CUNA COMMENT LETTER

Project to Revise Articles 3 & 4 of the Uniform Commercial Code.

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Re: Scope of Revisions to Articles 3, 4 and 4A

Dear Gentlemen:

The undersigned financial institution organizations are writing to you to urge that electronic negotiable instruments be included within the scope of the National Conference of Commissioners on Uniform State Laws (NCCUSL) current effort to revise UCC Articles3 and 4. We believe this UCC Article3 and 4 revision project represents a unique and critical opportunity for NCCUSL to provide leadership to the states and the financial institution community on the timely and important issue of electronic negotiable instruments.

We were quite surprised by the announcement this spring that it had been preliminarily decided not to include electronic negotiable instruments within the scope of the UCC Articles3 and 4 revision project. It had been our understanding that one of the primary motivations for NCCUSL to undertake this project was to address electronic negotiable instruments under UCC Articles3 and 4. Indeed, the exclusion of UCC Articles 3 and 4 from the Uniform Electronic Transactions Act ("UETA--) and the recently enacted federal E-Sign Act were supported based on indications from NCCUSL that electronic negotiable instruments would be addressed in the upcoming revision to UCC Articles3 and 4. As argued by representatives of the Federal Reserve and others, we thought it was agreed that the issues raised by electronic negotiable instruments should be addressed by check law experts in the context of UCC Articles 3 and 4, rather than in the more general UETA and E-Sign Act.

It is essential to address electronic negotiable instruments in this UCC Articles 3 and 4 revision project so that the developers and users of emerging electronic payment products can, if they so choose, utilize check law to support their products. Checks are the payment product of choice for consumers and businesses. According to Federal Reserve statistics, in 1999, check volume was almost five times the volume of automated clearing house payments, credit card payments, and debit card payments combined. The popularity of the check results in part from its ease of use, the ability to transfer the check to any third party without a prior agreement and without accessing a central network, and the well-established and well- understood legal structure supporting check payments.

Absent coverage of electronic negotiable instruments under UCC Articles 3 and 4, developers and users of the emerging electronic payment products will not be able to utilize check law for these products. Given the open nature of check systems – which as described above is one of the check system's great strengths relative to other payment systems – a check law-based legal foundation cannot be replicated by private agreements, because it is impossible to identify all of the parties potentially interested in each transaction. It is only the UCC (or another federal or state law) that can provide a comprehensive uniform legal framework applicable to all persons potentially interested in the electronic negotiable instrument, including the drawer, payor bank, indorsers, other third party transferees and collecting banks. One concern that we understand has been raised about including electronic negotiable instruments within the scope of the revision project is that it may be premature to do so given the degree of experience with electronic negotiable instruments. We disagree. There has been a significant amount of experimentation with electronic negotiable instruments. Attached to this letter are two recent American Banker articles that detail certain of these programs. In the context of these programs, the UETA, the E-Sign legislation and otherwise, there has been a significant amount of consideration given to the check law rules that should apply to electronic negotiable instruments. More importantly, given the time frame for another UCC Article 3 and 4 revision initiative and the time it takes for the states to enact NCCUSL-proposed UCC amendments, as well as the pace of development of the emerging electronic payment products, it will simply be too late if electronic negotiable instruments were to be tabled until the next UCC Article 3 and 4 revision.

We also have heard concern that inclusion of electronic negotiable instruments in the UCC Article 3 and 4 revision project may complicate and slow the project. However, we believe that it will be possible to provide for electronic negotiable instruments under UCC Articles3 and 4 without extensive revisions to these Articles, and that their inclusion will not delay the revision project.

Congress and the state legislatures, through the E-Sign Act and the UETA, respectively, have established a legal framework for check law to apply to images and other electronic representations of paper checks. It is now time for NCCUSL to complete this work by extending this legal framework to electronically-initiated checks. The failure to address electronic negotiable instruments in the UCC at this time will have the effect of precluding the use of check law for these emerging electronic payment products. We believe the choice of the legal framework for these payment products should be made by the market – the providers and users of these products – rather than by artificial legal constraints. It would be particularly tragic if these artificial legal constraints preclude the use in the virtual world of our country's most popular legal framework for payments in the physical world.

For the foregoing reasons, the undersigned organizations urge the inclusion of electronic negotiable instruments within the scope of the current UCC Articles3 and 4 revision project. If you have any questions regarding this letter, please contact David Walker, Executive Director, the Electronic Check Clearing House Organization, at (972) 371-1444.

Supporting Organizations

Bank of America
Bank of Hawaii
Bank of New York
Bank One, National Association
Branch Banking &Trust Company
BITS
California Bankers Clearing House Association
The Chase Manhattan Bank
Citibank, N. A.
Clearing House Association of the Southwest
Comerica Bank
Credit Union National Association
Electronic Check Clearing House Organization
Financial Services Roundtable
Fleet Bank, National Association
The Frost National Bank
HSBC Bank USA
KeyBank National Association
Old Kent Bank
Mellon Bank, N.A.
Mid-America Payments Exchange
National Clearing House Association
New York Clearing House Association L.L.C.
Payments Resource One
Small Value Payments Company L.L.C.
Southwest Automated Clearing House Association
Summit Bank
Union Bank of California, N.A.
Wachovia Bank, National Association

Technology

Online Shops Breathe Life Into E-Checks

Thursday, July 20, 2000
By Steven Marjanovic

Five years after their debut, electronic checks are finally gaining a toehold.

Support for the technology, which enables consumers to use information from paper checks to buy merchandise online, is far from widespread, but it is starting to come from influential places. Wells Fargo & Co. and eBay Inc. created a big stir when they said last month they would work to make e-checks available on eBay's popular online auction site. Morgan Stanley Dean Witter, Wachovia Corp., and FleetBoston Financial Group also have recently thrown their weight behind the concept.

Electronic checks may have been ahead of their time five years ago when the Financial Services Technology Consortium first demonstrated them. Now, as Internet payments take off, they are filling a need as companies look for new ways to execute electronic payments.

Wells Fargo's plans are indicative of where Internet payments are headed and how e-checks fit in. "Wells Fargo wants to offer a menu of services, so you, the merchant, can offer credit cards and e-checks," said Debra Rossi, a Wells executive vice president. "We also hope to be able to offer stored value, or gift certificates, or even micro cash."

E-checks will help Wells replicate online the physical-world choices of credit cards, checks, or cash, Ms. Rossi said. And she said there is good reason to pursue substitutes for credit cards, which are used in 81% of online purchases.

Internet transactions are the most expensive kind of card payment for merchants, because of the extra risk involved in not dealing with cardholders face-to-face. Merchant fees, which usually run about 2% of the value of a transaction for regular credit card purchases, can double or triple when purchases are made online or by telephone.

Those costs are magnified by chargebacks incurred when Internet payments are returned because of fraud or nondelivery of goods. Industry sources say that 6% to 7% of online purchases are charged back.

"There are people who do not have credit cards or prefer not to use a credit card on the Internet," Ms. Rossi said. "You have to wonder why checks are still the largest payments system in the physical world when in the 1970s there was talk of a paperless society."

Wells is testing e-checks with a few eBay customers, and ultimately will market them to the 10,000 Wells Fargo merchant customers who do business on the Web. It will be an option for all sellers on eBay by the end of the summer.

Ms. Rossi said she believes Internet checks will coexist with credit cards. "So far, even in the physical world, credit cards have had tremendous growth. After all of those years of talk about checks going away, checks have not gone away."

Morgan Stanley Dean Witter Online is turning to e-checks as a way for consumers to add funds to their brokerage accounts. Rather than using the mail, overnight delivery services, or wire transfers to move money into accounts, customers could write an electronic check while logged on to Morgan Stanley's Web site.

The brokerage is using eCheck Secure software from Troy Group Inc. to offer the service, which will be available at the end of this month. The existence of the account is verified in advance by Equifax Inc. of Atlanta, one of three major credit bureaus.

Wachovia is seeking to make e-checks a standard form of payment for its merchant customers who operate Web sites. So far, 35 of Wachovia's merchants have opted to accept Internet checks.

Wachovia encrypts check payment information entered by customers and transmits it to Telecheck, a Houston-based check acceptance unit of First Data Corp., which matches the information against its checking account databases.

Wachovia is reselling the Telecheck service to its merchant customers "to provide more payment alternatives," said Kevin Gallagher, a director of E-Business Strategies at Wachovia Merchant Services.

As a participant in the original e-check initiative of the Financial Services Technology Consortium, FleetBoston Financial Group has a longstanding interest in the checks. Along with Bank of America, Fleet is a sponsor of an FSTC test of Internet checks with the U.S. Treasury that began in 1998.

Based on the FSTC pilot, Fleet determined that e-checks were an opportunity to be explored. In March, it spun off a company, Clareon, to develop e-checks as a commercial product. Fleet holds a 17% stake in the company, which also has secured $15 million of funding from Mayfield Fund, Berkshire Partners LLC, and BancBoston Ventures.

Portland, Maine-based Clareon now has 60 employees, including vice president Frank Jaffe, formerly a technologist at Fleet and point person on the FSTC project. FSTC was successful in proving the merits of the technology, Mr. Jaffe said, but also showed that the technology had "some serious adoption problems," which Clareon will seek to rectify.

E-checks also face issues of regulatory oversight. "The full force of the law" has not yet determined whether Internet checks fall under Regulation E guidelines, said David Kurrasch, president of Global Payments Advisors of Alameda, Calif. Regulation E offers stronger consumer protections than the Uniform Commercial Code laws that govern checks.

"As long as there is a doubt, the informed individual will say, 'I think I will use my credit card so I know that I am protected by Reg E,' " Mr. Kurrasch said. "As long as that happens, it is always going to be difficult for the check events to be popular over the Internet."

Steve Fabes, director of financial services at Commerce One, a leading provider of business-to-business electronic commerce software, said his company is exploring a wide range of payment alternatives for buyers and suppliers on marketplaces supported by Commerce One.

Mr. Fabes, a 16-year veteran of Bank of America, said he is in discussions with Clareon and particularly liked the "remarkable simplicity" of e-checks.

"Merchants need alternatives," Mr. Fabes said. "They need all existing payment schemes, and they are absolutely ripe to look at new ones. There is a sense of a frontier land out here."

Online Banking

Morgan Stanley to Use Fleet Spinoff's E-Checks

Wednesday, September 13, 2000
By Andrew Roth

Morgan Stanley Dean Witter has become the first customer of Clareon Corp., a technology firm born out of a decade-long experiment with electronic checks.

The New York brokerage firm announced Monday that it had agreed to use a payment network being formed by Clareon, of Portland, Maine, based on technology developed by the Financial Services Technology Consortium, a bank-sponsored research group.

FleetBoston Financial Corp., which sponsored the consortium's test of electronic checks with the Treasury Department and the Federal Reserve, spun off Clareon six months ago to develop the payment vehicle as a commercial product.

The Morgan Stanley agreement, which includes a $10 million investment from Morgan's MSDW Strategic Ventures Inc., establishes Clareon as a new force in business-to-business Internet payments, said Avivah Litan, research director of payment services for GartnerGroup.

"Now Clareon is not a fly-by-night start-up," Ms. Litan said. "I think we'll see a lot more companies sign up with them."

The agreement also sharpens Morgan Stanley's focus on using electronic checks to help its clients execute safe, low-cost Internet payments that include remittance information, she said.

Tom Clarke, a managing director in MSDW's E-Commerce Group, has been appointed to Clareon's board. "We are looking to marry old and new technologies to provide better service to our customers," he said.

Clareon will set up a network for member businesses to conduct Internet payments. Financial institutions will not need to be members of the network, but businesses and individuals making and receiving the payments will.

"We are not a gateway solution," said Paul Walsh, chairman and chief executive officer of Clareon. "We don't hand off to another party for the actual processing. We provide transparency from beginning to end -- the ability to provide remittance information to reconcile against payables and receivables."

Morgan Stanley plans to use Clareon's system to support payments in its credit card, retail, and institutional business lines, Mr. Clarke said.

"It still remains to be seen just how the application is going to be used," he said. "It may allow our institutional clients to make payments on-line without the use of checks, or credit cards users to make payments without checks."

Clareon has raised $45 million in two rounds of venture funding (including the $10 million from MSDW). It plans to use the money for technology development, marketing, and exploration of markets outside the United States.

Morgan Stanley has been using software from Troy Group Inc. on a limited basis to let retail customers use electronic checks to add funds to their brokerage accounts, Mr. Clarke said.

The firm's interest in electronic checks is part of a slowly growing groundswell of support for the technology. Wells Fargo & Co. recently said it would support electronic checks for payments on the auction Web site EBay.

Electronic checks are being marketed as an alternative to credit cards for Internet purchases. Because of the added risks associated with Internet or telephone purchases, merchants often pay double or triple the normal fees for these credit card transactions.

Mr. Clarke said MSDW chose Clareon after an extensive due diligence process in which it considered several possible online payment providers.

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