regulation to protect their interests in spite of the benefits of non-public bank regulation).

⁷⁹ See BUDNITZ & FREEMAN SAUNDERS, *supra* note 70, at 99-107.

using value stored on the card that can be accessed through a computer terminal. Some are re-loadable, meaning that when the funds available on the card are spent, more can be “loaded” onto the card.⁸⁰ The most popular examples of stored value cards are pre-paid phone cards and gift cards.⁸¹ These cards can be beneficial to consumers for multiple reasons. Since the cards are pre-paid, consumers who do not qualify for credit cards can still obtain stored value cards. In addition, unlike with debit cards, consumers do not need to have bank accounts.

However, the cards often come with hidden costs and other problems.⁸² For example, some cards deduct value not only for the amount of the purchase, but also for a wide variety of additional charges.⁸³

⁸⁰ Some cards can contain substantial value. For example, the “Usher Card” can carry up to \$2500 in value. MasterCard, Cardholder Agreement, *available at* www.ushermc.com/terms.html (last visited Dec. 4, 2004).

⁸¹ A National Retail Federation survey found that sales of gift cards for the 2004 holiday season were projected to be \$17.34 billion, a \$100 million increase from the previous year. Anne Mitchell, *Gift Card Sales Roar*, NEWS-PRESS (FT. MYERS, FL), Dec. 14, 2004, at 1D. Cards are used for other purposes as well. There are cards for Filipino sailors and Hispanics who use the cards to send money overseas, and cards to disburse financial aid to college students. *Paper or Plastic: New Card Options Promise To Further Displace Checks*, ITEM PROCESSING REP., July 29, 2004. Prepaid phone cards can be used to pay for online adventure game subscriptions. Lavonne Kuykendall, *Payment Firms Offering Prepaid Game Card*, AM. BANKER, Nov. 7, 2004, at 5.

⁸² See *A Commercial Lawyer's Take on the Electronic Purse: An Analysis of Commercial Law Issues Associated with Stored-Value cards and Electronic Money*, 52 BUS. LAW. 653 (1997); Mark E. Budnitz, *Stored Value Cards and the Consumer: The Need for Regulation*, 46 AM. U. L. REV. 1027, 1028, 1034–35 (1997); BUDNITZ & FREEMAN SAUNDERS, *supra* note 70, at 172–75. In December 2004, the Consumers Union launched a campaign urging Congress to pass “The Fair Gift Act,” to protect consumers from excessive fees. ConsumersUnion.org, *Consumers Union Calls on Congress To Rein in Gift Cards Fees* (Dec. 14, 2004), *available at*, www.consumersunion.org/pub/core_financial_services/001711.html. The N.Y. Attorney General persuaded seventeen national retailers to change their policies on lost or stolen gift cards because consumers believed the protections that apply to debit or credit cards also applied to gift cards. Press Release, Office of N.Y. State Attorney General Eliot Spitzer, National Retailers Agree To Improve Gift Card Policies (Feb. 25, 2003). The Attorneys General of New York, Massachusetts, New Hampshire, and Vermont sued Simon Property Group, alleging their gift cards violated state law. *Simon Says Settlement Is OK*, CARDLINE, March 4, 2005 (reporting that Simon and the N.Y. Attorney General had reached an out-of-court settlement).

⁸³ The Usher card includes the following fees, among others: \$15 activation fee; \$3.95 fee to load value onto card; cash withdrawal fee of \$2.00; balance inquiry fee of \$1.50; monthly maintenance fee of \$4.95; \$9.95 replacement card fee; \$5 charge for a paper statement; \$5 overdraft fee, \$1.50 per minute to talk to a live service

Dormancy charges are often imposed if the card is not used for a certain period of time.⁸⁴ Many cards also contain expiration dates after which the cards cannot be used.⁸⁵ Some cards do not permit consumers to redeem any unused value, while others impose a fee on any allowable redemption.⁸⁶ Consumers may not even be able to ascertain how much value remains on a card. If a card is lost or stolen, the consumer bears the full loss of any value on the card. Sometimes, even if a card is defective, consumers may not be able to obtain a new card from the issuer. In fact, consumers may have no way to find the issuer's address or phone number, and thus have no way to even contact the issuer. Finally, the company that issued the card may go

agent; \$9.95 fee to redeem unused funds. Usher Debit Mastercard, Cardholder Agreement (Dec. 4, 2004), *available at* www.ushermc.com/terms.html. The Hello Kitty card has comparable fees along with additional fees not found on the Usher card, including a \$14.95 application fee, and an annual fee of \$14.95 after the first year, a card cancellation fee of \$10, and a charge of \$5 to withdraw funds from the card using a bank teller. Hello Kitty Debit Mastercard, Cardholder Agreement (Dec. 4, 2004), *available at* www.hellokittycard.com/cardholder_agree.doc. See Carolyn Said, *Hip-hop Tycoon Jumps into Banking / Prepaid Debit Card for Those Without Bank Accounts*, SAN FRANCISCO CHRON., Sept. 19, 2004, at J1 (quoting publisher of payment system newsletter claiming that "[t]hese are excessive fees that unfortunately poor people get socked with by marketing companies" and describing the fees charged for using the Rushcard, sponsored by Russell Simmons).

⁸⁴ Phil Kabler, *Why Us? English Only Bill Target of Media Barbs*, CHARLESTON GAZETTE, April 18, 2005 (reporting that many gift cards have dormancy fees).

⁸⁵ *Id.* (reporting that many gift cards have expiration dates).

⁸⁶ One study of gift cards found that 6% of the money on the cards was never used. Deena M. Amato-McCoy, *Will Gift Card Fees Kill Customer Loyalty? Gift Cards Help Build Store Loyalty, but Hidden Fees Can Anger Consumers and End Up Hurting a Retailer's Image*, GROCERY HEADQUARTERS, Aug. 1, 2004. This represents a source of income for stores. *Id.* Some states, however, require retailers to turn unused funds over to the state under Abandoned Property laws, while other states exempt gift cards from that requirement. Carolyn Shapiro, *Retailers Hope Customers Will Spend More Than Amount of Gifts*, VIRGINIA-PILOT, Dec. 31, 2004. Even if gift cards are subject to the Abandoned Property laws, merchants can reduce the balance on the card to zero if they impose dormancy and other fees. Deborah Turcotte, *Treasurer Wants To Make Fees on Gift Cards Illegal*, BANGOR DAILY NEWS, Dec. 14, 2004. Because some states limit fees, merchants have tried to avoid state Abandoned Property laws by having federally chartered banks administer their card programs, claiming that national bank involvement exempts the gift cards from state law. *National Issuing Overcomes U.S. Regulatory Burden*, CARDS INTERNATIONAL, Dec. 20, 2004. The Office of the Comptroller of the Currency disputes this, saying the National Bank Act does not preempt state law on this issue. *Branded Gift Cards Are in Crosshairs of State Regulators*, ATM & DEBIT NEWS, Feb. 24, 2005.

out of business, leaving the consumer with no source to remedy any problems.⁸⁷

No federal laws govern stored value cards.⁸⁸ Most states also have no laws in place. A few states have passed laws to regulate certain aspects of specific types of cards, primarily gift cards.⁸⁹ Absent an applicable state law, the parties' rights and responsibilities arise solely from the contract between the consumer and the issuer. If a problem arises, the consumer's sole course of action is a lawsuit for breach of contract. However, a skillfully drafted contract in which the issuer disclaims responsibility for problems will foreclose this avenue of relief for the consumer.

Consumers likely do not realize that they have minimal, if any, legal protections when using stored value cards. One source of confusion is the fact that these cards are made to look like debit and credit cards. In fact, Visa and MasterCard issue stored value cards imprinted with their logos.⁹⁰ Because stored value cards bear a striking resemblance

⁸⁷ Budnitz, *Stored Value Cards*, *supra* note 82, at 1028 (stating that several issuers of stored value cards have gone out of business after selling thousands of worthless cards). The Office of the Comptroller of the Currency (the "OCC") has warned consumers that when they buy a gift card they are putting their trust in the company's financial stability. *Gift Cards: OCC Provides Holiday Tips for Consumers*, available at www.treas.gov/ftp/release/2004-108a.pdf. Gift cards also are used to perpetrate fraud. *See., e.g.* News Release, FTC Accepts Settlement with Final Defendant in "Pre-Approved" Credit Card Scam (Aug. 16, 2004), available at www.ftc.gov/opa/2004/08/firstcapital.htm. (settling case brought by FTC alleging that company promised consumers pre-approved credit cards, but instead sent them stored value cards requiring prepayment before use).

⁸⁸ The FRB proposes to regulate one type of stored value card, the payroll card. *See Reg. E Proposed Amendment*, *supra* note 38. The FDIC proposes that FDIC insurance cover certain types of stored value cards. Definition of "Deposit;" Stored Value Cards, 69 Fed. Reg. 20,558, 20,563 (Apr. 16, 2004) (to be codified at 12 C.F.R. pt. 303) [hereinafter FDIC Proposed Rule].

⁸⁹ *E.g.*, CAL. CIV. CODE § 1749.5 (2005); MASS. GEN. LAWS ANN. ch. 200A, § 5D (2005); S.B. 6611 227th Ann. Leg. Sess. (N.Y. 2004); S.B. 6612 227th Ann. Leg. Sess. (N.Y. 2004); R.I. GEN. LAWS § 6-13-12 (2005); WASH. REV. CODE ANN. § 19.240.040 (2005). Several of these statutes include a major exemption, excluding from coverage third-party card issuers that issue devices usable at multiple, unaffiliated merchants. *E.g.*, R.I. GEN. LAWS § 6-13-12(a) (2005); CAL. CIV. CODE § 1749.45(a) (2005). California also regulates prepaid telephone cards. CAL. BUS. & PROF. CODE § 17538.9 (2005).

⁹⁰ The significance of merchants teaming with Visa and MasterCard to issue gift cards has become an issue in litigation brought against the Simon mall card by several state attorneys general and illustrates the confusion surrounding these cards. Simon contends that Bank of America issues its card with a Visa logo and that, as a national

to credit and debit cards,⁹¹ consumers may believe there is some type of legislatively mandated error resolution procedure and limit on liability for unauthorized use.⁹² Consumer confusion will only increase as companies issue cards that combine credit, debit, and stored value on one card.

Another type of stored value card, the payroll card, has become increasingly popular with employers — particularly those with many workers without bank accounts into which wages can be transferred electronically by direct deposit. Transferring funds through payroll cards is much cheaper than issuing payroll checks.⁹³ Typically, the

bank, both Bank of America and its cards are subject only to federal law and Visa rules. The OCC and the state attorneys general contend that Simon issues the card, not the bank. Hannah Bergman, *Gift Card Case Has OCC Siding with States*, AM. BANKER, Nov. 17, 2004.

⁹¹ The Duetto card combines the functionality of a credit card and a stored value card. The consumer can use the card as a general purpose Visa credit card or as a stored value card to purchase coffee at Starbucks; purchases with the card also earn cash rewards that can be redeemed at Starbucks. Hilary Cassidy, *A Latte with That Purchase? New Programs Entice Users*, BRANDWEEK, June 21, 2004.

⁹² Visa and MasterCard have “zero liability” policies that apply to their gift cards, but they differ from the limited liability provisions of Reg. Z and Reg. E. Visa’s website states in some places that its zero liability policy applies to “unauthorized” transactions, and in other places that it applies to “fraudulent” transactions. *See* VISA, Zero Liability, at www.visa.com/personal/security/zero_liability.html (last visited Dec. 11, 2004). Because the terms are not synonymous, it is difficult to ascertain what the legal standard might be. ATM transactions are excluded. *Id.* Furthermore, financial institutions that issue the cards may impose greater liability if they determine an unauthorized transaction was caused by “gross negligence or fraudulent action of the cardholder, which may include . . . delay for an unreasonable time in reporting unauthorized transactions.” *Id.* MasterCard’s website states that cardholders need to pay only for purchases that they “authorize.” Mastercard, Zero Liability, at www.mastercard.com/general/zero_liability.html (last visited Feb. 9, 2005). However, to be eligible for Mastercard’s zero liability policy the consumer’s account must be in good standing, the consumer must have exercised reasonable care in safeguarding the card, and the consumer must not have reported two or more unauthorized transfers in the past year. *Id.* The Usher Card bears a MasterCard logo, but states a policy that differs from that stated on the MasterCard website. Usher, Cardholder Agreement, at www.ushermc.com/terms.html (last visited Feb. 9, 2005). For example, the zero liability policy only applies if the cardholder notifies the card issuer within two days. *Id.* If the consumer notifies the issuer later, and the issuer can prove it could have stopped the card from being used if the consumer had notified it within the two days, the consumer could be liable for as much as \$50. *Id.*

⁹³ Mark Furletti, Conference Summary, *Prepaid Cards: How Do They Function? How Are They Regulated?*, Payment Cards Center, Federal Reserve Bank of Philadelphia 10 (June 2–3, 2004).

employer sets up a bank account and issues cards to employees, who then can go to an ATM or store with a point-of-sale terminal to withdraw their wages.⁹⁴ A payroll card has advantages over payroll checks for employees who do not have a bank account.⁹⁵ If issued a payroll check, such employees often go to check cashers who charge exorbitant fees.⁹⁶ Check cashers may induce employees to purchase additional expensive goods and services such as payday loans and rent-to-own furniture and appliances.⁹⁷ In addition, after going to a check casher, employees paid with checks will be walking around with a substantial amount of cash, risking loss or theft.

Payroll cards, however, also have disadvantages. Employees may be charged a fee every time they use an ATM.⁹⁸ Although the fee for each withdrawal may be lower than the fee charged by a check casher, if employees want to avoid carrying their entire wages with them in cash, and instead use an ATM to withdraw smaller amounts as needed, the total ATM fees for the successive withdrawals may be as much as the check casher's one-time fee. Additionally, employees may only be able to withdraw wages from ATMs in certain multiples, such as \$20. As a result, they may not be able to withdraw the full amount of their wages for a given pay period. This may impose a hardship on minimum wage employees who need access to every dollar of their pay during each pay period. ATMs that employees can use to withdraw funds may not be located close to where the employee lives or works.⁹⁹

The FDIC has proposed that FDIC insurance would cover those wages on cards where the employer has a separate account or sub-account for employees.¹⁰⁰ In addition, the FRB has proposed a rule that would extend the protections of Reg. E to payroll cards.¹⁰¹ Even

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *See id.*

⁹⁷ *See* James P. Nehf, *Effective Regulation of Rent-to-Own Contracts*, 52 OHIO ST. L.J. 751 (1991); MICHAEL HUDSON, 'Rent-to-Own,' *The Slick Cousin of Paying on Time*, in *MERCHANTS OF MISERY: HOW CORPORATE AMERICA PROFITS FROM POVERTY* 146 (Michael Hudson ed., 1996).

⁹⁸ Furletti, *supra* note 93, at 11.

⁹⁹ David Gosnell, *Debit Card Report*, CREDIT CARD MANAGEMENT, Sept. 1, 2004 (reporting that even if employer contracts with an ATM service operating thousands of ATMs, the payroll cardholder may not find one close by).

¹⁰⁰ FDIC Proposed Rule, *supra* note 88, at 20,558, 20,560, 20,562-563.

¹⁰¹ Reg. E Proposed Amendment, *supra* note 38, at 55,996, 55,999. The Office

if these rules become final, however, there will still be a need for a comprehensive uniform law, because these proposals only apply to limited types of stored value cards and issuers, and most states have no laws that fill in the gaps.

C. Consumer Confusion: Deciphering the Legal Landscape

For consumers of payment products, the current legal landscape is incomprehensible. Different payment products are subject to very different laws, or no law at all besides contract law. Consequently, consumers' rights and responsibilities vary greatly. As discussed below, the disparity in rights to disclosures, notices of rights, liability for unauthorized use, and error resolution demonstrates the need for uniformity.

1. Disclosures and Notices of Rights

The UCC is the principal law that applies to the bank-consumer aspects of check transactions.¹⁰² The Truth in Savings Act and Regulation DD also apply to check transactions and require disclosure to customers of information such as fees and conditions.¹⁰³ Nevertheless, these laws are of limited benefit to consumers. Neither law requires, for example, that consumers receive notice regarding their rights and responsibilities under the UCC. Moreover, Congress repealed the section of the Truth in Savings Act which had provided customers with a private right of action.¹⁰⁴ Therefore, consumers still

of the Comptroller of the Currency has issued an Advisory Letter that lists its concern that national banks engaged in payroll card systems may "directly or indirectly support unfair or deceptive practices." Payroll Card Systems, OCC Advisory Letter 2004-6 (May 6, 2004), *available at* 2004 OCC CB LEXIS 36, at *5. It is unsettled whether several of the matters listed in the Advisory Letter would be dealt with if the FRB's proposed rule to subject payroll cards to Reg. E becomes final. *See* Reg. E Proposed Amendment, *supra* note 38, at 55,999. Examples include disclosing "risk exposures including absence of deposit insurance and potential bankruptcy of any third parties holding funds, where and how the payroll cards will be accepted and the funds accessed including whether workers can access their funds without charge at ATMs. *See* Payroll Card Systems, OCC Advisory Letter 2004-6 (May 6, 2004), *available at* 2004 OCC CB LEXIS 36.

¹⁰² The other major laws are Reg. CC and Check 21. *See* discussion *supra* Part II.

¹⁰³ *See* 12 U.S.C. § 4301 (2000) (Truth in Savings Act); 12 C.F.R. § 230.1 (2005) (Regulation DD). *See generally* Barnes v. Fleet Nat'l Bank, N.A., 370 F.3d 164 (1st Cir. 2004) (holding that the bank's notice regarding changes in the customer's account was false and misleading, in violation of the Truth in Savings Act).

¹⁰⁴ Omnibus Consolidated Appropriations Act of 1996, Pub. L. No. 104-208, § 2604(a), 110 Stat. 3009, 3009 (1996) (repealing 12 U.S.C. § 4310).

have rights under the statute, but no remedy for a violation. They must depend on enforcement by federal agencies.¹⁰⁵

Check 21 requires disclosure of important information to consumers, but only to a limited number of check customers. Consumers who have not agreed to have their checks truncated have a right to a disclosure that describes “substitute checks” and their right to a recredit if they file a complaint and the bank cannot resolve it within ten days.¹⁰⁶ Unfortunately, the 60% of consumers who have agreed to have their checks truncated have no right to this crucial information unless their bank voluntarily or inadvertently provides them with a “substitute check.”¹⁰⁷ In contrast, if the consumer pays with a credit card, Regulation Z (“Reg. Z”) requires extensive and continuous disclosures.¹⁰⁸ Likewise, Reg. E requires banks to provide comprehensive disclosures to consumers who agree to electronic transfers, including those who use debit cards.¹⁰⁹

A recently proposed interagency guidance on overdraft protection programs goes even further than any current regulations.¹¹⁰ According to the “best practices”¹¹¹ named in the proposal, financial institutions should not only “fairly represent” these programs, but also “inform consumers generally of *other* available overdraft services.”¹¹² Moreover, the guidance recommends that financial institutions explain the “costs and advantages of various alternatives . . . and identify for consumers the risks and problems.”¹¹³ These suggested disclosures would “minimize potential consumer confusion and complaints, foster good customer relations, and reduce credit and other potential risks

¹⁰⁵ 12 U.S.C. § 4309.

¹⁰⁶ *Id.* § 5011.

¹⁰⁷ Check 21 requires the bank to provide the disclosure only to consumers who have been “provided” a substitute check, *Id.* § 5011(b), and only those customers who have not agreed to truncation have a right to be provided a substitute check. Check 21 Final Rule, *supra* note 5, at 47,322.

¹⁰⁸ 12 C.F.R. §§ 226.6–226.9.

¹⁰⁹ *Id.* §§ 204.7–205.9. The NACHA rules include consumer protections that go further than Reg. E, but for the most part do not require disclosure of those rights to consumers. See *supra* notes 70–74 and accompanying text.

¹¹⁰ Interagency Guidance on Overdraft Protection Programs, 69 Fed. Reg. 31,858 (June 7, 2004).

¹¹¹ *Id.* at 31,863 (characterizing “best practices” as “practices that have been implemented by institutions and that may otherwise be required by applicable law”).

¹¹² *Id.* (emphasis added).

¹¹³ *Id.*

to the institution.”¹¹⁴ If this approach were applied to consumer payment products, financial institutions would be required to educate their customers in a manner beyond anything now required.

The benefits would not accrue only to consumers of financial institutions, however. The best practices that the federal regulatory agencies point out in regard to overdraft programs should also apply to other payment systems. Indeed, there is a direct link between the proposed guidance on overdraft programs and payment products and systems. Consumers who are not well informed about how payment products and systems operate are less likely to understand the importance of careful recordkeeping and ensuring there are adequate funds in their accounts. Consequently, these customers are more apt to have insufficient funds to pay checks they have written and electronic payments they have authorized, thus triggering the overdraft programs the guidance proposes to cover. In addition, they are less likely to realize how essential it is to promptly review their monthly statements to look for errors such as multiple debits due to substitute check glitches or unauthorized electronic transfers. Moreover, consumers who are not well informed about alternatives, risks, and problems are unable to pick the systems and products most appropriate to their needs and financial resources.

For these reasons, the disclosure practices suggested in the interagency proposal should be considered in the context of payment products and systems. Currently, a consumer who uses a stored value card is entitled to no disclosures under federal law.¹¹⁵ Furthermore, few states require disclosures for gift and phone cards.¹¹⁶ Other types of cards are not regulated at all in any state.

2. Liability for Unauthorized Use and Error Resolution

If a wrongdoer forges the consumer's signature on a check, uses a counterfeit check, forges an endorsement, or alters the amount of the check, the consumer has no liability.¹¹⁷ Although this “zero

¹¹⁴ *Id.*

¹¹⁵ In fact, no federal law applies to any aspect of the transaction.

¹¹⁶ *E.g.*, CAL. BUS. & PROF. CODE § 17538.9 (West 2003) (requiring disclosure for prepaid phone cards); MASS. ANN. LAWS. ch. 200A, § 5D (Law. Co-op. 2004) (requiring disclosure for gift cards); N.Y. GEN. BUS. LAW § 396-i(3) (McKinney 1997) (same); WASH. REV. CODE ANN. § 19.240.040 (West 2004) (same).

¹¹⁷ A check with those infirmities is not considered to be “properly payable.” U.C.C. § 4-401(a) (2002). The consumer's bank should not have paid it and charged the consumer's account, and if the bank did so, the bank must reimburse the consumer. *See id.*

liability” approach is strong protection for consumers, there is no legally mandated error resolution procedure for enforcing this liability rule. Therefore, if the bank refuses to comply with the rule, there is no way for the consumer to exercise this protection short of going to court (or arbitration if the deposit agreement so requires). Moreover, consumers are exposed at least to partial loss if they do not exercise ordinary care.¹¹⁸ In addition, the zero liability rule does not apply if the consumer fails to promptly notify the bank after receiving a periodic statement.¹¹⁹ Courts have permitted banks by contract to require customers to report problems as quickly as two weeks from when the statement was sent.¹²⁰

If the consumer did not agree to truncation, a substitute check was involved, and there was an erroneous debit due to an unauthorized transfer, Check 21 makes the bank liable to the consumer.¹²¹ Whereas the UCC requires the consumer to report unauthorized transfers promptly and permits the bank to impose a short period for the consumer to report, Check 21 permits the consumer to take up to forty days to notify the bank of an unauthorized transfer.¹²² At the same time, however, Check 21 imposes other requirements upon the consumer submitting a claim to the bank that are far more onerous than the UCC.¹²³ Unlike the UCC zero liability rule, Check 21 requires the bank to engage in an investigation and requires a recredit to the consumer’s account if the bank cannot determine whether or not the claim is valid within ten days while it continues the investigation.¹²⁴

If there is unauthorized use of a credit card, the consumer’s liability is capped at \$50 and could be as little as zero if the consumer reports the theft or loss of a card before the thief has used the card to make any purchases.¹²⁵ For unauthorized use of a debit card or other

¹¹⁸ *Id.* § 3-406(b).

¹¹⁹ *Id.* § 3-406(a). The consumer’s failure to exercise ordinary care must “substantially contribute” to the failure in order for the consumer to be responsible for any of the loss that occurred. *Id.* U.C.C. § 4-406(c) requires the consumer to notify the bank “promptly” after examining receiving the monthly statement. *Id.* § 4-406(c).

¹²⁰ *See, e.g.,* Borowski v. FirststarBank Milwaukee, 579 N.W.2d 247, 252–53 (Wisc. Ct. App. 1998).

¹²¹ 12 U.S.C. § 5005(a) (2000).

¹²² *Compare* U.C.C. § 4-406(c) with 12 U.S.C. § 5006(a)(2).

¹²³ *Compare* U.C.C. § 4-406(c) with 12 U.S.C. § 5006(b)(1).

¹²⁴ *Compare* U.C.C. § 3-406(a) with 12 U.S.C. § 5006(c)(2)(B).

¹²⁵ 12 C.F.R. § 226.12(b)(1) (2005).

electronic fund transfer access device, the consumer is liable for up to \$50 for the two days following the time when the consumer should have realized the card was lost or stolen, and up to \$500 thereafter, until sixty days after the monthly statement on which unauthorized transactions appear.¹²⁶ After those sixty days, the consumer's liability is limited only by the amount in the consumer's account and any credit limit on that account.¹²⁷ If the unauthorized electronic fund transfer did not involve an access device, only the sixty-day rule applies; the consumer has zero liability until the sixty days have passed.¹²⁸ Unless the amount of loss is substantial or small claims court is a viable alternative, a lawsuit will be financially impractical.¹²⁹

If the transaction involves a substitute check, however, Check 21 provides that consumers who did not agree to truncation can force their banks to investigate alleged errors and recredit their accounts up to \$2500 if the bank cannot resolve the consumer's complaint within ten days.¹³⁰ Check 21 even requires a consumer awareness notice informing consumers of the error resolution procedure.¹³¹ Nevertheless, Check 21 may put the error resolution procedure beyond the reach of many consumers by imposing strict requirements on consumers when they file a claim.¹³² Unless the claim contains all the required information, banks may refuse to initiate the error resolution procedure.

If the consumer uses a credit card, Reg. Z permits consumers to withhold their payments until the issuer resolves the consumer's complaint.¹³³ Reg. Z also includes a comprehensive fair credit billing

¹²⁶ *Id.* § 205.6(b)(2).

¹²⁷ *Id.* § 205.6(b)(3).

¹²⁸ *Id.* An example of an unauthorized electronic fund transfer not involving an access device is a preauthorized electronic fund transfer. *See id.* § 205.10 (providing rules governing preauthorized transfers).

¹²⁹ Rubin, *The Code*, *supra* note 25, at 22 (arguing that numerous factors deter consumers from obtaining remedies for violations of the UCC).

¹³⁰ 12 U.S.C. § 5006(c) (2000).

¹³¹ *Id.* § 5011(a)(2).

¹³² *Id.* § 5006(b)(1) (requiring consumers to describe their claim, including why the substitute check was not properly charged to the consumer's account or why there is a warranty claim, a statement that the consumer suffered loss as well as an estimate of the amount of the loss, the reason why the original check or a better copy of the original is necessary to determine the warranty claim or the validity of the charge to the consumer's account, and adequate information for the bank to identify the substitute check and conduct an investigation).

¹³³ 12 C.F.R. § 226.12(c).

dispute resolution procedure which must be disclosed to the consumer.¹³⁴ If the consumer uses a debit card, the consumer has no right comparable to the credit cardholder's right to withhold payment, although Reg. E does include a detailed error resolution procedure for electronic fund transfer disputes.¹³⁵

In most states, by contrast, if the consumer uses a stored value card, there is no legislatively mandated error resolution procedure.¹³⁶ This situation presents a serious gap. Many cards are targeted at vulnerable populations who are not well-equipped to assert their claims and defenses without legal mandates in place for error resolution. These groups include young people,¹³⁷ the poor,¹³⁸ people with no bank accounts,¹³⁹ and immigrants.¹⁴⁰

¹³⁴ *Id.* § 226.13.

¹³⁵ *Id.* § 205.11. See Ronald J. Mann, *Regulating Internet Payment Intermediaries*, 82 Tex. L. Rev. 681, 694 (2004) (questioning the appropriateness of providing the right to withhold for credit cardholders but not for debit cardholders).

¹³⁶ California's statute on prepaid phone cards requires the issuer to maintain a toll-free customer telephone number staffed by a live operator at all times so consumers can submit complaints and obtain information. CAL. BUS. & PROF'L CODE § 17538.9 (West 2003).

¹³⁷ Susan Parrott, *Who's in Charge?; To Some, Kids' Purchase Cards Are a Tool; Foes Fear They Lead to Lifelong 'Debt,'* DAILY OKLAHOMAN, Nov. 26, 2004 (reporting that consumer groups warn that Hello Kitty cards are "a savvy marketing trick" to attract children); Mike Wendland, *Hello Kitty, Hello Debit Card for Girls*, DETROIT FREE PRESS, Nov. 22, 2004 (reporting that the Hello Kitty card is targeted at girls from eight years of age); Bryony Gordon, *Who's on the Scent of a Nice Little Earner? Cliff Richardson's Latest Release Is a "Romantic" Perfume*, DAILY TELEGRAPH, Oct. 13, 2004 (reporting that the Usher card targets people under eighteen who cannot qualify for credit cards).

¹³⁸ Said, *supra* note 83 (publisher of payment system newsletter claims that companies target the poor and charge them excessive fees).

¹³⁹ Furletti, *supra* note 93, at 10 (payroll cards are marketed to employers of workers who do not have bank accounts).

¹⁴⁰ Yolanda Rodriguez, *Bank on It; Latinos Can Count on Being Wooed As a Red-Hot, Untapped Market Segment*, ATLANTA JOURNAL-CONSTITUTION, Aug. 18, 2004 (describing Bank of America's SafeSend, a stored value card with a Visa logo that can be used to send funds to Mexico); Oscar Avila, *Phone-Card Scams Slammed; Officials Warn of Hidden Costs*, CHI. TRIB., Oct. 28, 2003 (reporting on phone cards targeting immigrants; claiming that some issuers are undercapitalized, some cards have hidden fees, and government agencies have brought enforcement actions accusing issuers of deceptive advertising and fraud).

3. Similar Problems of Non-Uniformity in the Context of Payment Systems

When consumers use a variety of payment products, differences — in disclosures, requirements, notices of rights, liability for unauthorized use, and error resolution — proliferate and confusion intensifies. Payment systems pose similar problems of non-uniformity. If a consumer pays exclusively by check, consumer rights and responsibilities differ vastly, depending upon whether a substitute check is involved and Check 21 applies. Check 21 itself applies different disclosure, zero liability and error resolution standards to different consumers. The inevitable confusion which results from such disparate treatment damages consumer confidence and discourages consumers from trying new payment products and systems.¹⁴¹

IV. A Proposed Uniform Law

The preceding discussion demonstrates that consumers need a new statute to ameliorate the present consumer confusion and legal chaos. Although many believe that it is more efficient to let the competitive marketplace work things out,¹⁴² moderate statutory action seems necessary and more compatible with the present regulatory environment. As Professor Silber has advocated, “[r]eplacing a market mechanism by a regulatory mechanism should depend on whether an intrinsic market weakness exists — including within that concept consumers’ cognitive limitations — and whether regulation is more effective and efficient than the forces of the marketplace.”¹⁴³ Due to the tremendous complexity of modern payment systems and the bewildering array of applicable laws, consumers have difficulty

¹⁴¹ See generally Mark Fullei & Stephen Smith, *The Laws, Regulations, and Industry Practices That Protect Consumers Who Use Electronic Payment Systems: Credit and Debit Cards*, Jan. 2005, available at www.phil.frb.org. (concluding their study by finding “that the consumer protections associated with credit and debit cards are complicated, largely inaccessible, and disparate”).

¹⁴² Judith Rinearson, *Regulation of Electronic Stored Value Payment Products Issued By Non-Banks Under State Money Transmitter “Licensing Laws,”* 58 BUS. LAW. 317, 347, n.114 (2002) (claiming that regulation of stored value products would retard development of an industry that could make the nation’s payment system more efficient); David G. Oedel, *Why Regulate Cybermoney?*, 46 AM. U. L. REV. 1075, 1097 (1997) (arguing that the cybermoney market is too new to be regulated; that historically new payment systems are not regulated until they have established an efficient prototype).

¹⁴³ Norman I. Silber, *Observing Reasonable Consumers: Cognitive Psychology, Consumer Behavior and Consumer Law*, 2 LOY. CONSUMER L. REV. 69, 74 (1990).

understanding their rights and responsibilities, and determining what payment systems are best for them. The situation is comparable to that which consumers faced prior to the Truth-in-Lending Act, a law that made the complexity of comparing interest rates and other charges far more manageable for consumers.¹⁴⁴ In such an environment, the marketplace cannot work efficiently absent some regulation because consumers cannot reasonably obtain the information necessary to make rational choices.¹⁴⁵

For the most part, the uniform law proposed below would not encroach on previously unregulated transactions. Rather, the proposed measures would function primarily to introduce greater consistency and uniformity to the regulation that presently exists.¹⁴⁶ These reforms will inure to the benefit of the financial services industry, as well as to consumers. Greater protection will instill consumer trust and confidence. Uniformity and universality will lessen consumer confusion. As a result, consumers will be more willing to try new payment products and adapt to the inevitable increase in the use of electronic payment systems.

A. General Principles

Three principles should be followed in the implementation of the new law. First, consumers need universal protection — they should be protected regardless of the type of payment product they use and the system through which the payment is processed. To enable universal protection, stored value cards should not remain largely unregulated.¹⁴⁷ In addition, important consumer protection for electronic payments should not reside solely in the NACHA rules. Second, consumers need uniformity, that is, one rule or procedure that applies regardless of the payment system or product, to the extent this is practicable. Third, the new law should not result in the loss of consumer protection established in current law.

¹⁴⁴ *Id.* at 72–73.

¹⁴⁵ Silber has described the various limitations on the consumer's cognition including the time and expertise necessary to understand complex information. *Id.* at 72.

¹⁴⁶ The proposal does involve adding some federal regulation where none presently exists, such as an error resolution procedure in all check transactions and federal regulation of limited aspects of stored value cards. To some extent, however, those transactions are already regulated; Check 21 mandates error resolution for many check transactions and the FRB proposes to regulate one type of stored value card, the payroll card.

¹⁴⁷ Avila, *supra* note 140 (“When there aren’t regulations, everyone has a party.”) (quoting the vice-president of a phone card producer).

Given that current payment law exists primarily on the federal level,¹⁴⁸ reforms should be implemented through federal law. The primary state law is UCC Article 4, which has been modified to be consistent with federal law. Change has been rapid, and inevitably, the law will have to be amended to adjust to new developments. However, enacting a uniform state law is a long and arduous process, and states often adopt non-uniform amendments. A federal law that delegates rule-making authority to the FRB would solve that problem. By issuing an advanced notice of proposed rule-making, the FRB can solicit comments from affected parties and make necessary adjustments within a relatively short time period. Subsequent modifications can be made through the FRB's official staff interpretations.

At the same time, states should not be frozen out of this arena. States vary greatly in the characteristics of their populations and the types of financial services available. For example, some states have large numbers of residents for whom Spanish is the primary language, while other states have many elderly residents. Access to financial services in rural Montana is different than in New York City. Individual states should be able to require extra safeguards as they feel necessary to account for these local factors. Furthermore, even among states with similar populations and financial services, different approaches may be suitable. Especially in an era of momentous change, the states can serve as a laboratory for experimenting with various ways to tackle a problem.¹⁴⁹ To some extent, state law that provides greater rights in areas covered by the federal statute detracts from uniformity. But, as discussed below, states should be permitted to enact laws that raise the bar when their legislators and courts determine that consumers

¹⁴⁸ Payment systems, for example, are governed by the Truth in Lending provisions on credit cards, the EFTA, Check 21, Reg. CC. See discussion *supra* Part III.A. Also, although not federal law, the NACHA Rules have uniform national application. See generally Rubin, *supra* note 44.

¹⁴⁹ In arguing against a "National Commercial Code," Professor Overby contends that "state-by-state enactment [of commercial law] has the benefit of allowing states to experiment with the Code and with other state legislation to address local mercantile practices or contract issues that might not be widespread nationally. This allows for individually-tailored law that still accomplishes the underlying federalism goals of the UCC." A. Brooke Overby, *Modeling UCC Drafting*, 29 LOY. L.A. L. REV. 645, 686 (1996). See Letter from Helen P. Howell, Director, Dept. of Financial Institutions, State of Washington, to John D. Hawke, Jr., Office of Comptroller of the Currency (Oct. 3, 2003) (arguing against OCC preemption and noting that "[t]he states have historically been a model of innovation in the area of financial services regulation . . . However, the real strength of the states is local supervision") (on file with author).

need greater protection.¹⁵⁰ This article proposes only a uniform national floor, the basic minimum that consumers absolutely need.¹⁵¹

B. Specific Recommendations

In creating uniformity, the proposed law should provide universal coverage by defining payment systems and products broadly to include checks, preauthorized drafts, electronic transfers, credit cards, and stored value cards. Because of the widely different characteristics of these products and the systems used to process payments made with them, it likely will be necessary to make some exceptions to the general rules. But to the extent possible, the rules should be applied across the board. Otherwise, the goals of universality and uniformity will not be met.

For example, the rule should provide uniform protection from unauthorized use. The \$50 cap in the Truth in Lending Act is generally understood by consumers and is easy to apply.¹⁵² It should be the general rule. The UCC's rule asserting that consumers are not liable for any amount due to forgery or alteration should be retained.¹⁵³ The \$50 rule should apply to some types of stored value cards, such as payroll cards.¹⁵⁴ However, as suggested in the Model Stored Value

¹⁵⁰ Consumer protection law typically establishes federal minimum standards while permitting states to ensure greater protection. Jean Braucher, *Rent-Seeking and Risk-Fixing in the New Statutory Law of Electronic Commerce: Difficulties in Moving Consumer Protection Online*, 2001 WIS. L. REV. 527, 560–561.

¹⁵¹ The EFTA illustrates the type of balancing contemplated by this article. The EFTA permits states to enact their own laws as long as they are not inconsistent with the EFTA. 15 U.S.C. § 1693q (2000). Under the EFTA, a state law is not considered “inconsistent” if it provides consumers with greater protection than the EFTA provides. *Id.* Another example is the various approaches states have taken to customer requests for copies of checks in a truncated environment.

¹⁵² *Id.* § 1643(a). In contrast, the EFTA's scheme is baffling. Under the EFTA, the consumer's liability is capped at \$50 if the consumer informs the financial institution within two business days after learning of a card's loss or theft. 12 C.F.R. § 205.6(b) (2005). The cap jumps to \$500 thereafter if the consumer does not notify within two days and the institution establishes the transfers would not have occurred if the consumer had notified it within two days. *Id.* There is no cap on liability for transfers later than sixty days after the institution sends a periodic statement if the consumer fails to report unauthorized use within the sixty days and the institution can establish that the loss would not have occurred if the consumer had notified the institution within the sixty-day period. *Id.*

¹⁵³ Consumers are liable, however, if they fail to exercise ordinary care, U.C.C. § 3-406(b) (2002), or fail to report forged drawer signatures or alterations promptly. *Id.* § 4-406(d).

¹⁵⁴ In supporting its proposal to extend Reg. E coverage to payroll cards, the FRB

Card Protection Act, there should be an exception for cards whose remaining amount on the card cannot reasonably be determined since the issuer cannot stop the thief from access to the funds.¹⁵⁵

Consumers also need an error resolution procedure, regardless of payment system or product. Error should be defined broadly to include billing errors, defective cards, unauthorized use of a card or account number, erroneous debits, incorrect amounts received from electronic terminals, and unauthorized types of processing.¹⁵⁶ Requiring an error resolution procedure would mainly affect checks not subject to Check 21 and stored value cards. Furthermore, the consumer should be able to easily invoke the error resolution procedure. For this reason, the Check 21 requirements for submitting a claim should be repealed where they impose intolerable burdens on consumers.¹⁵⁷ The “four walls” rule of the EFTA should also be repealed because it unduly limits the scope of the financial institution’s investigation.¹⁵⁸ There should be one rule dictating the length of time a consumer has to notify the financial institution. It is unfair and confusing to consumers to have a forty-day rule for Check 21, a sixty-day rule for electronic transfers, and a UCC rule whose vagueness permits banks to impose a far shorter time by agreement.¹⁵⁹

noted, *inter alia*, that the salaries paid through payroll cards often represent the “bulk of the consumer’s income” and the cards use the same types of access devices, electronic terminals, and other EFT services as traditional electronic transfers. Reg. E Proposed Amendment, *supra* note 38, at 55,999.

¹⁵⁵ See MODEL STORED VALUE CARD PROTECTION ACT, in BUDNITZ, *supra* note 34, at 397–99 (requiring a receipt only if the transaction is for \$5 or more; requiring the issuer to reimburse the consumer for damage to the card, but only if the funds remaining on the card can be determined). See also BUDNITZ & FREEMAN SAUNDERS, *supra* note 70, at 398 & n.16. The N.Y. Attorney General persuaded seventeen national retailers to provide policy exceptions for certain lost or stolen gift cards. Press Release, *supra* note 82. Under the agreement, the retailers will reissue lost or stolen gift cards if the consumer provides evidence that they purchased a lost or stolen card. *Id.* The policy also would apply to damaged cards. *Id.*

¹⁵⁶ An example of an unauthorized type of processing is where a consumer sends a check to a lockbox, and the merchant processes the payment as an electronic check conversion without proper notice to the consumer. 12 C.F.R. § 205.3(b)-3 official interpretation (2005) (stating that to qualify as an authorized electronic check conversion, the consumer must receive notice).

¹⁵⁷ Budnitz, *supra* note 15, at 374–75 (describing the requirements for submitting a claim).

¹⁵⁸ The FRB recently proposed clarifying the “four walls” rule, but not extending it beyond the “four walls.” Reg. E Proposed Amendment, *supra* note 38, at 55,997.

¹⁵⁹ Borowski v. Firststar Bank Milwaukee, 579 N.W.2d 247 (Wis. Ct. App. 1998)

The recredit right under the EFTA and Check 21 should be extended to all types of payment systems.¹⁶⁰ Both statutes require the financial institution to recredit the consumer's account if it cannot determine the validity of the consumer's claim of an erroneous transfer within ten days.¹⁶¹ However, the recredit right under Check 21 is subject to a \$2500 limit, whereas the EFTA imposes no such cap.¹⁶² Given the similarity between electronic check conversion, subject to the EFTA, and Check 21 transactions, Check 21's \$2500 restriction, should be repealed. A consumer who writes a check for over \$2500 has just as great a need for the full amount to be recredited as a consumer who writes a check for a smaller amount. It is likely that banks will object, however, contending that the \$2500 limit is needed to protect against fraudulent claims. But the vast majority of consumer checks are for far less than \$2500.¹⁶³ Furthermore, if this is a real concern, banks will have an incentive to resolve claims involving checks in higher amounts within the ten days in order to avoid having to recredit. In addition, like Reg. CC, Check 21 includes bank safeguards for risky accounts.¹⁶⁴

As discussed previously, the NACHA rules include several provisions that grant consumers greater protection than they have under the EFTA.¹⁶⁵ Those rules should be incorporated into Reg. E. Where

(holding that banks may impose a period as short as fourteen days); BARKLEY CLARK & BARBARA CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* ¶ 10.05[1][c][i] (5th ed. 2004).

¹⁶⁰ See Cooter & Rubin, *The Code*, *supra* note 25, at 116 (arguing that banks should be required to reverse charges that consumers claim are erroneous). The recredit right would have no applicability to credit transactions where consumers have not yet paid anything. The rules in the Truth in Lending Act permitting withholding serve a comparable purpose and should be retained. 12 C.F.R. § 226.12(c) (allowing cardholder to withhold payment up to the amount of credit outstanding for the property or service that caused the dispute as well as any other charges imposed on that amount). Those rules with limited applicability to transactions within the state or within 100 miles should be reconsidered. *Id.* § 226.12(c)(3).

¹⁶¹ 12 U.S.C. § 5007 (2002) (Check 21); 15 U.S.C. § 1693f(c) (EFTA).

¹⁶² See discussion *supra* note 19.

¹⁶³ The average value of checks paid by financial institutions varies considerably because larger institutions maintain both commercial and consumer deposit accounts, whereas credit union data reflect only consumer accounts. Geoffrey R. Gerdes & Jack K. Walton II, *The Use of Checks and Other Noncash Payment Instruments in the United States*, 88 FED. RES. BULL. NO. 8 360, 363 (2002). The average value of credit union checks in 2000 varied depending on the size of the credit union, from a high of \$208 to a low of \$178. *Id.*

¹⁶⁴ See 12 U.S.C. § 5006(d)(2) (2000).

¹⁶⁵ See *supra* note 72 and accompanying text.

the FRB otherwise lacks the authority to bring them into Reg. E, the EFTA should be amended to include them. This should be done for the following reasons. First, it is more appropriate for uniform national consumer protection rules to be issued by the government, not a private body. The government relinquishes its rightful role when it allows a private body to do this.¹⁶⁶ In addition, NACHA can repeal or amend its rules at any time, without any prior notice or hearing afforded to consumers or the government.¹⁶⁷ Furthermore, most of NACHA's consumer protection rules do not require disclosures to consumers informing them of their rights.¹⁶⁸ Therefore, consumers have no way to know about and how to take advantage of those rights. The proposed uniform law should require disclosure of consumers' rights. Finally, it is not clear that consumers can use a business' violation of the NACHA rules as a cause of action in a lawsuit.¹⁶⁹

Non-financial institutions such as merchants are intimately involved in many payment systems. Therefore, to the extent appropriate, the proposed law should impose requirements on those businesses as well as financial institutions.¹⁷⁰ For example, when a consumer disputes an electronic transfer and the bank cannot locate the source of the problem within its own four walls, the bank's investigation should include an inquiry of other parties to the transfer, including the merchant. Furthermore, the law should require the merchant to assist the bank in its investigation.¹⁷¹ The FRB has acknowledged its

¹⁶⁶ The Association of Credit and Collection Professionals International also is concerned that the differences between Reg. E and the NACHA rules "[undermine] the authority of the FRB and the integrity of the electronic payments process." Letter from Valerie L. Hayes, Legal Counsel, Director, Internet & Check Services Program, ACA International, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System 6 (Nov. 19, 2004), available at www.federalreserve.gov/SECRS/2004/November/20041123/R-1210/R-1210_81_1.pdf. Unlike the proposed law, however, ACA International opposes incorporating NACHA's greater consumer protection, and would remove NACHA's rulemaking role altogether. See *id.* ("The FRB should not allow another organization to develop rules for utilizing the electronic payment process.").

¹⁶⁷ See *supra* notes 73, 75–76 and accompanying text.

¹⁶⁸ See *supra* note 74 and accompanying text.

¹⁶⁹ *Id.*

¹⁷⁰ See Mann, *supra* note 135, at 681 (recommending regulation of third party intermediaries operating Internet payment services such as PayPal).

¹⁷¹ See generally 15 U.S.C. § 1681s-2(b)(1) (2000) (requiring furnishers of information to consumer reporting agencies to conduct an investigation when a consumer disputes the completeness or accuracy of the information the furnisher supplied to a consumer reporting agency); 12 U.S.C. § 5005(e)(3) (requiring

authority to do this under the EFTA.¹⁷² Likewise, the Gramm-Leach-Bliley Act's privacy provisions demonstrate such authority with its very broad definition of "financial institution."¹⁷³

The periodic statement will become increasingly important as ever more types of products and systems are developed and payments are processed more and more quickly. Consumers' demand deposit accounts act as a financial hub. Moving in and out of that hub are debits and credits resulting from their use of many types of payment products traveling along various types of transfer systems. Consumers need an accurate and comprehensible statement that enables them to identify errors and to report those errors within the applicable time limits.¹⁷⁴ In order for the statement to satisfy the consumer's needs, it is essential that items be clearly designated on the statement. At present, there is no standardized way to identify transactions on a periodic statement. Consequently, consumers may have difficulty identifying transactions. For example, consumers may not be able to easily determine what payments were made through electronic check conversion, and which by other processing methods.¹⁷⁵ As a result, those customers will have difficulties determining the existence and source of errors on their statements. The proposed law should delegate to the FRB the task of issuing a rule establishing standardized terms for periodic statements.

The proposed law should limit the fees that can be assessed for certain items. Examples include requests for substitute checks or

indemnified parties to assist indemnifying bank in connection with claims the bank brings against a warrantor).

¹⁷² See, e.g., 12 C.F.R. § 205. (2005) (Reg. E) (requiring merchants and other payees to obtain a consumer's authorization for an electronic check conversion).

¹⁷³ For purposes of the privacy provisions of Gramm-Leach-Bliley, "financial institution" includes check cashers, travel agencies operated in connection with financial services, collection agencies, credit counselors, and tax preparation firms. See 16 C.F.R. § 313.1(b).

¹⁷⁴ U.C.C. § 4-406(c) (2002) (requiring a customer to examine the statement with "reasonable promptness" and notify the bank of forgeries and alterations "promptly"); 12 U.S.C. § 5006(a)(2) (Check 21) (requiring consumer to submit a claim for a recredit within forty days of the date the bank delivers a statement or makes the substitute check available); 12 C.F.R. § 205.11(a)(2)(b) (Reg. E.) (requiring the consumer to notify the bank of errors within sixty days after the bank sends the statement).

¹⁷⁵ For example, a major regional bank designates payments made through electronic check conversion on its monthly statement as "automated checks." See Wachovia Statement (on file with author).

truncated checks, requests for documentation, and fees for investigating claims. A separate section of the proposed law should deal with fees on stored value cards, with subsections for gift cards, phone cards, and payroll cards. Alternatively, the statute should give the FRB the authority to develop disclosure requirements and limitations in regard to fees and practices that impose additional costs even if they are not in the nature of fees. For example, for gift cards, the statute or FRB regulations should deal with activation fees, dormancy fees, monthly service fees, and redemption fees. In addition, regulations should require issuers to permit consumers to redeem unused funds and provide reasonable periods before cards expire.

The proposed law should require financial institutions and others issuing payment products to disclose to consumers their rights under the law.¹⁷⁶ The disclosures would notify consumers of their limited liability for unauthorized use, the limits on fees, their right to dispute charges to their accounts and demand an investigation, their recredit right, and how to invoke these entitlements. Congress should require the FRB to examine the need for further disclosures to provide consumers with information about product alternatives, and the risks and problems consumer may encounter in using various products and systems.¹⁷⁷

Some businesses may want to make the disclosures required by the proposed law electronically. The federal Electronic Signatures in Global and National Commerce Act (the "E-Sign Act") includes an important provision requiring consumer authorization before a business can send notices mandated by the law electronically.¹⁷⁸ The proposed law should clearly incorporate the consumer authorization requirement. The E-Sign Act should be amended to make it clear that the authorization requirement applies even if a state has enacted the Uniform Electronic Transactions Act. In addition, Check 21 should

¹⁷⁶ Federal agencies proposed required disclosures for stored value cards several years ago. *See, e.g.*, Electronic Fund Transfers, 61 Fed. Reg. 19,696, 19,700 (proposed May 2, 1996) (to be codified at 12 C.F.R. pt. 205). *See* Budnitz, *Stored Value Cards*, *supra* note 82, at 1069. *See generally* Jean Braucher, *Delayed Disclosure in Consumer E-Commerce as an Unfair or Deceptive Practice*, 46 WAYNE L. REV. 1805 (2000); William C. Whitford, *The Functions of Disclosure in Consumer Transactions*, 1973 WIS. L. REV. 400 (1973).

¹⁷⁷ The federal regulatory agencies have proposed disclosures of alternatives, risks, and problems in regard to overdraft protection programs. *See supra* notes 110–114 and accompanying text

¹⁷⁸ *See* Check 21 Final Rule, *supra* note 5, at 47,303.

be amended to state that E-Sign's consumer authorization rule applies to checks subject to that act.¹⁷⁹

The disclosures and protections granted under the proposed law are meaningless if the statute does not provide incentives for enforcement. The statute should follow the scheme of the federal Consumer Credit Protection Act and grant rule-making and enforcement powers to the relevant state and federal government agencies.¹⁸⁰ In addition, consistent with that scheme, the law should authorize a private right of action, liability for actual damages, statutory damages, costs and attorney's fees.¹⁸¹ Finally, the statute should prohibit mandatory pre-dispute arbitration.¹⁸² Enforcement of the law must not be undermined by allowing those who own the products and systems to relegate all consumer disputes to a forum that often is costly and inconvenient. The integrity of the national payments system depends on compliance with the law. Mandatory pre-dispute arbitration undermines that integrity because arbitrators are not required to follow the law and decisions cannot be appealed.

The proposed uniform law is intended as a first step only. Consumers need far more protection than is recommended here. Some of that protection, however, cannot be provided by a uniform law with universal coverage. Stored value cards are a prime example. There are striking differences among phone cards, gift cards and payroll

¹⁷⁹ In its Final Rule on Check 21, the FRB claimed that the consumer authorization requirements of the E-Sign Act did not apply to Check 21 because Check 21 contains its own rules and does not refer to E-Sign. *Id.* at 47,303.

¹⁸⁰ See *infra* note 183 and accompanying text (discussing the Consumer Credit Protection Act and state preemption).

¹⁸¹ The law should not include artificial restrictions on consumer remedies. For example, Check 21 restricts its indemnity provision to those who are recipients of substitute checks. 12 C.F.R § 229.53 (2005). See Check 21 Final Rule, *supra* note 5, at 47,324. Consumers need the relief made available by the indemnity provision when they suffer damages due to a transaction involving a substitute check whether or not they received a substitute check.

¹⁸² See Linda J. Demaine & Deborah R. Hensler, "Volunteering" To Arbitrate Through Pre-dispute Arbitration Clauses: The Average Consumer's Experience, 67 LAW & CONTEMP. PROBS. 55 (2004); Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 LAW & CONTEMP. PROBS. 133 (2004); Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration To Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. 75 (2004); Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237 (2001). A comprehensive critique of mandatory pre-dispute consumer arbitration is beyond the scope of this article.

cards. Additional individualized legislation is needed to deal with unique characteristics of certain products and systems.

C. Preemption

As discussed, a federal law is needed to reduce the consumer confusion and legal chaos that characterize the present payment system. In order to accomplish the objective of providing a uniform minimum level of consumer protection to all consumers, any federal law setting a minimum standard should preempt state law that does not provide that level of protection. Under the proposed uniform law, however, states would be permitted to enact laws that provide consumers greater protection. In fashioning a preemption rule for the proposed law, it is helpful to understand the role preemption plays in consumer protection statutes, recent federal regulatory actions, and challenges that can be expected from industry.

All of the subparts of the Consumer Credit Protection Act include provisions preempting state law.¹⁸³ These provisions offer a model for the proposed uniform federal law. The typical preemption provision provides that the federal law does not exempt any person from complying with state law “except to the extent those laws are inconsistent with any provision of [the federal law], and then only to the extent of the inconsistency.”¹⁸⁴ Under these preemption provisions, the FRB is authorized to determine whether state law is inconsistent.¹⁸⁵ Some of the provisions explicitly provide that a state

¹⁸³ See Fair Credit Billing Act, 15 U.S.C. § 1666(j) (2000); Truth in Lending Act, *id.* § 1610(a)(1); Consumer Leasing Act, *id.* § 1667e(a); Credit Repair Organizations Act, *id.* § 1679(j); Equal Credit Opportunity Act, *id.* § 1691f; Debt Collection Practices Act, *id.* § 1692(n); Electronic Fund Transfers Act, *id.* § 1693(q). Professor Overby likely would characterize this arrangement as “cooperative federalism.” A. Brooke Overby, *Our New Commercial Law Federalism*, 76 *TEMPLE L. REV.* 297, 328 (2003) (“Movements toward more purely cooperative federalism schemes, which rely less upon preemption and displacement than on the creation of joint federal-state regulatory regimes, also have begun to arise in commercial law areas.”).

¹⁸⁴ See, e.g., Fair Credit Billing Act, 15 U.S.C. § 1666(j) (2000); Truth in Lending Act, *id.* § 1610(a)(1); Consumer Leasing Act, *id.* § 1667e(a); Credit Repair Organizations Act, *id.* § 1679(j); Equal Credit Opportunity Act, *id.* § 1691f; Debt Collection Practices Act, *id.* § 1692(n); Electronic Fund Transfers Act, *id.* § 1693(q). Professor Overby likely would characterize this arrangement as “cooperative federalism.” A. Brooke Overby, *Our New Commercial Law Federalism*, 76 *TEMPLE L. REV.* 297, 328 (2003) (“Movements toward more purely cooperative federalism schemes, which rely less upon preemption and displacement than on the creation of joint federal-state regulatory regimes, also have begun to arise in commercial law areas.”).

¹⁸⁵ E.g., 15 U.S.C. § 1666(j).

law is not inconsistent if the FRB “determines that such law gives greater protection to the consumer.”¹⁸⁶

Recent legislative developments, however, may be a harbinger of what could happen to the proposed law as a result of the preemption controversy. Battles over preemption issues stalled the enactment of amendments to the Fair Credit Reporting Act (the “FRCA”). Industry wanted broad preemption so they would not have the burden of having to comply with more than one set of laws — including those of states granting consumers greater protection.¹⁸⁷ Consumer advocates believed that consumers who lived in states that provided greater protection than the FRCA should have the benefit of those state laws.¹⁸⁸ The end result is a very complex partial preemption scheme. While the FRCA’s preemption section contains a provision permitting state laws that are not inconsistent,¹⁸⁹ there is an extensive list of exceptions,¹⁹⁰ and even exceptions to those exceptions.¹⁹¹

Further complicating the partial federal preemption scheme of the federal consumer protection statutes, the Office of the Comptroller of the Currency (the “OCC”) has largely exempted national banks from having to comply with state law. The OCC’s regulation provides that state laws that “obstruct, impair or condition a national bank’s ability to exercise its . . . deposit-taking powers are not applicable.”¹⁹² Other rules preempt state laws that interfere with a national bank’s lending powers.¹⁹³ Finally, the OCC has claimed exclusive “visitorial powers” over not only national banks, but also their operating subsidiaries.¹⁹⁴

¹⁸⁶ *Id.*

¹⁸⁷ Rob Blackwell, *How Measure May Alter Path for FCRA Renewal*, AM. BANKER, Aug. 20, 2003 (reporting that the president of the Financial Services Roundtable preferred a tough national standard if it was accompanied by preemption that obviated compliance with many different state laws). The Bush administration also supported preemption. See Michelle Heller, *White House’s Support for FCRA Comes at Price*, AM. BANKER, July 1, 2003 (quoting Treasury Secretary John W. Snow’s statements supporting preemption and national uniform standards).

¹⁸⁸ See generally Blackwell, *supra* note 187 (reporting that because California had passed a strong privacy law, Senators Shelby and Sarbanes would not support FCRA preemption).

¹⁸⁹ 15 U.S.C. § 1681t(a).

¹⁹⁰ *Id.* § 1681t(b).

¹⁹¹ *Id.* §§ 1681t(b)(1)(F), (b)(2).

¹⁹² 12 C.F.R. § 7.4007(b)(1) (2005).

¹⁹³ *Id.* §§ 7.4008(d)(1), 34.3.

¹⁹⁴ *Id.* § 7.4000.

The proposed uniform law arguably conflicts with the OCC's preemption rules to the extent the law would permit states to require national banks to provide greater protection than the proposed uniform law to consumers paying by check.¹⁹⁵ Arguably, however, the OCC's previously-issued interpretations have resolved any such problems. Articles 3 and 4 of the UCC, as adopted by the states, regulate payments by check and define the rights and responsibilities of the parties when problems arise in check transactions.¹⁹⁶ NCCUSL and ALI, the organizations that sponsored the UCC were concerned that the OCC's regulation preempted Article 4.¹⁹⁷ Responding to these concerns, the OCC has taken the position that the UCC "does not obstruct, impair or condition the ability of national banks to exercise fully the powers granted by federal law."¹⁹⁸ The proposed federal law would apply to many of the same areas of check processing as the UCC. Ostensibly, then, the OCC would not find that the proposed law interferes with national banks' ability to exercise their powers under other federal law.

D. The Consumer's Dilemma: Uniformity May Reduce Consumer Protection

Congress might give serious consideration to a proposal by consumer advocates to enact uniform federal legislation that would guarantee basic consumer protection along the lines proposed in this

¹⁹⁵ See *supra* text accompanying notes 149–151, proposing that banks be required to provide consumers an error resolution procedure, while permitting states to mandate greater consumer protection.

¹⁹⁶ U.C.C. §§ 3-404, 3-405, 3-406, 4-406 (2002).

¹⁹⁷ See NCCUSL, News Release, OCC Declares UCC Not Affected by New Federal Preemption Rule (June 25, 2004), available at www.nccusl.org/Update/DesktopModules/NewsDisplay.aspx?ItemID=109 ("On May 12, 2004, the National Conference of Commissioners on Uniform State Laws and the American Law Institute wrote to the Office of the Comptroller of the Currency (OCC) expressing concerns about the impact of the recently promulgated OCC Rule concerning preemption of state laws on the Uniform Commercial Code").

¹⁹⁸ Letter from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, OCC, to Fred H. Miller, President, NCCUSL (June 10, 2004) (on file with author). Lawsuits filed by the attorneys general of Massachusetts, Connecticut, and New Hampshire have forced the OCC to determine whether state laws on gift cards are preempted. Hannah Bergman, *Gift Card Case Has OCC Siding with States*, AM. BANKER, Nov. 17, 2004. The attorneys general allege that the Simon mall gift card violates their states' laws on expiration dates and fees. Simon alleges that since the card is issued by a national bank, state law is preempted. The OCC has said it does not regard the card as a "bank product." *Id.*

article.¹⁹⁹ In addition, although industry representatives likely would not support many of the substantive consumer protection provisions consumer advocates would recommend, they might welcome the opportunity to have Congress consider the need for uniform legislation so they could proffer their own model legislation.

If Congress were to consider the proposed uniform law and the inevitable competing industry recommendations, Congress might respond by enacting a law that provides too little consumer protection. Past experience suggests that Congress could enact legislation that effectively would undermine the objectives of those recommending the type of law proposed in this article. For example, Congress might be content to require only disclosure, rather than substantive protection. This was Congress's approach to the Truth in Lending Act²⁰⁰ and the Magnuson-Moss Warranty — Federal Trade Commission Improvement Act.²⁰¹

As was true in the battle over the amendments to the FCRA, industry can be expected to urge Congress to include a strong preemption provision as part of any uniform law governing payment systems. If such a preemption clause were included along with a statute requiring nothing more than minimal disclosures, consumers would end up with less protection than at present. Currently, consumers in some states

¹⁹⁹ The recent failure of the Uniform Electronic Transactions Act to include consumer protection demonstrates that consumers cannot rely on the uniform law process to ensure rights. Braucher, *supra* note 176, at 531–32. Professor Braucher contends that consumers have a greater chance at passing consumer protective legislation on the federal level because lobbying one legislature is cheaper and the process is more publicly exposed for review. *Id.* at 532.

²⁰⁰ 12 C.F.R. pt. 226 (2005). The Truth in Lending Act offers little substantive protection; it does not limit the interest or other charges creditors can impose, but instead merely requires disclosure. See Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 884 (2003). Exceptions are the right to rescind transactions in which a security interest is taken in the consumer's principal dwelling, 15 U.S.C. § 1635 (2000), and protections for high cost loans included in the Home Ownership Equity Protection Act portions of the Truth in Lending Act. *E.g.*, *id.* §§ 1639(c)–(h).

²⁰¹ 15 U.S.C. §§ 2301–12. The Magnuson-Moss Warranty-Federal Trade Commission Improvement Act is largely a disclosure statute that does not ensure that consumers receive goods that perform in a manner commensurate with the price paid by the consumer. An innovative feature of the act is its provision regarding alternative dispute resolution. *Id.* § 2310; 16 C.F.R. § 703 (2005). The courts have substantially undercut those provisions, however, by enforcing warrantors' mandatory pre-dispute arbitration clauses. *E.g.*, *Davis v. S. Energy Homes, Inc.*, 305 F.3d 1268 (11th Cir. 2002); *Walton v. Rose Mobile Homes LLC*, 298 F.3d 470 (5th Cir. 2002).

have the protection of strong phone and gift card laws.²⁰² If the uniform law were to preempt those statutes, consumers in those states would be left with less protection than they have now. In the long-term, this would benefit neither consumers nor the industry. Without the minimal protections proposed herein, consumers will continue to be confused and will not have the confidence and trust in the newer payment products and systems needed to ensure consumer acceptance. Therefore, state law should be preempted only to the extent it is inconsistent with the minimum guarantees mandated in the proposed law. States would be permitted to enforce laws that grant consumers greater protection.

The payments industry likely will object to this partial preemption scheme, arguing that the benefits of uniformity are lost if states can enact their own laws, requiring the industry to comply with several sets of laws. In reality, however, the industry would not really be substantially worse off than it is now. At the present time, the industry must comply with several sets of laws. At the federal level it has to comply with the different rules of Check 21, Reg. Z, and Reg. E; in addition, it has to comply with the state-implemented versions of the UCC.²⁰³ Even the UCC is riddled with non-uniform amendments, requiring financial institutions operating in several states to apply different rules to identical transactions.²⁰⁴ The only difference is that if the proposal were enacted, the industry would have to comply with the minimum federal requirements. Such compliance would not be a huge burden for many businesses. For example, it is likely that most already provide some sort of error resolution procedure, even where not required to do so by law. As noted above, the various subchapters

²⁰² *E.g.*, CAL. CIV. CODE § 1749.5 (2005) (making it unlawful to sell a gift card that contains an expiration date or a service fee, and providing that gift cards are redeemable in cash or for replacement with a new gift certificate). *But see* CAL. CIV. CODE § 1749.45 (excluding a gift card that can be used with multiple sellers if any expiration date is printed on the card); IOWA CODE § 556.9 (2003) (prohibiting imposition of charges for the consumer's failure to present the gift certificate in a timely manner unless permitted by an enforceable written contract); MASS. GEN. LAWS ch. 266, § 75C (2004) (imposing fines upon sellers of prepaid gift certificates that impose redemption deadlines of less than seven years as well as upon sellers who refuse to redeem the certificate before the expiration date occurs); MASS. GEN. LAWS ch. 255D, § 1 (defining "gift certificate" to include stored value cards); WASH. REV. CODE ANN. § 19.240.040 (West 2004) (imposing requirements for when a dormancy or inactivity charge may be imposed).

²⁰³ *See* discussion *supra* Part III.C.

²⁰⁴ *E.g.*, U.C.C. § 4-406 (2002). The variations are described in BUDNITZ & FREEMAN SAUNDERS, *supra* note 70, at 11.

of the federal Consumer Credit Protection Act contain preemption provisions that allow state laws as long as they are not inconsistent with the federal law.²⁰⁵ The lack of industry pressure to substitute the current scheme with one providing for total preemption indicates that the industry has not found it difficult to live with this type of partial preemption.

There is another reason that the federal uniform law should not preempt all state laws. At the present time the marketplace is very dynamic, undergoing constant change as new payment products are marketed. There are many suitable approaches to regulating these new products, and the states can serve as valuable laboratories for experimenting with various regulatory schemes. Consequently, it would be beneficial to permit states to try different regulatory strategies for some period of time. Ultimately, it may be wise to preempt state law more broadly in regard to some payment products. Those products may reach a mature development stage, and Congress may then have enough evidence of the success of various state regulatory schemes to enable it to choose the optimal legislative solution to displace state law. Until that time, however, Congress should adopt partial preemption.

V. Conclusion

Due to the many significant recent changes in consumer payment products, the systems that transfer payments and the law that governs or fails to govern them, this country needs a uniform payments law that would establish national minimum requirements. As far as possible, the law should require uniform rules that would apply to all types of payment systems. Under this optimal system, consumers would not surrender rights they already have. The statute would include a rule providing protection from unauthorized use, a mandated error resolution procedure, a right to a recredit if the validity of the consumer's dispute cannot be determined within ten days, a limit on fees and disclosure of rights. The FRB would have the task of developing standardized terms for periodic bank statements. NACHA rules that establish important consumer protections would be incorporated into the uniform law. The proposed law would set forth the absolute minimum that is needed. For this reason, and also because of the dynamic nature of the current marketplace, states should be free to adopt their own laws if they are not inconsistent with the federal

²⁰⁵ See *supra* Part IV.C.

uniform statute. At some time in the future, when there is enough experience with various legislative approaches, it may be appropriate to have only one completely uniform law in regard to certain types of payment products. But that should be a law that provides far more protection than is proposed by this article.

Congressional consideration of a national uniform law is fraught with risks. Congress might take to the basic idea of one universal uniform law, but enact a law that requires only disclosure. Furthermore, Congress may enact a law that totally preempts states from regulating payment products, thereby inhibiting the development of the law. The resulting law would then provide only the most minimal protection based on market conditions extant when the law was enacted, contrary to the proposed law's original intent. These suggestions are recommended only as a starting point. More protection will be needed and adjustments will be essential as products and systems mature and as new ones develop.

