

## **ELECTRONIC PAYMENT SYSTEMS**

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### **Abstract**

Electronic commerce online is expanding at an exponential rate. Much of this relates to the type of consumer transactions which would otherwise have been fulfilled in the market using one of electronic funds transfer at the point of sale devices (EFT-POS), such as cheque cards, debit cards, credit cards or debit cards. The legal consequences of the use of the cards are based on the contract between the card issuer and the card holder. Without exception, these contracts will be standard form, on the issuer's provisions. The Consumer Credit Act 1974 (CCA) is considered the main source of statutory regulation of plastic cards. However, it does not apply to all plastic cards. This article aims to identify general rules of the law relating to new payment systems, and concludes that the collection of payment system law should abide in a body of statute. This would provide clarity for the parties about their rights and duties, and avoid any misunderstanding.

**Keywords:** Electronic payment, credit cards, debit cards, credit token, credit token agreement

### **Introduction**

Banking development has created a new mode of funds transaction called 'electronic banking'. This form of banking made transactions of funds between buyers and sellers easier, faster and more secure. Electronic fund transfer at the point of sale (EFT-POS) means the movement of an amount from a payer's account (card holder) to a seller's account, enabling funds to be transferred electronically via the card holder's plastic card in order to obtain goods or services without the use of notes or coins. This form of electronic service offers the rightful holder access to the bank account at any time, from any geographic location in the world. This type of access is possible via the use of plastic cards issued by the bank or corporation in the holder's name and can be used at the point of purchase, at a cash point machine, at the bank or via telephone transaction.<sup>2</sup>

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<sup>2</sup> Cards are assured by the bank and business organization. For further details, see Ellinger, E., Lomnicka, E., Hooley, R., *Modern Banking Law (4th ed.)*, (2006), p.581.

In the United Kingdom, payment law did not give specific definitions for the payment; however, the legal commerce community provided a different definition for fund transfer systems. It is either a credit transfer system or a debit transfer system based on the methods of payment instructions that are communicated to the payer's bank. A credit transfer pays the funds from a payer's account to the seller, and authorises the payer's bank to debit his account, while at the same time the seller's bank account will be credited. In contrast, a debit transfer order is receipt of the funds by the seller through giving his or her bank an order to collect the funds from the payer's bank. The aim of this article is to provide an overview of the electronic payment system under English law. This will summarise the most significant issues arising from uses of an electronic payment and categorise them, rather than considering all the electronic payment methods that have been present in the last two decades.

## **1 Definition of Electronic Payment**

### ***A Search for Definition***

The law does not give a specific definition of 'payment'.<sup>3</sup> Goode has defined payment as 'a gift or loan of money or any act offered and accepted in performance of a money obligation.'<sup>4</sup> According to this definition, a payment is not always money but can also be some other form or act of exchange between the two parties involved in a transaction. In addition, the acceptance of payment by the transferee is conditional, thus affecting the completion of a transaction.<sup>5</sup> Over the last few years, many systems have emerged by which the consumer may make their payment by electronic methods, such as cards. Benjamin Geva defined a payment mechanism every electronic device which allows the transfer of funds from the debtor's bank account to the creditor's bank account by physical transfer.<sup>6</sup> Also, payment under electronic methods are initiated by payment instructions, either given by the debtor or under his legal estate, which are known as a funds transfer by either debit transfer or credit transfer.

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<sup>3</sup> Tyree, A., Beatty, A., *The Law of Payment Systems*, (2000), p.1.

<sup>4</sup> Goode, R., *Payment Obligations in Commercial and Financial Transactions (2nd ed.)*, (1995), p.501.

<sup>5</sup> Brindle, M., *Law of Bank Payments (3rd ed.)*, (2004), p.1.

<sup>6</sup> See Geva, B., *The Law of Electronic Funds Transfers*, (2003), Section 1.03 [1]; Geva, B., *Legal Aspects Relating to Payment by E-Money: Review of Retail Payment System Fundamentals*, (2001), p.11.

Electronic payments either by debit transfer or credit transfer are involved in the settlement of balances on the accounts of the debtor and the creditor.<sup>7</sup> The Jack Report defined EFT-POS as a means of transferring money from the payer's account to the seller's account by use of the payer payment via his or her card at the seller's cash point to obtain the goods, services and cash (or any of them).<sup>8</sup> This definition clarified EFT-POS online, but EFTPOS can also accrue offline.<sup>9</sup> In this position, there is no direct contact between the payer and the seller.<sup>10</sup> Under United Kingdom, law there is no particular definition of payment instruction; moreover, the Banking Act 2009 does not give any definition of payment instruction. The common definition is that a 'payment instruction' is an order or a mandate by the customer to his or her bank carried out under the agency law rules.<sup>11</sup>

A credit transfer system is a method of transferring money from payer's account to the seller's account due to the fact that the payer gives an order to his or her bank to debit his account. As a result, the seller's account will be credited. In contrast, a debit transfer system is the withdrawal of funds by the seller from the payer, when the seller gives his or her bank an order to collect the money from the payer bank.<sup>12</sup> Where the funds transfer from the payer's account to the seller's account, it is easier if they have accounts at the same bank because the bank will be settlement of the debt between the parties. However, if each party involved in the transaction has an account in a different bank, then the order to transfer funds from debtor's account to the creditor's account must involve a third bank (the Bank of England) to complete the settlement between the parties.<sup>13</sup> A 'payment instruction' in this article means:

An instruction transferred, immediately or not immediately, from the customer to its bank to another bank to make funds transfer order whether credit transfer or debit transfer of a sum of money to advantage which does not condition to payment to the advantage other than time of payment.

From this definition, a payment instruction has several elements. For example, the purpose of the payment order is the payment or collection the money; the sum of money

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<sup>7</sup> Sealy, L., Hooley, R., *Commercial Law (4th ed.)*, (2009), p.720.

<sup>8</sup> Review Committee, 'Banking Services Law and Practice Report', (1989), Cm 622, para.9.09.

<sup>9</sup> Sadeghi, A., Schneider, M., "Electronic Payment Systems", in Becker, E., et. al., (eds.), *Digital Rights Management*, (2003), p.121.

<sup>10</sup> Smith, M., Robertson, P., '*Plastic Money*' in *Law of Bank Payments*, (2004), p.200.

<sup>11</sup> Arora, A., *Electronic Banking and the Law*, (1988), pp.49-53; Ellinger, et. al., *Modern Banking Law*, p.363; Brindle, *Law of Bank Payments*, p.112.

<sup>12</sup> Sealy, et. al., *Commercial Law*, p.716; Brindle, *Law of Banking Payments*, paras. 3-003 - 3-005.

<sup>13</sup> *Ibid.*, p.726; *Ibid.*, para.3-006.

must be fixed; the customer is free to determine the time of payment;<sup>14</sup> and finally, the payment order has to be addressed to a bank.<sup>15</sup> Generally, electronic payment system development cannot happen without involving a bank, as with the classic giro transfer order. Electronic payment always depends on transfer of the money from a debtor's bank account to the creditor's bank account, irrespective of whether this is by debit transfer system or credit transfer system.

Under Section 35 of the Sale of Goods Act 1979, when the payer purchases goods and does not give any impression or action to the seller, the sale will be valid. However, by mere fact of acceptance of sale, the seller trusts in the completion of this transaction. On this point, the Sale of Goods Act itself has been exposed to criticism,<sup>16</sup> but the Act is still in use. The legitimacy of the analogy between the acceptance of goods and acceptance of payments is considered valid as it was first implemented by Hobhouse J in *TSB Bank of Scotland Ltd v Welwyn Hatfield DC and Council of the London Borough of Brent*.<sup>17</sup> In that case, the dispute arose between the debtor and the creditor – the parties to a complicated transaction. The debtor paid a certain sum to the creditor who communicated to the debtor that the payment was only to be accepted as a partial payment. The creditor requested an acceptance of this term from the debtor, simultaneously promising to keep the debtor's money in a separate account and to return it should the debtor reject the new term of transaction. The creditor violated the terms of his communication by not creating a separate account for debtor's money, by lending it to others and by earning interest on it. The judge ruled that the creditor's action amounted to full acceptance, creating a new rule; when a party puts money unconditionally at the disposal of a creditor; and the conduct of the creditor, viewed objectively, amounts to accept once, then the party is considered to have made the payment regardless of the communication between the parties.

Since the case was not litigated on the appellate level, whether Hobhouse J was correct in his understanding of the current law remains questionable, but the analogy is logical and is likely to stand up to any level of litigation. Consequently, payment by the payer to the beneficiary could be final in spite of the payer's bank not paying the beneficiary's bank, if the beneficiary bank was ready to credit the beneficiary's account in progress of

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<sup>14</sup> Uniform Commercial Code (1960), Article 4A-103(A)(1)(I).

<sup>15</sup> Bill of Exchange Act 1882, section 2.

<sup>16</sup> Geva, B., *Benigamin's Sale Goods (5th ed.)*, (1997), para.12.

<sup>17</sup> [1993] 2 Bank LR 267.

collection. Conversely, the beneficiary bank may delay crediting the beneficiary's account until having itself collected the funds from the payer's bank. This is done because the bank may doubt the exact account of the beneficiary or the validity of payment. It then delays payment as between payer and the beneficiary to give itself sufficient time for the verification.<sup>18</sup>

### ***Unification of Electronic Payment Law***

At the beginning of the twenty-first century, nobody discussed payment legislation because payment by Bills of Exchange and cheque were the most common way to settle a payment<sup>19</sup> Nevertheless, the significant statute in the United Kingdom governing electronic payment, either by credit transfer or debit transfer, is the Cross-Border Credit Transfer Regulations 1999,<sup>20</sup> which was a transcription from the United States Article (4) 1989 and the Uniform Commercial Code (UCC) 1960. In the last 40 years, payment has been developed in a sophisticated way through payment by plastic card, although there is no law governing all types of plastic payment. The Consumer Credit Act (CCA) 1974 and the Consumer Credit Act (CCA) 2006 consider the essential source of statutory regulation of electronic money; however, they do not apply to all types of electronic money (though there is no doubt they govern payment by credit cards). In the UK, debit card transactions are not governed by legislation. However, the agreement between the parties governs the relationships between them. In addition, internet banking relationships could be regulated by contract and internet rules. Apart from this, common and public law govern the contractual schemes between the parties. Payment system laws raise important legal issues: first, whether it is best to create specific payment system legislation or to leave the matter to case law; second, which freedoms should be given to the parties, for example, should they choose their rights and liabilities or leave this to legislation?

Some analysis and answers to these questions might be found in Commercial Law which, according to the literature, is codified in areas limited to security and quasi-security interests of the companies, while leaving the bulk of the operational issues to be resolved by the common law – even though legal scholars argue that a more efficient legal system is needed and that it could be created by a more comprehensive codification of the commerce law found in the cases. The advantage of codification is the

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<sup>18</sup> Brindle, *Law of Banking Payments*, p.8.

<sup>19</sup> Governed by the Bills of Exchange Act 1882 and the Cheques Act 1957, respectively.

<sup>20</sup> SI 1999/1876.

fact that all similar issues could be easily and quickly resolved by referring to the statute, as illustrated by the decision in *Royal Products Ltd. v Midland Bank Ltd.*<sup>21</sup> In that case, the litigants were Royal Products (plaintiff); a 'Maltese company [which] trades in Malta', Midland Bank in the United Kingdom; a third party, namely the correspondent bank of the Midland Bank called the 'National' (also located in Malta); and the Bank of Industry, Commerce and Agriculture Ltd (BICAL). Royal Products had an account with the Midland Bank and with BICAL in Malta. The plaintiff gave an order to the Midland Bank to transfer approximately £13,000 from their current account to BICAL, with which they also had a current account. Midland Bank did not charge Royal Products for the transfer. It used the National to transfer money to Malta, ordering a subsequent transaction from the National to BICAL. The National was aware of imminent financial problems for BICAL, but nevertheless transferred the money. BICAL collapsed the next day, Royal Products lost its money, and undertook legal proceedings against Midland Bank and the National.

Part of the reason for Royal Products' loss may be attributed to the absence of clear commercial legislation. At present, banks conduct their operations with each other based on bilateral contracts; however, some transfer systems depend upon multilateral contracts whereby each member bank has to conform to the system rules. Although transactions such as the one that Royal Products was engaged in do not create automatic private obligations between the payer and the payee, they may be able to rely on the system rules in order to ascertain their rights under the transaction. Such a position obviously creates a high risk of exposure for the payer, who in the absence of clear rules has to rely on the uncertain legal principles outlined in case law. Had there been a clearly defined legal position describing the obligations of all the parties involved, as in comprehensive commercial law, Royal Products probably would not have lost its money; it would have been able to protect itself under legislation and create specified terms in its transaction contracts. Thus, creating specific payment system legislation for would be ease dealings between the parties. However, some commentators argue that there is a possibility that payment legislation will be not enough to include all the data required for a payment system. Additionally, if new and different legislation dealing with payment systems is enacted it may lead to confusion as to which statute will apply,<sup>22</sup>

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<sup>21</sup> [1981] 2 Lloyd's Report 194; see also, *R v King* [1991] 3 All ER 705.

<sup>22</sup> Rogers, J., 'Unification of Payments Law and the Problem of Insolvency Risk in Payment Systems', (2008) 83 *Chicago Kent Law Review* 2, p.691.

unless new law is narrow enough to specify exactly the types of relationships and transactions that it regulates.

Overall, supposing that the law had been enacted in relation to payment in body, other problems would arise: the problem of whether the law should be set out in one statute or whether each method of payment should have a specific piece of legislation. Considering the complexity of modern day commercial transactions and the density of already accumulated legal information concerning the subject, the system would most benefit from a comprehensive legal framework, perhaps modelled after the very successful and highly respected UCC, Article 9, in the United States. Before implementation of Article 9, there were several bodies of legislation, governing security devices. But Article 9 adopted one law for all types of security devices which read:

Applie[d] to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's line, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security".<sup>23</sup>

However, Rogers criticised this, saying, 'Article 9 still has a variety of rules that distinguish between, for example, inventory versus equipment finance, or business versus consumer transactions.'<sup>24</sup> Certainly, if one concluded that virtually all, or even most, of the rules should be different for different payment systems, then it would make little sense to try to formulate a unitary body of law. But, it seems fairly implausible to suppose that is the case for payment systems. Additionally, the process of creating an instrument similar to the UCC would provide a good opportunity for a restatement and essential modernisation of the law in this area, which is long overdue. Many of the relevant statutes were passed a century ago, during a time of much slower transactions and a much lower volume of banking operations. They therefore cannot adequately address the needs of modern day commerce, which is based on a high volume of increasingly sophisticated types of transactions. To answer the second question, should methods of payment have specific legislation? Midland Bank's contract with Royal Products did not contract them to supply a fund transfer because the relationship

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<sup>23</sup> Section 9-102 (2).

<sup>24</sup> Rogers, 'Unification of Payments', p.692.

between them was bank and client. Usually, to use a fund transfer, the paying bank has a private agreement with the payer, in exchange for a fee.<sup>25</sup>

So, the terms and conditions of the contract between the parties will be significant in determining the duties and the obligations for all parties. In such a case, often the bank records in the contract that it will be not responsible for negligence or failure issuing from its customers. In contrast, the decision of the judge in the court is not always accepted by the litigants. It is arguable that they have no choice; if the litigants are dealt with by a statute, this may or may not allow for the parties to alter the rules governing the agreement.<sup>26</sup> There are several reasons why the payment system should be governed by a unified body of payment law; nevertheless, it is incorrect to say that all of the rules in said body of law should be applied to all payment systems. There should be one method for one payment system and another method for another payment system. In short, a variety of rules would be appropriate for a variety of payment systems.

## **2 Electronic Payment System Types**

There are two types of electronic payments; the first falls under credit-token agreements while the other does not.<sup>27</sup> The overall common aim for a credit-token agreement is to enable the card holder to obtain goods, services and/or cash by using a card.<sup>28</sup> Credit tokens are regulated by Sections 14 (1) and 51 of the Consumer Credit Act 1974 (CCA) and credit token agreements are regulated by Sections 14 (2), 16, 66, 84, 85 and 189(1) of the same statute. Cards that are not classified as credit tokens and that are not credit-token agreements do not fall under the CCA 1974 and are regulated by general principles of contract.<sup>29</sup>

### ***Plastic Cards***

There are several types of plastic card used in this jurisdiction. The first are Cheque Guarantee Cards. In the United Kingdom, Cheque Guarantee Cards' contracts are typically concluded subject to the following conditions:

- (a) The cheque contains holder's information and holder's signature before becoming effective; (b) the cheque is effective from the date of issue; (c) the card

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<sup>25</sup> *Royal Products v Midland Bank*, p.209.

<sup>26</sup> Rogers, J., 'The Basic Principle of Loss Allocation for Unauthorized Checks', (2004) 39 *Wake Forest Law Review* 2, p.455.

<sup>27</sup> Ellinger, et. al., *Modern Banking Law*, p.598.

<sup>28</sup> *Ibid.*, p.585.

<sup>29</sup> Sealy, et. al., *Commercial Law*, p.808.



information is written on the cheque by the issuer; (d) the card has not been changed after issued; (e) the cheque must be addressed to a known bank.

The aim of a cheque card or cheque guarantee card<sup>30</sup> is to secure the sellers, in that they can claim funds from either the card issuer or, if the card issuer becomes insolvent, from the card holder.<sup>31</sup> In these four contractual relationships, the essential payment duty is on the card issuer and this is well illustrated by the decision of Evans J in *First Sport Ltd v Barclays Bank plc*.<sup>32</sup> The judgment stated that under any circumstance the bank will be responsible to make payment to a seller on a cheque supported by a cheque guarantee card, as long as the bank agreed to be liable for payment of any sale and purchase in spite of the fact that the user is a thief.

Cheque cards are issued by banks to their clients. Most critics believe that cheque cards are not issued under a credit-token agreement.<sup>33</sup> Under Section 14 of the Consumer Credit Act 1974, cheque cards guarantee to beneficiaries that the cheque holder's account is solvent for the funds of the cheque, even if the cheque card is used to settle the transaction made between the cardholder and the third party. The guarantee is for the cheque not for the settlement.<sup>34</sup> Sometimes cheque card agreements may fall within a credit-token agreement under Section 14(1); that happens when the card holder uses the overdraft facilities of the cheque card and the bank is held by the contract to honour the payment obligation even if the card holder's balance is overdrawn.<sup>35</sup> Additional limitation is found in the first part of Section 14(1), which states that an issuer must be someone other than a company which offered goods, services and cash under credit. If the cheque card current account is in debt it cannot be used to obtain more goods or services because it is uncertain when the card holder will pay if his account is already overdrawn. The bank's obligation in this case falls under the second part of Section 14(1), which holds the bank liable to pay for the goods, services and/or cash even if card holder's account is in debt.

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<sup>30</sup> A 'guarantee' is a pledge from the bank to fulfil the bank's customers' debt; if they are insolvent, then the bank will be liable for the debt. Judge, S., *Business Law (2nd ed.)*, (1999), p.320.

<sup>31</sup> Brindle, *Law of Banking Payments*, p.189.

<sup>32</sup> [1993] 3 All ER 789, p.795.

<sup>33</sup> Keenan, D., Riches, S., *Business Law (8th ed.)*, (2007), p.400; Sealy, et. al., *Commercial Law*, p.835; Hapgood, M., et al., *Paget's Law of Banking (13<sup>th</sup> ed.)*, (2007), p.65.

<sup>34</sup> *Ibid.*

<sup>35</sup> Ellinger, et. al., *Modern Banking Law*, p.473-474.

The standard contract to issue a cheque card states that the card holder will be liable for refunds of any overdrawn amount that he incurs.<sup>36</sup> So, if the cheque card holder's current account is overdrawn and the bank provides funds on his behalf to a third party, the bank has a right for subsequent reclamation of the funds from the card holder's account.<sup>37</sup> Such a transaction is regulated by Section 8(2) of the CCA.<sup>38</sup> This allows the beneficiary to demand the cheque and payment. Under the franchise agreement, if the cheque is not guaranteed by the holder then the payment is considered absolute and the seller has no request against the buyer.<sup>39</sup> Sometimes a payer sends the cheque by post after the payee has accepted; in this case, the payer will not be obligated to the seller, exemplified in *Luttenberger v North Thoresby Farms Ltd.*<sup>40</sup> The principle in *Luttenberger* was that payment by cheque is considered final payment, not from the date the cheque is honoured, but from the date of the cheque's posting. In conclusion, if the seller agrees for payment by cheque posted, that means the payment has been paid from the day the cheque was posted. Where the cheque is guaranteed by the cheque card, payment by cheque is a conditional payment and the payer has a limited obligation to the seller for that payment for goods/services, and payment by cheque is still conditional and within the payer's duty. The payer is not liberated from the cheque until it has been honoured, due to this payment being conditional.<sup>41</sup> It is worth explaining that the UK Payment Administration decided that the cheque guarantee card scheme will be phased out of service by 30th June 2011.<sup>42</sup>

The second type of plastic card is a debit card. Debit card payment has grown rapidly in the last twenty years, possibly because it allows Electronic Funds Transfer at the Point of Sale (EFTPOS),<sup>43</sup> which is a debit transfer payment. In the UK, VISA and MasterCard considered the typical types of debit card works as EFTPOS. Debit card payment works by authorising the holder to either make retail payment at the point of obtaining goods,

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<sup>36</sup> Smith, et. al., *Plastic Money*, p.190.

<sup>37</sup> Ellinger, et. al., *Modern Banking Law*, p.590.

<sup>38</sup> Conditionally, the holder is an individual or the overdraft is in limited funds (Section 8(2)). See Brindle, *Law of Banking Payments*, pp.243-244.

<sup>39</sup> *Smith v Ferrand* (1827) 7 B. and C.19; ER 632.

<sup>40</sup> [1993] 17 EG 102.

<sup>41</sup> Brindle, *Law of Banking Payments*, p.625.

<sup>42</sup> Press Release, 'The Cheque Guarantee Card Scheme announces closure date of 30<sup>th</sup> June 2011', UK Payments Administration, 25 September 2009:

[http://www.ukpayments.org.uk/media\\_centre/press\\_releases/-/page/719](http://www.ukpayments.org.uk/media_centre/press_releases/-/page/719).

<sup>43</sup> Brindle, *Law of Banking Payments*, p.198. There are a couple of important EFTPOS debit card types, namely, Visa card and MasterCard. See Sealy, et. al., *Commercial Law*, p.809.

services or cash via Automated Teller Machines.<sup>44</sup> The security of the transaction is assured by the issuance to the customers of personal identification numbers (PINs).<sup>45</sup> This is to ensure that the card and the PIN belong to the rightful holder, by comparing the card's details with the bank's customer account. When the rightful holder uses a PIN to make a purchase, the debit will be on his or her current account; as such, the card holder's account must always be kept in credit,<sup>46</sup> unless the cardholder obtains credit from the card issuer in case he or she agrees for an overdrawn account. In this type of transaction, the retailer will get payment money transferred to his account from the purchaser's account within a few days at a maximum.<sup>47</sup> As a result of debit card usage, the buyer's account and the seller's account are settled by the debit and credit message sent electronically over the network.<sup>48</sup>

Legal and commercial communities disagree over the classification of debit cards. One group of scholars<sup>49</sup> argues that debit cards are credit-token agreements regulated by the CCA 1974 because they can have an overdraft facility, but not for debit card payments without overdraft facilities. An overdraft is a contract to provide people with an overdraft facility, otherwise called a running-account credit (Section 10(1)(a)).<sup>50</sup> An overdraft facility on a card holder's bank account will often be an unrestricted-use credit contract, which means it does not fall within a pre-existing agreement with any sellers. Therefore, it is a debtor-creditor agreement (section 13(c)).<sup>51</sup> A debit card with an overdraft facility is a 'credit-token'; therefore it falls under the CCA 1974, Section 187(3)(a), as well as under the Banking Act 1987, Section 89. This is subject to exceptions created by the CCA excluding them from CCA (Sections 56 and 75) due to the fact that they are not considered to be debtor-creditor supplier agreements. Therefore, under these regulations the debit card issuer is not automatically responsible for any misuse by the

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<sup>44</sup> Caskey, J., Sellon, G., 'Is the Debit Card Revolution Finally Here?', (1994) 79 *Economic Review* 4, p.80.

<sup>45</sup> Since 14 February 2006, rightful holders demand to recognise their PINs. For more details see Sealy, et. al., *Commercial Law*, p.809; Klee, E., *Paper or Plastic? The Effect of Time on Check and Debit Card Use at Grocery Stores*, (2006), p.5.

<sup>46</sup> Sayer, P., Barrister, M., *Credit Cards and the Law: An Introduction*, (1988), p.5; Hapgood, et. al., *Paget's Law of Banking*, p.63; Rosenthal, D., *Guide to Consumer Credit Law and Practice*, (1994), p.97.

<sup>47</sup> Mann, R., 'Credit Cards and Debit Cards in the United States and Japan' (2002) 55 *Vanderbilt Law Review* 4, p.1056.

<sup>48</sup> Sealy, et. al., *Commercial Law*, p.809.

<sup>49</sup> *Ibid.*, p.836; Goode, R., *Consumer Credit Law and Practice* (1999), paras 25.83-25.84; Sayer, et. al., *Credit Cards and the Law*, p.5; Smith, et. al., *Plastic Money*, p.232.

<sup>50</sup> Consumer Credit Act 2006

<sup>51</sup> Consumer Credit Act 1974

seller. The other group of scholar claims that debit cards are not credit-tokens because they function more like cheques,<sup>52</sup> which are used to transfer funds from payer to the seller directly from the payer's account, rather than credit cards which represent a form of credit.<sup>53</sup> There is no question that those debit cards that are issued with overdraft facilities under the Consumer Credit Act 1974 necessarily qualify as credit-tokens, even though the holder did not want this facility.<sup>54</sup>

Smith, Robertson and Guest belong to the group that classifies debit cards as not credit-tokens,<sup>55</sup> regardless of whether there are overdraft facilities or not, because they consider that when the card holder pays by debit card, the holder is held to pay from his or her bank account under the conditions of the bank's contract. Smith, Robertson and Guest argue the fundamental principle that there is insufficient connection between the provision of the overdraft and the use of the debit card. So, regardless of whether there is an overdraft or not, debit cards do not issue under the CCA according to these general principles. But this position is disputed by Mark Hapgood,<sup>56</sup> who states that debit cards are regulated under the CCA 1974, Section 12 (debtor-creditor-supplier agreement). He argues that this is because the holder obtains goods or services from the seller, and he or she is paid from his or her bank account. He suggests that the definition of credit-token agreements is 'regulated agreements', so debit cards are just a method of payment and outside the ambit of the CCA. Since credit is drawn by the debit card user from the card issuer at the point of purchase, the relationship between the card holder and the card issuer falls under Section 14(3) of the CCA, so it is not easy to argue that debit cards do not fall under the statute.<sup>57</sup> Section 14(3) clarifies the relationship between the users of debit card and their issuers, through the provision concerning the card issuer, covering withdrawals every time the cardholder receives goods, services or cash from the third party.<sup>58</sup>

Without prejudice to the generality of section 9(1), the person who gives to an individual an undertaking falling within subsection (1)(b) shall be taken to provide

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<sup>52</sup> Caux, T., et al., *Electronic Banking and Treasury Security*, (2000), pp.8-9.

<sup>53</sup> Sealy, et. al., *Commercial Law*, p.836; Ellinger, et. al., *Modern Banking Law*, p.601.

<sup>54</sup> *Ibid*; Hapgood, et. al., *Paget's Banking Law*, p.64.

<sup>55</sup> Brindle, *Law of Banking Payments*, pp.245-246; Guest, A., Loyd, M., *Encyclopedia of Consumer Credit Law* (1975), para 2-015; Ellinger, et. al., *Modern Banking Law*, p.474.

<sup>56</sup> Hapgood, et. al., *Paget's Banking Law*, p.83.

<sup>57</sup> *Ibid.*, p.84.

<sup>58</sup> Sealy, et. al., *Commercial Law*, p.836.

him with credit drawn on whenever a third party supplies him with cash, goods or services.

Under section 14(2) of the CCA 1974, the above relationship falls under credit-token agreements. On the whole, not all agreements where a credit token is issued fall within the definition of credit token agreements; for instance, not all debit card issues fall under an overdraft account.

The third type of plastic card is a credit card. Credit card payment is the most substantial and popular payment system in use across the world.<sup>59</sup> Despite the name 'credit card', it works as a debit transfer system.<sup>60</sup> A credit card is a plastic card issued by a bank or corporation<sup>61</sup> to authorise the holder to obtain goods and/or services from a seller via electronic transaction, without the usage of notes or coins.<sup>62</sup> Furthermore, the rightful holder using his or her credit card can obtain cash at Automated Teller Machines (ATMs).<sup>63</sup> Credit cards fall under the credit-token classification of the CCA and as such are regulated by Section 14(1).<sup>64</sup> The overall common aim for a credit-token is to enable the card holder to obtain goods, services and/or cash by using a card.<sup>65</sup> Section 14(1) defines a credit token as follows:

A credit-token is a card, check, voucher, coupon, stamp, form, booklet or other document or thing given to an individual by a person carrying on a consumer credit business, who undertakes:

That on the production of it (whether or not some other action is also required) he will supply cash, goods and services (or any of them) on credit, or;

That where, on the production of it to a third party (whether or not any other action is also required), the third party supply cash, goods and services (or any of them), he will pay the third party for them (whether or not deduction any discount or commission), in return for payment to him by the individual.

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<sup>59</sup> Brindle, *Law of Banking Payments*, p.265; Chen, Z., *Electronic Payment Systems*, (2004), p.123; Penney, N., *The Law of Electronic Fund Transfer Systems*, (1980), pp.1-7.

<sup>60</sup> Ellinger, et. al., *Modern Banking Law*, p.593.

<sup>61</sup> Cards are assured by the bank and business organization; for further details see, Ellinger, et. al., *Modern Banking Law*, p. 581.

<sup>62</sup> Holloway, D., *Commercial Law*, (1997), p.383; Sayer, *Credit Cards and the Law*, p.4; Drury, T., Ferrier, C., *Credit Cards*, (1984), p.5.

<sup>63</sup> Alexander, N., 'The Evolution of Retailer, Bank and Customer Relationships: A Conceptual Framework' (1998) 26 *International Journal of Retail & Distribution Management* 6, p.226.

<sup>64</sup> Ellinger, et. al., *Modern Banking Law*, p.585.

<sup>65</sup> *Ibid.*

A 'consumer credit business' refers to any purchase and sale, and therefore the provision of credit within regulated consumer credit agreement is necessary.<sup>66</sup> Also, a credit card is issued under a credit-token agreement,<sup>67</sup> which is the transaction between the debtor and the supplier<sup>68</sup> under a debtor-creditor-supplier agreement regulated by the CCA under Section 12(b). This was also illustrated in *Bank of Scotland v Alfred Truman*.<sup>69</sup> In this case, a firm of lawyers acting on the behalf of its clients entered into a merchant service agreement with a Bank, to enable the lawyers to accept credit card payments from the clients who sold those clients cars. 11 cars buyers did not receive their cars and made a claim for the reimbursement of the money they paid to clients via the firm of lawyers from the card issuer under Section 75 of the CCA. It was held that where the card holders have a claim for breach of contract against the seller clients, the card issuers are liable to meet the obligation under Section 75, while the card issuers in turn are entitled to charge back from the Bank, who, under the terms of the merchant service agreement with Truman, was entitled to full restitution plus interest. Thus, the law of agency created a contractual obligation between clients (represented by the firm of lawyers) and the Bank.

Linked lender liability arises in absolute use credit contracts when the card holder makes a payment under a prior contract between the issuer of the card and the seller of goods and/or services.<sup>70</sup> The peculiar feature of credit card transactions is that the provider of goods, services or cash is paid not at the time of their transaction but instead at the end of the month, while the card holder does not have to pay anything at the point of purchase, but has to pay the sum to the card issuer incrementally at the monthly date specified by the contract.<sup>71</sup>

### **3 Electronic Payment Schemes**

There are different types of electronic payment agreement schemes, some involving a tripartite agreement,<sup>72</sup> and others a multi agreement.<sup>73</sup> It is arguable that electronic payment involves four parties: the card holder (buyer), the issuer of the card for the

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<sup>66</sup> Sealy, et. al., *Commercial Law*, p.835.

<sup>67</sup> Consumer Credit Act 1974, S.11(4).

<sup>68</sup> Consumer Credit Act 1974, S.189(1).

<sup>69</sup> [2005] EWHC (QB), paras. 86-87.

<sup>70</sup> Consumer Credit Act 1974, S.12(c).

<sup>71</sup> Mann, 'Credit Cards and Debit Cards', p.1056.

<sup>72</sup> Sealy, et. al., *Commercial Law*, p.833.

<sup>73</sup> Ellinger, et. al., *Modern Banking Law*, pp.529-543.

holder, the seller and the seller's bank.<sup>74</sup> Indisputably, these agreements will depend on the issuer's terms and conditions. These will be different from one issuer to another.<sup>75</sup> The CCA 1974 provides the important statutory regulation of such agreements, but there is also a relatively small amount of regulatory legislation governing the agreement between cardholders and their bank, or the sellers and their bank. Indeed, banks also comply with the Unfair Contract Terms Act 1977 and Unfair Terms in Consumer Contracts Regulations 1999.

### ***The agreement between the card holder and the card issuer***

Normally, the contract between the card issuer and the card holder entitles the issuer to pay for the holder's transactions from the holder account,<sup>76</sup> which sometimes is issued under the CCA 1974 (such as credit card).<sup>77</sup> Section 14(2) defines a credit-token agreement as a 'regulated agreement for the provision of credit in connection with use of a credit-token.' That credit-token is a credit card, as when the card holder is an individual the credit card is issued under the credit-token agreement.<sup>78</sup> However if the contract was not issued under the CCA, it will be issued under common law (such as debit and cheque cards).<sup>79</sup>

In the case of credit card issues, Section 189(1) of the CCA 1974 explains the meaning of the contract as being between an individual (debit account) and other (credit account) creditors giving the debtor money, except if the contract falls within Section 16, then this applies to an individual not a company.<sup>80</sup> This contract contains holder's information which the bank obtains from the holder when he or she wants to open a new account.<sup>81</sup> Examples include the the holder's name, the holder's address, and sums of money the holder wants to credit to his or her current account. Generally, the agreement between the card issuer (a bank) and the customer falls within contract law,<sup>82</sup> with all buying and selling in general,<sup>83</sup> and the contract depends on the agreement between them.<sup>84</sup> The

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<sup>74</sup> Shy, O., Tarkka, J., 'The Market for Electronic Cash Cards', in *Journal of Money, Credit & Banking* (2002), p.302; Lowe, R., *Commercial Law (6th ed.)*, (1983), p.472.

<sup>75</sup> Smith, et. al., *Plastic Money*, p. 188.

<sup>76</sup> *Ibid.*, p.203.

<sup>77</sup> *Ibid.*, p.205.

<sup>78</sup> Sealy, et. al., *Commercial Law*, p.808.

<sup>79</sup> Lambert, J., *Banking the Legal Environment*, (1993), p.60.

<sup>80</sup> Sealy, et. al., *Commercial Law*, p.835.

<sup>81</sup> Sayer, *Credit Cards and the Law*, pp. 44-45.

<sup>82</sup> Ellinger, et. al., *Modern Banking Law*, p.107.

<sup>83</sup> Hapgood, et. al., *Paget's Banking Law*, p.110.

relationship is created when the bank account was opened for the customer, who applied for it, and paid a deposit on the account.<sup>85</sup> Generally, banks or other financial institutions, such as a card issuer, have a discretion to vary the terms and conditions on which the card is issued.<sup>86</sup>

### ***The agreement between the seller and the card issuer***

This contract is based on the relationship between them.<sup>87</sup> Generally, the contract between the sellers and the card issuer will contain a form of determination for the cards that the seller is entitled to accept for the settlement.<sup>88</sup> On the one hand, the card issuer accepts liability for paying the card holder's transactions,<sup>89</sup> while on the other hand, the seller burdens the card issuer to pay the seller, based on the contract between them.<sup>90</sup> The seller cannot refuse to sell goods and/or services to the holders who paid by any legal card under the contract between the seller and the issuer. The position of debit cards is different from credit cards; the seller undertakes to present the goods and/or services sold after his or her physical payment (cash) for such goods or services.<sup>91</sup>

### ***The agreement between the seller and the card holder***

The third contract is between the seller, the supplier of goods/services and the card holder. This contract remains under the Sale of Goods Act 1979 or the Supply of Goods and Services Act 1982.<sup>92</sup> The goods and prices are provided and fall within a contract of sale,<sup>93</sup> or the supply of services and prices are provided and fall under a contract of supply of goods and services. So, if the card holder paid by debit, charge or credit cards, the card issuer will pay for the transaction.<sup>94</sup> The rights of the card holder and the seller are based on the agreement. If the issuer provides a settlement to the seller, that means the card holder authorises the issuer to pay, leaving the issuer to exercise his right from

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<sup>84</sup> Arora, A., *Banking Law*, (1993), p.77.

<sup>85</sup> Lambert, *Banking the Legal Environment*, p.62.

<sup>86</sup> Smith, et. al., *Plastic Money*, p. 206.

<sup>87</sup> Sayer, *Credit Cards and the Law*, p.68.

<sup>88</sup> Smith, et. al., *Plastic Money*, p. 206.

<sup>89</sup> Sayer, *Credit Cards and the Law*, p.68.

<sup>90</sup> *Metropolitan Police Commissions v Charles* [1977] AC 177, p.182, per Lord Diplock.

<sup>91</sup> Smith, et. al., *Plastic Money*, pp. 206-207.

<sup>92</sup> Ellinger, et. al., *Modern Banking Law*, p.477; Brindle, *Law of Bank Payments*, p.200.

<sup>93</sup> Miles, R., *Blackstone's Sale and Supply of Goods and Services*, (2001), p.15.

<sup>94</sup> Ellinger, et. al., *Modern Banking Law*, p.107.



the card holder's account.<sup>95</sup> In *Re Charge Card Services*,<sup>96</sup> Millett J refused any examination of the card transaction and identified the consideration for the goods or services to the card holder regardless of payment methods:

Three possibilities have been canvassed. The first is that the consideration for the supply is not the price (which is to be paid by the card-issuing company, a stranger to the contract of supply) but production of the card and signature of a voucher. I reject this analysis, which is quite unrealistic. Production on the card and signature of a voucher are not the consideration itself but the means of obtaining it. Moreover, a sale of goods requires a monetary consideration: see section 2(1) of the Sale of Goods Act 1979. This analysis would thus lead to the conclusion that, where payment is to be made by credit or charge card, the contract of supply is not a sale of goods, with the result that the statutory conditions and warranties are not implied. The second possibility which has been suggested is that there is a sale of goods, but the contract is a tripartite contract under which the consideration for the supply to the cardholder is the undertaking of the card-issuing company to pay the price to the supplier. I reject this analysis, which confuses the result of all the arrangements made with the means employed to achieve it. On the use of the card, there is no tripartite agreement, but three separate bilateral contracts come into operation. In my judgment, the true consideration in the contract of supply is the price, to be satisfied by the cardholder, by means of the card if he wishes.

Millett J was correct in that there is no difference between the cases where the payer pays via plastic money and those cases where the payer pays via cash.

### ***The agreement between the buyer's bank and the seller's bank***

Some commentators prefer to consider electronic money agreements as involving four parties.<sup>97</sup> The fourth contract (as well as the three contracts explained above) is between the buyer's bank and the seller's bank. This contract arises when the card is used abroad, such as MasterCard and Visa cards, which demand a specific internet system.<sup>98</sup> In contrast to a three party agreement, four party agreements do not imply a contract between the card issuer and the seller. This point is illustrated by the decision in *Office of Fair Trading v Lloyds TSB Bank Plc*.<sup>99</sup> The relationship between them, if the buyer's

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<sup>95</sup> Pelly, L., 'Bradley Crawford, Payment, Clearing and Settlement in Canada', (2004) 40 *Canadian Business Law Journal* 3, p.470.

<sup>96</sup> [1987] Ch.150, p.720.

<sup>97</sup> Guadamuz, A. Usher, J., 'Electronic Money: The European Regulatory Approach', (2008), *Social Science Research Network (SSRN)* 173-201: <http://ssrn.com/abstract=1285961>, pp. 6-7; Cornelius, S., 'The Legal Nature of Payment by Credit Card', (2003) 15 *Afr. Mercantile L.J.*, p. 145; Smith, et. al., *Plastic Money*, p. 200.

<sup>98</sup> Caux, et. al., *Electronic Banking and Security*, p. 4.

<sup>99</sup> [2004] EWHC 2600; *Customer and Excise Commissioners v FDR Ltd* [2000] STC 672, paras. 6-10.

bank has paid for his or her customer transaction, is to authorise the seller's bank to transfer the funds to the seller's account.<sup>100</sup> In spite of that, it is common that the seller's bank and the payer's bank are the same, thus the scheme's agreement will be just a tripartite agreement.<sup>101</sup>

## **Conclusion**

A bank's duty to create Electronic Funds Transfer at The Point of Sale is always governed by a personal account as nobody can get any facilities without having an account with a financial institution or a bank, which issues electronic devices (such as plastic cards) which customers can use to pay for their purchases. As long as customers have an account with the financial institution or bank, their transactions will be honoured by them based on the terms and conditions of the franchise agreement between the customer and the bank or the financial institution. The collection of payment system law should abide in body of law statute; this would provide clarity for the parties about their rights and duties, and avoid any misunderstanding. Therefore, the payment system should be governed by a unified body of payment law. However, this is not to say that all of the rules of that body of law should be applied for all payment systems. One could assume that certain issue should be treated as relating to one method in one payment system and another method in another payment system. In others words, a variety of rules on that specific issue would be appropriate for variety of payment. At present, the Consumer Credit Act 1974 is considered the main statute to apply to electronic payment; however, as noted above, it cannot govern all plastic cards. There is agreement that it applies for credit cards but disagreement about whether it applies for debit cards, charge cards and cheque cards. Moreover, it is now a very old Act and likely to constitute an obstacle to the adaptation needed for changes in electronic payment systems.

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<sup>100</sup> Lowe, *Commercial Law*, p.474.

<sup>101</sup> Guadamuz, 'Electronic Money', p. 7.