FIRST ASSIGNMENT
COMMERCIAL PAPER & PAYMENT SYSTEMS
Professor Budnitz
Spring 2009

Payment by Paper, Plastic and Blips

In a broad sense, this course is about one of the most basic features of economic life, the transfer of money to pay for goods and services. The first class is designed to expose you to several different methods of transferring value and the implications of using one method rather than another. Subsequent classes will broaden and deepen your understanding of the issues dealt with in this introduction.

I. The Payment Devices We Will Consider

We will consider a typical retail transaction in which Cary Consumer purchases a $60 cell phone from Martina Merchant. We will discuss, in order, Consumer's paying for the purchase in the following ways:

1. Cash

2. Promissory note. Consumer pays by handing to Merchant a piece of paper which says:

> Atlanta, Georgia
> January 8, 2009
>
> For value received, I promise to pay to the order of Martina Merchant in 30 days $60 plus $5 interest.
>
> (Signed) Cary Consumer

3. Ordinary check which has Cary Consumer's name, telephone number, and Atlanta address printed on it, made payable to Martina Merchant.

4. Bank issued Visa credit card.

5. Visa "Check Card." This is one type of debit card, a plastic card which is almost identical in appearance to the Visa credit card. It is used in the following manner. Consumer or Merchant puts the card into a computer terminal. Some cards require Consumer to type his personal identification number (PIN) onto the keyboard; most do not require a PIN. Merchant types relevant information about the transaction into the terminal. If the system is "on-line" the $60 is immediately

transferred electronically from Consumer's bank account to Merchant's bank account. If off-line, the transfer occurs later but is treated as if it were transferred immediately.

6. GSU PantherCash. This is a stored value card (SVC). The SVC is a plastic card which contains a computer chip or magnetic stripe. The money the Consumer has paid the card issuer, in this case GSU, can be accessed and transferred via the stripe or chip. Review GSU's PantherCard web site: www.gsu.edu/panthercard Click on "PantherCash Overview." Once on the Overview page, click on "PantherCash" to the left of the picture of the PantherCard. That will take you to a page where there is a picture of the PantherCard on the left side of the page and a list of topics. Double click on "PantherCash Application Form." Review the terms and conditions on the second page of that form. Because the type is quite faint and small, you probably will have to print that page to be able to read it.

Assume Consumer purchases a reloadable PantherCash card for $100 and uses it to purchase the cell phone at the GSU bookstore.

More on SVCs— Visa calls its SVC a "Cash Card" and it is almost identical in appearance to the Visa credit card. In the future, Visa and Mastercard will combine the features of a credit card, debit card and SVC all on the same card. Customers of many banks can go to an ATM (automated teller machine) and buy SVCs, the money coming out of the customer's bank account. Cards also can be purchased inside the bank, or through vending machines and at other locations. Some cards are disposable (prepaid gift cards and telephone cards). Once the value is spent, the card can no longer be used. Other cards are reloadable; the consumer can reuse the card by transferring new value to the card from an ATM, vending machine or by phone.

7. Buying on the Internet. Consumer sees the cell phone on www.cell phonesRfree.com. He uses his mouse to click on the cell phone model and color he wants, then types in his Visa credit card number and its expiration date. He clicks on a button labeled "Sell me this cell."

II. Scenarios We Will Consider

A. The parties

Consider each of these payment systems from the vantage point of both Merchant and Consumer. Which payment device is most advantageous to each party? What other parties are involved?

B. The Scenarios

Review each payment device with the following in mind. We will discuss these in class.

1. The cell phone is a piece of junk.

2. Cary Consumer places a high value on his privacy. He is an absolutely honest person, but would prefer that as few people as possible know that he has purchased the cell phone. The federal government's efforts to gather personal information from cell phone companies in its battle against terrorism make him want to safeguard his privacy more than ever.

3. Martina Merchant depends upon heavy sales volume for the success of her business. Ask yourself this question: Would it hurt Martina's sales volume to refuse to accept payment via any of the seven payment devices or systems described above?

4. Martina Merchant needs money in order to purchase additional inventory and pay the rent. She needs to be able to transfer the payment device used by Consumer to purchase the cell phone in such a way that she can realize value from it in the near future so she can buy more phones to sell and pay the rent.

5. Consider the consequences if the payment device is presented, not by Cary Consumer, but by a thief who stole Cary's payment device and is using it to purchase the cell phone.

III. Statutes and Regulations

In connection with the above, **briefly** review the following statutory provisions. We will go into a detailed analysis of statutes and regulations in subsequent classes, but not in this first class.

1. Money - Uniform Commercial Code (UCC) §§1-201(24) & 3-102(a). The UCC is included in <u>2008 Comprehensive Commercial Law Statutory Supplement</u> (hereafter referred to as <u>SS</u>.) The first part of the statutory citation refers to one of

the several Articles of the UCC. §1-201 refers to Article 1, section 201. The sections referred to are in SS pp. 21 & 332.

2. Promissory notes - UCC §§3-201(a) & 3-306. (SS pp. 346 & 362.) Merchant needs an instrument which she can transfer to a third party so she can obtain cash quickly. The third party will purchase the instrument from Merchant at a discount (e.g., $55), and in return obtain the right to collect the face amount ($60) from Consumer. Merchant therefore wants an instrument which is negotiable, meaning transferable. Furthermore, to increase the marketability of the instrument, she needs a promissory note which the transferee, the holder, can take and use to demand payment from Consumer, without having to worry about any dispute between Consumer and Merchant. If the transferee has the status known as "holder in due course" the transferee takes the instrument free of such worries. For purposes of the class discussion, assume Cary Consumer's promissory note is a valid negotiable instrument which can be transferred to a holder in due course. Nevertheless, are there potential disadvantages to Merchant's accepting payment by this device?

3. Checks - UCC §4-403(a) (an "item" includes a check)(SS p.441).

4. Credit cards - Consumer Credit Protection Act, Regulation Z, §226.12(b) & §226.12(c). (SS pp. 1074-75.) (Read to get a sense of the general scheme; don't worry about the details for now.)

5. Point of sale debit card - Electronic Fund Transfers Act, Regulation E §205.6(b); (SS pp.1140-41.) Do not spend a great deal of time trying to completely understand this provision; just get a general idea of the consumer's notification duties and the limits on consumer liability.

6. Stored value card. No federal statute applies to this payment device. Should Congress enact a law to require disclosures and guarantee the minimal consumer protection included in credit and debit card law?

7. Buying on the Internet and paying with a credit card. Is this transaction different from any other purchase using a credit card? Are additional or different rules needed? For example, should the consumer's $50 limit on credit card liability for unauthorized use be increased for Internet sales since consumers buying on the Internet should understand the need to guard against unauthorized use of the card? Should additional disclosures be required about the increased risk of using a credit card to purchase goods on the Internet?

Outline of Payment Systems Features

The following outline summarizes the key features of the payment systems examined above. While it is highly unlikely you will understand most of the outline initially, after we discuss the above scenarios, it should be a useful aid to seeing common features of and relationships among various systems.

Transfer of value

Transfer of instruments
- Actual physical transfer of possession: cash, notes, checks
- Contrast with payment devices where no physical transfer: credit, debit & SVC cards & payment over Internet

Evidence of an obligation — notes, credit & debit card receipts
- If pay with cash & no receipt, no evidence of transaction
- If pay over Internet & no printable screen or e-mail confirmation, no evidence of transaction

Devices for transmitting funds — checks, debit card, stored value card, personal computer, ATMs, wireless devices such as cell phones

Risk of ownership dispute — payment instrument as property
- Loss or theft of cash, check, credit, debit or SVC card

Transferability to third party
- Notes & checks — protection for 3rd party if Holder-in-Due-Course
  - Usually transferred by indorsement plus physical transfer
- Owner can transfer credit, debit, & gift cards

Time of payment: from consumer's perspective
- Before purchase — SVC (consumer buys SVC before purchasing anything with it, but when value is transferred from consumer depends on how consumer pays for the SVC)

- At time of purchase — instantaneous: cash, debit card

- In near future — checks

- In more distant future — credit card, note (typically payment is due in more distant future than checks, but could be due soon if demand note or note specifies early payment)

Time of payment: from merchant's perspective

Before consumer's purchase using card — SVC
When consumer makes purchase or soon thereafter — cash, credit or debit card, bank-issued SVC

Self-protection — when consumer buys goods that are defective or never delivered: stop payment (checks & pre-authorized electronic transfers), reversibility (in Michigan, debit cards), withholding payments (credit cards). No protection: cash, debit card, SVC