Risk Management in Third Party Bill Payment

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Introduction

In the last five years we have seen the birth and rapid growth of the industry known as Third Party Bill Payers (TP). It is another sign that our society is taking its infant steps toward the fully electronic banking and commerce.

The anatomy of TP is simple. An affiliate of your bank puts into operation a host Computer using some communication and banking software and signs up the bank's customers at a monthly fee of around $6-10. For this fee the TP undertakes to make your bill payments to merchants of your choice on the date that you specify through your home computer. A forerunner of the home computer system accepted payment instructions via touch-tone telephones. The back-room operation is the same in both cases. Merchants capable of full electronic transactions get their payments by wire-transfer, while the majority of merchants, not so equipped, are mailed checks written by the TP to be negotiated and paid out of the bank customer's account. Such checks do not bear the signature of the account owner and are understood to have the owner's consent. Everything works well until a check gets lost in the mail. Who bears the risk of lost checks? The banks and their affiliate TPs would like to see the entire risk placed on the bank customers. Indeed there is some evidence that some TPs have made changes in their customer agreements in this direction. I will argue that this is the business risk of the TP and should not be transferred on to bank customers.

Some Historical Reminders

This is heady stuff, happening so fast in what used to be the most conservative sector of our commerce. Changes are happening so fast that they have outstripped the ability of courts and legislators to play referees. The regulators see the whole TP issue as a private contract matter between the customer and the TP. One can not escape the overwhelming feeling of deja vue. In the industrial revolution there was much the same tension between consumers and businesses (mainly railroads and manufacturers). After the birth of the automobile, it took twenty years before the New York Court of Appeals first recognized liability on the part of Buick Motor Co. for a defective steering mechanism. Very much like bank regulators of today such matters were originally labeled as contractual matters between car buyers and dealers.

In the information revolution it will not take decades for liabilities to be correctly placed on various parties. A far more sophisticated consumer sector exists today which will show greater agility in reacting to commercial injustice.

Arguements of the Bank/TP & Their Recommended Solution

There are two arguments used often by a TP when a check gets lost in the mail: 1) We can not be responsible for the actions of the US Postal Service. Our duties end at the Mail Box." 2) The same thing could have happened if you were writing your own checks. What would you have done if one of your checks got lost in the mail?"

Armed with the above two arguments, the bank/TP goes on to push customers to act in the following manner when a check gets lost in the mail, whether they agree to this or not: 1) Customer gets contacted by merchant for non-payment. 2) Customer should investigate and make sure the stray check has not cleared his/her account. 3) Customer should place a stop payment on the stray check at a cost of $10-$20 . 4) Customer himself should go home and write a replacement check to the merchant and mail it immediately. 5) Customer should wait a month to receive evidence of the stop payment charge and the late fee charge of the merchant and turn this evidence into the bank/TP so that they can decide if they wish to reimburse the customer.

Arguements is Favour of Shifting the Risk onto the Bank/TP

1) Customer is paying for timely payments and is entitled to the benefit of his bargain. 2) Leaving the bank/TP free to breach the contract with impunity does not foster freedom of contract or economic efficiency. 3) TP charges a fee to make timely payments. TP is in control of the method it chooses for delivery. If the US Postal Service is not reliable let TP make an alternative choice. 4) The customer pays a fee not to have bill payment hassles. Involving him/her in lost checks defeats this purpose. 5) When TP sets itself out as being in the "bill paying business" customer has a right to have higher expectations from such "expert" t han the average person. This is similar to the higher than usual " Inn Keeper" standard when tort feasors are found negligent in performance o f fee services for which they are supposed to have expertise . So even-though one may have a check get lost in the mail when one pays his own bills, he may expect better when he hires an expert in the bill paying business for a fee. 6) It is not possible for a customer to replace lost checks, if having duly relied on his bill paying service the customer has chosen not to keep any checks of his own. 7) Some banks have made their computer banking business into divisions separate and apart from their branch banking. The faces of customers will no longer be known to their bankers. Is there sufficient "knowing" of the customer to accept stop payment orders over the phone? 8) In computer banking the greatest privity exists between the bank and the TP who is always an affiliate of the bank. This is were lost check solutions need to be implemented for greatest overall security.

Proposed Solution

The singular duty on the part of a customer would be to immediately call or e-mail his bank/TP that a certain check for certain amount has not made it to the appropriate merchant. From this point on the bank/TP computer systems would go to work: 1) Verify that such a request was made. (Protection from customer abuse) 2) Verify (either computer to computer or by voice) that the merchant has really not gotten the check a week or ten days after the due date. 3) Make sure the check has not cleared customer's account at the bank. 4) Stop payment on the stray check. 5) Reissue a replacement check and send to the merchant. Undoubtedly, there must be some changes to the computer banking customer agreements if the proposed solution is to work. In a safe harbor clause, the customer gives up litigation rights in favor of the proposed solution. The bank/TP, on the other hand must agree to submit their annual rate of "lost in the mail" to a comparison against the genera l loss rate of the Postal System and satisfy regulators that it is not blaming internal mistakes on the Postal System and hiding behind the safe harbor clause. The bank/TP would further indemnify the customer against all late charges, stop payment charges which sums would be accepted by the customer as liquidated damages.

Obviously, there will be cases where deals in the millions of dollars will depend on timely payment by the TP. It would be in the best interest of any TP to have future payments specially flagged by size so that more secure means of delivery can be employed on larger payments which carry the likelihood of the greatest actual and consequential damages. In fact TPs should give serious consideration to offering a sliding scale of timeliness and fees. After all isn't that what the Postal System has finally recognized? But that is a whole article in itself. Here we have only talked about checks lost, not delayed.

Conclusion

Overall economic efficiency will be served by the solution proposed here. Since most people are likely to forfeit small rights or property to avoid confrontation, banks are likely to deny the existence of any widespread problem. The few pro-active customers will be paid off to leave rather than sue the bank. But even if people volunteer to do the work of the bank/TP they will not do it as efficiently and there will be higher transaction costs.

The solution must come in the form of agreements that fairly places the risk of lost checks in a way that would make the overall bill payment system most efficient, taking into account transaction costs. In the meanwhile consumers would do well choosing their TP carefully and shop around for one which guarantees against the risk of mail loss. One such service is called “MR. BILL”. Even if your agreement does not guarantee mail loss explicitly it may do so implicitly. When your bank calls to tell you what “you need to do”, stop and think. Ask yourself “did I agree to do this if my on-line payment did not get paid?”