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ELECTRONIC CASH—MORE QUESTIONS THAN ANSWERS

*Kerry Lynn Macintosh**

MICHAEL MEURER:

Professor Macintosh is a Professor at Santa Clara University School of Law and a member of the high technology program there. She has written extensively about contracts and commercial transactions and her most recent scholarship explores high technology issues within the commercial law, with particular emphasis on electronic cash. That is the topic for today.

KERRY MACINTOSH:

I have been asked to talk for roughly fifteen minutes about electronic cash, which is like being asked to talk about the world in fifteen minutes: a very hard task. This is a rapidly evolving field. Technological and business solutions are advancing, but there are still many legal and policy unknowns. Accordingly, I have entitled my remarks *Electronic Cash—More Questions Than Answers*.

A few years ago, it was fair to say that most electronic payment products were a complete failure.¹ Consumers, especially American consumers, did not like, want, or use electronic cash. Many companies were forced to give up their starry-eyed dreams of e-money and go on to provide other financial products or services.² Other companies simply went bankrupt.³

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¹ See Peter Wayner, *Electronic Cash for the Net Fails to Catch On*, N.Y. TIMES, Nov. 28, 1998, available at <<http://www.nytimes.com/library/tech/98/11/cyber/articles/28cash.html>>.

² See *id.* ("First Virtual . . . shut down its system for processing electronic cash transactions and began to focus on a new business, interactive messaging Another

Today, however, there has been a renaissance in electronic payments. There are many, many new products competing for market share right now.⁴ In fact, there are so many products that I could not possibly begin to describe them all in the fifteen minutes that I have today, and I am not even going to try. Instead, I will lay the foundation for my remarks with a very generalized description.

Electronic payment products, including those smart cards that you have heard so much about, represent the obligation of a private company to provide value.⁵ Usually this value comes in the form of dollars, or dollar-denominated funds. In some cases, however, the value can come in the form of goods and services. Electronic cash can operate in real space, and on the Internet. My comments are going to focus on the Internet because I think that is where electronic cash is going to offer the most significant benefits.

How many people in this room have had the experience of buying something on the Internet? Show of hands? Almost everybody. That is why you are here. You like e-commerce. Chances are you used credit cards to make those purchases. Everybody here is doubtless familiar with the advantages and disadvantages of credit cards. But let me review them briefly anyway.

Buyers like credit cards. Why? Well, it is nice to buy things now and pay for them later. We are a nation of people who are addicted to credit. Also, we have these nice federal laws that protect buyers who use credit cards.⁶ Buyers do not have to pay for unauthorized charges.⁷ And, sometimes, buyers can even reverse charges if the goods or services turn out to be unsatisfactory.⁸

Sellers, however, do not always like credit cards. When buyers claim that charges are unauthorized or reverse charges, sellers lose profits. Moreover, sellers also have to pay discount fees ranging from one to four percent.⁹ This further erodes their profits. For these and other reasons, sellers do not accept

company, CyberCash, still offers a system called CyberCoin, but most of the company's revenue comes from processing credit card transactions.”).

³ See *id.* (noting that Digicash filed for bankruptcy).

⁴ See Simon L. Lelieveldt, *How to Regulate Electronic Cash: An Overview of Regulatory Issues and Strategies*, 46 AM. U. L. REV. 1163, 1166 (1997); *E-cash 2.0*, THE ECONOMIST, Feb. 19, 2000 (describing recent digital currencies being propagated).

⁵ See Paul Taylor & Tom Forenski, *Smart Cards' Time Has Come*, FIN. POST, Oct. 26, 1996, at C20, available in 1996 WL 5744118 (discussing smart card technology and applications); Brian W. Smith & Ramsey J. Wilson, *How Best to Guide the Evolution of Electronic Currency Law*, 46 AM. U.L. REV. 1105, 1006-07 (1997).

⁶ See, e.g., 15 U.S.C. § 1643 (1994).

⁷ See *id.* § 1643(a)(1).

⁸ See 15 U.S.C. § 1666(i) (1994).

⁹ See Gary Gensler, *Internet Model Adds New Dimension to Financial Services Business Strategy*, BANK SYS. + TECH., July 1, 2000, at 50, available in LEXIS, Market Library, Prompt File; Shannon Buggs, *Savings May be in the Cards*, HOUS. CHRON., Feb. 21, 2001, available in LEXIS, News Library, Hchrn File.

credit cards for every transaction in real space. Many purchases, especially small ones, are made with money.

For years now, hopeful entrepreneurs have been saying, "look, if money is useful in real space, it is logical to assume that it could be useful on the Internet also." This is especially true now that we have a maturing Internet. More and more online sellers are individuals or small businesses that are not enrolled in the credit card system and cannot accept credit cards. There are also people on the Net who want to sell things at prices that are too small to support the costs of the credit card system. We also have buyers, such as teenagers or foreigners, who simply do not have credit cards.

A recent survey found that consumers were dissatisfied with the payment options that they had online.¹⁰ That same survey predicted credit card payments would drop from ninety-five percent to eighty-one percent of the value of online transactions by the year 2003.¹¹ Now, that still leaves credit cards in a very dominant position, but it also creates a gap. The question is: "what is going to rush in to fill that gap?" Given that it is not physically possible to transmit metal coins or paper dollars over telephone wires, electronic cash becomes a possible answer.

That brings me to my first question: where is electronic legal tender? We have got all these privately issued products out there. But the federal government is not issuing the electronic equivalent of paper dollars. Why not?

The standard response has been that the federal government does not want to get involved right now while these products are still evolving.¹² An electronic dollar could be so powerful that it might distort or squelch private efforts to develop new payment products.¹³ That explanation is consistent with the position that the Clinton Administration took in 1997, when it issued the *Framework for Global Electronic Commerce*.¹⁴ As we heard earlier today, one of the key principles of that report was that the private sector should lead.¹⁵

Now, I am skeptical of this semi-altruistic explanation for why the

¹⁰ See *E-cash 2.0*, *supra* note 4.

¹¹ See *id.*

¹² See WILLIAM J. CLINTON & ALBERT GORE, JR., A FRAMEWORK FOR GLOBAL ELECTRONIC COMMERCE § I.2 (1997), available at <<http://www.iitf.nist.gov/eleccomm/ecommm.htm>> [Hereinafter FRAMEWORK]. In particular, this document notes: "At this early stage in the development of electronic payment systems, the commercial and technological environment is changing rapidly. It would be hard to develop policy that is both timely and appropriate. For these reasons, inflexible and highly prescriptive regulations are inappropriate and potentially harmful." *Id.*

¹³ See Kerry Lynn Macintosh, *The New Money*, 14 BERKELEY TECH. L.J. 659, 665 n.37 (1999).

¹⁴ FRAMEWORK, *supra* note 12, § I.2.

¹⁵ See U.S. GOVERNMENT WORKING GROUP ON ELECTRONIC COMMERCE, FIRST ANNUAL REPORT 5 (Nov. 1998) [Hereinafter E-COMMERCE REPORT] (noting that private sector leadership was among the principles proposed to guide the development of the new digital economy).

government is not involved. Why am I skeptical? The answer is seigniorage.

Seigniorage is the interest that is earned on the face value of money while it is in circulation or lying dormant in your pockets.¹⁶ The federal government earns billions of dollars in seigniorage on metal coins and paper dollars every year.¹⁷ So, why hasn't the government issued electronic dollars? Perhaps it believes, whether rightly or wrongly, that there is too much risk and not enough profit at this point in time. However, I believe that once private companies are successful in issuing electronic currency and earning seigniorage on it, the government will want a piece of that action. This is particularly true given the potential that a good money product has to establish not just an American, but rather a global customer-base. If we do not have electronic dollars, the void will be filled by electronic Euros or the electronic currency of some other ambitious government.

Perhaps, however, it is the very potential for wide circulation of electronic dollars that frightens the federal government. What if we did have electronic dollars that functioned in the same way that paper dollars do? What if we did have electronic dollars that were anonymous and capable of being circulated all over the world at the click of a mouse? This would, of course, raise the dreaded specter of money laundering.

Money laundering brings me to my next topic, and next set of pesky questions. The *Framework for Global Electronic Commerce* recognized that all of these electronic payment products are at a very early stage of development, making it difficult to develop appropriate policy.¹⁸ Inflexible regulations and rules could be inappropriate and potentially harmful.¹⁹ So, if you have come here today to hear about the latest cutting-edge legal developments for electronic money, you may be surprised to hear that most federal agencies have taken a hands-off approach. Indeed, a few years ago the Financial Enforcement Network of the United States Department of the Treasury, affectionately known as "FinCEN," issued proposed amendments to anti-money laundering regulations that would have required issuers of stored value and other electronic payment products to register with the government.²⁰ Industry squawked, and squawked pretty loudly, and FinCEN backed off.²¹

¹⁶ See David G. Oedel, *Why Regulate Cybermoney?*, 46 AM. U. L. REV. 1075, 1077 n.6 (1997).

¹⁷ Catherine Lee Wilson, *Banking Law Symposium: Banking on the Net: Extending Bank Regulation to Electronic Money and Beyond*, 30 CREIGHTON L. REV. 671, 694 ("The interest income on the securities from seigniorage, approximately \$20 billion annually, is turned over to the Treasury Department.").

¹⁸ See E-COMMERCE REPORT, *supra* note 15, at 14-15; FRAMEWORK, *supra* note 12, § I.2.

¹⁹ See *id.*

²⁰ See Proposed Amendment to the Bank Secrecy Act Regulations, Definition and Registration of Money Services Businesses, 62 Fed. Reg. 27,890, 27,893-94 (1997).

²¹ See Amendment to the Bank Secrecy Act Regulations—Definitions Relating to, and Registration of, Money Services Businesses, 64 Fed. Reg. 45,438, 45,442 (1999) (exempting stored value issuers and sellers from any money services business registration

However, there is a companion state law project waiting in the wings that could impose substantial regulatory burdens. You may not have heard about it before, but the name of the project is the Uniform Money Services Act.²² The National Conference of Commissioners on Uniform State Laws approved the Act last summer; it is complete, except for style revisions and comments. We are fortunate to have the Reporter for the Act here with us today. So, perhaps, if there are specific questions about the Act, she may have something to add to my comments.

The Uniform Money Services Act would apply to businesses that provide money services.²³ Traditional businesses of that kind include companies that wire money, sell traveler's checks, cash checks, exchange currency, and so forth.²⁴ A key goal of the Act is to join states in the fight against money laundering.²⁵ Towards this end, the Act requires money services businesses to be licensed, keep extensive records of their transactions, and submit to audits.²⁶

A separate but additional goal of the Act is to address safety and soundness concerns.²⁷ As I mentioned earlier, many payment products represent the obligation of a private issuer. What happens to people holding such products if the issuer goes bankrupt? To guard against such risk, the Act requires many money services businesses to provide security and maintain permissible investments sufficient to cover their outstanding obligations.²⁸

Now, all of this may seem unremarkable. In particular, the safety and soundness provisions are drawn from state laws that have governed money transmitters for many years. However, the drafters of the Uniform Money Services Act have done one very ambitious thing. They have included electronic payment products within their statutory framework.²⁹ Their intent is to cover the widest possible range of electronic payment products—not just those that function as cash equivalents but also electronic gift certificates, such as Flooz, electronic incentive programs, such as Beenz, and electronic

obligation in the final amendment). Note, however, that the amended regulations do treat stored value issuers and sellers as financial institutions for purposes of the Bank Secrecy Act. Thus, stored value issuers and sellers must report currency transactions in excess of \$10,000. *See id.* Also, rules requiring record-keeping for funds transfers of \$3,000 or more may apply to businesses that participate as financial intermediaries in transactions in which stored value is transferred electronically. *See id.*

²² *See* UNIF. MONEY SERVS. ACT (2000), available at <<http://www.law.upenn.edu/blilulc/moneyserv/msb0620.pdf>>).

²³ *See* UNIF. MONEY-SERVS. BUS. ACT prefatory note 1(A)(i), at 1 (draft for approval 2000).

²⁴ *See id.*

²⁵ *See id.* prefatory note 3, at 14-16.

²⁶ *See* UNIF. MONEY SERVS. ACT §§ 104, 201, 301, 401, 601, 605.

²⁷ *See* UNIF. MONEY-SERVS. BUS. ACT prefatory note 3, at 15.

²⁸ *See* UNIF. MONEY SERVS. ACT §§ 203, 206, 701-02.

²⁹ *See id.* § 102(14), (16), (21).

warehouse receipts for precious metals, such as e-Gold.³⁰

I have many questions about the Uniform Money Services Act. Some are technical, and I plan to explore them independently with the Reporter. But the Act also raises some broad policy-oriented questions that I think are appropriate to bring to this discussion.

My first question is: What price law enforcement? I loved Professor Meurer's Freudian slip before Mr. Maxwell's presentation—"policing for the emerging marketplace"—because it ties in perfectly with my comments here today. As I am sure this audience is keenly aware, there is a tension between the needs of electronic commerce and the demands of law enforcement.³¹ The battles over what would go into the FinCEN regulations, and, to some extent, the Uniform Money Services Act, are just further manifestations of that tension.

One of the things that I noticed when I read through the Act was that a business licensed under the Act would have to maintain records of payment instruments or stored value obligations sold, outstanding or paid.³² I asked the Reporter what this meant, and she assured me that the goal was simply to assure that safety and soundness regulations were being followed. The facts to be recorded were, for example, the amount of the instrument sold, and an identifying number for the instrument.

But, as I contemplated this Act and thought about future laws, I wondered how far the battle against money laundering might go. What if some other law, some future law, required companies to record names and addresses of individuals who purchased, held or redeemed electronic cash? Certainly, that kind of recording would keep a paper or electronic trail that might help reduce money laundering, but, at the same time, it would reduce the level of privacy enjoyed by consumers. As lawyers, and academics who advise lawyers, we have a sincere interest in making the world a better place. We are tempted to believe that one more law or one more regulation can stamp out crime. However, we also have to remember that there is no such thing as a free lunch. Regulation always costs money, but often does much more than that. It reduces economic opportunity. It impinges on other freedoms that are important to us, including privacy. How far we go in policing money laundering, or any other kind of disfavored conduct, is a matter of priorities. We need to face up to the policy tradeoffs involved, or the needs and demands of law enforcement will, by default, become our highest priorities.

That brings me to my final question. In a world of competing cultures and values, which values are going to be respected in the global electronic marketplace? This also ties in with what our distinguished speaker from the Department of Commerce was saying earlier. I want to bring us back to that

³⁰ See *id.* § 102(21); UNIF. MONEY-SERVS. BUS. ACT prefatory note 4(B).

³¹ See Macintosh, *supra* note 13, at 669-71.

³² See UNIF. MONEY SERVS. ACT § 605.

Yahoo! case he mentioned.³³ A French court recently imposed steep fines, in the amount of \$13,000 a day, unless Yahoo! ended auctions of Nazi memorabilia, such as copies of Hitler's book *Mein Kampf*.³⁴ Yahoo! filed a lawsuit in San Jose, asking a federal judge to refuse to enforce the French decision on First Amendment grounds.³⁵ But shortly after the suit was filed, Yahoo! declared that it was going to stop the auctions, ostensibly for its own business reasons.³⁶ Observers suspect this "business decision" was intended to moot the French case.³⁷

The *Yahoo!* case raises deep concerns for all of us as Americans. We worry that other countries and cultures will not respect our freedom of speech. However, just as we cherish freedom of speech, other countries and cultures may place financial freedom and privacy above our law enforcement concerns. Suppose foreign companies or offshore companies provide Americans with anonymous electronic cash and refuse to comply with our anti-money laundering laws. What is our government going to do about it? Haul the companies into American courts? Put economic or even military pressure on countries where the companies are located? Realistically, as participants in a global marketplace, we cannot expect that other nations will honor our values, while we reject theirs.

What then is the answer? Well, as a favorite law professor of mine in school used to say, "I don't know." Electronic cash, like everything in electronic commerce, does raise more questions than answers. And all we can do is ponder those questions.

Thank you.

MICHAEL MEURER:

Thanks very much. Ten minutes for questions now, before we get to our last two speakers. For any of the three speakers we've had so far.

QUESTION & ANSWER SESSION

QUESTION:

This question is for the last speaker. The Money Services Act - that Uniform Act, does it deal with the problems of federal preemption and that

³³ See *Lawsuit accuses Yahoo of justifying war crimes*, Jan. 23, 2001, CNET NEWS, available at <<http://singapore.cnet.com/news/2001/01/23/20010123m.html>>.

³⁴ See Lisa Guernsey, *Welcome to the Web. Passport, Please?*, N.Y. TIMES, Mar. 15, 2001, at G1.

³⁵ See John Reynolds, et al., *Europeans Claim Extraterritorial Jurisdiction Over Cyberspace*, METROPOLITAN CORP. COUNS., Mar. 2001, at 15, available in LEXIS, News Library, MCC File.

³⁶ See Kristi Essick, *Yahoo to Ignore French Deadline*, WASH. TIMES, Feb. 22, 2001, at B7, available in LEXIS, News Library, Wtimes File.

³⁷ See *id.*

type of national values?

KERRY MACINTOSH:

To some extent, yes. I would invite the Reporter to follow up on my comments, if she is willing. The Act includes a section on exclusions. The Act does not apply to the United States, or a department, agency, or instrumentality thereof. It also does not apply to banks, which are already heavily regulated by the government. The Act does not apply to a board of trade designated as a contract market under the Commodity Exchange Act, and so on and so forth. Also exempted are entities that provide clearance or settlement services, or operators of payment systems.

Would the Reporter care to say anything else?

REPORTER—PROFESSOR ANITA RAMASASTRY:

I am the Reporter for the Uniform Act. I am from the University of Washington. I should know that. The Act began, I think, with the emphasis on money laundering in the non-bank financial services sector and the money transmitters and check-passers and currency changers. It quickly became a state safety and soundness law, with a side benefit of licensing being a mechanism that might provide a law enforcement tool. The electronic money that was included in the statute was less because of a concern about money laundering – again, I think that is a hypothetical issue at the moment – but more because of the same kind of prudential and safety and soundness concerns with respect to non-bank issuers of different types of currency products. A variety of the states have already begun to regulate and to require licensing in a very disparate fashion of things. So we actually had industry participation from some of these emerging companies to craft something because they do believe that conformity, if there is going to be state licensing in fifty states, because that is how it works in the non-bank area, would be preferable, with somewhat of a light touch, and expression. So, if anyone is interested, I invite you to read it. I invite you to engage in the debate because, again, even if these states adopt the record law, how a state interprets and deals with what kinds electronic products actually fall within in the scope is something that is up to their discretion.

QUESTION:

I have a question for the last speaker. I do not quite understand your point about the federal government not being interested in entering e-cash. But, as I understand it, seigniorage is the difference between what it costs the sovereign to generate a piece of currency, and the face value of currency. Surely the sovereign issues e-cash. I was just wondering—

KERRY MACINTOSH:

I am sorry if I was not understood. My question was: Why is the federal

government *not* issuing electronic cash? It *should* be interested in doing so, because it could make money. I think the government is waiting until the market for e-cash is solid enough. As soon as it is solid enough, and the opportunity to make profits is there, I think the government will be there too.

MICHAEL MEURER:

Surprisingly, silent crowd. Any more questions out there?

[INAUDIBLE QUESTION]

JANE WINN:

I think there is no, with regard to the freedom from defenses, I think that is something about which there is not very much consensus. I think that, if you talk to the people at Freddy Mac and Fannie Mae, they think it is really important that they take "free from defenses." What they are concerned about is fraud by the people who do the closings. That is a consistent problem, that people are tricked into signing two promissory notes at the closing, and then later they do not want to pay on one of them. Freddy Mac and Fannie Mae do not want to get involved. It is not their problem. So I had a friend at the American Bar Association who is a practicing attorney and whenever somebody from the real estate industry would raise this argument, he would scream at them, "It's just a price issue!" I mean, so there are a lot of people in the industry, I mean he was not an academic, he was just an attorney, you know, and his point was you can allocate that risk wherever you want and just adjust the price accordingly. But some people in the industry do not feel that way. It is like a question of religious conviction. So there is not any clear consensus on the defenses and it is extremely controversial. So even on the industry side some people think that is a bargaining chip they should be prepared to give up.

With regard to competing claims of ownership, I think that that is a problem that changes shape in the electronic environment because what you are assuming is that there is somebody who is providing a sort of electronic environment within which transactions take place. As far as I can tell, talking to people who are trying to get pilots up and running, no one is even going to participate in a pilot unless the person who has built the e-commerce infrastructure guarantees that there will be no competing claims of ownership. They have to represent and warrant that, and if they are not prepared to step up to the plate and say, you know, if it turns out somebody has a competing claim of ownership, "we will make you whole because our technology failed." There is not a commercial transacting party in the world who is going to sign up for that system. I mean, this is the sort of the Microsoft or VeriSign model called: "We have got really amazing technology, but if there is any problems just call this 800 number." Right? So, I mean, there is a lot of people who are trying to develop and market technologies on that basis and no sophisticated party that is already doing B2B e-commerce today is going to adopt that. So the people

who are trying to put together transferable record technologies understand that they will have to step up to the plate and guarantee that it is a *jus tertii* problem, and that *jus tertii* problems are their responsibility.