REGULATING THE NEW CASHLESS WORLD

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ABSTRACT

Internet and mobile payment volume is growing exponentially. From established technology giants like Amazon, Google, and PayPal to relative newcomers like Square and LevelUp, Internet and mobile payment systems are changing the face of modern commerce. Consumers and merchants have embraced cashless payment options like mobile wallets and mobile credit card readers. Unfortunately, existing laws and regulations lag behind. State money transmitter laws, once a virtual unknown, have become a source of frustration and confusion. These statutes historically regulated money transfer businesses like Western Union with an eye toward preventing consumer harm. The plain language of such statutes, however, purports to broadly regulate the receipt of money or monetary value for the purpose of transmitting it to another place or location by any means. As such, an array of business activity, from bike messengers to app stores, is potentially implicated.

In the absence of clear guidance and inconsistent state enforcement, a number of services that accept customer payments on behalf of merchants, in connection with the sale of the merchant’s goods and services, have struggled with the question of whether their unique business models are subject to regulation. Some companies, such as Square, have apparently decided that licensing and compliance with state money transmitter laws is not required for the operation of their payment business. However, doing so comes with very real risks. The Illinois Department of Financial & Professional Regulations recently issued a cease and desist order for alleged violations of the state’s Transmitters of Money Act. As a result, those that do not take preventative action to comply may face regulatory enforcement action if a state regulatory agency subsequently decides that a particular business activity falls within the scope of the statute. In the face of such uncertainty, Amazon, Google, and PayPal have all become licensed

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money transmitters under state law. Even Facebook has become licensed in advance of launching a payments product in order to mitigate the risk of sanctions as the development of their payments product continues to evolve. While established companies can afford to comply, the licensing and regulatory compliance costs exist as a barrier to entry for payment start-ups and may stifle continued innovation if left unsettled.

This Article takes the first in-depth look at the intersection of technology and consumer protection in the context of new and emerging payment systems and seeks to resolve the apparent tension between the two, suggesting a framework for modernizing state money transmitter laws to accommodate new technology, innovative business models, and the realities of a cashless world while still respecting the statutory purpose of consumer protection where appropriate. As a result, the framework proposed in this Article will facilitate continued development of new payment services, which benefits merchant sellers (both small and large) by providing them with more efficient and sometimes cheaper options for accepting payments from customers without increasing the risk of harm to the consumer customers who rely on such services to make payments.

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INTRODUCTION

As merchants and consumers increasingly adopt and embrace technological innovations to the traditional channels through which they engage in commerce, established laws and regulatory frameworks must be reassessed for both relevance and applicability. Nowhere is this more evident than with respect to new and emerging forms of payment. The way that consumers pay for goods and services has undergone transformational change in recent years. Where paper-based payment systems such as cash and checks once ruled, and credit/debit cards and stored value cards now dominate, Internet and mobile payments threaten to take over.1

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The use of Internet and mobile payment technologies to conclude purchase and sale transactions has become commonplace and is expected to grow exponentially. Some forecasts predict that global business to consumer e-commerce sales will top $1.25 trillion per year by 2013, noting that annual business to consumer e-commerce sales increased by 20% from 2010 to 2011.\(^2\) Goldman Sachs predicts similar growth, finding that global e-commerce sales will reach $963 billion by 2013, with an annual growth rate of 19.4%.\(^3\) Mobile commerce will likely see a similar upward trajectory with analysts anticipating that mobile payment transactions will grow nearly four-fold over the next five years to more than $1.3 trillion.\(^4\)

Capitalizing on these changing commerce habits, payment industry innovators have introduced a number of new services that facilitate the acceptance of Internet and mobile payments by merchants when selling their goods or services. Instead of developing the capability to accept Internet and mobile payments directly, merchants may now select from a host of third-party service providers. Those who provide some form of Internet or mobile payment services to merchants include giants such as Amazon,\(^5\) Google,\(^6\) Isis (an alliance between T-Mobile, AT&T and Verizon

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Wireless), Merchant Customer Exchange (a mobile commerce platform created by leading U.S. retailers including BestBuy, Target Corp., and Wal-Mart Stores), PayPal, Apple, and Android. In addition, upstarts such as Square and LevelUp clutter the market.

While the business model, functionality, and scope of each payment service can vary greatly, the service provider generally offers a mechanism through which it acts on behalf of a merchant in accepting an Internet or mobile payment from a buyer of the merchant’s goods or services and facilitates the transfer of the payment to the merchant. Online marketplaces, application stores, checkout or shopping cart services,

7. See ISIS, http://isisforbusiness.com/ (last visited Sept. 30, 2013) (describing how merchants can use Isis to accept mobile payments); see also infra Part II.C.


11. See Developers, ANDROID, http://developer.android.com/distribute/googleplay/about/monetizing.html (last visited Sept. 30, 2013) (discussing how app developers can distribute their apps via the Google Play app store); see also infra Part II.C.


13. See LEVELUP, https://www.thelevelup.com/how-it-works (last visited Sept. 30, 2013) (describing how LevelUp facilitates the acceptance of mobile payments); see also infra Part II.C.


15. Online marketplaces like the Amazon Marketplace allow independent merchants (big and small) to sell on Amazon.com. In connection with providing the sales platform, Amazon handles the payment process, receiving credit/debit card information from the buyer and settling with the merchant. See infra Part II.C.
mobile wallets,\textsuperscript{18} and mobile card readers\textsuperscript{19} all involve some degree of Internet or mobile payment acceptance and processing on behalf of merchant sellers. Although the customer pays the service provider (e.g., by providing credit/debit card information), the merchant is in fact the seller of record from whom the purchase is made. As such, the service provider essentially functions as a third-party intermediary who accepts Internet and/or mobile payments from a buyer on behalf of the merchant, subsequently transferring the funds to the merchant (hereinafter referred to generally as “payment services”).

The sheer number of Internet and mobile payment options and speed of adoption highlights the conundrum: how can any legal and regulatory regime possibly keep up with the pace of technological advances and adoption? Internet and mobile payment methods have revolutionized modern commerce, but the law understandably lags behind. As a component part of establishing a comprehensive and consistent regulatory regime for new and merging payment systems, this Article suggests that existing laws, such as state money transmitter laws, must be reexamined in light of technological advances and changes in consumer behavior to clearly define the scope of their applicability to new business models.

Money transmitter laws are essentially “safety and soundness” laws aimed at protecting consumers from suffering losses, and have traditionally governed money transfers services like Western Union. However, the sweeping language of such statutes and the lack of clearly applicable exemptions threaten to subsume a number of innovative business models, including many new and emerging payment systems. Given the burden and expense of state-specific licensing and compliance requirements, this has created real problems for potentially regulated businesses who must struggle to ascertain whether money transmitter laws extend to their activities. In short, businesses are faced with a choice between two

\textsuperscript{16} App stores depend on independent developers to create apps that are made available for purchase on hosted app stores. The service provider receives payments from those who purchase apps and subsequently settles with the developer/seller. See infra Part II.C.

\textsuperscript{17} Payment services, such as PayPal and Amazon Payments, allow merchants to accept credit/debit cards via the Internet by placing a “check out” button or “shopping cart” on the merchant’s website. Although the buyer visits the merchant’s website instead of a third-party marketplace, the payment process is operated by a third-party service provider who subsequently settles with the merchant. See infra Part II.C.

\textsuperscript{18} Mobile wallets, such as Google Wallet, Isis, Square, LevelUp and Merchant Customer Exchange, allow a consumer to use a smartphone like a credit/debit card. The consumer’s credit/debit card information is stored by the service provider, and in-store purchases can be made by waving the phone in front of a scanner provided to the merchant, which transfers the payment card information with the service provider, subsequently settling with the merchant. See infra Part II.C.

\textsuperscript{19} Payment services like Square and PayPal provide merchants with a mobile credit/debit card reader and a mobile application that allows the merchant to use its own mobile device to accept credit/debit card payments. The service provider receives the payment card information, initiates the payment process, and facilitates settlement with the merchant. See infra Part II.C.
undesirable alternatives\textsuperscript{20}: forgo state licensing and risk sanction from a state regulator\textsuperscript{21} or bear the potentially unnecessary cost of compliance.\textsuperscript{22} While established companies like Amazon, Google, PayPal, and even Facebook have the resources to mitigate the risk by becoming licensed, the cost for start-ups may be prohibitive. Accordingly, the unsettled legal and regulatory environment has the potential to disincentivize the continued development of desirable payment innovations.

This Article attempts to reconcile the apparent conflict between the statutory purpose of consumer protection and the desire for advancements that promote commerce by: (1) setting forth an approach for recasting state money transmitter laws in light of technological advances while respecting the consumer protection purpose of such statutes; and (2) supporting the adoption of an exemption that is tailored to differentiate new payment services in light of their relative risk of consumer loss—extending regulation where appropriate and exempting innovations where little risk exists.

Part I of this Article overviews the laws and regulations that presently govern the business of money transmission. In the absence of an explicit statutory exemption, state money transmitter laws purport to regulate any activity that falls within the statutory definition of “money transmission”\textsuperscript{23}

\textsuperscript{20} Complaint at 3–4, Think Computer Corp. v. Dwolla, Inc. et al, No. 5:13-cv-02054-EJD (N.D. Cal. May 6, 2013), available at http://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1379&context=historical (describing the dilemma facing payments providers in determining the applicability of state money transmitter laws to new technology along with the inconsistent enforcement of such laws by state regulators).


\textsuperscript{23} “Money transmission” is often broadly defined as the receipt of money or value for the purpose of transferring it to another person or location by any means. See infra Part I.A.1.
and imposes a myriad of state-specific licensing, financial security, examination, recordkeeping, and reporting requirements.

Part II of this Article illustrates how the broad definition of “money transmission” coupled with a limited list of explicit exemptions results in an uncertain regulatory environment where a host of services from bike messengers to app stores could potentially fall within the scope of regulation.

Part III of this Article explores the growing outcry about the lack of clarity and how it adversely impacts the providers of Internet and mobile payment services. The providers of such services face an unappealing dilemma. They can obtain a license and incur the cost and expense of maintaining compliance with a patchwork of state-specific requirements (perhaps needlessly), or they can elect to forego licensing and run the risk...
of civil and criminal penalties should a state regulator determine that their business constitutes money transmission.32

Part IV of this Article illustrates how the statutory purpose of money transmitter laws—to protect consumers from suffering losses at the hands of non-performing money transmitters—is not served by blindly extending regulation to Internet and mobile payment systems.33 In situations where there is no greater risk of consumer loss, such an approach is overly expansive and needlessly impinges upon commerce while wholly ignoring the evolving habits of merchants and consumers.

Part V of this Article concludes that the continued growth of Internet and mobile payments accentuates the need for legislative action and proposes that state money transmitter laws be amended to include a narrowly tailored “agent of the payee” exemption. Such an exemption would amend the definition of “money transmission” to unambiguously exclude the receipt of a payment for delivery to a merchant in connection with a sale by the merchant so long as: (1) the service is provided to or on behalf of a merchant and not directly to a consumer; (2) the service provider is acting pursuant to a written contract with the merchant; and (3) the contract and terms of service mitigate the risk of loss to the consumer by acknowledging that payment to the service provider constitutes payment to the merchant and that the merchant has no claim against the consumer for the failure of the service provider to transfer the payment to the merchant.34 This approach assures that state money transmitter laws will be fittingly recast in light of technological advances and market realities while upholding the consumer protection goals of such statutes where warranted.35

I. THE LEGAL AND REGULATORY LANDSCAPE OF MONEY TRANSMISSION

United States regulation of money transmission employs a dual-system of both state and federal laws. State money transmitter laws vary by jurisdiction36 and focus on consumer protection concerns.37 As such, state

33. See infra Part IV.
34. See infra Part V.
35. See infra Part V.
37. See, e.g., Cal. Fin. Code § 2002 (West 2013) (noting that the purpose of the statute is to protect the interests of consumers); Va. Code Ann. § 6.2-1902(B) (2010) (“This chapter shall be construed by the Commission for the purpose of protecting, against financial loss, residents of the Commonwealth who (i) purchase money orders or (ii) give money or control of their funds or credit
money transmitter laws are essentially “safety and soundness” statutes designed to ensure that consumer funds are protected from loss. In contrast, the Bank Secrecy Act (BSA), which regulates money transmission at the federal level, exists primarily as an anti-money laundering statute. Despite the differing purpose, state and federal money transmitter laws both opt to define the regulated activity of “money transmission” in broad terms, relying on a list of explicit statutory exemptions to narrow the scope of regulation. Unless an exemption applies, any person engaging in an activity that constitutes “money transmission” must be licensed under state law and comply with a host of regulatory requirements involving financial security, recordkeeping, reporting, and examination.

A. State Regulation of Money Transmission

While the statutory language varies from state to state, money transmitter laws generally seek to regulate the business of receiving money (or monetary value) for the purpose of transmission to another person or location. State money transmitter laws require that any person engaging in such activity obtain a license from the appropriate state regulator and into the custody of another person for transmission . . . .")}; Regulation of Money Transmitters in Texas: An Overview, TEXAS DEP’T OF BANKING, http://www.banking.state.tx.us/news/speeches/2004/11-10-04sp.htm#texasregulations (noting that “the overriding focus is consumer protection”).

38. See UNIF. MONEY SERV. ACT, prefatory note, 7A U.L.A. 163–64.


40. See, e.g., CAL. FIN. CODE § 2003(o) (West 2013); WASH. REV. CODE ANN. § 19.230.010(18) (West 1961). But see NEV. REV. STAT. ANN. §§ 671.010, 671.040(1) (LexisNexis 2009) (generally regulating the business of “receiving for transmission or transmitting money” without otherwise defining the scope of such activity).

41. See, e.g., ARIZ. REV. STAT. ANN. § 6-1203 (2007); COLO. REV. STAT. ANN. § 12-52-105 (West 2010); UNIF. MONEY SERV. ACT § 103 cmt. 1, 7A U.L.A. 184 (2006) (noting five exemptions that are typically available).


43. See infra Part I.A.3.

44. While state money transmitter statutes differ from jurisdiction to jurisdiction, there have been efforts to achieve more uniformity. Recognizing that existing state regulation is “extremely varied,” the National Conference of Commissioners on Uniform State Laws has advanced the Uniform Money Services Act of 2000, which regulates money services business like money transmission. To date, only 6 states have enacted some form of the Uniform act. See UNIF. MONEY SERV. ACT, prefatory note, 7A U.L.A. 163–64 (2006); Legislative Fact Sheet—Money Services Act, UNIFORM LAW COMMISSION, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Money%20Services%20Act. As a result there is little uniformity amongst state money transmitter laws.

45. See, e.g., CAL. FIN. CODE § 2003(s); UNIF. MONEY SERV. ACT § 102(14), 7A U.L.A. 178 (2006).

46. See, e.g., IDAHO CODE ANN. § 26-2903(1) (2000) (requiring a license from the Director of the Idaho Department of Finance to engage in money transmission business); 205 ILL. COMP. STAT. ANN. 657/10 (West 2007) (requiring a license from the Director of the Illinois Department of Financial
comply with other requirements imposed on licensed money transmitters. Unlicensed money transmission is flatly prohibited unless a valid exemption applies and is punishable by both criminal and civil penalties. When analyzing whether a specific activity is regulated under a state money transmitter statute the key considerations are: (1) whether the activity falls within the definition of money transmission; and (2) whether a statutory exemption exists to remove the activity from the ambit of the statute. In the absence of an applicable exemption, any activity that otherwise falls within the definition of “money transmission” is potentially subject to the scrutiny of state regulators.

1. The Definition of Money Transmission Under State Law

Most states attempt to define the scope of regulation by way of a broadly inclusive statutory definition. The definitions set forth in the Arizona and Maryland statutes are illustrative of the breadth that is often found. Arizona defines “transmitting money” as “the transmission of money by any means including . . . by payment instrument, wire, facsimile, internet or any other electronic transfer, courier or otherwise.” In Maryland, the term “money transmission” is defined as “the business of selling or issuing payment instruments or stored value devices, or receiving money or monetary value, for transmission to a location within or outside the United States by any means, including electronically or through the Internet.”

Institutions to engage in money transmission business; N.Y. BANKING LAW § 641(1) (generally requiring a license in order to engage in the business of receiving money for transmission or transmitting the same); WASH. REV. CODE ANN. § 19.230.030 (requiring a license in order to engage in the business of money transmission or to hold oneself out as providing money transmission); UNIF. MONEY SERV. ACT § 201, 7A U.L.A. 186 (setting forth the licensing requirement).

47. See infra Part I.A.3.


49. See supra note 32.

50. See Hurh & Luce, supra note 30 (“Government representatives from both civil and criminal enforcement agencies shared cautionary tales of both new and established companies that learned the hard way about the broad applicability of state money transmitter licensing laws.”); Money Services Act Summary, supra note 48.

51. See, e.g., IDAHO CODE ANN. § 26-2902(11); 205 ILL. COMP. STAT 657/5. But see NEV. REV. STAT. ANN. § 671.010 (LexisNexis 2009); NEV. ADMIN. CODE § 671.005-.100 (2010) (regulating the business of transmitting money or credits without providing a statutory definition or any other guidance as to the intended scope of regulation, which results in ambiguity and the possibility of the statute being narrowly or broadly construed).


Instead of narrowly defining the types of businesses that constitute money transmitters (e.g., money transfer services directed toward consumers), the Arizona and Maryland statutes, like many other state money transmitter laws, depend on a sweeping definition that is constrained by few explicit limits. The definitions do not appear to be concerned with the volume of money transmission or the method by which the transmission is accomplished. In addition, the statutes do not apply solely to the transmission of money (typically defined as a medium of exchange that is authorized or adopted by the United States or a foreign government). Instead, the scope has been expanded to encompass the transmission of monetary value (typically defined as a medium of exchange, whether or not redeemable in money). The only explicit limitation within the definition itself is the requirement that the money transmitter provide money transmission as a business. Therefore, despite definitional differences between jurisdictions, money transmission arguably encompasses almost any commercial activity where money is taken from one person or place and delivered to another. California state regulators have quite literally adopted such an approach, acknowledging the use of a plain language test to guide decisions on whether a particular business model or technology falls within the scope of regulation. Under this test, if a person takes money (or value) from person A and pays it to

55. See Ariz. Rev. Stat. Ann. § 6-1201(17); Md. Code Ann., Fin. Inst. § 12-401(m)(1). But see Unif. Money Serv. Act § 102(14), 7A U.L.A. 178 (2006) (defining “money transmission” broadly as “selling or issuing payment instruments, stored value, or receiving money or monetary value for transmission” but excluding any “delivery, online or telecommunications services, or network access” from its scope, which appears to exclude entities that solely provide delivery services (presumably courier or package delivery services) and entities that act as mere conduits for the transmission of data (such as internet service providers)).
57. See id. § 102(12), 7A U.L.A. 178 (2006); see also id. § 102, cmt. 10 (noting the expansion of the definition of money such that it is inclusive of anything that (1) serves as a medium of exchange and (2) places the customer at risk of the provider’s insolvency while the medium is outstanding).
58. See supra note 55.
59. See, e.g., Mich. Comp. Laws Ann. § 487.1003(c) (West Supp. 2013) (defining “money transmission services” as “selling or issuing payment instruments or stored value devices or receiving money or monetary value for transmission”); N.J. Stat. Ann. § 17:15C-2 (West 2001) (defining “money transmitter” as “a person who engages in this State in the business of: (1) the sale or issuance of payment instruments for a fee, commission or other benefit; (2) the receipt of money for transmission or transmitting money within the United States or to locations abroad by any and all means, including but not limited to payment instrument, wire, facsimile, electronic transfer, or otherwise for a fee, commission or other benefit; or (3) the receipt of money for obligors for the purpose of paying obligors’ bills, invoices or accounts for a fee, commission or other benefit paid by the obligor”).
60. See Thomas, supra note 30 (discussing the use of a plain-English test by California regulators); see also infra Part II (providing examples of the wide range of activities and business models that may fit within the plain language definition of “money transmission”).
61. Id.
person $B$ on behalf of person $A$ then the activity is subject to regulation. A broadly inclusive construction has also been supported by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in its uniform act to address money services business like money transmission. Accordingly, money transmitter laws are not strictly limited to regulating traditional money transfer businesses like Western Union. Instead, a variety of business models from courier services to Internet and mobile payment services such as PayPal and Square could conceivably fall within the scope of regulation.

2. Exemptions from Regulation Under State Law

Given the potentially expansive scope of money transmission, each state’s list of exemptions exists as the only meaningful mechanism for ensuring that a particular activity is excluded from regulation. The state-specific nature of money transmitter statutes makes generalization difficult. However, there is some minimal level of commonality. State money transmitter statutes often exempt “money transmission” when conducted by certain categories of persons. The most common exemptions are for: (1) the federal and state government; (2) those making transfers on behalf of the government or in connection with government benefits; (3) regulated banks and financial institutions; (4) authorized agents or delegates of a licensed money transmitter; and (5) the United States Postal Service. As such, only a lucky few—usually the government and those operating in heavily regulated industries—will be able to take advantage of an exemption. Exempt persons generally may engage in what would

62. Id.
63. See Money Services Act Summary, supra note 48.
72. See id. § 103(4), (6), (7), (8), (10), 7A U.L.A. 184.
73. See id. §§ 103(1)–(10), 201, 7A U.L.A. 183–86.
otherwise be categorized as “money transmission” without a license and without complying with the regulatory requirements imposed on licensed money transmitters.\footnote{\textit{See, e.g., ARIZ. REV. STAT. ANN. § 6-1203 (2007); FLA. STAT. ANN. § 560.104 (West 2012); NEV. REV. STAT. ANN. § 671.020 (LexisNexis 2009). In some cases, only limited exemptions are available. For example, authorized agents of a licensed money transmitter are typically exempt from the licensing requirements and must comply with other regulatory requirements. \textit{See, e.g., WASH. REV. CODE ANN. §§ 19.230.120, 19.230.130–40, 19.230.180, 19.230.230–40, 19.230.290.}}}

Perhaps recognizing the practical implications of a broadly inclusive definition coupled with a limited number of exemptions, certain states have incorporated additional exemptions. While the availability of such exemptions may be limited, they provide additional certainty by explicitly eliminating certain activities from regulation. For example, some states exempt money transmission by: (1) an incorporated telegraph or cable company so long as the money received is immediately transmitted;\footnote{\textit{See, e.g., COLO. REV. STAT. ANN. § 12-52-105 (West 2010); NEB. REV. STAT. § 8-1003(2)(1)(c).}} (2) a courier service;\footnote{\textit{See, e.g., HAW. REV. STAT. ANN. § 489D-4 (LexisNexis2012) (defining “money transmission” as not applicable to courier services).}} (3) an agent or authorized delegate of a person who is exempt from the statute;\footnote{\textit{See, e.g., NEV. REV. STAT. ANN. § 671.040(2) (permitting agents of a payee to engage in money transmission); N.Y. BANKING LAW § 641 (McKinney 1939) (permitting agents of a payee to engage in money transmission); OHIO REV. CODE ANN. § 1315.01(G) (West Supp. 2013) (defining the term “transmit money” as not including “transactions in which the recipient of the money or its equivalent is the . . . authorized representative of the principal in a transaction for which the money or its equivalent is received, other than the transmission of money or its equivalent”).}} (4) an agent of a payee (i.e., someone who is authorized by the principal to whom a payment is made to receive and transfer such payment to the principal);\footnote{\textit{See \textit{e.g.}, KAN. STAT. ANN. § 9-511 (2001).}} or (5) money transmissions that are incidental to and a necessary part of a lawful business.\footnote{\textit{See \textit{e.g.}, OKLA. STAT. ANN. tit. 6, § 1512(6) (West Supp. 2013); OKLA. ADMIN. CODE 191207-0(9).}}

The impact of new technology on the manner in which money is transferred amongst multiple parties by way of bookkeeping entries in lieu of physically delivering a tangible form of payment has also spurred the adoption of additional exemptions. Certain states have recognized the potential for money transmitter regulations to apply in the contexts of: (1) clearing and settling credit/debit card transactions,\footnote{\textit{See \textit{e.g.}, OKLA. STAT. ANN. tit. 6, § 1512(6) (West Supp. 2013); OKLA. ADMIN. CODE 191207-0(9).}} and (2) issuing stored

\footnote{\textit{See \textit{e.g.}, ARIZ. REV. STAT. ANN. § 6-1203 (2007); FLA. STAT. ANN. § 560.104 (West 2012); NEV. REV. STAT. ANN. § 671.020 (LexisNexis 2009). In some cases, only limited exemptions are available. For example, authorized agents of a licensed money transmitter are typically exempt from the licensing requirements and must comply with other regulatory requirements. \textit{See, e.g., WASH. REV. CODE ANN. §§ 19.230.120, 19.230.130–40, 19.230.180, 19.230.230–40, 19.230.290.}}

\footnote{\textit{See, e.g., COLO. REV. STAT. ANN. § 12-52-105 (West 2010); NEB. REV. STAT. § 8-1003(2)(1)(c).}}

\footnote{\textit{See, e.g., HAW. REV. STAT. ANN. § 489D-4 (LexisNexis2012) (defining “money transmission” as not applicable to courier services).}}

\footnote{\textit{See, e.g., NEV. REV. STAT. ANN. § 671.040(2) (permitting agents of a payee to engage in money transmission); N.Y. BANKING LAW § 641 (McKinney 1939) (permitting agents of a payee to engage in money transmission); OHIO REV. CODE ANN. § 1315.01(G) (West Supp. 2013) (defining the term “transmit money” as not including “transactions in which the recipient of the money or its equivalent is the . . . authorized representative of the principal in a transaction for which the money or its equivalent is received, other than the transmission of money or its equivalent”).}}

\footnote{\textit{See \textit{e.g.}, KAN. STAT. ANN. § 9-511 (2001).}}

\footnote{\textit{See \textit{e.g.}, OKLA. STAT. ANN. tit. 6, § 1512(6) (West Supp. 2013); OKLA. ADMIN. CODE 191207-0(9).}}
value devices such as gift cards. To clarify the scope of regulation in these new contexts, some states have adopted limited exemptions that appear to apply where the risk of consumer loss is minimal. For example, the exemption for money transmission in connection with clearing or settling credit/debit card transactions only applies where the person transfers money between exempt persons (i.e., financial institutions) who are otherwise subject to a comprehensive regulatory regime. Likewise, the issuer of a stored-value device can only take advantage of an exemption in a closed-system where the gift card is redeemable only for goods or services from the merchant who issues the card and not in an open-system where the card is redeemable broadly at a number of different merchants.

Even so, many states have done little to address the treatment of new and emerging payment mechanisms such as stored value, electronic currency, and mobile wallets under money transmitter laws.

As illustrated by the foregoing, state money transmitter statutes contain state-specific nuances. However, the statutory language is often broadly worded such that they may be deemed to regulate a wide variety of business activities unless a statutory exemption applies. Statutory exemptions vary by state but only apply to a narrow set of enumerated persons, potentially leaving a great deal of activity subject to regulation.
3. Compliance Requirements Under State Law

In the absence of an applicable exemption, state money transmitter laws purport to regulate any activity that falls within the definition of money transmission.85 Those that engage in money transmission must apply for and obtain a license from the applicable state regulator.86 In addition, licensed money transmitters are subjected to state-specific regulatory requirements that primarily seek to ensure the financial security of those who provide money transmitter services to consumer customers.87 The failure to obtain a license or otherwise comply may result in both civil and criminal penalties.88

In order to obtain a license, a prospective money transmitter must submit an application along with certain personal, business, and fitness-related information regarding the applicant and the business.89 The state regulator generally makes the decision to grant or deny the application for a license on the basis of: (1) the application; (2) an investigation of the applicant’s financial condition and responsibility, financial and business experience, competence, character, and general fitness; and (3) in some cases, an on-site examination.90 In connection with the licensing process, the applicant must also pay various fees, which may include an application fee, an annual license fee, and the costs of regulatory assessments and investigations.91 While the process is relatively benign, the burdens and costs of obtaining licensure under state laws increase exponentially where a money transmitter must navigate the process in multiple jurisdictions (i.e., subjecting to regulation under every state licensing regime in which the person wishes to engage in the business of money transmission).92

85. See Hurh & Luce, supra note 30 (noting that panelists at the annual Emerging Payments Systems conference “reminded participants that ‘money transmission’ is broadly defined to encompass any and all means of transmitting funds, with limited exceptions under various state and federal laws and regulations”); Money Services Act Summary, supra note 48.
87. The financial security requirements generally include an obligation to provide a surety bond, which varies in amount depending on the state. See, e.g., COLO. REV. STAT. ANN. § 12-52-107(1)(a) (West 2010). In addition, licensed money transmitters must typically satisfy a state-specific minimum net worth and may also be required to maintain a minimum amount of permissible investments. See, e.g., CONN. GEN. STAT. ANN. § 36a-603 (West 2011); D.C. CODE § 26-1004 (2001).
89. See, e.g., WASH. REV. CODE ANN. § 19.230.040.
90. Id. § 19.230.070.
91. Id. § 19.230.320; see also 205 ILL. COMP. STAT. ANN. 657/45; KY. REV. STAT. ANN. § 286.11-021 (LexisNexis Supp. 2010).
92. See UNIF. MONEY SERV. ACT § 201, cmt., 3 U.L.A. 192–93 (2006) (noting that state law governs jurisdictional decisions regarding whether a person is engaging in the business of money transmission and that factors such as targeting customers in the state may be relevant).
Licensed money transmitters must also comply with regulatory requirements aimed at protecting the public by ensuring that money transmitters have sufficient resources to honor their obligations to consumer customers\textsuperscript{93} and giving the state regulator sufficient supervisory power and insight into the licensee’s business to identify problems and pursue enforcement actions.\textsuperscript{94} While the specific requirements vary widely from state to state, licensed money transmitters must typically: (1) furnish a surety bond or similar security device;\textsuperscript{95} (2) satisfy minimum net worth requirements;\textsuperscript{96} (3) maintain minimum levels of specified types of permissible investments (e.g., government obligations and other low-risk investments);\textsuperscript{97} (4) retain specified business records for statutorily mandated periods of time;\textsuperscript{98} and (5) file annual and periodic reports relating to financial condition and upon the occurrence of significant events.\textsuperscript{99} In

\textsuperscript{93} The primary purpose of requiring delivery of a surety bond (or other security), along with the imposition of minimum net worth and minimum permissible investment levels, is to ensure that the money transmitter has sufficient resources to honor its obligations to its customers. See \textsc{Unif. Money Serv. Act} § 204, cmt., 7A U.L.A. 192–93 (2006); \textit{id}. § 207, cmts. 1–2, 7A U.L.A. 196–97.


\textsuperscript{95} See, e.g., ARIZ. REV. STAT. ANN. §§ 6-1205(A), 6-1205.01 (2007) (imposing minimum bonding and net worth requirements); COLO. REV. STAT. ANN. § 12-52-107(1)(a) (West 2010) (requiring bond of $1,000,000, which may be decreased to no less than $250,000 based on financial condition); CONN. GEN. STAT. ANN. §§ 36a-602, 36a-604 (West 2011) (imposing minimum bonding and net worth requirements); D.C. CODE § 26-1007(a) (2001) (requiring that licensed money transmitters furnish a surety bond of $50,000 plus $10,000 per each additional location, not to exceed $250,000); KAN. STAT. ANN. § 9-509(b)(2)-(3) (Supp. 2012) (requiring deposit of cash or securities with the state treasurer or an approved bank in the amount of $200,000 which can be increased to a maximum of $500,000 depending on financial condition, or alternatively the delivery of a surety bond in the same amount); \textsc{Unif. Money Serv. Act} § 204, 7A U.L.A. 192 (2006) (requiring that each prospective licensee deliver a surety bond, letter of credit or similar security device in the amount of $50,000 plus $10,000 for each additional location, not to exceed $250,000, when applying for a license, and noting that the amount of security can be raised to a maximum of $1,000,000 if necessitated by the licensee’s financial condition).

\textsuperscript{96} See, e.g., D.C. CODE § 26-1004 (requiring a minimum net worth, at all times, of not less than $100,000 plus $50,000 for each additional location or authorized delegate, not to exceed $500,000); KAN. STAT. ANN. § 9-509(b)(1) (requiring a minimum net worth, at all times, of not less than $250,000); \textsc{Unif. Money Serv. Act} § 207, 7A U.L.A. 196 (2006) (requiring that each licensee maintain a minimum net worth of at least $25,000).

\textsuperscript{97} See, e.g., CONN. GEN. STAT. ANN. § 36a-603; KY. REV. STAT. ANN. § 286.11-015(1) (requiring a licensed money transmitter to maintain minimum permissible investments of no less than the aggregate amount of all of its outstanding payment instruments).

\textsuperscript{98} See, e.g., KY. REV. STAT. ANN. § 286.11-029 (requiring licensed money transmitters to maintain and preserve certain books and records for five years); MICH. COMP. LAWS ANN. § 487.1025 (West Supp. 2013) (requiring licensed money transmitters to maintain certain records for three years); \textsc{Unif. Money Serv. Act} § 605, 7A U.L.A. 214–15 (2006) (requiring that each licensee maintain extensive records for a period of three years).

\textsuperscript{99} See, e.g., FLA. STAT. ANN. § 560.118(2)(a) (West 2012) (requiring filing of annual financial statements and quarterly reports); \textit{id}. § 560.126 (requiring written notice of significant events); IOWA CODE ANN. § 533C.205(2) (West 2011) (requiring submission of an annual renewal report); \textit{id}. § 533C.503 (requiring filing of quarterly reports, and additional reports upon occurrence of certain material changes and other specified events); \textsc{Unif. Money Serv. Act} § 206(b), 7A U.L.A. 195 (2006) (requiring that each licensee submit a renewal report, including its audited annual financial statement,
addition, licensed money transmitters must open their business up for audit and investigation by the regulatory agency overseeing compliance. Those who fail to comply face administrative action with both criminal and civil consequences, ranging from imprisonment to monetary penalties. In addition to penalties under state law, federal laws regulating money transmission make it a crime, punishable by a monetary penalty or imprisonment, to operate as a money transmitter without complying with applicable state licensing requirements.

The regulatory implications of being subject to state money transmitter laws can be onerous and costly. Licensees must not only bear the direct costs of licensing and renewal, but also bear the expense of establishing a program to ensure compliance with ongoing requirements such as reporting. The state-specific nature of money transmitter laws only increases the burden of compliance.

B. Federal Regulation of Money Transmission

While the primary thrust of this Article centers on state money transmitter laws, a brief overview of federal regulation of money transmission is both enlightening and useful. Federal regulation of money transmission was enacted pursuant to the BSA. The requirements of the BSA are set forth in the text of the BSA and in the implementing or submit to an examination when requesting its annual license renewal); id. § 603, 7A U.L.A. 211–12 (requiring submission of reports following material changes); id. § 604, 7A U.L.A. 213–14 (2006) (requiring that each licensee provide the state regulator with a notice and request for approval of any proposed change in control); id. § 606, 7A U.L.A. 216 (requiring that each licensee file all necessary reports under federal and state money laundering laws).

100. See, e.g., MD. CODE ANN., FIN. INST. §§ 12-421, 12-423, 12-424 (LexisNexis 2011) (allowing the commissioner to require an audit by a certified public accountant and permission to conduct an investigation of books and records or an on-site investigation); IOWA CODE ANN. § 533C.501(1) (West 2011) (giving the state regulator the right to conduct an annual examination); UNIF. MONEY SERV. ACT §§ 601–02, 7A U.L.A. 210–11 (2006) (granting the state regulator authority to conduct, at the licensee’s cost, an annual examination and additional examinations if the regulator believes that the licensee is engaging in unsafe or unsound practices or is otherwise violating the statute).

101. See, e.g., MD. CODE ANN., FIN. INST. § 12-429 (imposing a civil penalty of up to $1,000 for the first violation of the Maryland money transmitter law and $5,000 for each subsequent violation); id. § 12-430 (classifying each knowing violation of the Maryland money transmitter law as a felony punishable by imprisonment for up to five years and a criminal fine of $1,000 for the first violation and $5,000 for each subsequent violation); UNIF. MONEY SERV. ACT § 803, 7A U.L.A. 224–25 (2006) (granting the state regulator the power to issue cease and desist orders); id. § 804, 7A U.L.A. 225 (granting the state regulator the power to enter into consent orders to resolve any matters under the Act); id. § 805, 7A U.L.A. 226 (granting the state regulator the authority to assess civil penalties of $1,000 per day for each outstanding violation plus costs and attorneys fees); id. § 806, 7A U.L.A. 226 (imposing criminal penalties for certain intentional or knowing violations of the Act).


103. See 31 U.S.C. § 5311; 31 C.F.R. §1010.100 (2012); see also FinCEN’s Mandate from Congress, supra note 39.
regulations promulgated by the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury. The BSA seeks to regulate financial institutions and other financial businesses by requiring them to assist U.S. government agencies in detecting and preventing money laundering. Accordingly, the purpose of the BSA is distinct from the statutory purpose of state money transmitter laws because the BSA is wholly unconcerned with protecting consumers from suffering a monetary loss. Notwithstanding the divergent statutory purpose, there are some similarities, including: (1) a broadly inclusive definition of money transmission; (2) the requirement of registration with the proper regulatory agency; and (3) the imposition of regulatory requirements, including civil and criminal penalties for noncompliance.

1. The Definition of Money Transmission Under Federal Law

Like state money transmitter laws that require licensing, the BSA requires money transmitters to register with the Secretary of the Treasury. The regulated activity of money transmission is defined as a component part of the term “financial institution.” The BSA itself simply provides that the term “financial institution” includes any “licensed sender of money or any other person who engages as a business in the transmission of funds.” The implementing regulations of the BSA go a step further and provide that the term “financial institution” includes any money services business. Money transmitters are one of seven different

104. See supra note 103.
106. See 31 C.F.R. §1010.100(ff).
107. See 31 U.S.C. § 5330 (requiring registration of all money transmitters); 31 C.F.R. § 1022.380 (requiring that all money transmitters register with FinCEN regardless of whether or not the money transmitter is already licensed with any State).
108. Due to the BSA’s focus on detecting and preventing money laundering, the regulatory compliance requirements naturally focus on reporting and record keeping. See, e.g., 31 U.S.C. § 5313 (requiring submission of reports in connection with certain transactions for the payment, receipt, or transfer of United States coins, currency, or other monetary instruments); id. § 5326 (granting authority for the federal regulator to impose additional recordkeeping requirements).
110. Id. § 5330; see also 31 C.F.R. § 1022.380.
112. Id.
113. See 31 C.F.R. § 1010.100(t)(3).
types of money services businesses. Money transmitters are broadly defined in the implementing regulations as: (1) any person that accepts “currency, funds, or other value that substitutes for currency from one person and [transmits the same] to another location or person by any means”; or (2) “[a]ny other person engaged in the transfer of funds.” Thus, the federal definition, like most state definitions, is broadly inclusive and potentially encompasses any activity where a person accepts and then transfers the money to another place or location. While traditional money transfer businesses such as Western Union fall within this definition, a host of other business models also appear to fit within the plain language of the definition (e.g., couriers delivering money or monetary value, the delivery of payments using an Internet-based systems such as PayPal).

2. Exemptions from Regulation Under Federal Law

Given the sweeping definition of money transmission and the use of a facts-and-circumstances test to make the ultimate determination, a potentially regulated person must look to the enumerated exemptions for guidance. Like state money transmitter laws, the BSA excludes money transmission by categories of persons already subject to regulatory oversight, including banks and any person regulated by the Securities and Exchange Commission or the Commodity Futures Trading Commission. However, while many state statutes have not yet modernized their money transmitter statutes to address technological advances, the federal regulations contain more robust exemptions.

The exemptions found in FinCEN’s implementing regulations show an understanding of the potential for money transmitter laws to implicate a host of electronic payment and delivery mechanisms. As such, the term money transmitter does not include any person who only:

114. Currency dealers or exchangers, check cashers, issuer of traveler’s checks or money orders, providers of prepaid access, money transmitters, the U.S. Postal Service, and sellers or prepaid access; 31 C.F.R. § 1010.100(ff)(1)–(7).
115. Id. § 1010.100(ff)(5)(i)(A).
116. Id. § 1010.100(ff)(5)(i)(B).
117. Id. §§ 1010.100(ff)(5)(i)(A), 1010.100(ff)(5)(ii); see also Bank Secrecy Act Regulations; Definitions and Other Regulations Relating to Money Services Businesses, 76 Fed. Reg. 43585-01 (July 21, 2011) (codified at 31 C.F.R. pt. 1010, 1021 and 1022) (noting that there is no activity threshold applicable to money transmitters).
118. 31 C.F.R. § 1010.100(ff)(5)(ii).
119. See id. § 1010.100(ff)(5)(i)(A)–(F) (enumerating exclusions to the defined term “money transmitter”); id. § 1010.100(ff)(8) (enumerating exclusions to the defined term “money services business”).
120. Id. § 1010.100(ff)(8).
(A) Provides the delivery, communication, or network access services used by a money transmitter to support money transmission services;

(B) Acts as a payment processor to facilitate the purchase of, or payment of a bill for, a good or service through a clearance and settlement system by agreement with the creditor or seller;

(C) Operates a clearance and settlement system or otherwise acts as an intermediary solely between BSA regulated institutions. . . .

(D) Physically transports currency . . . or other value that substitutes for currency as a person primarily engaged in such business, such as an armored car, from one person to the same person at another location or to an account belonging to the same person at a financial institution, provided that the person engaged in physical transportation has no more than a custodial interest in the currency . . . or other value at any point during the transportation;

(E) Provides prepaid access; or

(F) Accepts and transmits funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds. 122

Thus, federal law appears to take a more progressive approach toward addressing the scope of regulation in light of technological advances in the payments industry. In doing so, federal law specifically exempts any person who simply provides a delivery mechanism that is used by a money transmitter to effectuate the acceptance and transfer of money. 123 As such, providing the Internet service used by a money transmitter to accept and transfer currency will not subject the internet service provider to regulation. Federal law also appears to exempt the receipt and transfer of money in certain specified situations, where the money transmission generally supports the operation of a modern payment and financial system. 124 Specifically, federal law exempts: (1) any seller who receive and transmit money in connection with facilitating the sale of their products or services; 125 (2) any third party who acts as a payment processor by accepting and transferring a payment in connection with facilitating a purchase via an agreement with the seller; 126 and (3) any provider of stored

122. 31 C.F.R. § 1010.100(ff)(5)(ii)(A)-(F).
123. Id. § 1010.100(ff)(5)(ii)(A).
124. See id. § 1010.100(ff)(5)(ii)(B)-(F).
125. Id. § 1010.100(ff)(5)(ii)(F).
126. Id. § 1010.100(ff)(5)(ii)(B).
value regardless of whether the system is open-loop or closed-loop. Therefore, federal money transmitter laws have outpaced state law counterparts when it comes to incorporating exemptions to clarify the scope of regulation as applied to new payment technologies.

3. Compliance Requirements Under Federal Law

Absent an exemption, any person that constitutes a money transmitter under the BSA must be registered and comply with additional regulatory requirements. Given the focus on detecting and preventing money laundering, the BSA foregoes regulation focused on financial security in favor of comprehensive reporting and recordkeeping obligations. Reports must be filed after the occurrence of certain events. Reportable events include: (1) any transaction in currency in excess of $10,000; (2) any instance where currency in excess of $10,000 is physically transported from abroad into the United States or vice versa; and (3) the occurrence of any other suspicious transaction. Money transmitters must also comply with the recordkeeping requirements set out in Subpart D of 31 C.F.R. § 1010 by both making and maintaining appropriate records in connection with certain transactions. While federal money transmitter regulation does not impose obligations to provide surety bonds and similar financial security devices or involve the burdens of compliance with differing rules across jurisdictions, federal regulation does nonetheless impose arduous recordkeeping and reporting requirements.

II. THE POTENTIALLY EXPANSIVE REACH OF REGULATION

The sweeping statutory definition of money transmission under state law and the relative lack of exemptions lead to practical problems for any person that is engaged in any activity that involves the receipt of money or a payment for transfer to another person or location. Under state law, money transmission can be reasonably interpreted as extending far beyond traditional money transfer businesses like Western Union who are primarily engaged in the business of taking possession of and delivering money on
behalf of consumers. While the extension of money transmitter laws to new ways of providing money transfer services (e.g., Western Union’s use of the Internet to accept and transfer money on behalf of consumer customers), money transmitter laws potentially encompass everything from bike messengers delivering a check to any number of Internet and mobile payment services that take payment information from a buyer and deliver payment to the merchant seller. In both cases, the service provider is taking what amounts to money or monetary value under statute (e.g., the check or the credit/debit card information) and transferring it to another person.

A. Traditional Money Transfer Businesses

The definition of money transmission clearly covers traditional money transfer businesses like Western Union. Since there is little doubt that state money transmitter laws regulate such enterprises, money transfer businesses have historically applied for licenses and conformed to the requirements imposed by money transmitter laws. Money transfer businesses like Western Union provide various money transfer services to consumer and business customers. As a general matter, customers engage the money transfer business to take possession of funds, which are provided by the customer, and deliver the funds to a person designated by the customer who is located in another city, state, or country. The money

135. See, e.g., United States v. Cambio Exacto, S.A., 166 F.3d 522, 524–25 (2d Cir. 1999) (describing money transmitters in the traditional sense as an entity in the “business of sending money: collecting it from customers and, for a commission, delivering it to a designated recipient, typically in another country” and describing the process by which such transfer occurs as involving reliance “on independent agents at both ends of each transaction.” Specifically, “[c]ustomers give local agents the money they want sent; the agents then notify the money transmitter of the transaction and deposit the funds to be transferred in the transmitter’s bank account. Similarly, to physically turn over the funds to the recipient, money transmitters use entities doing business in the recipient’s vicinity. When performing that function, they are known as correspondents. To expedite the delivery process, correspondents sometimes distribute funds to the recipients before the amount actually arrives from the money transmitter.”).

136. See infra Part II.A–C.

137. See About Us, W. UNION, http://corporate.westernunion.com/about.html (last visited October 1, 2013) (describing the money transfer services provided by Western Union to its customers).


transfer business plainly receives and transfers money to another location or person as a service provider for the customer. In exchange for this service, the money transfer business is paid a fee by the customer. Thus, traditional money transfer businesses clearly fall within the scope of regulation.

Originally, money transfers were accomplished via a wire transfer through an intercontinental telegraph system, which required that a customer physically go to a telegraph office to deliver the funds for transfer. Likewise, the customer’s designated recipient was forced to travel to a telegraph office to receive the funds. While customers can still travel to a physical location to make a money transfer, technological advances have expanded the available delivery mechanisms. Customers can now initiate a money transfer over the phone or on the Internet. Instead of delivering physical currency, the customer provides the functional equivalent in the form of credit/debit card information or bank account information to the money transfer business, which electronically transfers the value to the customer’s designated recipient.

Notwithstanding changes in the way that money transfers may be accomplished, the broadly inclusive nature of state money transmitter laws, which explicitly govern transfers by “any means,” rightfully allows for the continued regulation of new ways of providing the same old money transfer services.

B. Incidental Money Transfer

While the breadth of state money transmitter laws appropriately allows for the regulation of traditional money transfer businesses along with new
ways of providing the same service, the definition of “money transmission” also implicates other enterprises that may only be involved in the receipt and transfer of money as an incidental part of its primary business. For example, the U.S. Postal Service, United Parcel Service, Federal Express, couriers, bike messengers, and others are primarily involved in providing delivery services to customers. Nonetheless, customers may on occasion request delivery of packages that contain currency or other monetary value such as checks, money orders, and gift cards. Because the service provider receives remuneration for the delivery, the service could be deemed the business of receiving money for the purpose of transferring it to another person or location. While most states exempt the U.S. Postal Service, few states provide an exemption applicable to delivery services generally. Moreover, state money transmitter laws typically do not contain a minimum activity threshold before regulation is triggered or otherwise limit regulation to those who have actual knowledge that money is being transported. As such, the breadth of the statute and the lack of clearly applicable exemptions leave couriers and other delivery services that may only occasionally deliver money within the plain language of the statute’s regulatory scope. The foregoing is illustrative of the potential applicability of state money transmitter laws to business models other than the money transfer businesses that have historically been regulated.

C. New and Emerging Payment Systems

While the broadly inclusive nature and lack of applicable exemptions has potential implications for delivery services and other businesses that occasionally engage in money transfers, no business sector is more impacted than the burgeoning Internet and mobile payment services industry. The adoption of new technology has changed the way that consumers and businesses send and receive payments in connection with the purchase and sale of goods and services. Increasingly, commerce is shifting from a paper-based payment system reliant on cash and checks to electronic modes of payment. Credit cards and debit cards have to some

148. See supra Part I.A.
149. See supra Part I.A.1.
150. See, e.g., GA. CODE ANN. § 7-1-681 (2013).
degree replaced paper currency.\textsuperscript{154} Gift cards have to some degree replaced paper gift certificates.\textsuperscript{155} Consumers can send electronic payments through a variety of providers over the Internet in lieu of sending a check.\textsuperscript{156} The advent of mobile payment systems has also enabled the use of smartphones as a payments mechanism.\textsuperscript{157} While the business models and functionalities differ, all of the following arguably involve the receipt of money or a payment by a third-party service provider for ultimate delivery to an independent seller of goods or services in connection with concluding a purchase and sale transaction: (1) the provision of stored value and gift cards; (2) the provision of payment processing services for third-party sales on a hosted marketplace like the Amazon Marketplace and various mobile application stores; (3) the provision of shopping cart or check-out functionality, such as PayPal or Google Checkout, for use by a merchant seller in connection with website sales; (4) the provision of mobile wallets, such as Google Wallet and LevelUp, that give merchant sellers the ability to accept payment information from a customer’s smartphone; and (5) the provision of hardware and related mobile payment processing services, such as Square and LevelUp, which give merchants the ability to use their own smartphone to accept credit/debit card payments. While some states have started to address the scope of money transmitter laws with respect to stored value,\textsuperscript{158} few states have adopted exemptions applicable to new Internet and mobile payment systems, leaving the question of scope undefined and such services potentially subject to regulation.\textsuperscript{159}

1. \textit{Stored Value and Gift Cards}

Given the potential costs of regulation as a licensed money transmitter, providers of stored value were quick to raise concerns about the lack of

\begin{itemize}
\item \textsuperscript{155} See \textit{FEDERAL RESERVE}, supra note 1 (discussing prepaid stored value as a replacement for paper-based payment instruments).
\item \textsuperscript{156} See infra Part II.C.2–3.
\item \textsuperscript{157} See infra Part II.C.4–5.
\item \textsuperscript{158} See, e.g., \textit{WASH. REV. CODE ANN. §§ 19.230.010(6), 19.230.020(12)} (West 1961) (providing a limited exemption for stored value). But see \textit{NEV. REV. STAT. ANN. §§ 671.010, 671.040(1)} (LexisNexis 2009) (regulating the issuance and sale of checks and the receipt of money transmission without any explicit mention of applicability to stored value).
\item \textsuperscript{159} In promulgating the Uniform Money Services Act, NCCUSL noted that for many states, the uniform act would “provide a new approach to the treatment of stored value and electronic currency at the state level.” See \textit{UNIF. MONEY SERV. ACT}, prefatory note, 7A U.L.A. 163–64 (2006). Even in states that have adopted the uniform act, technology continues to outpace regulation. The uniform act was drafted in 2004 and while it clarifies, to some degree, the treatment of stored value and internet payments, the question of applicability to newer business models such as mobile payments remains unclear. \textit{Id.}
Regulating the New Cashless World

clarity regarding whether state money transmitter statutes actually applied to prepaid products. The issuer of a gift card, for example, receives money from the person purchasing the gift card. An accounting of the amount paid is then loaded onto the gift card and stored electronically, which allows the holder to use the card to make purchases from any merchant who will accept it as a form of payment. As such, the issuer of the card could be construed as engaging in money transmission by receiving money from the person purchasing the card for the purpose of providing a mechanism (the gift card) that transfers money when the card is used to make a purchase from another place or location.

Because of confusion in the marketplace about whether issuers of stored value were required to become licensed money transmitters, a number of states attempted to clarify the question. States that have addressed the question generally exempt issuers of stored value in a “closed-loop” system where a merchant issues a card that can only be redeemed for goods or services sold by the merchant issuing the gift card (e.g., a gift card issued by Wal-Mart that can only be used to make purchases from Wal-Mart). In contrast, stored value in an “open-loop” system can be used to make purchases at many different merchants (e.g., prepaid debit cards issued by Visa that can be used at any merchant who accepts Visa or a mall gift card that can be used at any merchant located in the mall). Although exemptions for issuers of stored value are not available in all states, it appears that the issuers of “closed loop” stored value may be exempt in certain jurisdictions while issuers of “open loop” remain potentially subject to regulation.

160. See Federal Reserve, supra note 1.
163. See supra note 161.
164. Id.
2. Online Marketplaces and App Stores

While states have started to address the question of whether state money transmitter laws regulate stored value, much less progress has been made toward modernizing such statutes to account for online marketplaces and mobile applications.\(^{165}\) Money transmitter regulation is potentially implicated when a person: (1) hosts an online marketplace or mobile application store where merchants gather to sell their products; and (2) provides payment processing services to the merchants in connection with sales made. Such a service arguably falls within the scope of money transmitter regulation because the service provider is receiving credit/debit card payment information from customers who wish to make a purchase and subsequently facilitates delivery of the payment to the merchant selling the product.\(^{166}\)

For example, the Amazon Marketplace is a hosted site where merchants congregate to peddle their wares on Amazon.com\(^ {167}\) to over 4 million unique daily visitors.\(^ {168}\) Amazon is not the seller, but instead acts as a service provider to facilitate sales by independent merchants. The merchant agrees to pay Amazon a fee, which may include a monthly subscription fee, a referral fee equal to a percentage of the sale price, and for certain types of products, a fixed fee per item.\(^ {169}\) In exchange, Amazon allows the merchant to sell on Amazon.com and handles all of the payment processing and settlement for the merchant’s sales.\(^ {170}\) In doing so, Amazon acts on behalf of the merchant, accepting payments from the merchant’s customers (usually via a credit or debit card), and subsequently settling with the merchant for all sales made through the marketplace by paying the merchant an amount equal to the purchase price less any applicable fees.\(^ {171}\)

Thus, the providers of online marketplaces like the Amazon Marketplace

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\(^{165}\) See supra note 159.

\(^{166}\) See e.g., MD. CODE ANN., FIN. INST. § 12-401(l).


arguably accept money in the form of payment card information from the customer for the purpose of delivering to another place or location—to the banks processing the transaction and ultimately to the merchant.

Mobile application stores are similarly susceptible to being covered by the plain language of state money transmitter laws. While Apple, Android, Samsung, T-Mobile, and many others manufacture and sell smartphones on different mobile platforms, they often rely on independent software developers to create apps for use on those smartphones. Every mobile platform like Apple’s iOS. Customers who wish to buy an app pay (usually via credit/debit card or acceptance of a charge to the customer’s monthly phone bill) the operator of the app store (e.g., Apple). After receiving payment from the buyer, the app store operator settles with each developer by paying them the purchase price for all of the apps that have been sold minus any applicable transaction fees owed. Like the operator of an online marketplace, the app store operator could be construed as an intermediary who receives payment from buyers on behalf of the developer-seller in connection with the sale of the app, ultimately transferring such payment to the developer-seller. Therefore, like online marketplaces, the activities of app store operators may satisfy the technical definition of money transmission under state law. While such an outcome may seem patently ridiculous in what could be analogous to a reseller/distributor scenario, the application of the broadly inclusive statute and the plain language test advanced by some regulators highlights the potentially wide-ranging types of business models that may be impacted.


174. See, e.g., ANDROID, supra note 11 (describing payment options for customers who wish to buy apps).

175. See, e.g., Android Developer—Transaction Fees, GOOGLE PLAY, http://support.google.com/googleplay/android-developer/answer/112622?hl=en\&ref_topic=15867 (last visited Aug. 28, 2013) (providing for monthly payouts and noting that the developer receives 70% with the remaining 30% of the purchase price going to the distribution partner and to pay operating fees).
3. Shopping Carts and Checkout Services

States have also neglected to update money transmitter laws to clarify the scope of regulation with respect to third-party service providers who operate the checkout and payment process for a merchant website. Even though a customer may visit the merchant’s website instead of a hosted marketplace, money transmitter regulation is potentially implicated where a third party such as PayPal, Google, or Amazon operates the “shopping cart” or “check out” function for the merchant website, or where the merchant directs the customer to pay using a third-party service. In such situations, the service provider (not the merchant) receives and processes the customer’s payment in connection with ultimately facilitating the transfer of the payment to the merchant seller.

Services such as PayPal, Google Checkout, and Checkout by Amazon allow merchants to integrate a shopping cart or checkout function with the merchant’s website so that a customer can make a payment directly from the merchant’s website. To make a purchase, customers typically initiate payment by selecting a button on the merchant’s website, which directs the customer to provide payment information to the service provider to conclude the purchase. As such, the service provider accepts the payment from the buyer on behalf of the merchant, subsequently transferring the payment to the merchant less any applicable fees. In addition, many service providers simply give merchants the ability to send invoices and direct customers to make a payment through the service provider (e.g., a seller on eBay directing the winning bidder to pay through PayPal). Given the broadly inclusive definition of “money transmission,” checkout services and merchant-facing payment services offered by PayPal, Amazon, Google and others like them could all reasonably be interpreted as falling within the ambit of regulation unless a valid exemption applies.

176. See supra Part II.A.1–2.
181. See supra notes 177–179.
182. See, e.g., Checkout by Amazon, Amazon, supra note 179 (illustrating the payment process).
183. Id.
4. Mobile Wallets and Mobile Payment

Like the payment innovations discussed above, mobile wallets and other mobile payment platforms, which allow consumers to use their mobile devices to make payments, could be construed as money transmission. Where a third party provides the application that enables a customer’s mobile device to store payment information and the hardware that allows a merchant to accept a customer payment via the mobile device, money transmission regulation is potentially implicated because a third party arguably receives the payment and facilitates transfer of the payment to the merchant-seller.

Some examples of mobile commerce platforms that may constitute money transmission under state law include Google Wallet, Isis, Square Wallet, and LevelUp. In addition, Merchant Customer Exchange is in the process of developing a merchant-owned mobile payment platform for participating merchants. While the business models differ, each mobile payment platform essentially allows a participating merchant to accept payment from a customer’s enabled mobile device. When making a purchase, the customer simply uses his or her smartphone to transmit the credit/debit card information to an in-store terminal or scanner. In each case, the operator of the mobile payment platform

185. See Google Wallet, GOOGL, supra note 6.
190. See, e.g., Mark Hachman, Isis Carrier Venture Signs Payment Deals with Visa, MasterCard, Others, PCMag.COM (Jul. 19, 2011, 1:49 PM), http://www.pcmag.com/article2/0,2817,2388712,00.asp (describing Isis’ use of an NFC terminal to obtain payment information from the customer’s phone); Google Wallet, GOOGLE, http://www.google.com/wallet/shop-in-stores/ (last visited Sept. 27, 2013) (describing Google Wallet’s use of an NFC terminal to obtain payment information from the customer’s phone); Olga Kharif, AT&T-Verizon-T-Mobile Sets $100 Million for Google Fight: Tech, BLOOMBERG
could be deemed to be receiving money in the form of payment information from the buyer for the sole purpose of delivering it to the merchant seller.

5. Mobile Card Readers

One final innovative payment business model deserves mention due to the relative speed of its acceptance in the marketplace and its potential for falling within the scope of money transmitter regulation. The advent of mobile credit/debit card readers has allowed merchants to eschew the terminals provided by the credit card associations in favor of a scanner attached to the merchant’s mobile device, which allows the merchant to swipe a customer’s credit/debit card for payment. Such devices along with the related apps effectively allow a merchant to transform its mobile device into a cash register. Examples include Square, Inc.’s card reader, Square Register (launched in 2010 by Twitter co-founder Jack Dorsey and Jim McKelvey), and PayPal’s more recent introduction of the PayPal Here card reader. Both services arguably involve the receipt of money from a buyer in the form of credit/debit card information for the purpose of payment processing and ultimately the transfer of such funds to the merchant making a sale. Like many of the other payment systems discussed above, Square Register and PayPal Here operate as a kind of third-party intermediary that receives and delivers the purchase price in connection with a purchase and sale transaction between an independent buyer and

BUSINESSWEEK (Aug. 29, 2011), http://www.businessweek.com/news/2011-08-29/at-t-verizon-t-mobile-sets-100-million-for-google-fight-tech.html; LEVELUP, supra note 13 (describing LevelUp’s use of a unique code and scanner system to transfer payment information); Staley, supra note 187 (discussing Square Wallet’s use of GPS technology to transmit payment information).


192. See supra note 190.


seller. Thus, in the absence of clearly applicable exemptions, the service could be deemed money transmission under state law.

III. THE ADVERSE IMPACT OF UNCERTAINTY ON THE PAYMENT INDUSTRY

Uncertainty abounds regarding the scope of regulation under state money transmitter laws because of the broadly inclusive definition of what constitutes money transmission and the existence of few statutory exemptions. As discussed above, a host of activities other than traditional money transfer services potentially falls within the plain language of regulation.

While some states have recognized the need for re-evaluation and clarification of money transmitter laws in light of innovations such as stored value, far less certainty exists for the providers of other new and emerging payment services. Nonetheless, the rise of Internet and mobile payment services evokes similar questions and calls for increased clarity. In the absence of certainty, those who provide such services face increased transaction costs. As a result, the unsettled legal and regulatory framework has the potential to stifle ongoing payment innovation.

A. Transaction Costs

The uncertain scope of regulation needlessly increases the search and information costs of any person that currently provides a potentially regulated service or wishes to bring one to market. At present, any person that receives money or monetary value and transfers that money or monetary value to another person or location must evaluate whether his or her actions constitute money transmission under differing state laws. An array of Internet and mobile payment services currently in widespread use and those that are still in development effectively involve the receipt of money by person A (a service provider) from person B (a consumer) for the

195. See Mariani, supra note 30; Hurh & Luce, supra note 30; Thomas, supra note 30.
196. See supra Part II.
197. See supra Part II.C.
198. See supra Part II.C.
199. In addition to the outcry over the lack of certainty and consistency in the application of state money transmitter laws to Internet and mobile payment products, it should be noted that some have challenged the constitutionality of such state statutes. See Complaint at 4, Think Computer Corp. v. Venchiarutti, No. CV 11-05496 HRL, 2011 WL 7941050, at *4 (N.D. Cal. Nov. 14, 2011), available at ia600805.us.archive.org/15/items/gov.uscourts.cand.247574/gov.uscourts.cand.247574.1.0.pdf (challenging the constitutionality of the 2010 California Money Transmission Act). While questions of constitutionality are beyond the scope of this Article, the wide-ranging impact of state money transmitter laws on a system of modern commerce utilizing Internet and mobile payments is highlighted by the Think Computer Corporation lawsuit.
200. See Hogan, supra note 30; Mariani, supra note 30.
purpose of transferring it to person C (e.g., a seller). Given the lack of clearly applicable exemptions in each state, potentially regulated payment service providers are left to navigate an ambiguous legal and regulatory environment when determining whether they are subject to money transmitter laws and perhaps more importantly whether a state regulator enforcing the statute will interpret the scope similarly. As such, potentially regulated payment service providers must wrestle with several wholly undesirable options—either: (1) obtain a money transmitter license and bear the cost of implementing a regulatory compliance program to mitigate the risk of potential regulation and penalties for noncompliance; (2) forego licensing and risk the possibility of penalties in the event that a regulator ultimately deems that the person is in fact a money transmitter, or (3) stop development or provision of any potentially regulated activity until greater certainty exists. Furthermore, the lack of consistency between jurisdictions compounds the problem. Those that operate in multiple states must engage in the same futile exercise of attempting to discern the applicability of each state-specific regulatory regime, including any available exemptions. In the end, it is the potentially regulated person

201. See supra Part I; see also CAL. FIN. CODE § 2003(o) (West 2013) (broadly defining money transmission); Thomas, supra note 30 (discussing the use of a plain-English test).

202. See supra Part II.

203. See Mariani, supra note 30; Andrea Lee Negroni, Risky Business: State Regulation of Money Transmitters, CLEAR NEWS (Spring 2003), http://www.goodwinprocter.com/~/media/Files/Publications/Attorney%20Articles/2003/Risky_Business_State_Registration_of_Money_Transmitters.ashx (describing PayPal’s struggle with money transmission regulation, evolving from an assumption that their business model was unregulated to obtaining state money transmitter licenses in numerous jurisdictions); Thomas, supra note 30.

204. See Sean Sposito, Facebook Fast-Tracks Its Payments Business, AMERICAN BANKER (Feb. 21, 2012, 3:09 PM), http://www.americanbanker.com/issues/177_35/facebook-credits-money-transmitter-license-bank-regulation-1046825-1.html (noting that Facebook has recently become licensed under several state money transmitter laws). Even though Facebook has obtained licenses, uncertainty remains regarding the applicability of money transmitter laws to Facebook’s evolving payments product. See Brittany Darwell, Facebook Obtains Money Transmitter Licenses in 15 States, INSIDE FACEBOOK (Feb. 22, 2012), http://www.insidefacebook.com/2012/02/22/facebook-obtains-money-transmitter-licenses-in-15-states (Facebook’s S-1 filing contains the following statement: “Depending on how our Payments product evolves, we may be subject to a variety of laws and regulations . . . including those governing money transmission, gift cards and other prepaid access instruments, electronic funds transfers, anti-money laundering, counter-terrorist financing, gambling, banking and lending, and import and export restrictions. In some jurisdictions, the application or interpretation of these laws and regulations is not clear.”).

205. See Think Computer Corp., supra note 20, at 16–17 (discussing its decision to shut down a mobile payment system in light of threats of incarceration by the Department of Financial Institutions for operating without a licenses); see also Hurh & Luce, supra note 30 (Regulators warned conference participants of “both new and established companies that learned the hard way about the broad applicability of state money transmitter licensing laws.”).

206. See Mariani, supra note 30 (concluding that startups may be dissuaded from innovating in light of the unsettled legal environment and potential costs of regulation); Thomas, supra note 30 (noting the chilling effect of broad money transmitter laws on innovation).
that bears the risk of the imprecise and ambiguous nature of state money transmitter laws.

The following examples show how potentially regulated persons can opt to deal with the uncertain scope of state money transmitter laws. PayPal long struggled with the question of money transmitter licensing, 207 but ultimately became licensed under state law. 208 Other companies such as Facebook have also opted to become licensed in anticipation of offering payment products that may evolve in a way so as to fall within the potentially sweeping scope of money transmitter laws.209 Those that mistakenly determine that their business model does not constitute money transmission or who are not aware of the money transmitter regulation can face significant risk. The case of Think Computer Corporation’s ("Think") FaceCash mobile payment system is illustrative. Think operated the system until it was forced to shut down due to the California Department of Financial Institution’s threatened enforcement actions and penalties, including incarceration.210 Think claims that it shut down the business because of its inability to secure the information necessary to apply for a license, highlighting a perception that state regulatory discretion in the license application process results in inconsistent results for applicants.211 Most recently, Square’s payment service was scrutinized by the Illinois Department of Financial and Professional Regulation, which issued a cease and desist order alleging violations of the state’s money transmitter law.212 Despite the potentially broad application of money transmitter laws, the foregoing instances of regulatory enforcement actions at the state level appear to be isolated events rather than a component part of an attempt to clearly define the scope of such laws and consistently enforce regulatory requirements either at the state level or nationally.

As evidenced by the foregoing examples, state money transmitter laws increase transaction costs by virtue of an unsettled legal and regulatory

207. See Negroni, supra note 203.


209. See Darwell, supra note 204; Sposito, supra note 204.


211. Id.

environment. In addition to the costs and burdens of complying with state-specific regimes, potentially regulated persons suffer from greatly increased information and search costs when trying to independently evaluate the applicability of state laws. This is due to the lack of clear guidance regarding their scope. Moreover, there are real risks for failing to “properly” interpret the statutory scope because regulatory enforcement actions and penalties may follow. In the absence of clear guidance, it is the potentially regulated that unfairly bear the burdens and risks.

B. Stifling Innovation

While the problems of ambiguity stemming from state money transmitters affect all persons engaging in activities that fall within the definition of money transmission, the providers of Internet and mobile payment services are particularly sensitive to the need for clarity regarding the scope of regulation. Given the exponential growth of Internet and mobile payment volume and the stream of new payment services that may fall within the plain language of regulation, it is not surprising that the payments industry, attorneys advising potentially regulated payment services, and business media have expressed concerns over the potential impact of an uncertain regulatory environment on continued development of innovative business models and called for greater clarity on the scope of state money transmitter laws. Those who recognize the failings of state money transmitter laws to clearly address new payment innovations question whether the lack of clarity will stifle ongoing innovation. The costs of evaluating whether compliance is necessary, the actual costs of becoming licensed and otherwise satisfying the regulatory requirements, and the risks of operating without a license may all act as a deterrent to those who wish to develop payment innovations. Large companies may have the resources needed to: (1) investigate and gather information before making an informed decision on licensing; (2) become licensed and comply with ongoing regulatory requirements; or (3) simply mitigate risk by becoming licensed. However, start-ups may not have the same resources

213. See supra notes 2–4.
214. See supra Part II.
215. See supra note 30.
217. Mariani, supra note 30; Thomas, supra note 30.
or ability to mitigate risk. Accordingly, many may elect to wait until the regulatory requirements are more settled. Therefore, the impact of uncertainty may disproportionately impact start-ups, acting as a barrier to entry and stifling new payment innovations.

These concerns highlight the importance of constantly re-evaluating money transmitter laws to ensure that: (1) businesses engaging in activities potentially subject to regulation have clear guidance as to when licensing is necessary and when it is not; and (2) state regulators consistently apply regulatory oversight to only those activities, new or old, that implicate the same type of consumer protection concerns state money transmitter laws seek to mitigate.

IV. A MODERN APPROACH TO MONEY TRANSMISSION THAT RESPECTS CONSUMER PROTECTION

This Article suggests that state money transmitter laws must be recast in light of new technology in order to provide greater clarity on the scope of regulation. In doing so, the guiding principle should be to uphold the consumer protection purpose of such statutes by regulating only those activities that carry the same risk of loss as traditional money transfer services while leaving other activities unencumbered by the cost and compliance burden of becoming licensed unnecessarily. When analyzing Internet and mobile payment services through the lens of consumer protection, it is evident that the extension of state money transmitter laws may be inappropriate in many instances. Internet and mobile payment services that facilitate a purchase and sale transaction between a buyer and merchant seller appear to carry no more risk of loss to the consumer than in any direct purchase transaction between a buyer and merchant seller. As such, the goal of preventing consumer harm in the event of nonperformance by the money transmitter is not supported by the extension of regulation. Where there are few if any consumer protection gains, the extension of such laws to Internet and mobile payment services would result in a one-size-fits-all regulatory scheme that fails to differentiate between the unique risks of each potentially regulated activity. Such an approach fails to recognize current marketplace realities, specifically how commerce is and will continue to be conducted as technology advances and

218. Mariani, supra note 30; Thomas, supra note 30.
219. Mariani, supra note 30; Thomas, supra note 30.
220. Mariani, supra note 30; Thomas, supra note 30.
221. See infra Part IV.A–C.
222. See infra Part IV.A–B.
223. See infra Part IV.A.
224. See infra Part IV.B.
consumer habits change. Therefore, the extension of state money transmitter laws in the absence of a real consumer protection concern would needlessly hinder innovation to payments processes and commerce without materially advancing the statutory goals of such statutes.

A. The Unique Consumer Risks of Payment Innovations

The consumer protection purpose of state money transmitter laws is not well served by extending regulation because many payment services pose little real risk of consumer loss. Because Internet and mobile payment services typically facilitate the purchase of a product or service, the consumer’s payment to the service provider is effectively payment to the merchant seller. As a result, the consumer is entitled to the purchased item and often takes possession of the purchased item at that time. Therefore, the failure of the service provider to deliver the money to the merchant will result in a merchant loss rather than a consumer loss. In the event of a dispute between the consumer and the merchant, additional protections are available to give aggrieved consumers avenues for redress. Specifically, payment service providers often provide dispute resolution procedures that supplement the protections that the credit card associations provide to cardholders where a credit/debit card is used to make the purchase. In short, a consumer who makes a purchase via a third-party payment service provider is at no greater risk of loss than a consumer who makes a purchase directly from the merchant. Because the consumer protection concerns are far less pronounced, the statutory purpose of consumer protection is not served by levying additional regulatory compliance requirements on payment services, which do not carry the same risk of consumer harm.

225. See supra Part II.
226. See infra Part IV.A.1.
227. See Amy Martinez, Amazon Sellers Complain of Tied-Up Payments, Account Shutdowns, SEATTLE TIMES (Nov. 19, 2012, 11:55 AM), http://seattletimes.com/html/businesstechnology/2019705292_amazonseller18.html (describing disputes between merchants and payment service providers such as Amazon and eBay); Amy Martinez, Small Online Merchants File Suit Against Amazon, SEATTLE TIMES (Mar. 15, 2013, 1:30 PM), http://seattletimes.com/html/businesstechnology/2020568463_amazonsellersuitxml.html (discussing a class action suit filed by small merchants against Amazon for withholding payments from sales of merchant products and services via Amazon’s marketplace). While merchants may be dissatisfied with the payment service provider, it appears that they are not inclined to pursue any claims against the consumer purchaser. This is ostensibly a tacit if not explicit acceptance that such claims are unlikely to be successful where the merchant elects to use a particular payment service provider and directs the customer to make a purchase using such service. In those instances, common sense would indicate that the customer should not be liable for what amounts to be a dispute between the merchant and its service provider.
228. See infra Part IV.A.2.
229. See infra Part IV.A.2.
230. See infra Part IV.A.
1. Differentiating Risk

Unlike traditional money transfer businesses that act on behalf of consumer customers in delivering money, consumers face far less risk where the money transfer is a component part of a purchase transaction. With money transfer businesses like Western Union, consumers contracted directly with the service provider, and the service provider was paid by the customer to act on behalf of the consumer in ensuring safe delivery of the customer’s money. In such situations, state regulators have a legitimate interest in protecting consumers from being defrauded and suffering monetary losses in the event that the money transfer business fails to follow through on its promise to deliver the consumer’s money. If left unregulated, insufficiently capitalized businesses without the ability to reliably perform could cause consumer losses. Moreover, those with nefarious intentions could take money for delivery along with any associated fees without any intention of actually performing. Where a service provider does not perform, the consumer will lose the funds trusted to the service provider and might have little ability to locate the funds or otherwise seek a remedy. In such circumstances, consumer protection is an appropriate regulatory concern, and money transmitter laws ably function to reduce the risk of loss by requiring a license from the state, compliance with minimum net worth requirements, and delivery of surety bonds. Therefore, the imposition of state money transmitter regulations is entirely appropriate where there is a real risk of consumer losses.

In contrast, where the service provider contracts with a merchant to accept customer payments and deliver such payments to the merchant, there is much less consumer risk because the merchant engaging the service provider bears the risk of nonperformance. Instead of contracting with a consumer to provide delivery services on behalf of the consumer, a payment service provider enters into a relationship with a merchant seller and agrees to accept and process customer payments on behalf of the merchant. Here, the payment service provider to merchant relationship is
that of agent and principal. See RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) (defining agency as “the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act”).

237. See supra note 235.

238. See supra Part II.C.

239. For example, customers may make a purchase directly from a merchant website that utilizes a third party to accept the payment. See, e.g., Checkout by Amazon, AMAZON, supra note 179. Likewise, customers often make in-store purchases directly from a merchant who may use a third party to provide payment services such as a mobile wallet or mobile card reader. See, e.g., GOOGLE, supra note 190; Square Register, SQUARE, https://squareup.com/register#signature (last visited Sept. 16, 2013).

240. Even where a customer does not immediately take possession of the purchased item (i.e. delivery at a later date), the risk to the customer is no greater than if the customer paid the merchant directly with the expectation that the purchased item would be subsequently delivered. In both situations, the customer has made a payment on the expectation of future delivery and bears some risk of nonperformance by the merchant seller. The only potential for added risk is if the third-party service provider does not transfer the payment and the merchant withholds delivery as a result. However, in most cases, the credit card is not charged until the merchant has certified shipping or delivery. See Checkout by Amazon, AMAZON, supra note 179; see also MasterCard Rules, MASTERCARD app. B-1 (June 14, 2013), http://www.mastercard.com/us/merchant/pdf/BM-Entire_Manual_public.pdf (noting that merchants generally must not submit transactions until after the products are shipped or services performed). In addition, most merchants do not pursue claims against consumers for failure of a service provider selected by the merchant to abide by the terms of their private arrangement. See supra note 227.
hand.\(^{241}\) Similarly, when a caffeine-craving CEO stops into Starbucks for a triple venti non-fat no foam vanilla latte, she simply orders at the register and gives her name to pay.\(^{242}\) The GPS technology on the CEO’s mobile device allows the barista to pull up the customer’s name and picture to confirm the purchase, allowing the CEO to walk out with latte in hand.\(^{243}\) Thus, the functionality of mobile wallets such as Google Wallet, Square, Level Up, Isis, and Merchant Customer Exchange allows for the purchaser to receive the purchased item regardless of whether there is subsequently a problem with transferring the money from the service provider to the merchant seller.

The same is true of mobile card readers like Square Register and PayPal Here. If a customer wishes to purchase a shrimp po’boy from a food truck utilizing PayPal Here, the merchant simply swipes the customer’s card through a card reader plugged into the phone’s audio jack.\(^{244}\) The customer then signs on the screen of the smartphone to complete the purchase and can walk away happily with a meal.\(^{245}\) As evidenced by the foregoing, the failure of a service provider to perform the money transmission services or any other contractual obligations agreed upon between the service provider and the merchant is unlikely to result in an adverse impact on the consumer. In such situations, there is little risk of loss because the consumer receives the purchased item at the time of payment and does not expect anything further. Instead, the risk of loss in the event of non-performance lands squarely on the shoulders of the merchant who engages the service provider.\(^{246}\)

Where a consumer makes a payment via a third-party Internet or mobile payment service, there appears to be no greater risk of loss to the consumer than if the consumer were to pay the merchant directly. As might be expected, there is an implicit (if not explicit) recognition that the buyer is entitled to the purchased item upon delivery of the payment to the service

\(^{241}\) See GOOGLE, supra note 190 (discussing the payment process and identifying Bloomingdale’s as a participating merchant).

\(^{242}\) See SQUARE, supra note 187 (discussing the payment and checkout process for a hands-free transaction).

\(^{243}\) Id.

\(^{244}\) See PAYPAL, supra note 194 (noting that a merchant can also manually enter the card number or use the smartphone’s camera function to scan the card).

\(^{245}\) Id.

\(^{246}\) See supra note 227. An allocation of risk that results in the merchant bearing the risk of loss is appropriate because it is the merchant (not the consumer) who elects to engage a payment service provider and has the opportunity to evaluate the ability of the service provider to perform. The merchant will also have the opportunity to contract for and pursue any private rights and remedies in accordance with the terms and conditions of the agreement between the merchant and the seller. Thus, the merchant is not wholly without recourse. Moreover, the consumer protection concerns of state money transmitter laws do not support an extension of protections to merchants.
provider. Merchants who sell on online marketplaces like the Amazon Marketplace must often confirm shipment of the purchased item before the consumer’s credit/debit card is charged by the payment service provider and funds delivered to the merchant. In addition, where the purchased item is an electronic good like an app, the consumer typically obtains the ability to commence downloading the app immediately after payment. Therefore, in many cases, the consumer may receive the purchased item at the time of purchase or immediately thereafter, or at least be assured of the purchased item being shipped prior to being charged.

Even if the consumer were charged before receiving the purchased item, there would be no added risk when compared to a purchase directly from the merchant. If a consumer were to make a purchase over the Internet directly from a merchant who does not utilize a third-party payment service, the merchant would have received payment on the promise of subsequent delivery. The potential for non-delivery or delivery of a non-conforming item would still exist. With a third-party Internet or mobile payment service, the situation is no different. The consumer will have delivered payment to the service provider as directed by the merchant seller on the promise that the merchant will subsequently deliver the purchased item, leaving the consumer open to the same risk of non-delivery or nonconforming delivery. Therefore, the involvement of a third-party payment service provider does not appear to materially increase the likelihood that a consumer will suffer a loss in the event of the service provider’s failure to deliver the payment to the merchant.

2. An Added Layer of Consumer Protection

As noted above, consumers making a payment through an Internet or mobile payment service typically receive the benefit of their bargain (i.e., the purchased item) even when the service provider fails to perform (i.e., delivery of payment to the merchant). As such, there is less consumer protection concern than in a traditional money transfer business where the failure of the money transmitter to perform would result in the loss of the funds provided by the consumer. Internet and mobile payment services also mitigate the potential risk of loss with an added layer of consumer protection.

247. See supra note 227.

248. See Checkout by Amazon, AMAZON, supra note 179. While there is no law that prohibits a business from submitting a credit card transaction before delivering the purchase product or performing the purchased services, such a business practice is consistent with credit card rules and regulations that generally mandate delivery before submission. See MasterCard Rules, supra note 240, at app. B-1.


250. See supra Part IV.A.1.
protection. Where the consumer does not receive the purchased item or is dissatisfied with the delivered item (e.g., it is not as described or arrives damaged), the service provider may also provide a dispute resolution procedure and allow the consumer to recoup the purchase price.\textsuperscript{251} Such dispute resolution procedures supplement the protections afforded to those who make purchases with a credit card or debit card, which may give cardholders the ability to dispute or otherwise challenge charges.\textsuperscript{252} Therefore, consumers often have an additional avenue for redress that is not available in a direct purchase and sale transaction with a merchant seller, which further mitigates the risk of consumer loss.


\textsuperscript{252} Credit card transactions benefit from greater protections under Regulation Z than are available for debit card transactions under Regulation E. \textit{See} \textit{Truth in Lending (Regulation Z), 12 C.F.R. §§ 226.12(e)(1), 226.13(d)(1) (2012)} (giving credit cardholders the right to: (1) assert against the card issuer “all claims (other than tort claims) and defenses arising out of the transaction and relating to the failure to resolve the dispute” with the merchant; and (2) withhold “any portion of any required payment that the consumer believes is related to the disputed amount”); \textit{see also} 15 U.S.C. § 1693g (2006) (only limiting liability to debit card holders for unauthorized transactions); Ichiro Kobayashi, \textit{Private Contracting and Business Models of Electronic Commerce}, 13 U. MIAMI BUS. L. REV. 161, 192–95 (2005) (describing protections for credit cardholders); Daniel M. Mroz, \textit{Credit or Debit? Unauthorized Use and Consumer Liability Under Federal Consumer Protection Legislation}, 19 N. ILL. U. L. REV. 589, 603–08 (1999) (recognizing that debit cardholders benefit from less consumer protection than holders of credit cards); Neil M. Peretz, \textit{The Single Euro Payment Area: A New Opportunity for Consumer Alternative Dispute Resolution in the European Union}, 16 MICH. ST. J. INT’L L. 573, 598–99 (2008) (noting that credit cardholders may have remedies even if the purchase was authorized); David E. Sorkin, \textit{Payment Methods for Consumer to Consumer Online Transactions}, 35 AKRON L. REV. 1, 8 (2001) (“Paying by credit card affords much greater protection to a buyer than do other traditional payment mechanisms largely because of the credit card dispute rights provided by Federal Reserve Regulation Z.”); Jane K. Winn, \textit{Making XML Pay: Revising Existing Electronic Payments Law to Accommodate Innovation}, 53 SMU L. REV. 1477, 1491–92 (2000) (noting that Reg. Z “provides a simple and effective alternative dispute resolution process in the event the consumer is unhappy with the transaction”).
PayPal, Amazon, and Google all have dispute resolution procedures that facilitate the resolution of problems between sellers and buyers who utilize such services to send and receive payments. When a customer is dissatisfied with the purchase, he or she has the right to initiate a process whereby the service provider will investigate and refund the money if the customer prevails. Therefore, where a seller fails to deliver a purchased item or delivers an unsatisfactory item, the consumer may have a remedy.

In addition, an aggrieved consumer who pays using a credit card or debit card has the benefit of protection under federal law and credit card association operating rules. Under Regulation Z, consumers have the right to assert claims against a credit card issuer with respect to certain disputes between the seller and a buyer in a consumer goods transaction. Accordingly, if a consumer credit cardholder has a dispute with a merchant regarding the purchase of a consumer good, he or she can assert his or her claim against the bank that issued the credit card. Such a remedy would appear to apply regardless of whether the payment was made through a service provider or directly from a merchant. Because the protections for debit card transactions under Regulation E are much more limited, a consumer using a debit card to make a payment through an Internet or mobile payment service may have greater liability if a dispute arises.

However, the distinctly different treatment of credit/debit cards would appear to impact a cardholder similarly regardless of whether the payment


255. See Mediation, GOOGLE, supra note 251.

256. See supra notes 253–255.

257. See supra note 252.

258. See Visa, Visa International Operating Regulations 832–47 (Apr. 15, 2013), http://usa.visa.com/download/merchants/visa-international-operating-regulations-main.pdf (discussing the resolution of cardholder disputes); see also Sorkin, supra note 252, at 8–9 (noting that the credit card issuer can chargeback a transaction even if it does not qualify under Regulation Z).


260. Under the Electronic Funds Transfer Act, the consumer has limited liability for unauthorized transactions under Regulation E. See 15 U.S.C. § 1693g (2006). However, the definition of “unauthorized transaction” does not include authorized transactions where merchandise is not delivered or is nonconforming. See 15 U.S.C. § 1693a(b)(1). As such, the protections available for debit cards under the EFTA are not as strong as those available for credit cards under Regulation Z. Specifically, the right to assert claims relating to a dispute with the merchant against the card issuer is much more expansive than limited protections for unauthorized transactions. See Sorkin, supra note 252, at 7–9.
was made directly to the merchant or if the payment was made through an Internet or mobile payment service provider.

Notwithstanding the limited remedies of Regulation Z, consumers may have better luck disputing or challenging a charge directly with the credit card issuer. Upon receipt of the complaint, the credit card issuer will temporarily credit the cardholder’s account for the amount of the disputed transaction pending the results of an investigation. If the dispute is resolved in favor of the cardholder, the credit remains and the amount is “charged back” to the merchant. Merchants that wish to accept credit/debit cards must enter into an agreement with the credit card association (e.g., Visa or MasterCard) and agree to abide by the terms and conditions of their operating rules. Included in the terms and conditions are a number of broad chargeback rights. For example, amounts may be charged back to the merchant if: (1) the merchant fails to perform the service or deliver the merchandise; (2) the merchant delivers defective or damaged merchandise; or (3) the merchant delivers merchandise that is not as described on the transaction receipt or is otherwise unsuitable for the purpose sold.

As illustrated above, a consumer that uses a credit card or debit card to make a purchase via an Internet or mobile payment service at worst benefits from the same protections that are available to all credit/debit card transactions. However, certain payment service providers may provide for added consumer protections in the form of buyer protection efforts to supplement those generally available for credit/debit card transactions. As such, it appears that in many cases there is no greater risk of consumer loss to justify or otherwise support the extension of money transmitter regulation.

262. See Mroz, supra note 252 (describing the chargeback process); Sorkin, supra note 252, at 8–9; see also Chargebacks & Dispute Resolution, VISA, http://usa.visa.com/merchants/operations/chargebacks_dispute_resolution/index.html (last visited Sept. 27, 2013) (discussing the chargeback process generally and noting that a chargeback to the merchant is often triggered by a customer dispute); VISA, CHARGEBACK MANAGEMENT GUIDELINES FOR VISA MERCHANTS 29 (2011), http://usa.visa.com/download/merchants/chargeback-management-guidelines-for-visa-merchants.pdf (discussing customer dispute chargebacks).
263. See VISA, CHARGEBACK MANAGEMENT GUIDELINES FOR VISA MERCHANTS, supra note 262, at 29.
264. Id. at 32.
265. See VISA, supra note 252, at 397 (mandating a merchant agreement).
266. Id. at 831–34 (describing available chargeback rights).
267. See supra note 252.
268. See supra note 251.
B. Statutory Purpose Does Not Support Indiscriminate Extension

In the absence of additional consumer risk, the main purpose of money transmitter laws—to protect consumers—is not served by indiscriminately extending regulation to all third-party Internet and mobile payment service providers who accept and transfer payments on behalf of merchants. This Article suggests that a more nuanced approach would better serve the statutory purpose of state money transmitter laws by only extending regulation to those activities that implicate meaningful consumer protection concerns of the sort raised by traditional money transfer business. Instead of taking the one-size-fits-all approach of extending regulation to all activities that fall within the sweeping definition of money transmission, state money transmitter laws should be recast so as to support the statutory goal of consumer protection where appropriate and to clearly exclude other activities from regulation.

As noted above, many payment services do not materially increase the risk of loss to the consumer. 269 While the use of such services does not come wholly without risk, many consumers making payments via an Internet or mobile payment system face a risk profile that is almost indistinguishable from any other purchase and sale transaction effectuated directly between a buyer and seller without the involvement of a third-party payment service. 270 Where a payment service does not increase the risk of consumer loss, 271 the extension of regulation would not serve the purpose of state money transmitter laws. 272 As such, the regulation of such services would be inappropriate and wholly unsupported by statutory purpose.

It is important, however, to clarify that all payment services should not be wholly excluded from the ambit of money transmitter regulation. Under the approach advocated by this Article, the consumer protection purpose of state money transmitter laws should guide the scope of regulation. To the extent that new or emerging payment systems raise increased risks of consumer loss, regulation under the money transmitter law regime would be fitting. For example, Western Union’s use of new technology to effectuate a money transfer on behalf of a consumer customer should continue to be regulated as a money transmission. Perhaps more illuminating is the case of PayPal. As noted above, PayPal provides a number of payment services, such as the mobile card reader PayPal Here and a checkout service for merchants, which do not appear to raise

269. See supra Part IV.A.
270. See supra Part IV.A.
271. See supra Part IV.A.
272. See supra Part IV.A.
consumer protection concerns. However, PayPal also offers a consumer-facing product that allows individual consumers to send money to their friends, family, and others. Such a service appears to operate as the functional equivalent of a traditional money transfer business and carries with it the same potential for consumer harm. As such, under the approach advanced by this Article, PayPal would need to obtain a license and comply with state money transmitter laws. The distinction, however, is the basis for regulation. PayPal would not be subject to regulation because its varied payment service offerings to merchants can be construed as money transmission. Instead, PayPal would be deemed a money transmitter as a result of the money transfer service it provides to consumers.

In short, the statutory purpose of consumer protection does not compel the indiscriminate application of state money transmitter laws to all Internet and mobile payment service providers. A nuanced approach that focuses on the consumer protection goals of the statute would better serve the purpose of state money transmitter laws by mandating oversight when justified by consumer protection concerns and exempting other activities from needless regulatory burdens.

C. What About Merchant Protections?

To the extent that payment services are provided to merchants, they appear to offer a distinctly different risk profile than services provided to consumers. In such situations, the risk of loss shifts in large part from the consumer to the merchant seller. While state consumer protection laws seek to provide protections for individual buyers of goods and services, it is less clear that such statutes should offer similar protections for merchants who sell goods and services. The question of what protections (if any) should be available to merchants using Internet and mobile payment services is beyond the scope of this Article. However, it is clear that forcing merchant sellers to bear the entire risk of loss in the event of nonperformance of a payment service provider may be unappealing.

On the one hand, merchant sellers can be viewed as distinctly different than individual consumers. By acting in a commercial capacity to sell goods or services, merchant sellers could be reasonably expected to exercise care in selecting those who will provide payment services on their behalf. As such, merchant sellers should bear the risk of nonperformance,

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273. See supra Part III.
275. See supra Part IV.A–B.
276. See supra Part IV.A–B.
277. See supra note 37.
and are in the best position to conduct due diligence on the qualifications of the service provider and negotiate any necessary protections to guard against the risk of nonperformance.\textsuperscript{278}

Unfortunately, not all merchant sellers possess the same level of sophistication or bargaining power. As a result small business owners such as the sole proprietor of a food cart may in fact be viewed as more closely analogous to a consumer. If so, providing merchant protections via statute may be both necessary and appropriate in certain limited circumstances. In the absence of such additional protections, smaller merchant sellers may be particularly susceptible to significant losses (e.g., delivery of goods or services without payment) in the event of that a payment service provider does not perform. As compared to consumers, merchant sellers more appropriately bear the risk of loss.\textsuperscript{279} Nonetheless, additional statutory protections may be warranted if simply allowing merchant sellers to sue nonperforming payment service providers to enforce contractual rights and remedies is viewed as insufficient.\textsuperscript{280}

\textbf{D. Indiscriminate Extension Needlessly Hinders Innovation and Ignores Marketplace Realities}

Because the indiscriminate extension of state money transmitter laws to all Internet and mobile payment mechanisms is not supported by statutory purpose, doing so would: (1) needlessly hinder continued innovation and competition in the payments industry; and (2) wholly fail to accommodate a societal shift toward conducting commerce over the Internet and mobile platforms and using non-paper-based payment mechanisms. Instead the nuanced approach advanced by this Article clarifies the scope of regulation while appropriately recasting state money transmitter laws to accommodate technological advances and the development of innovative business models. Guidance and support for such an approach abounds. The need to ascertain the scope and applicability of existing laws and regulations in light of new and emerging technologies is nothing new.\textsuperscript{281} In the context of money transmitter regulation at the federal level, regulators have already recognized the need to accommodate previous payment system

\begin{footnotesize}
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\item \textsuperscript{278} See supra note 222.
\item \textsuperscript{279} See supra note 222.
\item \textsuperscript{280} See Martinez, supra note 227 (discussing merchant law suits against nonperforming payment service providers).
\item \textsuperscript{281} See, e.g., Am. Libraries Ass’n v. Pataki, 969 F. Supp. 160, 161–82 (S.D.N.Y. 1997) (noting that (1) judges and legislators are “faced with adapting existing legal standards to the novel environment of cyberspace,” (2) the “Internet . . . requires a cohesive national scheme of regulation so that users are reasonably able to determine their obligations,” and (3) the “[r]egulation on a local [l]evel . . . will leave users lost in a welter of inconsistent laws, imposed by different states with different priorities”).
\end{itemize}
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innovations. Moreover, financial laws, including in the heavily regulated banking industry, have historically been appropriately reinterpreted in light of technological changes. The foregoing supports the proposition that state money transmitter laws can and should be appropriately recast in light of new ways of conducting commerce.

1. Lessons from the Federal Reserve Board

In 2005, the Federal Reserve Board addressed the lack of clear and consistent state and federal regulation of prepaid products such as gift cards, including concerns over the applicability of state money transmitter laws. At the time, industry participants felt that “uncertain legal and regulatory conditions [could] stifle innovation in the industry, as compliance with an increasing number of laws and regulations, particularly at the state level, [could] make products too expensive to offer.” Industry participants also noted that existing regulations failed to adequately differentiate between types of prepaid products, which may have very different risk characteristics for the general public. In responding to these concerns, the Federal Reserve Board concluded that: (1) significant changes were taking place in payment systems; (2) payment systems varied widely and a one-size-fits-all regulatory approach may not best fit the needs of the industry or best address the risks associated with prepaid products; and (3) regulation should not unduly hinder innovation.

Just eight years later in 2013, the discussion of Internet and mobile payment systems is like déjà vu. The payments industry is rightfully expressing concern regarding the lack of clear and consistent guidance as to regulation of Internet and mobile payment systems. Moreover, the speed of innovation has resulted in different business models with unique risk profiles. Nonetheless, existing regulation fails to adequately differentiate Internet and mobile payment services for purposes of regulation. Like the providers of prepaid products, the proponents of new and emerging payment systems rightfully fear that the lack of clarity and the costs of
compliance will have a chilling effect on innovation.\textsuperscript{291} Given the similarities, the Federal Reserve Board’s 2005 conclusions may very well be an inspired utterance as to the appropriate means for reconciling the tension between potentially sweeping regulation and innovative business models. Transposing the Federal Reserve Board’s conclusions to the present situation mandates the recognition of ongoing transformational change with respect to payment systems. As noted by the Federal Reserve Board, a one-size-fits-all regulatory scheme may not fit the needs of the industry or address the risks of new and emerging payment systems. Because the Internet and mobile payment services vary widely in functionality and potential risk to the general public, such an approach would be inappropriate, and would unnecessarily hinder payment innovation. In contrast, the Federal Reserve Board’s conclusions support the adoption of the more nuanced approach advanced by this Article. Such an approach is flexible enough to differentiate between payment innovations and address the actual consumer risk that results from each unique payment service. Instead of needlessly hindering the growing e-commerce and mobile payment practices of the modern marketplace, this approach supports continued innovation by eliminating the costs of regulatory compliance where consumer protection is not served and by providing greater clarity as to the potential scope of regulation. As such, the Federal Reserve Board’s conclusions regarding prepaid products accentuates the need for recasting state money transmitter laws in light of the real risks of each new payment innovation instead of indiscriminately extending regulation to any new innovation that falls within the plain language of the statutes.

2. Lessons from Banking and Financial Regulation

Examples of situations where regulatory requirements have been reinterpreted in light of technological advances abound. The banking industry, in particular, has constantly addressed the regulatory implications of new ways of conducting the very old business of banking.\textsuperscript{292} As

\textsuperscript{291} See supra note 30.

\textsuperscript{292} See, e.g., Indep. Ins. Agents of Am. v. Ludwig, Inc., 997 F.2d 958 (D.C. Cir. 1993) (declining to recast a statute permitting banks located in towns having a population of 5,000 or less to sell insurance as limiting such sales to local townspeople where new technologies such as telephones and direct mailing allow for nationwide business and solicitation not contemplated by legislators in 1916); Office of the Comptroller of the Currency, Interpretive Letter No. 875 (Oct. 31, 1999) (setting forth the regulatory agency’s opinion that 12 U.S.C. § 24 (2006) authorizes banks to engage in certain new Internet-related services on the basis that such activities are new ways for performing traditional bank functions or are incidental thereto); RICHARD SCOTT CARNELL ET AL., THE LAW OF BANKING AND FINANCIAL INSTITUTIONS 198 (4th ed. 2009) (noting that Internet banking holds the potential to eviscerate any remaining limitations on geographic expansion by a bank).
discussed below, the resolution of regulatory uncertainty can be prompted by marketplace demand. In addition, the determination of how to appropriately recast existing laws and regulations can be made on a case-by-case evaluation that takes into account the marketplace demands of both industry participants and the public.

The advent of the automated teller machines (ATMs) is illustrative. Historically, banking laws restricted geographic expansion and branching by banks. In many states, unit banking—a requirement that state-chartered banks have only one place of doing business—was the norm. Under federal law, a nationally chartered bank could only have branches in its home state and to the extent that state-chartered banks were permitted to branch under state laws. The ATM created a great deal of uncertainty because it was unclear whether an ATM constituted a bank branch. Nonetheless, ATMs were broadly supported by both the banking industry and consumers on the grounds of increased convenience for the public. In the 1970s and 1980s, many state legislatures acted to liberalize branching restrictions in response to both public and industry demands. At the national level, the question of whether an ATM constituted a branch remained unsettled until the National Bank Act was amended to specifically exclude ATMs from the definition of the term “branch” under 12 U.S.C. § 36(j) (2006). Thus, the spread of both intrastate and interstate banking was, in part, the result of a changing marketplace that pushed for the liberalizing of branching rules to allow the operation of ATMs. The case of the ATM illustrates the need to recognize marketplace realities when recasting and clarifying the appropriate scope of existing regulation.

Like the banking industry, the means of conducting commerce and making payments are prone to being impacted by technological change. When recasting money transmitter regulation, care should be taken to

294. See Kevin J. Stiroh & Philip E. Strahan, Competitive Dynamics of Deregulation: Evidence from U.S. Banking, 35 J. MONEY, CREDIT & BANKING 801, 806 (2003); see also First Nat’l Bank in Plant City, Fla. v. Dickinson, 396 U.S. 122 (1969) (discussing Florida’s unit banking statute, which only allowed banks to have one place of doing business).
296. See CARNELL ET AL., supra note 292, at 25.
297. Id. at 190–91.
298. Id. at 25.
accommodate the growing role of Internet and mobile payment services as a preferred alternative to other payment mechanisms. As with the adoption of ATMs, the growing acceptance of such payment services in an ambiguous legal and regulatory environment highlights the importance of providing clarity regarding the scope of regulation. The nuanced approach of recasting state money transmitter laws seeks to ensure that Internet and mobile payment systems are evaluated with a critical eye and a determination made as to whether the purpose of state money transmitter laws is served by regulation. Instead of blindly extending regulation or simply bowing to marketplace demands, this Article seeks to determine the appropriate scope of such regulation in light of the unique nuances of each service and any benefits to the marketplace. Basing the determination of regulation on the extent of consumer protection concerns implicated by each unique payment service accomplishes this goal. Where the extension of regulation is not supported by consumer protection concerns, regulation would needlessly burden commerce by forcing ill-suited regulatory requirements upon innovative payment services that make purchase and sale transactions more convenient for consumers and merchants. In addition, it would needlessly raise the costs of providing such payment services and potentially reduce the incentive for continued innovations. However, if consumer protection concerns are implicated, the statutory purpose of state money transmitter laws is appropriately upheld by extending regulation. In doing so, state money transmitter laws are modernized to account for marketplace realities while simultaneously staying committed to the consumer protection goals of money transmitter regulation.

V. THE FRAMEWORK FOR A MODEST PROPOSAL

Because law and regulation often lag behind innovative business models, the need to consistently re-evaluate and adapt existing regulatory schemes is nothing new.299 Given the rise of Internet and mobile payment systems,300 it is high time that state regulators and legislators look critically at state money transmitter laws and unambiguously address the extent to which such laws apply to new methods of transferring money and making payments over the Internet and mobile networks.301 This Article has


300. See Richard, supra note 1, at 262 (“In five to ten years, the remittance industry will change greatly because of increases in the variation of service providers and transfer business models.”).

advocated for state money transmitter laws to be modernized to account for technological changes while respecting the consumer protection purpose of such statutes.\textsuperscript{302} Given the distinctly different risks between money transfer services provided to consumer customers and payment services provided to merchant sellers, an appropriate line of demarcation could be made by extending regulation to the former (and any new ways of conducting the former) while exempting the latter from regulation in the absence of an equivalent consumer protection rationale. To do so, this Article advances a framework for a narrowly tailored statutory exemption that builds on the “agent of a payee” exemption available under Nevada,\textsuperscript{303} New York,\textsuperscript{304} and Ohio\textsuperscript{305} law that would supplement other more specific exemptions that states may enact to clarify the scope of regulation to technological advances such as stored value or payment processing. The adoption of such an exemption would provide added certainty for the payment industry while simultaneously upholding the consumer protection goals of state money transmitter laws and addressing the unique characteristics of Internet and mobile payment services.

A. The Agent of a Payee Exemption

Each of Nevada,\textsuperscript{306} New York,\textsuperscript{307} and Ohio\textsuperscript{308} have money transmitter laws that contain express statutory language that could be construed as precluding regulation of payment service providers who take and deliver customer payments on behalf of a merchant seller where certain conditions are satisfied.\textsuperscript{309} These states provide for a so-called “agent of a payee” exemption. In these states: (1) no person may engage in the business of money transmission without a license; and (2) no person may engage in the business of money transmission as an agent “except as an agent of a payee.”

\textsuperscript{302} See supra Part IV.
\textsuperscript{303} NEV. REV. STAT. § 671.020 (2011).
\textsuperscript{304} N.Y. BANKING LAW § 641(1) (McKinney 1939).
\textsuperscript{305} OHIO REV. CODE ANN. § 1315.01(G) (West 2013).
\textsuperscript{306} See NEV. REV. STAT. § 671.020 (appearing to exclude agents of a payee).
\textsuperscript{307} See N.Y. BANKING LAW § 641(1) (appearing to exclude agents of a payee).
\textsuperscript{308} OHIO REV. CODE ANN. § 1315.01(G) (defining the term “transmit money” as not including transactions in which the recipient of the money or its equivalent is the authorized representative of a principal in a transaction for which the money or its equivalent is received, other than transactions for the transmission of money or its equivalent).
\textsuperscript{309} Unlike the Nevada, New York, and Ohio statutes, the Texas money transmitter law does not contain express statutory language that exempts agents of a payee from regulation. However, the Texas Department of Banking is of the opinion that payment processors who act as agents of a merchant by temporarily holding merchant funds at the end of the settlement process are exempt from licensing under the money transmitter law. See Tex. Dep’t of Banking, Op. No. 06-01 (May 15, 2006), available at policy.ctspublish.com/txdob/; see also Tex. Dep’t of Banking, Op. No. 03-01 (June 4, 2003), available at policy.ctspublish.com/txdob/.
licensee or as agent of a payee."\textsuperscript{310} The foregoing requirements are somewhat unclear. However, the language regarding money transmission as an agent appears to expressly allow “agents of a payee” to engage in money transmission without a license and without otherwise being subject to the regulatory requirements of the state’s money transmitter statute.\textsuperscript{311}

The New York statute and associated regulations provide additional detail regarding the application of this exemption. Under New York law, agents of a payee include “any person authorized by a payee to receive funds on behalf of the payee and to deliver such funds received from the payor to the payee.”\textsuperscript{312} The key to qualifying for the exemption is the presence of a contractual agency relationship between the service provider and the merchant seller. According to the New York Banking Department, factors that indicate a valid agency relationship include: (1) a contract between the agent and the payee; (2) authorization for the agent to receive payments on behalf of the payee and deliver such payments to the payee; (3) a receipt from the agent to the customer indicating that payment to the agent constitutes payment to the payee; (4) the absence of risk of loss to the customer if the agent fails to remit the payment to the payee; and (5) the payee treats customers as if the payee received the payment whether or not the agent actually delivers the funds to the payee.\textsuperscript{313} The New York Banking Department has also emphasized that the exemption only applies where delivery of funds to the agent results in no greater risk to the customer than if payment were delivered directly to the payee.\textsuperscript{314}

While the “agent of a payee” language is not listed in the statutory exemptions section of the New York and Nevada statutes, it appears to function as such, and could be available to Internet and mobile payment service providers where the service is: (1) provided to a merchant pursuant to a valid agency agreement and (2) steps are taken to ensure that the buyer faces no greater risk of loss in delivering a payment to the service provider instead of paying the merchant directly.

\textsuperscript{310} See NEV. REV. STAT. § 671.020 (emphasis added); N.Y. BANKING LAW § 641(1); see also OHIO REV. CODE ANN. § 1315.01(G).


\textsuperscript{312} N.Y. COMP. CODES R. & REGS. tit. 3, § 406.2(1) (2013).

\textsuperscript{313} N.Y. Banking Dep’t, Interpretive Letter (April 24, 2007), available at http://www.dfs.ny.gov/legal/interpret_opinion/banking/lo070424.htm; see also N.Y. BANKING LAW § 640(10) ( McKinney 1939) (defining the term agent as requiring a written agency contract, albeit in the context of agents of a licensee as opposed to agents of a payee).

\textsuperscript{314} N.Y. Banking Dep’t, Interpretive Op., supra note 299 (determining that agent of a payee exemption was inapplicable where a company that received student payments for prepaid meals at a secondary school did not give a receipt indicating that payment to the agent was deemed payment to the payee, and emphasizing that there “ought to be no greater risks than if the funds were delivered directly to the payee”).
B. The Federal Approach

In addition to the minority of states that have adopted an agent of a payee exemption, federal laws regulating money transmission have been quick to adapt to payment innovations. In 2009, amendments clarifying the application of the BSA’s money transmitter regulations to payment services were initiated. The term “money transmitter” was amended to specifically exclude any person that “[a]cts as a payment processor to facilitate the purchase of, or payment of a bill for, a good or service through a clearance and settlement system by agreement with the creditor or seller” from the definition of money transmitter. This exclusion is most likely applicable to third-party payment services offered to merchant sellers. However, it only applies to payment processors, which may be narrower than the New York and Nevada approach of exempting any agent of a payee. It is unclear whether all Internet and mobile payment services provided to a merchant would be deemed payment processors. In addition, the term “money transmitter” was amended to exclude any person that “[a]ccepts and transmits funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds.” This second exclusion appears to be focused on sellers themselves who may directly engage in money transmission when selling their own goods or services. As such, it is unlikely to be of benefit to third-party payment services not acting as sellers themselves.

When compared to the agent of a payee approach, the federal amendments provide more certainty in clearly excluding certain activities from the definition of money transmission and thus, the scope of regulation. However, because the federal approach opts to exclude very narrowly defined payment activities, any business model that does not clearly fit the description may be resigned to the same unsettled legal and regulatory landscape.

C. A Mash-Up of the State and Federal Approaches

This Article suggests that the best framework for amending state money transmitter laws to accommodate payment innovations while continuing to protect against consumer losses requires a mash-up of the “agent of a payee” approach and the amendments to the BSA. Specifically,

317. 31 C.F.R. § 1010.100(f)(5)(ii)(F).
state money transmitter laws should be amended to unambiguously exclude any agent of a payee from the definition of money transmission. In determining the availability of the exemption, the key factor would be whether the receipt and transmission of money by the agent to the payee results in any greater risk of loss to the purchaser of the good or service than a purchase and sale transaction where the payment is made directly to the seller. As such, the exemption would depend on: (1) a valid written agreement with the payee/seller; and (2) enforceable terms and conditions between the agent/service provider, confirmation that the receipt of funds by the agent/service provider is deemed receipt by the payee/seller and that the payee/seller has no recourse against the purchaser for any failure of performance by the agent/service provider.

This framework combines the substantive inclusiveness and consumer protection focus of the “agent of a payee” approach with the clarity and drafting finesse of the amendments to the BSA. By basing the exemption on the more inclusive “agent of a payee” approach, the exemption is better able to account for the variations between different payment services and innovations while allowing consumer protection to remain the driver for regulation. In contrast to limiting the exemption to specific types of payment services like the BSA amendments, or attempting to explicitly list each and every type of exempt service, this framework allows consumer protection to exist as a guiding principle on questions of regulatory scope instead of focusing on the underlying technology, the type of service, or business model nuances. In addition to being better suited to differentiating between existing services, the “agent of a payee” approach allows for ongoing guidance with respect to new payment innovations by not being too narrowly focused.

The foregoing notwithstanding, the New York and Nevada approach suffers for not clearly exempting agents of a payee from regulation via an explicit statutory exemption or amendment to the definition of money transmission. Instead, New York and Nevada have inserted the agent of a payee language into the licensing mandate, which may result in some confusion. Therefore, this Article suggests that, like the amendments to the BSA, the agent of a payee language should be incorporated by amending the definition of “money transmission” to exclude the activity, or otherwise provide for an explicit exemption. Doing so provides for a more clearly articulated position on the scope of regulation.

It should be noted that this Article does not mean to suggest that there is no benefit to adopting activity-specific exemptions that narrowly address

318. See supra Part IV.
319. See supra notes 313–314.
defined types of payment services such as stored value, payment processing, and money transmission by sellers where it is necessary and integral to the sale of the seller’s goods and services. To the contrary, targeted exemptions can and do provide added certainty regarding the question of whether regulation applies to specific payment innovations and new business models. However, such narrowly focused exemptions will be of little benefit in clarifying the scope of regulation more broadly with respect to new and emerging payment systems. As such, the agent of a payee exemption would be an ideal supplement to targeted exemptions dealing with new business models or technological advances.

D. Benefits of the Proposed Framework

The adoption of the agent of a payee framework for an exemption would not only address the uncertain regulatory scope of money transmitter laws, but also modernize such laws to account for new and emerging forms of payment activity. Such an approach is narrowly crafted to ensure that the consumer protection purpose of state money transmitter laws is served by continuing to apply regulatory compliance requirements on those services that pose a real risk of loss, and only exempting activities that will not run afoul of the purpose of such statutes. Moreover, clarifying the scope of regulation will allow for the continued development of innovative payment mechanisms and the use of such mechanisms to facilitate the growth of commerce in a modern cashless world without burdening those in the payment industry with: (1) the cost and expense of complying with inappropriately scoped regulatory requirements; (2) the transaction costs of evaluating the scope and applicability of a statute that has yet to catch up to technological advances; and (3) the risk of uncertain application of such statutes by state regulators.

1. Providing Much Needed Clarity

The adoption of an exemption that clearly defines the compliance obligations of third-party payment services providers that receive funds on behalf of sellers will greatly reduce the risks facing such businesses by virtue of an uncertain legal and regulatory landscape. The intentionally broad definition of “money transmission” under most state laws leaves open the very real possibility that a state regulator could elect to broadly

322. See, e.g., 31 C.F.R. § 1010.100(f)(5)(i)(F).
323. See supra Part III.
interpret the scope of the statutory language and seek to require licensing and regulatory compliance of a number of businesses, including Internet and mobile payment systems.324 Because few states currently have express statutory exemptions that clearly apply, there is little certainty.325

In Nevada, New York, and Ohio the agent of a payee exemption appears to apply to exempt these services from regulation.326 In one other state, Texas, these types of payment businesses may take some comfort in the presence of an interpretive opinion that may be construed to indicate the state regulator’s present position that payment processing is exempt from money transmitter regulation.327 In other states, uncertainty over potential regulation remains. Providers of Internet and mobile payment service to merchant sellers must at a minimum bear the transaction costs of evaluating the risk of potential regulation and deciding whether or not to obtain a license.328 In addition, any person that elects to obtain a license and comply with the regulatory requirements will bear the costs of maintaining a money transmitter license and the compliance costs as an added expense of doing business.329 Because these types of services do not result in added consumer protection concerns, the added regulatory burdens are both unnecessary and ineffectual.330 If a license is not obtained, the risk of potential regulation and liability for noncompliance remains and may compound over time.331

Those who elect not to obtain a license and comply with regulatory requirements may have an argument based on statutory interpretation that money transmitter laws are inapplicable to their services. At its most basic level, the argument is that by acting as an agent for a seller of goods or services, the agent is not in fact receiving money for transmission. As an agent of a seller, receipt of funds by the agent is the equivalent of receipt of funds by the seller. Therefore, receipt of payment by the agent and subsequent delivery of funds to the seller who acts as principal is not money transmission. While this is both a reasonable and perhaps even appropriate interpretation, the possibility of regulation remains due to the breadth of most state statutes and the lack of a clearly applicable exemption

324. See Think Computer Corp., supra note 30; see also Hurh & Luce, supra note 30.
325. See supra Part II.
326. See supra Part V.A.
328. See supra Part III.
329. See Sposito, supra note 204 (quoting Brian Riley that “[t]he pain in the neck is when you do it in all 50 states”).
330. See supra Part IV.
or other guidance indicating that compliance is not required.\textsuperscript{332} As evidenced by the foregoing, providers of such payment services are left in the unenviable position of having few good options when it comes to money transmitter regulation and compliance.

Given this uncertain legal and regulatory backdrop, state money transmitter laws would benefit by clarifying the scope of money transmitter regulation and answering the question of whether a host of new payment services must become licensed money transmitters.\textsuperscript{333} As advanced by this Article, the agent of a payee framework for a new exemption succeeds in resolving this question by drawing an appropriate distinction between payment services provided to merchant sellers pursuant to a contractual arrangement that protects consumers and traditional money transfer services provided directly to consumers. The former category of services would be exempt while the latter would continue to be regulated under state money transmitter laws based on a case-by-case assessment of the risk of consumer loss.\textsuperscript{334} Accordingly, the adoption of the proposed regulatory framework would provide the benefit of added certainty for those who provide such services, those who seek to develop similar services, and the state regulators who are tasked with enforcing the mandate of state money transmitter laws.

2. Upholding Consumer Protection

In addition to providing certainty, the proposed agent of a payee framework strikes an appropriate balance by allowing the breadth of state money transmitter regulation to reach new services that raise the same consumer protection concerns as traditional money transfer businesses while leaving those without the same risks free to operate without licensing and oversight.\textsuperscript{335} The consumer protection purpose of state money transmitter laws is upheld by continuing to require licensing and regulation of traditional money transfer businesses like Western Union that provide money transfer services directly to consumer customers.\textsuperscript{336} This would be true regardless of whether the money transfer service is provided from a brick and mortar location or electronically via the Internet or a mobile application.\textsuperscript{337}

For example, where Western Union receives money from an individual consumer through the Western Union website and the consumer engages

\textsuperscript{332} See supra Part II.
\textsuperscript{333} See supra Part IV.
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Western Union to deliver the funds to a designated person or place, a money transmitter license and compliance with the state regulatory regime would be required. In such instances, the agent of a payee exemption would not apply because Western Union would not be receiving and delivering funds as an agent of a merchant seller in connection with facilitating the sale of the seller’s goods and services.338

In contrast, where a merchant seller contracts with a third party to receive and deliver payments from the seller’s customers and complies with the requirements for mitigating consumer loss, the activity would be exempt from regulation.339 For example, if a book store contracts with Amazon Payments or PayPal to provide a mechanism for accepting online payments from a customer who wishes to purchase a book, Amazon Payments and PayPal would not be engaging in regulated money transmission so long as there were a valid contractual agreement with the book store that eliminates any risk of loss to the buyer of the book after a payment is made to Amazon Payment or PayPal, as the case may be.340 However, Amazon Payments and PayPal can both be used by individual consumers to effectuate money transfers to designated individuals in the absence of a purchase and sale transaction.341 In those instances, the receipt and delivery of money is no different than the use of the Western Union website. Therefore, licensing and regulation would be necessary for services like Amazon Payments and PayPal for the latter activity, but not the former.342

The foregoing examples illustrate how the proposed framework for an agent of a payee exemption is narrowly tailored to not only maintain regulation and licensing where appropriate due to the continued risk of consumer harm, but also to clarify the scope of the statute in light of technological advances. In doing so, the proposed framework would more appropriately respond to the risks of these activities by acknowledging and distinguishing between money transfer services provided to a consumer customer and payment services on behalf of a seller pursuant to a contractual agreement, which is inherently different. Therefore, the agent of a payee exemption operates so as to support the consumer protection purpose of state money transmitter laws.

338. See supra Part V.C.
339. See supra Part V.C.
340. See supra Part V.C.
342. See supra Part V.C.
3. Accommodating Innovative Business Models, Modern Technology, and Commerce

Finally, the proposed framework recognizes innovative business models in the payments industry and new technology while appropriately adapting existing laws to society’s growing e-commerce habits instead of trying to force new payment systems into an incongruous regulatory box. By differentiating between payment services and recognizing the unique risks that each poses to consumers, the proposed framework promotes continued innovation in the payments industry, which supports the realities of a system of commerce that now relies heavily on non-cash payment methods. The providers of Internet and mobile payment services and those who continue to develop services will benefit by having an understanding of the scope of regulation and not having to unnecessarily bear regulatory burdens and costs. As such, money transmitter laws would be modernized and appropriately scoped to regulate the actual consumer protection risks implicated by changing technologies and advances in payment technologies without needlessly hindering the development of services that help to drive commercial growth in an increasingly cashless world.

CONCLUSION

State money transmitter laws, like many other statutes, suffer from an inability to predict and account for technological advances that occur in the years following enactment. Given the way that Internet and mobile payment technologies have been embraced, it is high time that state regulators and legislators look critically at state money transmitter laws and unambiguously address the extent to which such laws apply to the ever expanding ways that a person can electronically transfer money and make payments. In modernizing state money transmitter laws, it is imperative that we: (1) carefully consider and continually re-evaluate the scope of regulation in light of new services and technological innovations; (2) make an individualized determination of whether each new activity rightfully ought to be regulated as money transmission; and (3) adopt new amendments, as appropriate, to provide for clear and explicit exemptions where the consumer protection purpose of state money transmitter laws is not served.

Assuming that the consumer protection purpose of state money transmitter laws should inform decisions regarding regulatory scope, the agent of a payee exemption framework advanced in this Article strikes an appropriate balance between the potentially divergent interests of consumers and commerce. The framework provides guidance and clarity to potentially regulated persons. In addition, the framework upholds the
integrity of consumer protection that underlies state money transmitter laws by extending regulation to technological advances only where appropriate. Perhaps most importantly, the framework alleviates concerns about the chilling effect on innovation by embracing and exempting payment innovations that do not implicate overt consumer protection concerns. Thus, the agent of a payee framework will assist states in taking an important first step toward appropriately modernizing existing laws to accommodate new and emerging payment systems and developing a cohesive regulatory scheme for such systems.