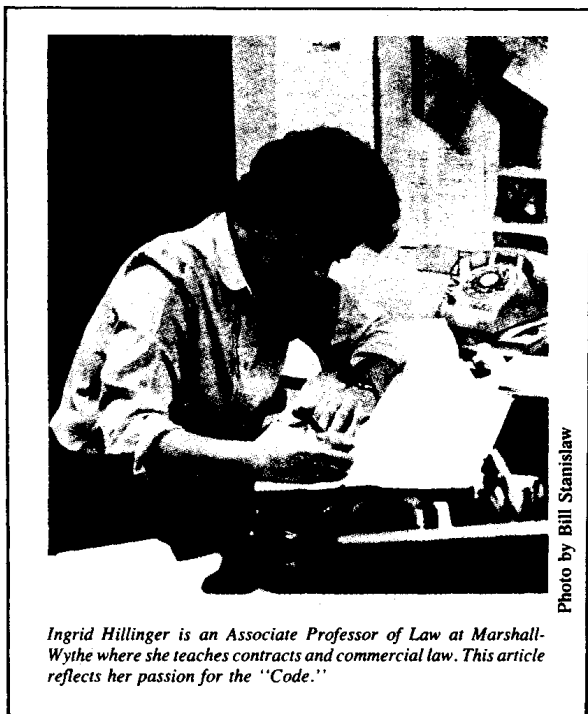


The UCC and ME in Process

By Ingrid Michelsen Hillinger



This past fall, I was invited to attend a three-day conference on the Uniform New Payments Code ("the NPC")¹, sponsored by the American Law Institute, the American Bar Association Committee on Continuing Legal Education and the Permanent Editorial Board for the Uniform Commercial Code. My reaction to the invitation was something akin to what I suppose would happen if Paul Newman asked me out for lunch. Only my love for family, Marshall-Wythe and country surpasses my love of and interest in the UCC and anything connected with it. Having devoted the better part (read that "waking moments") of an entire summer to a UCC problem which required extensive research into the UCC's tumultuous legislative history, the prospect of actually witnessing the UCC "in process" both excited and intrigued me. During the time that the UCC drafters debated and defended their Code (from about 1949 until 1962), doubting Thomases repeatedly questioned the need for a single uniform code covering all facets of a commercial transaction. Many took an "if it ain't broke, don't fix it" attitude. They argued that the existing law was certain and a massive overhaul would precipitate endless litigation. These individuals believed that ambiguities and trouble spots in the existing law could be and should be remedied by limited, focused changes. The law did not need and these critics did not welcome a uniform com-

mercial code with its difficult terminology, concepts, and rephrasing of every existing legal principle. As I plodded through the hundreds of pages of committee reports, law reviews and testimony of this period, I found myself invariably siding with the drafters. They were unquestionably the good guys, wearing the white hats and championing the cause of reason and commercial good sense. I reacted to the Code's critics with naked disbelief and scorn—after all, how could *anyone* in his right mind doubt the rationality of a uniform commercial code?

History repeated itself at the NPC conference. Scores of people went to the floor microphone to question the need for a uniform payments code, arguing that needed changes and clarifications could be accomplished by amending the existing code rather than by creating a whole new code. Although history was repeating itself, I was troubled because I seemed to be on the wrong side. I, too, was wondering why we needed the NPC and whether my allegiance had switched to the dark side. Did my opposition stem from an illegitimate source, *viz.*, six long and hard years, devoted to figuring out Articles 3 and 4? A commentator once noted that some of Article 3's oddities² stemmed from dutiful reverence of loyal sons to the N.I.L.³ It occurred to me that I might have become a loyal daughter of Article 4. By the end of the conference, I was relieved to know that the NPC drafters had persuaded me of the need for major change. The conference taught me a valuable lesson. It is a whole lot easier to make judgments about history than to judge history in the making.

Although this particular draft of the NPC will never see the light of day because the critical interest groups—banks, consumers and academics—all had serious problems with it, something like it is definitely on the horizon. The following synopsis provides a glimpse of the new joys and challenges that lie in store for all of us.

At the moment, thanks to financial and technological ingenuity, a variety of payment systems exist. Of course, there is the old and definitely unchic way of paying—cash. Also, there are the tried and true methods of check and promissory note. In the past couple of decades, payment by 3 party charge cards, the "plastic money" of VISA, Master Card, etc., has become extremely popular. More recently, electronic transfers—wire transfers—are the vogue. In addition, there are other, less well known payment systems. The so-called "off-line debit card" is conceptually identical to the check. The buyer gives the merchant his debit card, which the merchant then uses to prepare a slip. The buyer who signs the slip thereby directs his bank (the card issuer) to pay the merchant. The merchant forwards the slip through the bank collection process. When the slip arrives at the bank which issued the debit card, the bank pays the merchant in accordance with the buyer's instructions. This kind of payment is not accomplished by electronic means. An "on-line" debit card does effect payment by electronic transmission. It is referred to as a "point-of-sale" (POS)

transaction. The merchant has a computer terminal in his store and uses the buyer's debit card to debit the buyer's bank account and credit the merchant's account before the buyer leaves the store with his merchandise.

There is also the "ACH" method of payment (automated clearing house) whereby parties can prearrange automatic payment. An ACH *credit* is prearranged by the payor—e.g., an employer can pay his payroll by directing his bank to credit periodically his employees' accounts. An ACH *debit* is an automatic, prearranged debit by the payee. For instance, by prearrangement of the parties, a utility company, as payee, can initiate a debit against a customer's account on a periodic basis. In addition, payment can occur through an automated teller machine (ATM) which is a computerized banking terminal. In 1982, ATMs handled more than 2 billion transactions and involved in excess of \$240 billion dollars.⁴ The sheer volume of checks that must be processed today has produced another development, *viz.* check truncation. Rather than moving checks through the country, the first bank in the collection process retains all checks it receives. Thereafter the check collection process and payment are accomplished by electronic transmissions between all the banks. The number and kinds of payment systems are mind-boggling and no end is in sight.

Presently, Article 3 governs promissory notes, Article 4 governs checks, the federal Electronic Funds Transfer Act (EFTA) governs electronic transfers and the federal Truth-in Lending Act (TILA) addresses 3 party credit cards. No statutory law exists with respect to ACHs, ATMs or "on line" debit cards. No one is sure whether Article 4 governs "off-line" debit cards. Article 4 applies to "items," which § 4-104(g) defines as "any instrument for the payment of money even though it is not negotiable." Article 4's application to truncated checks is also problematic, where is me item?

The different bodies of law governing the different payment systems not surprisingly provide different rules. Not only does this affect user choice, it also creates an impossible situation if the payment system in question is an amalgam of two or more payment methods. One conference speaker said that he had recently received a package of checks called "Master check." The letter accompanying the checks described them as "companion check loans" to be treated like a cash advance—"no one will know you are using credit." He had a charge card but no checking account with the bank that had sent the checks. How would one characterize that situation to determine the applicable law?

The proliferation of payment systems and discrete bodies of law or no law at all led the NPC drafters to conclude that a single unified law concerning payments should be implemented. A unitary approach would avoid the legal quagmires and inconsistent approaches which have resulted and will continue to occur under our present state of affairs. The drafters believed that the "new legal framework should not distort user choices among different systems."⁵ To this end, the drafters imposed the same legal consequences on all kinds of transactions wherever technology and the nature of the transaction permitted similar treatment.⁶ The NPC proposes to replace Article 4, the EFTA and TILA. It also seeks to establish statutory rules for all those payment systems for which no statutory law presently exists and the common law is characterized by confusion and incon-

sistencies. At bottom, the drafters intended the NPC to do for disparate payment systems what Article 9 did for disparate security devices.⁷

A unitary approach to all payment systems required an approach which would, of necessity, cover both paper and non-paper based transactions. This, in turn, necessitated a whole new terminology and the NPC creates it with a vengeance, much to the bewilderment and audible groans of the audience. (I re-experienced the despair I had felt as a student taking Commercial Law I.) To begin with, we do not have "banks" under the NPC, we have "account institutions." We have "account institutions" rather than "banks," because the word "bank" does not encompass credit unions, mutual funds, savings and loan institutions, Mastercharge, ATMs, and other forms of life which are implicated in today's payment systems. Section 53(1) of the NPC defines an "account institution" as "any person which in the ordinary course of its business maintains accounts for its customers." That seems simple enough until you get to the definition of "account," which § 50(1) defines as "a liability in money" (that covers banks, credit unions, etc.), "credit extended" (that covers finance companies such as VISA or Mastercharge) or "interest in assets on which orders may be drawn or to which orders may be credited" (that covers mutual funds).

Because the NPC only applies to "orders," its definition of "order" is critical. Section 10(1) defines "order" 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, signed by the drawer." Although the NPC's "order" bears some resemblance to Article 3's definition of a negotiable instrument, there are several differences. First of all, the NPC obviously does not require a writing. As a result, it only requires a signature if there is a writing. Secondly, under Article 3, "bearer" can never be a specific payee but under the NPC, "he" can. Thirdly, the NPC adds a new thought by requiring an account which can be accessed to pay someone other than the drawer or drawee. The drafters deliberately excluded two-party charge cards from NPC coverage. Finally and most significantly, the NPC eliminates those dear little "magic words" of negotiability. What does that mean in terms of the fundamental concepts of negotiability, holder in due course rights and the ability to cut off claims and defenses? The NPC has a complicated answer to that. Claims and defenses are not cut off as against a consumer drawer or with respect to any order which states that it is not entitled to "due course" rights.

While some of us just mourned the passing of a venerable tradition, the banking spokesmen were furious. "Just exactly *how* did the drafters propose to distinguish a consumer order from a non-consumer order?" The banking interests viewed the situation as yet another instance of the law "dumping" on the banks. Professor Hal Scott, Chief Reporter for the NPC, responded that the banks obviously would have to figure out some way to identify consumer accounts and hence consumer orders, but in light of technology and banking ingenuity, he felt that surely the problem was not insurmountable. He sug-

gested a specially colored check or a special computer symbol.

The consumer interests vehemently objected to the consumer/non-consumer order distinction on other grounds. Section 50(12) defines "consumer account" as an account "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." Although § 800(4) imposes civil liability on an account institution which advises an individual to misrepresent his intentions with respect to the account's use, the consumer interests maintained that lower charges could persuade individuals to waive their consumer account protection. Rational consumers might opt for lower charges and presumably nonconsumer accounts would involve lower charges because banking risks were less.

The debate was followed by a huge (and heated) discussion about the advisability of allowing non-consumer drawers to eliminate due course rights by stating so on their instruments. This attack clearly surprised and bemused the drafters. Somewhat incredulously, they responded that Article 3 presently permits that. For instance, an individual can eliminate any possibility of a subsequent holder in due course by simply scratching out the words "to the order of" on his check. Even though the drafters were absolutely correct—they were not really changing anything at all—they failed to persuade the audience of that fact. The audience perceived this change as fundamentally threatening our orderly commercial society. (I found this concern to be uncommonly silly. Who would take either a check with the words "to the order of" scratched out or a NPC order indicating that due course rights were not available?)

The NPC distinguishes between "draw orders" and "pay orders." A draw order is "an order initiated by the drawer and transmitted to the payee . . ." A check, for instance, is an example of a draw order. A "pay order" is "an order initiated by the drawer to the drawee directing the drawee to pay . . . the payee . . ." The speaker on this topic said that a draw order *pulls* funds back from the payor account institution to the account institution of first deposit for the benefit of the depositor, while a pay order *pushes* funds from the payor account institution to the account institution holding the payee's account. This push/pull metaphor obviously enamored all the drafters. My initial response was "huh?" If you read it twenty times, you realize that the difference between a draw order and a pay order is to whom you give the order: draw orders go first to the payee, pay orders go directly from the drawer to the drawee.

Because the NPC applies to non-paper based payment systems, the term "holder" became useless—holder of what? Therefore, the NPC had to create a new person. He is the "funds claimant." Because you cannot indorse non-writings, indorsers and indorseees had to go too. The NPC substitutes in their stead "transferors" and "transferees." That seems manageable until you get to pay orders when you have "funds transferors" and "funds transferees." The "funds transferor" is the person directed to pay. The "funds transferee" is the person who is to receive payment. Even that is tolerable. It is only when you realize that there can be "funds claimant transferors" and "funds claimant transferees" that one begins to despair. Bowing to technological advances, the

NPC's new cast of characters also includes a new villain, the "interloper." He is the fellow who intercepts an electronic transmission and changes either the amount of the order or to whom it is payable or both. (By the time he was introduced, we were all tired and I was punchy. "Home, home on the range where the deer and the interloper play" kept going through my mind.)

All of this new terminology and pushing and pulling did not sit well with the audience. In addition to general confusion, noises began to be made that maybe electronic transfer payment methods were different from checks which were different from credit cards and the differences really justified different treatments. At about this time, it also came out that Article 3 would continue to govern promissory notes and Article 4 might have to remain to govern promissory notes collected through banking channels. The NPC then would *not* replace Articles 3 and 4. It would be *in addition* to Article 3 and 4! (I must admit to a fleeting sense of pleasure that if the NPC were adopted, our Commercial Law I course would have to be 8 credit hours.)

By the end of the three days, it was clear that no one much liked the NPC. Consumer interests believed that the NPC gave fewer rights to consumers, the banks believed that it gave too many rights to consumers. Everyone thought that the language and terms were unduly complicated. Finally, over and above everything else, actual adoption of the NPC seemed impossible. In light of the supremacy clause, states could not successfully enact the NPC because it overrides federal law, *viz.*, TILA and EFTA. That left as the only alternative federal enactment. No one dared to entrust the NPC to Congress. The overall consensus then, for one reason or another or several, was negative in the extreme.

Although this draft of the NPC will surely not be approved, and perhaps the basic dream of a uniform payments code will never become a reality, certainly some of its suggested clarifications of existing law will be adopted. For those devotees of Articles 3 and 4, here is a quick run down of issues you considered in Commercial Law I.

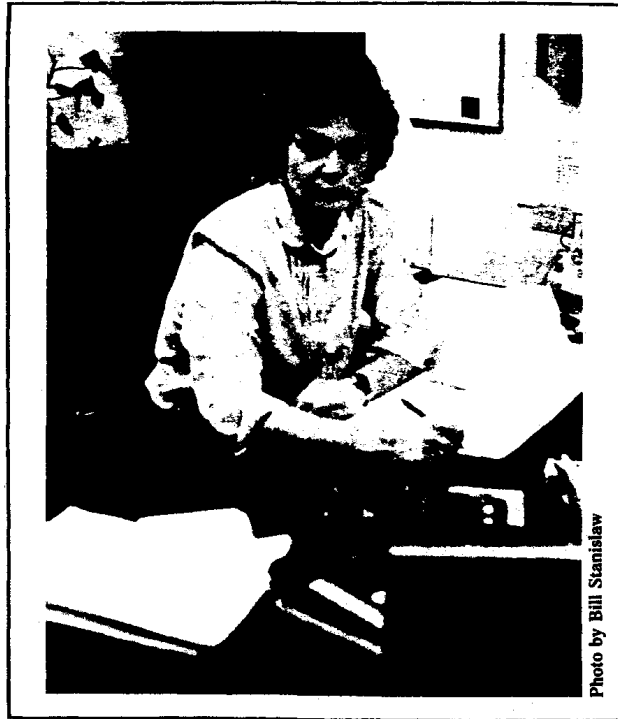
1. The NPC adopts the reasoning of the *West Side* case and eliminates completion of the process of posting as a benchmark for final payment. § 420.
2. A cow no longer qualifies as a negotiable instrument, nor do bricks, tissue paper or cocktail napkins. According to comment 1 to § 101, a payor account institution is only required "to pay authorized orders initiated by an access device provided to the drawer by the account institution." Banks customarily do not issue the above as means to draw on accounts.
3. Much to the objection of those in attendance, the NPC sounds the death knell to *Price v. Neal*. The drafters justified overturning this ancient doctrine by noting that with check truncation, the payor account institution cannot verify the drawer's signature. Even with non-truncated checks, banks do not verify signatures because it is uneconomical to do so. Section 204(1) sacrifices the finality afforded by *Price v. Neal* in favor of imposing the loss on the party who dealt with the thief.
4. The sum certain requirement is satisfied even if the order contains a variable interest rate, if that interest rate is based on a widely and publicly quoted

interest rate, such as the federal funds rate or prime rate of a particular account institution.

5. The NPC gives the intended beneficiary of a check a direct cause of action in conversion against the depository account institution, thereby codifying the present, albeit tortured, judicial "interpretation" of § 3-419(3) (§ 205(1).)
6. Section 50(3) defines "good faith" as the "absence of bad faith. Bad faith is dishonesty in fact, malice in the conduct or transaction concerned, or willful or reckless disregard of known material facts." (The banking representatives really kicked and hollered about this change. We were treated to impassioned pleas to shield banks from courts who might construe bank stupidity as bad faith. Banks maintained that the Code should protect their stupidity.)

I want to end my observations as I began them,—on a personal note. Professor Scott, a short man with wiry hair, typically sat at the front table facing the audience. He smoked. By the third day, he had taken to twirling his hair and chain-smoking. The situation must have been discouraging. On the first day, the chairman of the conference had said that, absent consensus from the assembled group, the NPC would never get anywhere. By the end of the conference, everyone knew what that consensus was and what it meant. As I watched the dream of a uniform payments code unravel and Professor Scott twirl his hair more and more rapidly, I felt very sorry for him and all the drafters who had worked for 6 years on the project. It was not until the last day, the last hour almost, that someone stood before the microphone and thanked the committee for their fine and hard work and noted that it had not gone unappreciated. At the time, I thought back to Karl Llewellyn and Grant Gilmore and wondered how they had managed to weather 20 years of hostile critics, powerful lobbying groups, sheer stupidity, infighting and every other unpleasantness that must be endured to make a vision become a reality. Emerging from the conference, I thought about the many unsung heroes whose blood, sweat and tears had changed our law for the better and paid my respects.

Post-Script: On February 20, 1984, the *Daily Press* carried an AP story headlined "Laws lacking on electronic crime actions." The article discussed a Justice Department report expressing great concern about the inadequacy of existing *criminal* laws with respect to electronic fund transfer and computer crime. Although electronic crimes have the same consequences as traditional theft,



the traditional requirements for theft may not be present. For one thing, an electronic command may not constitute a taking. For another, the contents of a computer memory bank may not be property. In addition, criminal fraud requires misrepresentation to a person and legally, a computer may not be a person. According to the report, the absence of law, in conjunction with the proliferation of electronic based systems and the concomittant opportunity for crime, has created a critical situation. The absence of *civil* law produces an equally critical situation as courts attempt to allocate loss between innocent victims of these crimes. The NPC provides a set of rules allocating risks and can guide courts and also inform the parties at risk so that they can take steps to protect against loss (for instance, insurance) or allocate the loss differently by contract.



FOOTNOTES

1. The origins of the acronym "NPC" are almost as complicated as the NPC itself. The Uniform Probate Code got to "UPC" first. That scotched the name "Uniform Payments Code." The drafters added the word "new" to give the letter "N" which was not the letter "U" and therefore permitted an available three letter acronym.
2. The Article 3 definition of "value" which differs from the Article 1 definition of "value" is a good example of such an oddity.
3. "N.I.L." stands for Negotiable Instruments Law, the law which preceded Article 3 and which every state had enacted as of 1924.
4. The *Daily Press*, Monday, February 20, 1984.
5. Memorandum to National Conference of Commissioners on Uniform State Laws from Hal S. Scott, Reporter to the 3-4-8 Committee, dated June 15, 1983, p. 1.

6. Under the present situation, parties have different rights depending upon the payment system used. For instance, if a consumer pays a merchant by check, the consumer has no recourse against his bank once final payment occurs. If a consumer pays by a bank charge card, § 170 of TILA gives him certain rights.
7. In fact, on the last day of the conference, a young, bright and somewhat brash academic noted the similarities of purpose between the NPC and Article 9 and then criticized the NPC for tracking itself along the lines of Article 4 rather than Article 9. In his opinion, Article 4 was the Code's most poorly drafted article and therefore a terrible model. Fairfax Leary ("Fax"), one of the Article 4 drafters, a general Code gadfly and conference participant, sat close by. The audience's response of "oohh" suggested that it did not want Fax's name to be taken in vain.