AN INTRODUCTION TO THE UNIFORM NEW PAYMENTS CODE

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In 1977, the Permanent Editorial Board of the Uniform Commercial Code (PEB) created the “3-4-8” Committee to evaluate whether the fact that the Uniform Commercial Code (UCC) did not cover electronic funds transfer transactions could create a serious problem in our legal system. The PEB is an organization jointly sponsored by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. The 3-4-8 Committee is well balanced. It is composed of academics and lawyers experienced in the field of commercial law, including those who have represented consumer groups. Federal Reserve Board staff have attended the meetings of the Committee on an exofficio basis. In February of 1978, Professor Hal S. Scott, the Committee’s Reporter submitted a “Report to the 3-4-8 Committee” concluding that existing Articles 3 and 4 of the UCC needed to be amended or replaced in order to establish a legal framework for all payment systems except for cash. The guiding philosophy of such an effort, as put forward by the Report, was that the new legal framework should not distort user choices among different payment systems, whether they be paper or card based, or electronic. This was to be accomplished by having the same legal consequences attach to all kinds of transactions, where technology and the nature of the transaction permitted.

In the spring of 1978, this Report became a discussion paper for a public invitational meeting in Williamsburg, Virginia, of bankers, lawyers, academics, consumer advocates, and state and federal regulators. While divergent opinions about the need and feasibility of a “New Payments Code” were expressed, the consensus was that there was little to lose and perhaps a lot to be gained from exploring whether such a Code could be drafted. Following the meeting, the PEB charged the 3-4-8 Committee with drafting an outline of the Code.

In connection with the development of the outline, Peter L. Murray prepared a report based on case research and meetings with lawyers across the country about what changes in check law needed to be made. As

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work on the outline progressed between 1978-81, it became clear that no meaningful assessment of the feasibility of the Code could be made without drafting actual language, so the "outline" became a Discussion Draft. Between 1978 and 1981 the Reporters prepared and the Committee considered a number of Discussion Drafts. Based upon a Committee meeting which considered Discussion Draft #5, on December 19-20, 1980, the 3-4-8 Committee decided to recommend to the PEB that the drafting effort proceed, because of the Committee's confidence in the conceptual feasibility of the Code based on efforts to that date. Discussion Draft #6 was submitted to the PEB in support of such recommendation. The PEB, at a meeting held on March 20, 1981, agreed with this recommendation.

On May 15-16, 1982, the 3-4-8 Committee recommended to the PEB that its latest draft, P.E.B. Draft #2, be submitted at the August meeting of the National Conference of Commissioners on Uniform State Law for an introductory reading and that it be made generally available to interested parties for consideration and comment. This recommendation was accepted. Two American Bar Association committees are actively reviewing the drafts of the new Code: the Uniform Commercial Code Committee, chaired by William Davenport of Chicago, and the Consumer Financial Services Committee, chaired by Carl Felsenfeld of New York. In addition, committees of the New York Clearing House Association and Federal Reserve Banks, as well as other interested parties, have reviewed and commented on drafts.

On July 26, P.E.B. Draft #3 of the Uniform New Payments Code (NPC) will be presented to the Commissioners for a first reading. The Commissioners require two readings, and the American Law Institute one reading, before an Official Draft is approve and promulgated.

The balance of this memorandum is organized in three parts: (1) an overview of the provisions of P.E.B. Draft #3; (2) general issues raised by the approach taken; and (3) issues raised by particular substantive provisions.

I. OVERVIEW OF DRAFT

A. Structure and General Provisions

The Code is organized into ten parts: (1) General Provisions (Part A); (2) Definitions (Part B); (3) Authorized Orders (Part C); (4) Unauthorized Orders (Part D); (5) Procedures for Resolution of Error (Part E); (6) Provisional and Final Payment of Orders (Part F); (7) Records and Evidence (Part G); (8) Agency and Authorization (Part H); (9) Disclosure (Part I); and (10) Miscellaneous (Part J).

Section 2, "Applicability of the Code," sets out the scope of the Code. It provides that the Code "applies to any orders payable by or at, or trans-
mitated by or to an account institution.” The definitions of “order” and “account institution” are discussed below. Certain “negotiable instruments” now covered by Article 3 will not be orders within this Code, e.g. promissory notes. See §10(5), and Article 3 will continue to deal with such instruments. On the other hand, orders, within the scope of the NPC, such as checks and drafts, will not be within the scope of Article 3. It is expected that NPC will replace Article 4 entirely. Article 4 covers “items,” and that term includes “non-cash” instruments such as promissory notes. If it is determined that Article 4 is necessary today for the collection of non-cash items, appropriate provisions of the NPC, derived from Article 4, will be made applicable to such items. In addition, NPC would replace the Electronic Funds Transfer Act (EFTA) and parts of the Truth-in-Lending Act (TILA), two federal statutes which deal with consumer rights in retail payment systems. This raises the question of the relationship of the NPC to federal law, a matter discussed in II B of this memorandum.

Section 3 of the NPC provides for “Variation by Agreement.” The effect of any provision of the Code can be varied by agreement of parties other than consumers, subject to the prohibition of disclaiming responsibility for exercising ordinary care, but only the effect of a few provisions can be varied by agreement with consumers. Certain specified rules, those pertaining to Article 4 type matters, e.g. §§400-423, can be varied without agreement of all the parties affected, through Federal Reserve regulation, clearing house rules and the like.

Section 4 of the Code defines a separate office of an account institution for the purpose of computing the deadline for taking action on orders. It works in conjunction with §413(11) to resolve when an order is presented on a particular account institution so as to trigger the running of the midnight deadline, a matter of some confusion under UCC case law.

Section 5 is an indexing provision. Certain parts of the Code (§§200, 302, 422, 425 and 800) contain dollar amounts. This section will periodically increase these amounts if there is an increase in inflation as measured by the implicit price deflator for the gross national product.

B. Definitions

Subpart 1 of Part B, “Definitions,” contains an extensive definition of the term “order” which is critical because the Code only applies to orders. An “order” is defined in §10(1) as a “complete and unconditional direction by a person to pay (a) a sum certain in money; (b) from an account which may be accessed to pay a person other than the drawer or the drawee; (c) to take place immediately or at a definite time; (d) to or for the benefit of a specific payee, which may be the drawer, or bearer; and (f) identifying the drawer and if it is a written draw order [check], signed by the drawer.” This definition defines the scope of the Code in much the same manner as the definition of a “negotiable instrument”, UCC
I-IAL 3-104(1), and "item", UCC 4-104(1) (g), currently define the scope of Articles 3 and 4 of the UCC, or the definition of "electronic funds transfer" EFTA §903(6), currently defines the scope of the EFTA and Regulation E of the Federal Reserve Board which implements that Act. The definition of order, is broad enough to cover all systems of payment except cash, if the order meets the basic requirements, e.g. is for a sum certain in money.

The definition of order does not include a two-party charge card which can only be used to pay the merchant card issuer, NPC §10 (1) (b), since the account accessed by a two-party card card only be used to pay the drawee (card issuer). The exclusion applies whether or not the card accesses a credit line or cash balance. If, of course, the card is used to pay a third party, e.g. a Sears card is used to pay Merrill Lynch, this is an "order" within the Code since the account at Sears can be used to pay parties other than the drawee or drawer (card holder). A check payable to a drawee, as in repayment of a loan, is covered since it accesses a demand deposit account which can be used to pay third parties.

The NPC deals with orders which access an "account." An account is defined in §50(1) as "a liability in money, credit extended or interest in assets on which orders may be drawn or to which orders may be credited." A check or wire drawn on a mutual fund for $1000 is an order drawn on an account since the shareholder has an "interest in assets." Similarly, a check or wire drawn on a line-of-credit account of a finance company is an order, since the borrower holds an account of "credit extended." If a department store offers third party payment services, whether based on credit extended or cash balances, accounts would also be involved. An account institution, §53(1), is "any person which in the ordinary course of its business maintains accounts for its customers." Aside from including depository institutions, like banks, savings and loan associations or credit unions, which maintain accounts representing "a liability in money," this definition could also cover mutual funds, finance companies and department stores, among others.

The definitions, see §51(1), (2), refer to two basic types of orders, a "draw order" and a "pay order", which are dealt with differently by many provisions of the Code. An index, Comment 4 to Section 51, sets out these special provisions. A draw order is "an order initiated by the drawer and transmitted to the payee, if any, or initiated on behalf of the drawer by the payee and transmitted to an account institution directing the drawee to pay the payee, or bearer or to accept and includes an order to pay to the drawer or the person authorized to draw on its behalf." An automated clearing house (ACH) debit would be a draw order initiated by the payee; a check would be a written draw order initiated by the drawer. The draw order pulls funds back from the payor account institution to the account institution of first deposit for the benefit of the depositor. Draw orders are subdivided into two kinds, written and non-written. A
"written draw order" is "a written order and includes a 'check' and a 'draft'." §51(6). A "written order" is paper based, and is defined as "an order which when drawn has its terms in writing on paper or a similar tangible substance in legible and readily understandable alpha-numeric characters, as long as it is transmitted in written form." §51(5). A paper check would be a written draw order as long as it is transmitted in paper form. If the check were truncated, e.g. the paper check kept at the bank of deposit and the information on the check further transmitted in electronic form, the check would cease to be a written draw order once truncation occurred. Again, specific provisions of NPC apply only to written or non-written draw orders.

A "pay order" is "an order, initiated and transmitted by the drawer to the drawee directing the drawee to pay or to effect payment to the payee either directly or through transmitting or settling account institutions and includes a 'wire transfer'". A postal GIRO order would be a written pay order; a wire transfer initiated at a corporate terminal would be a non-written pay order. The pay order pushes funds from the drawee (payor account institution) to the account institution holding the payee's account.

Both pay and draw orders can be arranged in advance. These are "prearranged orders", §51(4), such as ACH transactions. A prearranged draw order, such as an ACH debit, is "initiated and transmitted by the payee [e.g. utility company] pursuant to advance instructions of the drawer [e.g. bill payor]." A prearranged pay order, such as an ACH credit, is "initiated and transmitted by the drawer [e.g. employer] pursuant to advance notification given to the payee [e.g. employee]." Again, specific provisions of the NPC deal only with prearranged orders.

Section 52 defines the basic parties to different kinds of orders. Certain parties are defined in connection with all orders, e.g. drawer, drawee and payee. Others are only parties to draw orders, transferor and transferee, or to pay orders, funds transferee and funds transferor. Finally there is a key definition of "funds claimant," the NPC counterpart to "holder", UCC 1-201(20), which applies differently to different kinds of orders.

The definitions applicable to all orders are relatively straightforward. A "drawer" is generally the person who initiates an order and whose account is to be debited on the order. §52(4). An account institution which initiates and transmits an order in satisfaction of its own underlying obligation, or a draw order for another person (a remittance), can be a drawer. §52(4) (a). The bill payor on a prearranged draw order, e.g. ACH debit, is also a drawer. The drawee is a "person who is directed by an order to make payment, including a payor account institution." §52(5). A "payor account institution" is an "account institution which maintains the account directed to be debited by the drawer of an order." §53(1). The payee is the person "specified by the drawer as the beneficiary of an order". §52(6).

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There is also a special definition of "consumer drawer", which is relevant to several provisions of the Code applicable to consumers: §3 (ability to vary affect of Code by agreement); §101(2) (b) (drawer recovery of consequential damages from payor account institution for wrongful dishonor); §103(3) (prohibition on assertion of due-course rights against drawer); §425(2) (drawer's right to reverse payment of certain orders); §§500-507, (drawer's right to periodic statements and receipts); §§700-702 (disclosure requirements); §800 (liability of account institutions for violation of periodic statement, receipt, error resolution and disclosure provisions); and §802 (regulatory authority under periodic statement, receipt and disclosure provisions).

Section 52(1) defines the term "consumer drawer" as "an individual who is authorized to initiate orders against a consumer account." Section 50(12) defines a "consumer account" as one established "in the name of one or more individuals unless such individuals have represented in writing to the account institution that the account is not to be used primarily for personal, family or household purposes." See also §800(4) (civil liability of account institution advising individual to make a false representation about use of an account).

The terms "transferor," §52(7), and "transferee," §52(8) apply only to draw orders. The transferor is an endorser and the transferee is an endorsee. Section 55 defines endorsements of various kinds. A draw order is generally endorsed by transmittal "to another person in a manner which indicates that the person is entitled to receive payment on the order." §55(1). In the case of a written draw order payable to a specific person, endorsement must be by signature. §55(2). Generally a transferor of a written draw order can only incur endorser type liability if its signature appears on the order. See §§54(1) (b), (6); 102. This statement must be qualified for cases of transferor negligence, see §206. Further, any party who transmits an order, whether or not endorsed, makes certain warranties. §111.

The terms "funds transferor" and "funds transferee" apply only to pay orders. A funds transferor, such as the payor account institution, or a correspondent bank on a wire, is "any person other than the drawer or payee who is directed to pay or effect payment on a pay order to the payee and gives money or a credit to an account withdrawable as of right on such pay order." §52(10). A funds transferee is "any person, other than the drawer, payee or drawee, who receives on a pay order money or a credit to an account withdrawable as of right." The definitions of parties to pay orders focus on the flow of funds rather than the order, because the giving or receipt of value is crucial to defining rights and responsibilities. This focus on the flow of funds differs from the case of raw orders where parties are defined in terms of the movement of the order, i.e. the endorser transfers an order received by the endorsee whereas the funds transferor transfers funds received by the funds transferee.
The term “funds claimant,” §52(11), specifies the party who is entitled, in a variety of situations, to make a claim for payment based on an order. It is necessary to satisfy two general conditions to become a funds claimant. First, the person must become a payee, transferee or funds transferor on the order “at a time when the order is authorized.” §52(11) (a). While this memorandum defers until later discussion of the distinction between authorized and unauthorized orders, the general idea is that once an order is diverted to a wrong party, and thereby becomes unauthorized, no person becoming a party to the order after such diversion can be a funds claimant. This corresponds to the UCC notion that one cannot be a holder from a thief, at least on order paper. See 1-201(20); 3-202(1). Second, the person must not have been paid or must have reimbursed an unpaid party at the time it seeks to enforce its rights. §52(11) (b).

Additional requirements must be met in the case of written draw orders, depending on whether the order has been dishonored. If the order has not been dishonored, e.g. it is in the process of collection, see §52(c) (i), the funds claimant is the payee or last transferee to whom the order was delivered. Delivery is thus essential to “holder” type status under the NPC, which follows UCC 3-202(1). Delivery is defined as “any voluntary transfer of possession.” §50(22). In addition, the person must generally be in good faith possession of the order, again following the UCC, 1-201 (20). The possession requirement may be dispensed with, however, if the order has been lost or stolen or is otherwise unavailable for production. See NPC, §510. If the order has been dishonored, see §52(c) (ii), the funds claimant is the payee or earliest transferee (earliest with respect to time of endorsement) to have been given notice of dishonor.

On pay orders, aside from meeting the two general requirements, the funds claimant must be the specified payee or funds transferor and must have notice of the order prior to any revocation of the order by the drawer. If a receiving bank on a wire is not paid, and charges back any provisional credit given to the payee, the payee with notice will be the funds claimant. If the receiving bank cannot charge back, or chooses not to, it will be the funds claimant, since it meets the two general conditions—it is a funds transferor (to the payee) and has not received funds.

Section 53 contains definitions of “Parties Which Transmit Orders.” Most obligations under the Code are imposed on “account institutions,” §§53(1). The “payor account institution,” is the account institution which maintains the drawer’s account.

Sections 53(2) and (5), respectively, define two other important terms: “transmitting account institution” and “transmittor.” A transmitting account institution is “any account institution transmitting an order except the drawer or a payor account institution,” and a transmittor is “any person which transmits or processes an order.” Any transmitting account institution is a transmittor, but not all transmittors, e.g. a check courier or electronic switch, are transmitting account institutions, due to the lack.
of an account relationship. Some provisions of the Code, e.g. §204(2) (transmission liability), §412 (methods of transmitting orders), apply to the more general category of transmitters.

As already indicated, Part C of the Code deals with "authorized orders," basically those orders on or respect to which no fraud or mistake has occurred, while Part D deals with unauthorized orders. Section 54 contains the definition of "authorized order," which establishes the scope of these two Parts. Section 54(1) gives the basic definition of an "authorized order." It is an order "initiated by the drawer or with the drawer's consent or authorization or is authorized to be paid by the drawer and remains so unless it (a) is materially altered; or (b) is transmitted without any necessary authorization, including in the case of a written draw order, all valid endorsements." Section 54(3) defines material alteration, which includes changes in the amount or identity of parties. An order which is encoded, e.g. check, can be materially altered by the encoding. Section 54 also contains rules pertaining to whether and to what extent incomplete or materially altered orders may nonetheless be regarded as authorized, e.g. as to original tenor, following UCC 3-407 and 3-115.

D. Part C: Authorized Orders

Subpart 1, "Contracts and Rights," of Part C, sets out the basic contracts and rights of parties to authorized orders. Section 100, "Contract of Drawer," provides that the drawer is liable to a "funds claimant" upon dishonor of an order, independently of any liability on the underlying transaction. This provision applies to pay as well as draw orders. If the payee or a funds transferee is not paid on a pay order, which can occur due to the dishonor (nonpayment) of the order by the payor or a subsequent transmitting account institution, the funds claimant has an action against the drawer. The drawer has recognized its underlying obligation by initiating the order, and should be liable on the order if payment does not occur. The drawer may, of course, have an action for wrongful dishonor against its payor account institution, if the drawer's account has been debited for the order and payment has not occurred. See NPC, §101.

Similar liability on the order exists under §102 for a transferor (endorser of a draw order), following UCC 3-414, and a funds transferee (person receiving funds on a pay order). A funds transferee on a pay order agrees under §102, that it will "pay or effect payment to the payee or the payee's account institution in accordance with the terms of the order." Thus, if a transmitting account institution on a pay order has been paid, thereby becoming a funds transferee, and does not fulfill its obligation, it will be liable for the order to the funds claimant, the party who should have been paid.

This Part also deals with the obligation of the payor account institution
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to its customer. Section 101 provides that the payor account institution
should only pay orders authorized by its customer which are initiated by an
access device it has supplied or agreed to accept, i.e., cards, checks, or codes.
Tort type damages are provided for wrongful dishonor, §101(2), but
consequential damages are only available in a limited number of cases:
(1) for arrest or prosecution of a customer; (2) for dishonor of all orders
drawn on a consumer account; (3) for draw orders, if the dishonor results
from the failure of the account institution to observe the reasonable com­
cmercial standards of its business; and (4) for pay orders, where the dishonor
results from an intentional act, such as an unlawful setoff or hold. On
corporate pay orders, consequential damages are not recoverable for pro­
cessing errors, i.e. "the good faith failure to transmit." Section 101(4)
also allows the customer to recover the amount of any wrongful debit made
to its account and §101(5) provides that an account institution may seek
reimbursement from its customer in overdraft situations.

Sections 103-106 of Subpart 1 deal with the holder in duecourse issue.
These sections provide that any order drawn by a consumer or which
indicates within the order that it is "not entitled to due-course rights"
cannot, if sued upon before finally paid, be used by the plaintiff to cut off
the claims or defenses of the drawer, §103(3). On the other hand, any
person who has given value for any other type of order can, if the person
takes the order in good faith without notice of claims and defenses, cut-off
most claims and defenses of a party with which it has not dealt, §104. UCC
shelter rights are preserved in section 106. These provisions make two
important changes in existing law: (1) consumer checks are non-negotiable
and (2) the preservation of claims and defenses on credit card payments
is not subject to the current limitations of §170 of the Truth-In-Lending
Act, e.g. geographic proximity of payee to drawer, and does not persist
past the time at which the card issuer (payor account institution) has
finally paid the merchant bank.

Subpart 2 of Part C, "Discharge," §§151-155, provides for discharge
of contracts on authorized orders. Only an authorized order can create
a contract. If the order is unauthorized, then the basic obligations of parties
do not come into play and liability for loss is allocated under Part D. The
discharge sections do not require further comment here, except to state
they generally follow UCC §§601-604, 606.

E. Part D: Unauthorized Orders

Unauthorized orders are orders which are not authorized, see discussion
of §54 above. Given the existence of an unauthorized order, the Code
assigns liability for the loss which may result. First, there is the question
of the drawee's liability. Today there are different answers to that question
depending on what payment system is used, and whether the drawer is a
consumer. There is no drawer liability absent negligence for checks, a
§50 maximum liability for consumer users of credit cards, and §50 to unlimited liability for consumer transactions covered by the EFTA, depending on the particular facts. In wire transactions there is currently no statutory law. The Code adopts the credit card model, maximum liability of §50, for consumer drawers with respect to an unauthorized or series of related unauthorized orders of less than $500, §200(2) (a), and the check model, no liability without negligence, for all other orders. If the drawer never “accepted” the access device used to initiate the order e.g. a counterfeit card is involved, or notifies its account institution of an impending fraud before payment, the drawer has no liability whether or not a consumer account is involved, §§200(1), 201. The Code attempts to define certain cases where the drawer will be negligent if the engages in certain specified behavior, e.g. signs an incomplete order, or writes a security code on a card, §202(1). In these cases of “per-se” negligence the drawer may only escape liability if the negligence in no way caused the loss, or the person seeking to invoke the negligence acted in bad faith or has fraudulently and materially altered the order. The drawer is also subject to a duty to inspect its statement, and discover orders which it did not authorize, within a given period of time, or lose the ability to assert that certain orders are unauthorized. A failure to observe this duty may result in the drawer, including a consumer drawer, absorbing the full loss involved, §203.

Another important provision in this Part is “Transmission Liability,” §204, which allocates risk among parties on tort rather than warranty principles. Three liabilities are specified.

The first provision, §204(1), is applicable to draw orders. It provides that a customer, transmitting account institution or transferor is liable to all parties to whom an unauthorized order or duplicate of an order previously paid is subsequently transmitted, if such parties pay or give value in exchange for the order in good faith. A transmitting account institution includes such parties as the depositary bank on a check and the origination bank of a prearranged debit. Liability runs to any party which pays or gives value for an order, including a payor account institution. This provision abolishes the rule of Price v. Neal, reflected in the UCC, §§3-417(1), 3-418, 4-207(1), since any check containing a forged drawer’s signature is “unauthorized,” see §54. Payor account institutions which pay against electronic orders, as in check truncation, cannot perform a signature comparison and rely on the integrity of the message as received. Even payors which pay against the written draw order itself do not regularly verify signatures — it is uneconomical to do so. The rule adopted sacrifices finality for the value of placing the loss with the party that has dealt with the thief.

Section 204(2) covers the liability of any “transmitter” of an order, and applies to both draw and pay orders. A transmitter includes any account institution transmitting an order as well as a courier or switch. The trans-
mittor is liable for materially altering an order to all prior transmitters and all subsequent transmitters. Thus any party handling an order, whether or not it gives or receives value for that order, can be liable for materially altering it. Any switch or courier would be responsible for its own alteration of an order, but has no liability under §204(1) since it would not be an account institution.

The third provision, §204(3), establishes the liability of a funds transferee and payor account institution, on a pay order. These parties can be liable to any funds claimant if they fail to give value on the order as transmitted to them by the drawer, payee or last prior funds transferor to transmit the order. Although the commentary to this section must be consulted for a full explanation of how this provision works, two examples are provided here.

First, suppose that during a FedWire transaction and interloper changes the account number and identification of the payee somewhere between the Fed and the payee’s account institution (Receiving Bank). Further suppose the drawer of the wire has gotten a recredit from its payor account institution, see §§205(3); 101(1). The Fed is a funds transferor, through crediting the Receiving Banks’ reserve account, and the Receiving Bank has become a funds transferee through Fed settlement. The Receiving Bank is liable since it did not give value on the order to the party which was specified in the order as transmitted to it by the last prior funds transferor, the Fed. The payor account institution is also a funds transferor, having given value to the Fed, and has reimbursed a party to the order (the drawer). It is thus a funds claimant, §52(11), and can recover from the party liable, the Receiving Bank.

Second, suppose a point-of-sale (POS) transaction in which the cardholder gives its debit card to the merchant (payee) who transmits an order through a terminal to debit the cardholder’s account at Bank 1 by $500 and credit the merchant’s account at Bank 2 by the same amount. The order goes from the terminal to the switch which routes the debit to Bank 1 and the credit to Bank 2. An interloper changes the message after it leaves the switch but before it arrives at either bank to provide that the cardholder’s account is to be debited for $5000 and the interloper’s account at Bank 2 is to be credited by the same amount. Bank 1 subsequently settles with Bank 2 for $5,000. Suppose the cardholder gets a recredit from Bank 1, see §§205(3); 101(1), and Bank 1 sues Bank 2 under subsection (3). An electronic POS order is regarded as a pay order, see Comment 1 to §51. Bank 2 is a funds transferee, it has received funds from Bank 1 in settlement. Bank 2 failed to give value on the order as transmitted to it by the payee (merchant). The funds transferee, Bank 2, is therefore liable to Bank 1, which is a funds claimant, a funds transferor which has reimbursed the drawer.

The principle is to make receivers rather than senders of messages responsible for interloper fraud. Receivers are in the only position to detect
alteration, and are free to reject orders presented for payment, without
dishonor, if they are reasonably concerned about whether the orders are
authorized, see §412(5) (a).

Section 205 deals with the conversion type liability of an account
institution which gives value on an order to any person except the funds
claimant, the party entitled to be paid. This problem can occur on a
draw order when, for example, a depositary account institution pays a
thief cashing a check over a forged endorsement. It can also occur on a
pay order, as when a bank receiving a wire or prearranged credit pays the
wrong party. Only two causes of action are allowed in such conversion
cases. See §210. First, the drawer of the order may get a recredit from
the payor account institution, §205(3). This right is subject to the statute
of limitations, §207, and other defenses generally available against the
drawer, e.g. negligence, §202, or failure to inspect the statement, §203.
If a recredit is given, the payor account institution must look to the basic
liability provisions of section 204 for further redress, i.e. against the converter.
When a drawer is given a recredit, the drawer must itself reimburse the
intended beneficiary of the order. Second, the funds claimant, the person
who should have been given value and was not, can seek recovery directly
from the converter, the account institution which paid the wrong party,
§205(1). If this occurs, the account institution can defend on the ground
that the funds claimant was negligent, either on a per-se basis, e.g. the
forger of a check was an employee of the funds claimant, see §206(1) (a),
or generally. In cases of per se negligence, the funds claimant will be left
with the loss unless its action in no way contributed to the loss or unless
the account institution raising the defense acted in bad faith or fraudulently
and materially altered the order, §206(1). If such negligence was only
general, the funds claimant will be left with the loss if its acts substantially
contributed to the loss, and the account institution raising the defense
was not itself negligent, did not act in bad faith and did not fraudulently
and materially alter the order, §206(2).

In order to avoid different results depending on the alternative chosen,
the Code provides in §208 that the payor account institution can raise the
funds claimant’s negligence as a bar to its obligation to recredit the drawer,
and that the alleged converter can raise the drawer’s negligence in a suit
brought by the funds claimant.

Section 209 gives a funds claimant an action for unjust enrichment
against any person unjustly enriched, e.g. unintended beneficiary of a wire
transfer. See also §54(8).

F. Part E: Procedures for Resolution of Claims of Error

Part E of the Code, §§300-306, sets up an error resolution procedure
for customers—not just consumers—of account institutions to follow in
connection with alleged errors about debits or credits entered on their
accounts. Non-consumers can agree with account institutions to vary the effect of these provisions, §3(1). This Part attempts to integrate the somewhat different provisions of current Regulations E (electronic funds transfer) and Z (credit cards) covering such matters. Integration of two different regulations sometimes has required changes in each. For example, under section 301(2), notice of error "must (a) enable the account institution to identify the customer’s name and account number..." The Fair Credit Billing Act (FCBA), dealing with credit transactions, requires the customer to specify amount, 15 U.S.C. §1666(a) (2), while Reg. E, §205.11 (b) (1) (iii), only requires that the customer indicate the amount "to the extent possible." The NPC does not require the amount. Another example is provided by the requirement of the FCBA for a written notice of an error, as compared with Reg. E which allows oral or written notice, §205.11(6) (i). The NPC follows Reg. E. on this point, §301(1).

The matters covered in this Part apply to all orders, including wires and checks for which no statutory procedures are now available. It deals with a definition of error (§300); the required notice of error (§301)—a special requirement exists for returning a check or a copy of a check which is the subject of an alleged error; the investigation of an error (§302)—which requires recredits of up to $500 if an investigation is not complete within 10 business days; the extent of the required investigation—which may involve investigation outside the "four walls" (§303); procedures after the error determination is made (§304); withdrawal of notice of error (§305); and resassertion of error (§306). Section 800 establishes the liability of an account institution for violating these requirements. See discussion below.

G. Part F: Provisional and Final Payment of Orders

Part F of the Code consists of three subparts: (1) General Provisions; (2) Transmittal of Orders; and (3) Payment of Orders.

1. Subpart 1: General Provisions

There are two general provisions, the first dealing with the time orders are received for the purpose of calculating deadlines (cut-off hours), §400, and the second concerning when delays beyond required time limits are excused, §401. Special attention in the delay section is given to the problem of delay resulting from technical malfunctions. Section 401(3) provides delay is generally excused "if the delay resulted from a technical malfunction which was known to the customer (a) attempting to initiate the order before, at or immediately after the time the customer attempted to do so; or (b) at or prior to the time the customer's account was scheduled to be
debited or credited. The first excuse is particularly applicable to automated
teller machine or POS transactions, the second to automated clearing house
transactions.

2. Subpart 2: Transmittal of Orders

This Subpart deals with the obligations of parties which transmit orders, including transmitting account institutions and transmitters.

Section 410(1) follows UCC 4-201 in giving transmitting account institutions agency status on a draw order, unless a contrary intent appears in the Code. The commentary to this section explains that this section, as well as others in Part F, speak of “payment” instead of “settlement” of an order. The NPC refers to payment, provisional payment, and final payment instead of settlement of any kind. The current UCC terms of “settle,” “provisional settlement”, “settlement” and “final settlement,” in addition to “payment” and “final payment” are duplicative and confusing. Generally, provisional payment refers to payment that can be revoked and final payment refers to payment that cannot be. The term “payment” is sometimes used where either situation may be contemplated.

Section 411(1) provides that all parties transmitting orders must use ordinary care in receiving, processing, presenting and transmitting orders, but this section cannot be the basis for a claim that an order is unauthorized; its main purpose is to compensate parties for lost and delayed orders. Section 411(2) establishes ordinary care obligations with respect to notice of dishonor, giving value on an order when final payment is received and making or providing for any necessary protest. With respect to pay orders, §411(6) provides that no transmitting account institution is required to transmit an order before it becomes a funds transferee, i.e. is paid. Damage suffered as a consequence of lack of such care is recoverable up to the amount of the order by the party experiencing loss and cannot include consequential damages. Thus, for example, if an account institution transmitting a wire as a correspondent for the payor account institution fails to exercise ordinary care in transmitting the order on to the payee’s bank, e.g. it misplaces the order for 3 days and a real estate closing falls through, the correspondent would be liable for damages up to the amount of the order. This could represent loss of interest for three days but could not include consequential damages attributable to the unsuccessful real estate deal. The limitation on damages, where the account institution is merely an intermediary, is consistent with UCC 4-103(5). See also Etra v. Swiss Bank Corporation 673 F.2d 951 (CA 7 1982), cert. denied 103 S. Ct. 377.

Section 412 covers the question of the permissible methods of transmitting orders. It provides that account institutions have flexibility in choosing the routing and medium of transmittal of the order, as long as the order is sent by a “reasonably prompt method.” Institutions, must,
however, observe time limits imposed by their own system, if they are to avoid liability which may result from delay. The section also permits any part to whom an order is transmitted, whether for further transmittal or presentment, to demand reasonable assurances that the order is authorized, such as "reasonable coding of the message." This is an important protection against one's possible liability under sections 204 and 205 for giving value to the wrong party.

Other sections of this subpart deal with matters of presentment and dishonor, §§413-416. Sections 417 and 418 deal with excuse from and consequences of violations of these provisions. These sections go beyond the UCC by establishing a framework for presentment and dishonor of all draw and pay orders, paper or electronic.

Presentment and dishonor of draw orders follows the UCC quite closely. Presentment of pay order is "a demand that payment be made or effected to the payee made upon a funds transferee by the immediately prior funds transferor or upon the payor account institution by the drawer," §413(1). Dishonor of a pay order occurs if either the funds transferee or payor account institution fails, without excuse, to act on such demands, §415(2). Dishonor of a pay order triggers possible wrongful dishonor liability for the payor under §101, the drawer's obligation under §100, and the funds transferee's liability under §102.

3. Subpart 3: Payment of Orders

The third subpart of Part F, "Provisional and Final Payment of Orders," deals with payment of orders and contains a number of important provisions. Section 420 establishes the rules for final payment. If a payor account institution has finally paid an order or is deemed to have done so, it is liable to the funds claimant, the party seeking to collect on the order, as with a check, or the party who is entitled to receive funds on the order, as with a wire. The NPC follows UCC rules on final payment for draw orders, except for dropping the concept of final payment by posting which has become rather contentless since the decision in West Side Bank v. Marine Nat. Exchange Bank, 155 N.E. 2d 587 (Sup. Ct. Wisc. 1968), and by adding a special 7 day midnight deadline for resubmitted orders, e.g. checks once dishonored and resubmitted for payment, on the theory that the only hope for payment is for the payor to hold the order for longer than the usual time. See Graubart v. Bank Leumi Trust Co., 339 N.E.2d 930 (N.Y. Ct. App. 1979). NPC also establishes rules for final payment of pay orders.

A pay order is finally paid if it is unconditional—a payor account institution transmits an order or gives and advice that the order will be transmitted to the payee or the account institution receiving payment on its behalf, without a reservation of a right to revoke. If payment is condi-
tional, i.e. there is a reservation of a right to revoke, final payment will occur unless the orders is revoked by the end of the business day on which the order was transmitted or the advice given, §420(2). Final payment may be undone in two cases. See §420(3). First, drawing on National Automated Clearinghouse Association Operating Rule VII F, a carefully circumscribed procedure is set up for correcting erroneous or duplicating orders, §420(5). Prior payment can be reversed by non-consumers, e.g. business firms or account institutions, for 5 days after final payment or for 5 days after the value date for payment, whichever is later. Any party acting on such a reversal, e.g. receiving bank of a previous wire, can insist on indemnity. Second, consumer drawers, under another section discussed below—§425, are given a 3 day reversal right on certain orders. If the consumer exercises this right, final payment, and the concomitant liability to the funds claimant, is also overridden.

Section 421 provides when a customer has the right to withdraw funds represented by an order from its account institution. The right to withdraw must reflect the possibility of reversal to protect the account institution from having to both give funds to its customer and later having to honor a reversal order. This section also deals with the problem of an automated teller machine cash deposit remote from the branch office of an account institution, §421(3). While recognizing the need for verification of the actual amount of the cash deposit, it also provides that after a certain time has run—two business days—the deposit is available for withdrawal as of right.

Section 422 specifies procedures for deferred posting of draw orders along the lines of UCC 4-301. Its principal thrust is to allow a payor account institution to revoke any provisional credit, given for an order on the day of receipt, before its midnight deadline, if it has not otherwise made final payment. While it permits dishonor to occur by return of the order or notice of dishonor, §422(1), and such notice may be electronic, written notice must follow within 1 business day if written dishonor or return of the order has not previously occurred, §422(5).

The section also offers a possible solution to the delayed availability problem on draw orders such as checks. Section 422(6) provides that in cases of dishonor of draw orders over $2500, wire or telephonic notice of dishonor must be given to the first depositary institutions which has transmitted the order, e.g. depositary bank, if certain information needed by the depositary is available on the order “in readily decipherable form,” e.g. the name of the depositor. The procedure is optional for orders of $2500 or less. Since withdrawal as of right, in most cases, depends on when the account institution has learned that payment is final—which practically speaking means that it has waited long enough to know that the order has not been dishonored—this should speed up funds availability on orders over $2500. A depositary which receives such direct notice must make an
immediate payment to the payor account institution or incur interest charges, §422(7).

Section 422 must be read in conjunction with section 423, drafted along the lines of UCC 4-302, which makes the payor account institution (where it is not also the depositary) liable to the funds claimant if the account institution retains an order, without provisionally paying it, beyond midnight of the business day of receipt.

Section 424 specifies when an account institution may recover from its customer for provisional credits given out on an order. It applies to both draw and pay orders. It provides that an account institution can recover if it fails to receive final payment or final payment is overridden by a later reversal, as long as it promptly notifies its customer after learning that it has not been paid.

Section 425 deals with stop payment and reversibility. All drawers are given the present UCC right to stop payment on an order prior to the time of final payment or of other competing claims becoming effective, e.g. attachments. In addition, the section gives a consumer drawer 3 business days from the time of final payment to reverse payment unless the order if for cash withdrawal, is a written draw order (paper check) or the account holder has waived the right to reverse upon opening the account, §425(2).

Any payor account institution acting on a reversal has the right to recover credits previously given on the order, §425(4).

The section also deals with remittance type draw orders, like a cashier's check, and specifies under what circumstances an individual obtaining such an order can stop or reverse payment, a troublesome problem under UCC case law. See §425(7). A class of draw orders is also described which no person, including a consumer, can stop or reverse. Section 425(8) provides that "[n]either an account institution nor any other person may stop or reverse payment on an order which (a) an account institution has reduced to writing and on which it has assumed the obligation of the drawer or on which an account institution is an accommodation party or acceptor; (b) is issued in tangible form by the account institution to the person from whom it receives consideration for the order, or is endorsed or accepted in tangible form by the account institution; and (c) bears prominently on its face the legend that the order is not subject to stop or reversal and should be treated as cash." This should make a paper cashier's check delivered over-the-counter or through a machine unstoppable and irreversible. However, an electronic remittance order procured by a merchant at a terminal would not fit within this provision. The idea is that the act of procuring certain specified kinds of remittances is special enough to warrant treating such orders as cash. Subsection (9) specifies the information that must be given to the payor account institution to stop or reverse an order. Subsection (13) legitimates any fees or charges for stops or reversals which an account institution "reasonably believes are necessary to cover the cost of providing the service."
Section 426 deals with “Competing Claims to an Account.” Competing claims arise from events such as set-off, knowledge of the death of the drawer, or service of legal process, §426(1). This section determines when a “claim” comes early enough for the payor account institution to act on it, such as before final payment has or is deemed to occur, §426(2).

This subpart also deals with what the payor account institution’s response should be to the death or adjudication of incompetence of the drawer, §427, what different kinds of payment are generally acceptable, e.g. wire, correspondent account credit, cash, or authority to charge an account as in net settlement, and the result of taking acceptable or non-acceptable forms of payment, §428, and who bears the risk of the insolvency of an account institution which has debited its customer on an order but failed before making payment, §429. Section 429 changes the current provisions of UCC 4-214 by providing that preferred claims may be asserted only against federally insured failed payor account institutions, 429(2), and that certain claims must be brought and borne by account institutions rather than parties to the order, §429(3).

H. Part G: Records and Evidence

Part G of the Code deals with Records and Evidence. This is a critical part because the ability to assign risks, as under the transmission liability section, 204, or to complain about errors, depends on the availability of statements, receipts and an audit trail among the parties to the order. This Part is subdivided into three subparts: (1) Periodic Statements; (2) Receipts; and (3) Evidence.

The periodic statement and receipt provisions are applicable only to consumer accounts, see §50(12) and attempt to merge the existing provisions of Regulations E and Z and apply them to all orders, including checks. The periodic statement provisions cover frequency (§500) and required information about orders (§501), e.g. amount, date and the status of the account balance, as well as required descriptions of orders (§502), identification of the location of the transaction, §503, and what constitutes a legitimate excuse from these requirements, §504. Section 800 establishes the liability for failure to meet the requirements. See discussion below. The provision on receipts, Subpart 2, §507, requires receipts for orders initiated at an electronic terminal and basically follow Reg. E. It is envisioned that the periodic statement and receipt requirements would be adopted as federal law because regulatory flexibility is needed for such disclosure type obligations. Since technology and services can rapidly change, unanticipated problems of interpretation and applicability of the requirements will inevitably arise. Section 802 establishes federal regulatory authority under these sections. While certain provisions of the periodic statement sections will displace the Truth-in-Lending Act (TILA) and
Reg. Z, TILA will continue to govern all matters of disclosure concerning “finance charges” and “periodic rates.” §501(2) (e).

Subpart 3 on “Evidence” covers four matters. Section 508 specifies the burden of proof with regard to information on an order. It extends the UCC presumption of the validity of signatures on checks to all written orders, and creates a new presumption for contemporaneous copies of electronic orders, e.g. receipts, computer journals or other stored copies made at the time an order was received or sent. The presumption is that the copy accurately reflects the order. Section 509 specifies what can serve as evidence of dishonor and notice of dishonor. Section 510 permits courts to require indemnity for suits on orders where the plaintiff does not have the actual order in its possession; such possession is obviously impossible for electronic orders. Indemnity protects against the prospect of double liability. Section 511 provides for when receipts and other contemporaneous records can serve as evidence of transactions.

Section 512 establishes a vouching-in procedure, and follows UCC 3-803. It requires a party which does not respond to a vouching-in notice to compensate the moving party for certain costs of bringing a subsequent action against the party failing to respond in the first action.

I. Part H: Agency and Authorization

Part H of the Code deals with “Agency and Authorization.” Section 600 specifies when, for the purpose of liability, a party to an order is deemed to be acting as a representative of another or as the principal. Section 601 deals with prearranged orders, requiring written prearrangement agreements with customers and prenotification to account institutions to whom prearranged orders will be transmitted. Sections 602 and 603 cover acceptance and certification. Section 602 defines acceptance as the drawee’s engagement to honor a draw order, whether or not authorized, as presented. It is intended to cover the case where a card issuer “accepts” a check in a check guaranty program. The section specifies the conditions precedent, absent agreement to the contrary, for the drawee making good on an acceptance of a written draw order, e.g. prompt deposit of a demand order by the persons obtaining the acceptance, as well as the type of risks covered by the “acceptance,” e.g. the acceptor’s engagement does not apply if the order has been reversed by the acceptor’s customer, §602(4) (a). Section 110, which parallels Section 602 on acceptance, provides for the contract of a guarantor. A guarantor is a person other than a drawee, e.g. a check guaranty card issuer which is not the drawee of the check guaranteed. The guarantor engages to take up an order which is not paid by the drawee, subject to certain conditions. The guaranty runs only to the person procuring it to avoid creating a market in guaranteed orders. These sections go beyond the UCC in detailing the obligations of the guarantor and acceptor, following certain existing contractual agreements.
J. Part I: Disclosure

This Part only applies to disclosure to consumer drawers, i.e. customers with consumer accounts. It incorporates and merges various provisions of TILA and EFTA. Section 700 provides that the disclosure be in “plain english,” section 701 provides for initial disclosure of terms and conditions at the time an account is opened and section 702 specifies when disclosures about changes in terms and conditions must be made. Section 800 specifies the liability for failure to make disclosures. It is envisioned that these sections, like those covering periodic statements and receipts, will be federal law, and subject to regulatory implementation, §802. Disclosures of “periodic rates” and “finance charge” will be left to TILA, but other disclosure provisions of that Act would be displaced by the Code.

K. Part J: Miscellaneous

Section 800 establishes account institution liability for failure to comply with error resolution, periodic statement, receipt and disclosure requirements. It would significantly change the current liabilities of “persons” and “creditors”—here “account institutions”—as provided under §915 of the EFTA and §130 of the TILA. First, there would be no minimum liability in actions under this section, as currently under EFTA and TILA. Second damages would only be actual damages. While EFTA and TILA provide for only actual damages in individual actions, EFTA, §915(a) (1), and TILA, §130(a) (1), in the case of class actions there is no such limitation. Damages are available in “such amount as the court may allow,” according to certain factors the courts must consider. These kinds of discretionary class action damages are unavailable under this section. On the other hand, the excuse provisions of EFTA and TILA are incorporated. Also, there is no prospect of treble damages for any violation of the error resolution provisions, as under EFTA §908(e). No such provision exists under TILA §16(e), but the rescission right of up to $50 under that section is also dropped. No criminal liability is imposed for willful and knowing violations as under §916 of EFTA and §112 of TILA.

While the damage liability flowing from violations of these consumer provisions has been significantly curtailed, the substantive provisions of those sections now apply to all forms of payment, except cash, including checks. Expensive and burdensome regulation under these provisions can only be avoided if actual damages are the measure of liability, since otherwise account institutions, in order to avoid harsh prospective liability, will seek to have every question of statutory meaning worked out in advance through a detailed regulation. The principal reason such pressure has been generated under EFTA and TILA on the one hand, and not under the UCC, is the difference in the approach to damages. One must recognize however, that it will be difficult to prove actual damages. Hopefully,
providing expense recovery in successful actions will create sufficient incentives to sue in meritorious cases, but still avoid pressure for overly detailed regulation.

Section 800 also establishes a federal administrative enforcement mechanism, along the lines of the Federal Deposit Insurance Corporation Act, 12 U.S.C. §1818. A court is given the power to enforce, with injunctive relief, a cease and desist order of the enforcement agency and civil penalties are provided for one specific violation—advice by an account institution to an individual to make a false representation about the use of an account, see §800(4). This insures that persons using accounts for consumer purposes open consumer accounts and thereby become entitled to the protections of the Code.

Section 801 deals with the relationship of an order to an underlying obligation, and generally follows UCC 3-802, except that only the taking of remittances, e.g. cashier's checks, drawn on insured account institutions discharge the obligor. In addition, §801 provides that when a draw order is taken as payment for an obligation, and subsequently becomes unauthorized, the drawer is discharged on the order and the underlying obligation. This makes clear that the drawer can refuse to reimburse the obligee on the underlying obligation as well as on the order in a case where an endorsement is forged after the obligee takes the order. See also §205(3). Section 801 also adopts the EFTA rule providing for suspension of an underlying obligation due to a terminal malfunction, EFTA §912.

II. GENERAL ISSUES RAISED BY CODE

This part of the memorandum will set out some of the general issues raised by the Code.

A. The Need for the Code

Is there a real need for this Code? Some may argue that private contracts can structure relationships between account institutions and non-consumer customers, and that federal law and the UCC already establish a framework for consumer rights on EFT, credit card and check transactions. It may be further argued that any attempt to structure a legal framework for all payment systems except cash will at best become quickly outdated due to technological changes in the future, or at worst impede such changes. Finally, it can be pointed out that the well settled rules of Articles 3 and 4 will be replaced by a new and unseasoned framework. Many of these kinds of arguments were made by the New York Clearing House Association against enactment of Articles 3 and 4 of the Uniform Commercial Code during the hearings of the New York Law Revision Commission.

What can be said about the realtionship of this Code to the existence of private contracts? A number of provisions specially relate to consumers,
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e.g. liability for unauthorized orders (§200), error resolution (Part E), periodic statements etc. (Part G), and disclosure (Part I). NPC takes the position, which is reflected in various provisions of the EFT and Truth-In-Lending Acts, that the effect of such provisions should not be waivable by consumers. Even though contract could structure responsibility for these matters, a well established approach to consumer rights mistrusts the ability of consumers to protect themselves through contract. Second, in the absence of the Code contracts with corporate customers, which allocate risks and responsibilities, might not be enforceable in the courts. In the past, courts have invalidated various provisions of contracts on the theory that a bank cannot waive responsibility for ordinary care. The Code eliminates this enforcement uncertainty by giving banks wide latitude to contract out of the effect of the Code with corporate customers.

Second, there is a need for a set of backstop rules allocating risks which can guide the courts and transactors, when major risks are not covered by provisions in contracts. This is a significant step forward in the wire transfer area in which major risks are not covered by contract and the common law is poorly developed and fragmentary. There can be various reasons why a system or a particular account institution may fail to cover matters in contracts, including sloth, the need to economize on lawyers fees or the inability to reach an agreement acceptable to both sides. In considering the role of the Code in providing backstop rules, one should not think only about the payment systems which do an excellent job in covering problems in contracts, such as the bankcard systems or NAACHA, but should also keep in mind shared ATM or wire transfer systems. Even in the systems with well elaborated rules, certain matters may be avoided or ambiguously defined. The areas in which backstop rules can serve an essential purpose in wire transfers involve substantial sums of money and real problems, such as final payment (Herstatt), §420, wire fraud (Security Pacific), §204, or mistaken handling of orders (Swiss Bank Corporation), §411. Credit risks (Herstatt) are not usually insurable and fraud and mistake insurance may be cheaper and better designed if it functions against the background of clear legal rules.

Third, some matters are difficult to handle by contract because they involve the rights of third parties. For example, the question of competing claims. §426. Attachment could not be dealt with by contract since one would not know which potential attachors to deal with in advance. Another example is the obligation of all parties dealing with and order to handle it with care and in a prompt fashion, §411, or of payors of draw orders to give prompt notice of dishonor, §416. Any gives transmittor or payor may not deal with the originator of the order or its recipient, but it may be appropriate to impose obligations to these parties on a trans­
mitter. Indeed, the most basic rules of the Code give rights to funds claimants against parties they do not know and cannot contract with in advance. See e.g. §§100, 102, 204, 205, 420.
THE UNIFORM NEW PAYMENTS CODE

A fourth point to consider is the possible advantage the Code may have in influencing a standardization of the allocation of risks. Once the Code is enacted, account institutions may decide not to contract about matters that are covered by the Code in order to realize the cost savings of using one body of law to assess the risk and consequences involved in all their payment transactions. One of the major problems today in the law of EFT is the burgeoning proliferation and resulting confusion in the sources of rules, public and private. This is not to say that contracts will not be able to vary the Code, but rather the possibility exists that transactors will want to rely less on contracts.

Finally, the Code contains provisions on evidence, §§508-512, which will guide courts where litigation occurs. Obviously, only a publicly enacted statute can bind courts in matters of evidentiary presumptions.

As to consumer rights, there are a number of problems in the current legal framework. First, development of consumer rights on credit cards and EFT transactions have outstripped those provided on checks. It is not unrealistic to suppose that if such a framework is not established for checks, a demand for them will soon arise. Second, in many cases, consumer rights as between credit and debit payments are inconsistent. It is difficult to justify the differences that now exist with respect to consumer liability, periodic statements and receipts under EFTA and TILA. Third, there are some new payment systems which consumers use which are not covered by any federal law. Not only is this true for the occasional use of wires, but it is also true for paper generated debit card transactions (the EFTA only applies to electronically generated debits), and for check guaranty transactions, which are specifically excluded from the scope of the EFTA and raise problems not currently dealt with in Article 3. Finally, the difference in consumer rights, as between payment systems, distorts the choice among various means of payment. As stated in the 1978 Report to the 3-4-8 Committee, the Code should have the same rules for all types of payment to the extent feasible. This avoids having legal rules dictate the choice of payment systems. Choice of systems should instead be determined by underlying efficiencies and costs. This approach is not intended to ignore real differences among various forms of payment. As this paper points out rules must take into account the nature of the transactions involved. Pay orders and draw orders work differently, and written and electronic orders raise distinct problems. Many provisions of the Code are designed to handle these differences. Yet the majority of rules can apply to all systems.

As for the changes required in Articles 3 and 4, changes have been kept to a minimum. They have only been made when specifically suggested, e.g. elimination of posting concept, when required to set out a framework integrating current consumer rules for other payment systems with those of checks, e.g. drawer liability, or when needed to eliminate obstacles to check truncation, e.g. liability of payor account institution on forged checks.
There is no doubt that lawyers will need time to become familiar with the new language and concepts of this Code but this short term capital expenditure in education will be worth the long term gains in increased certainty and efficiency.

As for the issue of technological change, this is only a significant problem for disclosure requirements, where the rules have significant operational act. The creation of regulatory authority in this area responds to the need for a flexible legal framework.

B. State and/or Federal Law

Although the Code is designed to replace Articles 3 and 4 of the UCC, the question arises as to whether the Code should be enacted as federal law. The Code changes various existing federal statutes, e.g. EFT and Truth-In-Lending Acts, as well as various existing federal regulations, e.g. Regulations E, J and Z of the Federal Reserve Board. This draft already envisions federal enactment of sections 500-507, 700-702 and 802 because of the need for regulatory flexibility—to be uniform regulation must be federal, but other sections of the Code would be in conflict with existing federal law, e.g. §200. It is conceivable that the federal acts could be amended to defer to uniform state legislation. Alternatively, all provisions not requiring changes in federal law could be enacted at the state level, although this would require giving up, in substantial respect, the idea of a comprehensive Code and would not permit rationalizing the different consumer rules that now exist in different payment systems.

It should be noted that federal enactment could apply the same rules to payments made by and/or processed by the federal government as would apply to private sector payments. Arguably, the philosophy underlying the requirement that federally processed payments be priced to compete with the private sector, see §107 of the 1980 Deregulation and Monetary Control Act, also requires that the allocation of risks on federally processed payments, now established by Regulation J, should not differ from the allocation of risks for payments processed by the private sector. Federal enactment could also avoid the non-uniformity period that would exist during the possibly lengthy state by state enactment process, which could pose difficult problems in matters affecting the rights and responsibilities of account institutions inter-se, e.g. §204 (transmission liability), §420 (final payment). One must assess the cost to the payment system of having some states with the current UCC and others with the NPC.

If the Code were enacted as federal law, it does not follow that state enactment is not required. Since the federal government has demonstrated an unwillingness to pre-empt state law on consumer issues, where state law is more consumer protective than federal law, uniform state law on such issues can only be achieved by uniform state enactment. It may
make sense, therefore, to pursue both federal and state enactment of the Code.

A serious political problem with federal enactment is the obstacle of changing existing federal law. In addition there is, of course, the difficulty of increased federalization of commercial law.

Another possibility is coordinated state and federal enactment. Those parts of the NPC affecting relationships among account institutions, e.g. §§204-420, and those requiring federal regulations §§500-507, 700-702 and 802, could be enacted as federal law and pre-empt certain sections of Article 4. Those parts of the NPC principally affecting the relationship between account institutions and their customers, e.g. §§100-109, 300-306, 425, could be enacted as state law. Federal law could be amended to provide that upon 25 states enacting the relevant NPC provisions—a mechanism would have to be created to deal with non-uniform enactments—EFTA and TILA, and other relevant federal laws or regulations, would not apply, or would be narrowed in their application, to states enacting the NPC.

C. Regulatory Framework

The Code will depend mainly on resolution of ambiguities by courts in litigated disputes. This accords with the current approach of the UCC, but is at odds with the regulatory approach of the EFTA and TILA. The demand for regulatory authority and for detailed regulations has come principally from the financial community as a result of the stiff liability provisions provided in federal law for failure to make required disclosures in periodic statements, disclosure statements or receipts. When account institutions are faced with such liabilities they are unable to tolerate the normal ambiguity that arises out of a new statutory enactment.

The NPC follows the liability approach of the UCC, actual damages, and adds an administrative enforcement mechanism for injunctive relief. Consumer representatives, in deciding whether to support this Code, should consider that consumer rights on checks and certain EFT transactions, see e.g. §425, have been expanded even if the possible deterrence achievable by stiff damage penalties has been sacrificed.

III. SPECIFIC ISSUES RAISED BY THE CODE

Based upon the discussions of the 3-4-8 Committee and comments received, certain provisions of the Code are likely to be controversial. Most of the issues arise in the consumer area.

A. Holder-in-Due-Course on Checks (§103)

As indicated in Part I of this memorandum, the Code prohibits a party
from asserting due-course rights against a consumer drawer of a check. As the commentary indicates, this result not only conforms to the increasing lack of negotiability of consumer drawn checks, but should have little actual impact since parties which give value on such checks look to the credit of the parties they deal with, e.g. depositary bank to depositor of check, rather than to the credit of consumer drawers. Moreover, it is likely that most checks will indicate whether they are drawn on consumer accounts so that parties taking and giving value on them will be aware that they cannot assert due-course rights.

B. Transmission Liability (§204)

The objective of Section 204 is to devise a set of rules which can cover both draw and pay orders. Whereas this section may be viewed as unneeded, given private contracts, the fact is that large payment systems, such as the wire systems and small shared ATM or POS systems have few basic liability rules. Other systems with detailed provisions, such as ACHs and bankcards, often do not cover certain major risks, see §204(3). In any event, systems with rules can contract out of this Code, §3(1). The change in the rule of Price v. Neal seems warranted in terms of present banking practices and the impending development of check truncation.

C. Stop Payment and Reversibility (§425)

The provision on reversibility is controversial. The EFTA does not establish the right to reverse EFT transactions as a matter of federal law and left the question to the states. Michigan and Wisconsin have adopted reversibility provisions, but there is little to draw from the experience in those states, due to the limited number of transactions and places where terminals have been established; most terminals in Wisconsin are at supermarkets. The provision does not cover checks paid in written form due to operational considerations, but would be applicable to checks paid in electronic form, as can arise through check truncation. Credit card transactions are already in effect reversible through the combination of §170 of TILA and the private rules of the bankcard systems. The NPC cuts down the period of reversibility on credit cards to three days following issuing bank payment.

Reversibility, like stop payment, allows a bank customer to control goods and money when bargaining with a merchant to redress a grievance. This enhancement of bargaining power is justified if consumer grievances are on the whole meritorious. Without the power that comes from having his money, the consumer with defective goods will have no alternative but to sue an uncooperative merchant; the costs of such suit may well lead the consumer to abandon the search for redress. If the consumer has his money, the merchant has greater incentives to reach and accommodation.
The use of the payment system to enhance bargaining power affords a relatively easy way to overcome the transaction cost obstacles to seeking redress through the courts. The premise of this analysis is that consumer grievances are on the whole meritorious. Reversibility might well be abused to get something for nothing. Without empirical data it is difficult to know whether the right of stop payment has been abused; such data could well shape our attitudes toward the advisability of reversibility. The NPC gives the consumer the benefit of the doubt.

The NPC leaves the consumer free to have an account without reversibility. If the marketplace prices the value of reversibility, through bank charges and the selling price of goods, the consumer can rationally decide whether the prospective benefit of the right is worth the costs.

D. Liability for Unauthorized Orders Drawn by Consumers (§200(2))

Section 200(2) provides that the consumer will face a maximum of $50 liability on an order or series of related orders under $500, and will have no liability for orders over $500 unless negligent, if the account institution has acted reasonably in paying such orders. The strict liability rules for orders under $500 reflect the advantage in avoiding costly negligence determinations in the courts where relatively little money is at stake. No liability can be imposed on the consumer—or anyone else—if the transaction does not involve an accepted access device, see §201(1). From the consumer representative's point of view, the consumer is both better and worse off in various respects under this proposed rule.

The "negligent" consumer is better off with respect to checks, since the credit card rules will now apply to check transactions under $500. The "non-negligent" consumer is marginally better off with respect to credit card and EFT transactions over $500, since she will face no liability, whereas now she faces $50 liability. The "negligent" consumer is worse off, on the other hand, for credit card and EFT transactions over $500. She will face unlimited liability in place of the current $50 maximum. How much worse off the "negligent" consumer actually is depends, of course, on the likelihood that a consumer will be negligent, a question partially answered under §202. The NPC rules reflect the view that contributory negligence should be available as a defense and litigated in the interest of efficiency where substantial sums are at stake. The TILA and EFTA did not envision the large dollar card transactions which are now possible.

E. Merger of EFT and Credit Card Rules with Extension to Checks (Parts E, G and I)

In the past, the Federal Reserve Board has considered a proposal to merge various provisions of EFTA and TILA to realize the benefit of
having one rule for both debit and credit transactions. This proposal did not make much headway. Many difficult detailed issues were raised by the attempt, which are now dealt with by the NPC. The imposition of tougher requirements on creditors or EFT providers as a result of the merger, depending on the particular rule selected, can trigger opposition from the system saddled with the tougher rule for the first time. Although much of the opposition is in the nature of special pleading, some differences in treatment may be justified. The issue is complicated further, of course, by subjecting additional systems, e.g. checks and wires, to the merged rule.

F. Definitions of Order, Account Institution and Scope of Code

As the discussion of the definitions of “order” and “account institution,” and the scope of the Code, §2, indicated there is a great potential for disagreement as to what should and should not be covered by the Code. The NPC excludes two-party charge cards, on the theory that inclusion would be sure to trigger strong opposition from merchant issuers and because the use of such cards is only tangentially related to payment. Pressure for inclusion of two-party cards may come, however, from issuers of three-party cards, e.g. VISA cards.

Upon further reflection, however, it should become clear that three-party card issuers will not be treated more unfavorably than two-party card issuers. The “periodic rate” and “finance charge” provisions of TILA, including the liability sections enforcing those provisions, will apply to both. The other provisions of the NPC, liability for unauthorized transactions, periodic statement disclosures, receipt requirements and general disclosure obligations, are less onerous than the corresponding TILA provisions, particularly given the actual damage limitation in section 800.

IV. CONCLUSION

The Uniform New Payments Code is now ready for serious consideration. It provides a coherent and workable legal framework for payment systems.