

Some Impacts of Electronic Funds Transfers on Consumer Transactions

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The American consumer — the average depositor/borrower — is probably the most essential person to effective implementation of an electronic funds system. Yet, of the amazing quantity of literature published on EFTS in the last few years, virtually no attention has been paid to the consumer except as an abstract target of marketing studies. There are, however, serious problems in EFTS for the consumer which will have to be dealt with very soon. Some of these problems (which are to be addressed in another paper) are already being articulated in broad forms. The concern expressed is in a vocabulary of fear — fear of loss of control over personal finances, fear of lack of choice in the marketplace, and fear of increased invasion of privacy.

There is an entirely different level of problems in EFTS for consumers which will be the subject of this paper. For lack of a better term, I call them transactional problems since they arise from a search for a definition of rights and responsibilities under specific transactions, *i.e.*, direct payment orders (checking) and credit. They are considerably easier to describe than the concern for privacy but nonetheless problems which affect consumers in the context of credit transactions today without the aggravation of electronic systems. Since many people view the present bank credit card as the embryonic form of the electronic checkbook, it seems more than a bit wise to cure these problems now, in favor of the consumer, if only to create a healthy transactional climate in which an electronic system can develop on its economic merits. To that extent the

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problems discussed herein, although in a legal context, are the real marketing problems or, more properly, possible barriers to effective marketing of electronic funds.

Finally at this introductory stage, I should note that when I refer to EFTS, I am referring to a fully integrated system — the system of 1984 (or 1994) in which POS terminals have replaced merchant cash registers and plastic cards or similar terminal activating devices have replaced checkbooks, not just the existing experiments with automated tellers and pre-authorized debits and credits.

I. TWO BASIC THEMES

Throughout this paper I will attempt to identify transactional problems and offer solutions. Two basic themes are so common to these solutions as to justify their identification at the outset.

A. THE CONSUMER SHOULD BEAR NO RISK FOR MISHAPS IN AN ELECTRONIC SYSTEM

B. ALL COST SAVINGS SHOULD BE SHARED WITH THE CONSUMER

Who wants EFTS? A central fact underlying both of these themes is that there is virtually no demand in the consumer sector for an electronic system. To the contrary, the literature suggests that the impetus for the system lies exclusively with business interests, not all of which are financial institutions. The momentum seems to emerge primarily from a strongly felt need to eliminate what is perceived as a huge and ever increasing cost of processing paper. In addition, there seem to be legitimate drives for increasing efficiency and maximizing competition postures. Further, I see more than a little red-blooded American fascination for the production and acquisition of the latest technological gadgetry for its own sake.

The point is, however, that none of these and many other reasons for electronic funds, be they ever so legitimate and keenly felt by business, relate to any known pressing consumer need. For a potential supply force to beat the bushes to create a demand is not new to our economy. What may be unique to EFTS is that the demand generated may well prove to be little more than passive acquiescence, not acceptance, as a result of a system foisted upon the public by a series of direct government interventions — from automating clearinghouses on up through the issuance of all government payments (social security, welfare, etc.) in electronic form. If that is to be the case, then it is sheer folly to suggest, under a *caveat emptor* theory predicated on non-existent marketplace conditions, that consumers share risks inherent in the system, give up rights or benefits formerly enjoyed or be denied the opportunity to share any resulting cost savings.

II. THE DISAPPEARING CHECKBOOK

A. *Article 4 of the Uniform Commercial Code.* There is, in legal circles, a growing debate as to the applicability of Article 4 of the UCC — the basic law of checking — to electronic transfer systems.¹ Whatever the academic merits of the debate, it seems clear that none of the participants in the system are willing to make large investments on the assumption either that Article 4 will or will not apply. Thus far, the two major experiments, the Atlanta COPE and the California SCOPE, seem to have found a workable compromise out of the dilemma. If I read their supporting legal studies correctly, both projects contractually mandate that Article 4 applies, then proceed to depart from its standards only when technology demands either non-applicability or deviation.

Neither project involves a fully integrated electronic system, however, in that direct transfers from POS terminals or cash/credit capabilities are not involved. Thus, the true test of the applicability of Article 4 is yet to come.

In this regard I should point out that the Permanent Editorial Board of the UCC has recently constituted a committee to redraft Article 4 in light of emerging electronic capabilities. The most important question, however, may well be procedural rather than substantive. Why should an electronic system which will eventually be dependent on nationwide linkages for maximum effectiveness be governed by the uncertain actions of over 50 different legislatures? One prominent writer on EFTS, Mr. Gerald T. Dunne of the St. Louis Federal Reserve Bank, offers convincing arguments that any void in Article 4 be filled by regulations or operating letters of the Federal Reserve Board.² The broader question which I will address later is whether the problem is not better solved by comprehensive Federal legislation.

¹Atlanta Payments Project, Georgia Institute of Technology, Research on Improvements of the Payments Mechanism: *Phase III General Systems Design and Analysis of an Electronic Funds Transfer System*, Volume 6 of 6, Legal Considerations (1972). Baxendale, *Commercial Banking and the Checkless Society*, 1 RUTG J. Comp. Law 88 (1970); Clarke, *An Item Is An Item Is An Item: Article 4 of the UCC and The Electronic Age*, 25 Bus. Law 109 (1969); Clarke, *Bank-Customer Relationships in an Electronic Credit Transfer System*, 2 RUTG. J. Comp. Law 1 (1971); Dunne, *Variations on a Theme by Parkinson or Some Prospects for the UCC and the Checkless Society*, 75 YALE L. J. 788 (1966); Dunne, *The Checkless Society and Articles 3 and 4*, 24 Bus. Law 177 (1968); Homrighausen, *One Large Step Toward Less-Check; The California Automated Clearinghouse System*, 28 Bus. Law 1143 (1973); Odom, *Alternatives to the Present Check Collection System*, 70 Stan. L. Rev. 571 (1968); Penney, *Articles 4 and 8 of The UCC*, 26 La. L. Rev. 259 (1966); Penney, *Bank Statements, Cancelled Checks and Article Four in the Electronic Age*, 65 Mich. L. Rev. 1341 (1967), 85 Bank. L. J. 659 (1968); Cousins, Kelley, Imperato & Reinthaler, *Toward a Less-Check Society*, 47 Notre Dame Law. 1163 (1972).

²See Dunne *supra* note 1.

B. *Specific Problems Under Article 4.* The reader is referred to the articles cited above for a far more exhaustive coverage of problems with Article 4 than is available here. From the vantage point of the consumer/depositor, I wish to highlight four specifics which seem worth considering.

1. *Contract Formation.* The contract which underlies today's demand deposit account is, for all practical purposes, a non-contract in the sense of a written agreement. The only written memorandum is the depositor's card, a document more related to the purpose of signature verification than that of recording the terms of agreement. Typically, this card contains a single statement incorporating rules and regulations of the bank as the governing terms and conditions. Section 4-103 allows such an arrangement and, in addition, provides that Federal Reserve regulations and operating letters as well as clearinghouse rules have the effect of becoming part of the depositor "agreement."

This peculiar form of "contract" has not been particularly problematic in the past. Checking services are sufficiently standardized as to be understood by the general population without written documentation. Nevertheless there has been in recent years an increased demand among consumers to know more about their bank accounts. I refer you to the recent publication in San Francisco of a pamphlet entitled "How to Break the Banks."

In contrast to checking, consumer credit transactions are considerably detailed by virtue of the requirements of state statutes and Federal Truth in Lending. As a result all essential terms and conditions are presented the borrower, even if in technical terms, in the contract itself, or in supporting documents. In fact, Truth in Lending has sufficiently standardized credit transactions to lead some consumer advocates to suggest government preparation or approval of master forms for all commonly recurring transactions as a means of achieving increased consumer understanding and protection.

The sheer complexity of EFTS may lead bank depositor relationships in the same direction. At the present time, experiments with pre-authorized debits and credits create a situation where a typical depositor may have four or more separate contracts with respect to a demand deposit: (1) the basic checking relationship evidenced by the depositor's card; (2) a separate authorization form for pre-authorized credit of a "paycheck," legally a contractual modification of the checking contract; (3) a separate authorization or authorizations for pre-authorized debits; and (4) an "overdraft" loan account which is a credit transaction subject to Truth in Lending. In addition some banks offer a credit card plan which can be integrated with both the checking account and the overdraft plan.

It is not difficult to imagine continued proliferation of still further "satellite" contracts evolving from the demand deposit core as increased electronic capabilities become operational. Automated tellers give rise to a further contractual modification of the checking relationship as will the

capability of telephone authorization and the use of point-of-sale terminals. As savings and other investment relationships are integrated, still further contracts will become involved. At some point banks will begin experimenting with master contracts which combine many of the separate relationships suggested here.

Truth in Lending offers a suitable model for EFTS relationships. In this regard it is worth noting that contractual content involves considerations far broader than legal enforceability. The reduction of terms and conditions to written form can serve a valuable communication role in fostering consumer awareness and understanding and minimizing unnecessary and time-consuming disputes. Such factors were a major force in giving rise to Truth in Lending and other disclosure-oriented legislation and are not likely to be absent with EFTS.

EFTS will benefit from a similar approach. In that credit capability promises to be a major component in an electronic system, Truth in Lending will continue to require precise contractual disclosure as to all credit features. As activity of government agencies such as the Federal Reserve Board begins to play an increasing role in the development of governing standards on behalf of the public interest, it seems logical if not imperative that methods be utilized to make knowledge of those standards readily available to the public in a meaningful fashion.

2. Stop Payment Orders. Section 4-403 confers a right on depositors to stop payment on an item any time before that item is paid. With a fully implemented electronic system, however, payment of an order against a balance may be virtually instantaneous thus rendering Section 4-403 inoperative by its own terms. But public acceptance of the existence of the right to stop payment may be sufficiently strong to demand the continued maintenance of an equivalent right, perhaps one based on a fixed period of time. Depositor acceptance seems to have loomed large in the decision of the SCOPE project to provide a right of unqualified "adjustment" with respect to preauthorized debits within the earlier of either 45 days from the debit entry or 15 days from the sending of a statement covering the item.³ The SCOPE rules require a written order, however, while Section 4-403(2) allows an oral order to be binding for up to 14 days.

It is not difficult to visualize the creation of a "stop payment" equivalent for direct transfer orders based on the SCOPE model. Admittedly the SCOPE rules apply only to pre-authorized debits. In the case of direct transfers, however, a fixed period of time, e.g., three business days, could be recognized in which the depositor could unequivocally revoke the transfer order. Revoked items would then be returned against the account of the person to whom the order was payable. Consumers, therefore, would retain capabilities presently enjoyed with checking accounts. And

³Homrighausen *supra* note 1.

depository institutions would be free and clear of any disputes between depositors and merchants, much like the situation where the holder in due course and other defense insulating devices are denied in bank-card transactions.

3. Verification of Paid Items. Section 4-406 of the UCC confers a duty on depositors to examine periodic statements and retained items for unauthorized signatures and alterations. The duty is essentially an obligation to act timely to preserve bank liability for improper payment of an unauthorized or altered item under Section 4-401. Implicit in this provision is a duty on the bank's part to provide both a statement and the paid items. In addition, there is support in the common law for the depositor's right to possession of paid items.

Direct electronic transfer will not give rise to a cancelled or paid item which could be returned. It would seem, however, that the spirit of this provision is easily complied with although not the letter. If banks are to remain strictly accountable for unauthorized charges, a need will continue to exist for the provision of sufficient information for depositors to verify charges. Integration of checking, saving and credit accounts will tend to strengthen this need. In addition, there will be a continued demand for documentation for the general purposes of evidence of payment and general record keeping. Properly designed, a computer printout or similar form of communication could provide information equivalent to that of a cancelled check — date, amount, payee, and perhaps, mode of authentication — which together with the standard periodic statement would fulfill the purposes of both 4-406 and the common law.

The major issue here may not be that of the mechanics of payment verification. Of more far-reaching significance, in my opinion, is the underlying problem of security against unauthorized use, i.e., a viable alternative to personal signatures which will be discussed below.

4. Unauthorized Use. A simple but major problem with a fully electronic system lies with uncertainty over the adequacy of security measures available to prevent unauthorized use. As indicated, Section 4-401 of the UCC allows a bank to charge an account only to the extent an item is "properly payable," i.e., authorized and in the exact amount authorized. Under this section, payment of a virtually undetectable forgery or alteration is still an improper payment which until discovered by the depositor could lead to wrongful dishonor of properly payable items. As already discussed, the basic mechanism provided for detection or improper items is the bank's duty under Section 4-406 to provide both a statement and the paid items and the depositor's corresponding duty to report inaccuracies/discrepancies reasonably soon.

Perpetuation of these existing rights and responsibilities will not alone resolve the public concern for better controls over unauthorized use of devices such as a plastic card which may become the activating mechanism for automated tellers and point-of-sale terminals. Central to the Article 4

scheme is the notion of a unique signature as reliable authentication. Signatures cannot be stolen, however, nor mislaid by the depositor's negligence as can occur with a plastic card or other physical device. Thus, it is entirely possible that the existing provisions of Article 4 would not be construed to be available to protect a hapless depositor against unauthorized items which arose because of his own negligence in losing his wallet.

Here again an adequate analogy can be drawn from the law which has developed in credit transactions. As the use of credit coins, cards and other devices grew, creditors began inserting clauses in their contracts holding the consumer accountable for unauthorized use of the device. Courts honored these provisions despite the presence of an unauthorized signature on the paper evidencing the indebtedness. In addition, theories of negligence were accepted which served as a bar to a consumer complaining of unauthorized use.⁴ The problem continued to grow along with the expansion of the use of credit until Congress in 1970 amended the Truth in Lending Act to provide a maximum of \$50 liability for unauthorized use of credit cards. But even this limited liability exists only if the card issuer provides a means for identification and (1) gives adequate notice of the potential liability, (2) provides the consumer with a self addressed, prestamped notification for mailing in the event of loss or theft, and (3) the unauthorized use occurs before notification is provided by the cardholder.⁵

The potential \$50 liability provides an incentive to the consumer to safeguard the credit card. And the prescribed conditions provide adequate notice and the opportunity for the diligent to prevent any liability whatsoever. At the same time creditor exposure to all potential risks in excess of \$50 provides an incentive to develop more secure techniques surrounding honoring of the card.

A similar approach might be feasible for an electronic system by a device such as a plastic card, to cover situations of depositor negligence not protected by Article 4 until a technology can be identified which can further minimize if not eliminate the risks of unauthorized use. To the extent that the same device also serves as a credit vehicle it could easily be held subject to the Federal provisions for all purposes.

III. ELECTRONIC CREDIT

The combined cash/credit capability of EFTS invites close scrutiny of our present system for problems which will plague consumers in the future. The rapid development of bank credit cards offers a prototype for

⁴Cousins, Kelley, Imperato & Reinthaler, *supra* note 1 at 1178-1186.

⁵15 U.S.C. § 1633 (Supp. 1974).

an electronic system which is well worth studying. To a large extent electronic capabilities appear more likely to aggravate existing problems than to produce new ones. Some of these problems, however, are already the subject of legislative proposals.

A. Periodic Billing. There is considerable concern at the present time about problems encountered in the billing of "open-end" credit accounts. This concern is often expressed in terms of problems with "computer errors." The more specific claims assert the debiting of unknown or unfulfilled transactions, late crediting of payments and other credits, and erroneous computation of periodic balances and related finance charges. Also expressed are frustrations experienced in identifying transactions attributed to the account and in attempting to communicate with creditors about these and other problems.

Concern of this nature has given rise to corrective legislation recently in at least New York and Massachusetts. In addition, a Federal bill, named the Fair Credit Billing Act, incorporates similar but more far reaching standards. The bill was passed by the United States Senate in 1973 and again in 1974, S. 2101⁶ being the more recent version.

Legislation of this kind is relevant to EFTS in two respects: (1) in its applicability to the kind of credit arrangement most likely to be integrated with an electronic payments system; and, (2) in the precedent which may be established for similar concerns which may arise from the payments aspects of an electronic system. And while S. 2101 has yet to be passed by the House of Representatives, its provisions are sufficiently comprehensive to be considered a realistic measure of the kind of legislation which may be expected in the near future.

The concepts embodied in S. 2101 are fairly simple. At the heart of the bill is the creation of what may fairly be described as a communication flow between the parties. Under Section 161 creditors must, in response to a writing claiming a billing error, (1) acknowledge receipt of the writing within 30 days, and (2) within a specified subsequent period of time, either make appropriate corrections or forward an explanation of the creditor's belief in the accuracy of the matter in question. In either case the creditor must provide documentary support of the indebtedness in question if requested. During the time involved in this exchange, creditors are prohibited from attempting to collect the amount in question and, under Section 162, from reporting that amount as a delinquent indebtedness to a third party (e.g., a credit bureau). These prohibitions do not apply to indebtedness which is not subject to the inquiry or dispute.

⁶S. 2101 was incorporated into H.R. 11,221 (Depository Institutions Act of 1974) as a result of a House-Senate Conference Report accepted by voice vote in the House on October 9, 1974 and the Senate on October 10, 1974.

Section 104 of S. 2101 requires notice of these conditions to be provided consumers twice annually at appropriate intervals, in a form to be prescribed by the Federal Reserve Board. The chief enforcement mechanism provided is a denial to non-complying creditors of the right to collect disputed amounts. Other sections in the bill require prompt posting of credits to the account (payments, returns and other debt forgiveness) and, in the event of overpayment, either prompt credit or refund, as requested.

A recurring billing complaint not directly cured by S. 2101 is the inability to identify transactions specified in periodic statements. In recent years many creditors have abandoned their practice of accompanying the billing with supporting copies of sales slips and resorted to descriptive billing by computer printout. Section 226.7(b)(2) of the Federal Reserve Board's Truth in Lending Regulation Z [12 C.F.R. § 226.7(b)(2) (1974)] sanctions this practice by requiring statements to reflect only the amount and date of credit extension and "unless previously furnished, a brief identification of any goods or services purchased in other extensions of credit." A notation of this provision specifies that the "[i]dentification may be made on an accompanying slip or by symbol relating to an identification list printed on the statement." And subsequent official interpretations by the Board's staff have clarified that the provision of a sales slip at the point of sale is sufficient to meet this requirement where the periodic statement reflects only the date, amount and store or department name or code number and, of interest to EFTS, that an otherwise adequate periodic credit statement can be combined with another statement such as that associated with a regular checking account.

The problem articulated by consumers, however, is that the identification provided is too brief, if not altogether cryptic, considering the elapsed time between transactions and billing, a period which frequently exceeds normal monthly billing cycles where the creditor is an entity other than the merchant. Under EFTS the elapsed time should rarely exceed a monthly cycle. It may be, however, that any system which separates transactions from the actual billing procedure by even a few days will continue to generate confusion among a significant portion of the public, particularly as electronic capabilities assume increasing numbers of transactions. Creditor experience in conforming to standards such as those described in S. 2101 may provide some answers. The lesson, if any, for EFTS appears to lie with the development of improved descriptive techniques.

Significant here are the divergent patterns assumed by checking and credit systems. As noted earlier, the law and custom with respect to checking have been to provide the customer with receipts (i.e., the cancelled checks) subsequent to the transaction at the time of the accounting statement, an impossibility with electronic payments. Credit practices, however, sanctioned by law, rely on receipts being provided at the point of transaction. Since EFTS promises both credit and direct payment capabilities, a necessary accommodation will have to be reached in emerging

legal standards. Preserving the benefits of both systems would be most desirable with adequate documentation being provided at the point of transaction and again by printout at the time of the statement.

B. Record Keeping. A related point arises in connection with the need for institutions to maintain and preserve internal records of transactions. The requirement in S. 2101 that creditors provide complaining consumers with necessary documentation of questioned transactions is grounded upon an existing Truth in Lending requirement that all such records be kept for a minimum of two years. Evidentiary considerations further dictate that documents evidencing obligations be preserved at least until the indebtedness is satisfied. No such comparable requirement exists under UCC Article 4 with respect to checks although banking custom has long observed the practice of microfilming checks and preserving copies for extended periods.

Under regulations promulgated by the Secretary of the Treasury pursuant to the Federal 1970 Bank Secrecy Act, all checks in excess of \$100.00 must be microfilmed and preserved for at least six years.⁷ This obligation is created for purposes of official government access. The issue raised here is customer access to reliable documentation for purposes such as proof of payment. The need is for alternative documentation in lieu of sales slips, cancelled checks and other original memoranda which become lost or mislaid. As EFTS evolves and paper documentation decreases, dependence on an alternative preservation system could well increase. Current legal evidentiary standards are already flexible enough to accommodate computer printouts and facsimile reproductions.⁸ What remains for EFTS is the establishment of (1) a minimally acceptable period of time in which tapes should be stored (perhaps the generally accepted six year limitations period for commercial transactions), and (2) the conditions under which access to such tapes should be granted.

C. Access to Credit. As a general rule, our law does not recognize a right to credit. Thus, no duty exists on the part of creditors to extend credit to a customer deemed unsatisfactory. Traditionally, our system has relied on independent business judgments and the interplay of the free market to allocate payment services to the deserving. Concern for civil rights in the last decade has given rise to legislation which slightly alters this picture. Broadly based public accommodations acts have been interpreted to include credit granting services within their anti-discrimination

⁷12 U.S.C. §§ 1892b, 1892g, 1730d, 1953, and 1955. (Supp. 1974). The relevant regulations, 12 C.F.R. § 103.34(b)(3) (1973), were upheld by the U.S. Supreme Court in *California Banker's Association v. Shultz*, U.S., 42 U.S.L.W. 4481 (U.S. April 1, 1974)

⁸Atlanta Payments Project, Georgia Institute of Technology, *supra* note 1 at 35-37, 42-44; See also *Toward a Less-Check Society*, 47 *Notre Dame Law* 1163 at 1265-1283 (1972).

provisions.⁹ In the last two years credit has been a particular object of state legislation designed to prevent discrimination by reason of sex or marital status. S. 2101, described above in the context of credit billing, contains a separate Title (section 301 and 302) prohibiting sex or marital status discrimination in open-end credit. In addition, numerous other bills to the same effect are pending in the U.S. House and the Senate, most notably H.R. 14,856.

The thrust of all such legislation is to prohibit discrimination. Thus, the individual right created is not one of unqualified broad-based access. Rather, it is a right not to be discriminated against on the basis of sexual or racial or other credit-neutral status. Credit grantors complain, however, that the correlation between credit-worthiness and socio-economic status is sufficiently high as to cause serious problems in the honoring of anti-discrimination standards. In addition, sex or marital status prohibitions raise administrative problems with complex state property laws which attempt to allocate interests in family property among spouses.

This problem appears to be confined to credit. I am not aware of complaints or legislation directed against discrimination in access to checking or related-payment services.

Ideally, no business institution has an interest in discriminating against potential credit-worthy customers. The problem in credit granting arises with uncertainty of adequate criteria which measure credit-worthiness, particularly for low-income persons who complain of being trapped in the stereotype of socio-economic classifications. For this reason the National Commission on Consumer Finance recommended government-sponsored experimental credit programs which will develop data not presently available. In this connection the computer capability of an electronic system to more sharply define and manage criteria of credit-worthiness may prove the means to effectively administer non-discriminating policies.

D. Preservation of Claims and Defenses. A key issue in credit regulation involves the ability of the consumer to preserve claims and defenses arising out of a sale transaction against both the seller and the financing agency which holds the credit obligation, the so-called holder in due course problem.

Historically, a financing institution which purchased seller paper was able to insulate itself from underlying claims and defenses by one of two foolproof methods. If the obligation involved was a negotiable instrument, typically a promissory note, the financial institution which accepted the paper without knowledge of any underlying defects took it as a "holder in due course." Under the law of negotiable instruments (UCC Sections 3-301 to 3-305) a holder in due course is legally insulated from any claims or defenses arising from the transaction underlying the indebtedness.

⁹See *e.g.*, *Local Finance Co. v. Mass. Comm. Against Discrimination*, 355 Mass. 10, 242 N.E. 2d 536 (1968) (interpreting Mass. Gen. Laws Ch. 272, § 92A).

If the obligation was contained in a contract (instead of a negotiable instrument), the same effect could be achieved by inserting a "waiver of defense" clause wherein the buyer acknowledged that the contract would be assigned and agreed to waive any claims or defenses against the subsequent holder. By either approach, financing institutions could legally demand full payment from the buyer even though the underlying transaction resulted in a complete failure.

Neither legal doctrine affects the consumer's right to hold the seller accountable for failures in the transaction. If the seller is available and economically healthy, the issue is primarily one of negotiation leverage. If the consumer has the right to withhold payments because of failed goods or services, the financial institution involved will either bring its pressure upon an otherwise uncooperative seller to make good on the deal or return the obligation to the seller thereby restoring the disputants to their original positions. If the seller is bankrupt, has skipped town, or is otherwise economically unable to perform, however, the holder in due course or waiver of defense clauses leaves the consumer to bear the entire loss. Viewed in this light, the issue is one of allocating risk of loss between the consumer and the financial institution holding the obligation.

In the last 20 years, both legal doctrines have been subject to considerable erosion. By a combination of court decisions and statutory reform, neither is available in most consumer credit transactions in a slight majority of the states today. Currently, the Federal Trade Commission is considering a proposal which would prohibit sellers from using forms evidencing consumer credit obligations which give rise to either doctrine.

Bank credit-card plans present an analogous situation which falls outside most reform legislation designed to restrict the insulating effect of holder in due course and waiver of defense clauses, notwithstanding the fact that banks end up holding seller-initiated obligations. Consequently, a few states have enacted corrective legislation which attempts to preserve consumer claims and defenses in open-end credit plans and other sales finance arrangements where a close connection exists between a seller and a lender.¹⁰ And Section 170 of Senate Bill S.2101 would achieve similar results for open-end credit plans as a matter of Federal law.

The corrective legislation described, particularly those statutes which are specifically directed towards open-end credit transactions, leave significant questions unanswered. The most critical problem arises from uncertainty as to the maximum exposure of liability for financial institutions holding seller-generated credit obligations. Possible alternatives are: (1) total liability, as where the financial institution assumes full responsibility

¹⁰Calif. Civ. Code § 1747.90; Maryland Ann. Code art. 58A, §24 (Small Loan Act only); Mass. Gen. Laws Ch. 255, § 12F; N.Y. Gen. Bus. Law art. 15, §§ 252-254; Ore. Laws, 1973 ch. 626, §§1-2 (credit cards excluded); Vt. Stat. Ann. Tit. 9, § 1305 (applicable to in state bank credit cards only); Wisc. Stats. § 422.408.

for the seller, up to and including claims beyond the total value of the transaction, as in the case of personal injuries sustained from defective goods; (2) liability up to the full amount of the transaction, including sums such as down payments which were retained by the seller before transfer; (3) liability up to the amount owing at the time the financial institution acquired the paper; or (4) liability up to the amount owing at the time there is notice of the consumer's problem.

I am inclined to view the first alternative as unrealistic in the sense that it would make financing institutions into insurers responsible for product liability usually restricted to sellers, manufacturers, and others who have direct control over design, maintenance, and distribution. The choice between the remaining three alternatives is largely dependent on one's orientation. I tend to prefer the second on the premise that the goal, in the event of total failure of the transaction, is to make the consumer whole. On the other hand, financial institutions feel strongly that they should bear no more responsibility than that which they can control after receiving notice of the existence of the dispute. The solution, if one can rationally be reached, may well turn on the ability of banks to recoup any losses from merchants participating in EFTS.

The issue of preserving consumer claims and defenses has arisen only in credit transactions. Checks and other drafts drawn against a deposit account are negotiable instruments and, as such, give rise to the doctrine of holder in due course. However, instruments such as these represent a single-payment obligation only and do not involve the future commitments to further payments as arise with credit obligations. Consequently, corrective legislation of the kind described does not apply to checks and other demand drafts either by definition or specific exclusion.

A practical reason why checks are not involved in the holder in due course issue lies with the capability of stopping payment on the check in the event of an immediate failure or other dissatisfaction with the transaction. In fact, an argument frequently advanced in favor of remedial legislation preserving claims and defenses is to give the consumer who buys on credit a payment withholding capacity similar to that of the check issuer.

This parallel is obviously limited by the time factor involved in stopping payment. The analogy is of interest, however, due to the possibility that similar consumer concern might develop under EFTS because of the existence of mixed cash-credit capabilities and the possible loss under an electronic system of the opportunity to stop payment on an electronic payment order. Preserving the right to stop payment by substituting a fixed period of time for cancellation of orders — a possibility suggested above — would maintain the status quo. The capability of directing payments orders to be posted against either an existing deposit balance or a pre-arranged line of credit will preserve the consumer's existing options to pay by check or credit thereby selecting the benefits accorded by protective legislation.

E. Maximum Finance Charges. The basic issue in credit regulation is that of maximum charges. As you know, the general rule around the country for open-end credit has been a maximum of 18 percent or 1.5 percent monthly. There are, of course, significant exceptions to this rule, notably 15 percent in Pennsylvania, 12 percent in Connecticut, Minnesota and Washington, and 10 percent in Arkansas. And there are still a few states without statutory rates which invite the risk of a usury decision requiring even lower rates.

Not surprisingly the question of which maximum rates should apply is the subject of much controversy. Consumer advocates urge reductions below the common 18 percent based on the experience of the lower rates in the states mentioned. On the other hand, major bank card organizations claim insufficient or non-existent profit opportunities at 18 percent. Banks in particular point to lower market penetrations for their cards in the below 18 percent states as proof of the non-profitability of the lower rates. Significantly, increased computerization of open-end credit systems has not yet produced the cost savings which justify a competitive lowering of finance-charge rates.

Much has been written on the rate question and its interdependence on credit availability. Suffice it to say that much misunderstanding remains and that little progress is likely to be achieved until more hard data are available for public consumption. One solution being currently debated involves adoption of the public utility model through creation of a rate-setting body. In that EFTS is already permeated with questions of susceptibility to public utility treatment, it seems logical to raise the credit finance charge question to that same level as a possibly rational solution to a highly emotional problem. The broader issue is whether these questions should be raised at the Federal level or remain the province of 50 state legislatures.

IV. FEDERAL REGULATION OF EFTS?

Thus far in this paper I have pinpointed some but hardly all of the transactional problems which an electronic funds system might raise for the consuming public. Traditionally, despite the proliferation of Federal regulatory agencies in the last two generations, the responsibility for developing substantive standards for checking and credit has lain with the states. The enactment by Congress in 1968 of Truth in Lending was the first major exception to this general rule. Subsequently, Congress has enacted provisions on unsolicited credit cards and liability for unauthorized use of credit cards and the Fair Credit Reporting Act and is now considering legislation on credit billing errors and sex discrimination. In addition, Senator Proxmire who chairs the Consumer Credit Subcommittee of the Senate Banking Committee, and Congresswoman Sullivan, who chairs the Consumer Affairs Subcommittee of the House Banking Committee, have both made public speeches this year announcing their respective intentions to introduce more comprehensive Federal legislation on credit problems.

Thus far, neither bill has been filed. It does seem, however, that the drive for more comprehensive Federal regulation of consumer credit is remarkably coincident with electronic developments which are highly credit-related. The role of credit in our current battle with inflation is also under serious Federal scrutiny as well as proposals for implementation of the Hunt Commission's recommendations to restructure financial institutions. Thus, several major but divergent forces are converging in Washington with a coincidence of timing which suggests a role for Federal involvement in the regulation of day-to-day transactions which is unparalleled in our nation's history.

I do not mean to suggest that substantive Federal controls over electronic checking and credit are the only solution to the consumer problems discussed. It does appear, however, that the highly intricate national and international computer hookups and switching mechanisms inherent in a fully implemented electronic payments system require a degree of capital investment which could be easily frustrated by the enactment of varying standards by 50 different legislatures and court systems. Our payments system has always been characterized by a matrix of legal standards which offer the precision, clarity, and certainty needed for faith and confidence in the system. Neither the introduction of computer technology nor the demand for greater consumer protection alters that need. It is entirely possible, therefore, that EFTS raises far broader questions for our Federal system than the narrow issue raised by the Federal Reserve Board's current proposal to amend Regulation J.

Discussion

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The payments mechanism is the method or procedure, together with necessary supporting mechanics, that is employed to consummate simple economic transactions between creditors and debtors. Put the payments mechanism on a continuum. The method varies from time to time; the continuum can begin with whatever historical method we choose. To start it with the payments system that made use of large, smooth stones would be fanciful, but it makes the point that the methods used were characterized by and have depended upon the mechanics existing at the time. The methods have evolved by responding to the need for improved and faster methods, taking advantage of supporting mechanics available at the time.

The payments mechanisms set out on the continuum, started at whatever point in time congenial to the reader, will show that the barter system, coins and currency, and checks have each been used as a method of consummating business transactions. The continuum will end, in 1974, by a reference to something that is called EFTS. This acronym is used as shorthand to describe the method of consummating the debtor-creditor transactions by making use of a communication system that uses a technology based on electronics.

Whatever the range, whatever the complexity of the payments continuum, it should be clear that the method used at any one time is nothing more than a method, a tool, a means to an end. Its purpose, its *raison d'être*, is to enable me, and the society in which I operate, to accomplish an economic purpose. If, either upon initial inspection or after a period of use, the method is perceived by the society as not as "good" or not as "efficient" as one or more alternative methods, then the society will not use the method in question.

Because the payment system employed at any time is a method, a means to an end, it is necessarily and quite properly on trial every day of its life. Consider it from two points of view. Is it still the most efficient, the fastest way to get the job done? The stage coach flunked that test.

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Likewise, the barter system. The private automobile for some time now has been generally regarded as the best answer to the task of moving me from point A to point B. Likewise, the check on the payments system continuum. But the times, they are a changing. Consider another point of view. Is the automobile quite as "good" as first perceived? Does its unfettered use in its current mode begin to raise questions about where it fits into the society's value system? Not monetary values, but such things as clean air, open space, and quiet. Such questions have been raised, and such questions will perforce be answered. The struggle to find the best answers is proving to be difficult, and brings into question our table of values.

Is this new payments system, this method called EFTS, as good as advertised? From the first point of view, there is little doubt that it does the job faster, more efficiently than the method using paper checks. Taking that as given, what about the other point of view? Where does EFTS fit into the table of values of the society? Is it an unmixed blessing? Can we in good conscience and with confidence in a benign result leave this new method and its final configuration and ultimate impact in the hands of the technicians? It is most likely that the people possessed of the requisite skills are capable of providing us with a very, very efficient method, a system that will be guaranteed to get the economic job done most efficiently.

It is the thesis of this paper that we cannot in good conscience leave the matter entirely to the technicians. This thesis is inescapable if we adopt the second point of view. Remember — we are talking about a method, a tool, a means to an end. As such, it is incumbent upon society to measure the method by a means-end rationale. Is the method, the means, likely to impinge upon any of society's ends, upon its value system? If an impact is foreseen, is that impact likely to be entirely favorable and benign, or perhaps tinged with unfavorable and undesirable results?

It is beyond dispute that the new method is going to have an impact upon the society, and it is submitted that the impact will be felt at different levels and to the point where our table of values will be affected.

Witness the consumer transactional questions and concerns raised and explored by Messrs. Shick and Schuck, and the other issues raised during this conference. How, for example, to allocate the risks and share the burdens when dealing with the range of questions sometimes called transactional in nature. Questions dealing with rescission of the underlying sales contract, the holder in due course doctrine, to name only a couple. What, for example, will be the effect on the postal service if a large proportion of the paper checks now being sent via the mail system are converted to the electronic mode?

These are important questions. Their clear enunciation and their resolution congenial to a large majority of consumers will involve the traditional process of negotiation, debate and compromise, with the reasonable expectation that the interested parties, including the consumer, will be able to agree that the new method provides benefits that outweigh the

perceived disadvantages. The consensus reached will not, on the one hand, produce such dysfunctions in the new method as to seriously diminish its efficiency, and it will not, on the other hand, leave the consumer so disaffected that he will not use the new method. It can be expected that, at this level, the consumer will be left with a general feeling of satisfaction regarding the new method.

The next level, for the purpose of measuring the impact of the new method, is expressed in terms of choice. The consumer is comfortable with coin and currency, as well as with checks. He likes each of them, and has become so familiar with them that he has learned how to obtain the maximum benefits from them. (It may be pointed out to the consumer that any free or subsidized method such as checks will be over-used and that such excessive use may have an adverse effect upon the check method. It is most likely that the consumer will grant the point made by the economist — and continue to make profligate use of the method.) Does EFTS give the consumer greater benefits? Perhaps. Who says so? Let us put all the cards on the table so we can make an informed choice. No hidden costs, no slick advertising campaigns. Do not remove coin and currency and checks as on-going alternatives to the new method. The consumer may well decide to use each of the three methods, moving among coin and currency, checks, and the electronic mode, as the need or even the mood of the moment dictates. Whatever blend he is comfortable with, whatever mixture fits into his life style; the consumers will insist upon their ability to make such choices.

As with the class of questions described above as transactional in nature, resolution of the considerations involved in making a choice among methods will not present the architects and the builders of EFTS with insurmountable problems. They may find it necessary or politic to make changes in what appears to them to be the ideal model, but an efficient and viable model will be made available to the consumer for his potential use.

The third and last level upon which the new method will be measured is concerned with privacy, one of a class of values that the society holds most dear. This class of values is the foundation that supports the society in its present form. It is submitted that if a society has such a class of values, and as long as it has them, then everything else must be made to conform to them. Certainly, the devices, tools, methods, procedures that may well bring many benefits to the society in the form of a new payment are subservient to that class of values. Subservient to the point that if the new method was generally seen as having an undesirable effect upon any one of the values in that class, the society would be moved to dismantle the new method. Efficiency and ease of economic transactions — nice to have, but not if such acknowledged benefits lead us down the path where members of the society can be seen and can be dealt with as objects.

Privacy has been defined as that aspect of the social order by which people control access to information about themselves.

Presently available technology has great capacity for gathering information, storing it, retrieving it, publishing it. Information about almost any subject. Information about individuals. That technical capacity is so great and is so pervasive that it threatens the value of privacy. It is not easy to control information about oneself under such a circumstance. The battle to preserve that value has been joined in other arenas, with different factors and perspectives at play. Must privacy be held as an absolute, and as an indivisible absolute? Or can it be bargained away in bits and pieces? Those are very old questions. The answers are not all in. It is submitted, however, that if discussion is limited to a new method of making payments, the consumer will not permit such a means to a lesser end to impinge adversely upon his value of privacy. The consumer will want to control the gathering of information about himself and the access to that information. He will want to know how such information is being stored, how long, who has access to it. He will insist upon his right to review it and to challenge and correct any errors. He will want to know just what use that information is going to serve.

If the consumer is not content with the answers he obtains to such questions, he will tell the architects and builders of the new method that it is unacceptable. The cost is too high. And that reaction will be forthcoming even in the face of protestations that such an attitude from the consumer will dismantle, eviscerate and otherwise ruin the new system. The consumer, probably unsure of which payment system he prefers, will move to a new one only if the trade-off leaves him feeling comfortable, only if his life style is not changed very much. The consumer has recently become increasingly aware of his right of privacy. He realizes that it is not an absolute. He is willing to sell certain information, sometimes very sensitive information about himself, to gain a benefit. Witness the parents that submit confidential financial statements in support of a college scholarship application. It is submitted that the consumer will be less willing to reveal such information, less willing to lose control over such information, for the sake of moving to the next set of tools being designed to do a job now being done by methods that do not threaten any of his values. Whatever the final configuration of EFTS, it will have to be perceived by the consumer as compatible with the value of privacy.