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Research article

# Regulating payments for M-Content: The positive impact of the deregulation

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## ABSTRACT

This paper analyses the regulatory regime potentially applicable to the prepaid m-payments for m-content before and after the introduction of the Electronic Money Directive (2009) and the Payment Services Directive (2009). The paper concludes that the regulatory regime pre-2009 was neither technologically neutral nor did it provide legal certainty. In fact, the pre-2009 regulatory regime caused arbitrary distinctions to be drawn between marginally different m-commerce transactions, given the application of E-Money Directive to prepaid m-payments, but not postpaid m-payments. This, of course, caused significant confusion as the rather small preference for one, rather than another payment method would trigger a substantially different regulatory regime. However, the introduction of the 2009 Directives and the inapplicability of m-content transactions in both of the Directives (the deregulation), has removed this confusion. Furthermore, it concludes that currently, all m-commerce transactions for m-content are simply regulated by the respective contractual agreements, relevant commercial law, and by the PhonepayPlus Code of Practice (the regulator of all premium rate services), which provides a more pleasant outcome. Therefore, the deregulation in this case has had a positive impact.

**Keywords:** mobile commerce, mobile payments, distance selling regulations, electronic money directive, payment services directive, mobile content

<http://dx.doi.org/10.5339/irl.2014.9>

Submitted: 28 May 2014  
Accepted: 20 July 2014  
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## 1. INTRODUCTION

In the UK, the number of mobile phone customers using prepaid plans is estimated to include 65 per cent of people who own mobile phones.<sup>1</sup> The prepaid method of payment is simple, since it does not involve entering a card, security or any kind of pin number, and the price is deducted directly from the existing credit of the purchaser. Furthermore, most items purchased by this method, such as logos and ringtones, are low cost which make it more of a suitable method of payment than those that require a credit or debit card. This is because the cost of processing and collecting credit and debit card payments makes them financially unviable for low value transactions. Another factor that makes this method of payment simple and suitable is the fact that it provides people who are unable to obtain credit or debit cards with an alternative method of payment than cash, especially since these transactions are distance selling transactions and a large section of the market includes people under the age of 18 who do not possess credit cards.<sup>2</sup>

This paper analyses the regulatory regime potentially applicable to the prepaid m-payments for m-content before and after the introduction of the Electronic Money Directive (2009) and the Payment Services Directive (2009). The paper concludes that the regulatory regime pre-2009 was neither technologically neutral nor did it provide legal certainty. In fact, the pre-2009 regulatory regime caused arbitrary distinctions to be drawn between marginally different m-commerce transactions, given the application of the E-Money Directive to prepaid m-payments, but not postpaid m-payments. This, of course, caused significant confusion as the rather small preference for one, rather than another payment method would trigger a substantially different regulatory regime. However, the introduction of the 2009 Directives and the inapplicability of m-content transactions in both of the Directives (the deregulation), has removed this confusion. Furthermore, it concludes that currently all m-commerce transactions for m-content are simply regulated by the respective contractual agreements, relevant commercial law, and by the PhonepayPlus Code of Practice (the regulator of all premium rate services), which provides a more pleasant outcome. Therefore, the deregulation in this case has had a positive impact.

Before entering into this discussion, it is essential to first determine on what grounds information technology (IT) regulation (which m-commerce is part of) can be assessed. Therefore, the discussion is divided into three main parts: The first considers the objectives/principles of IT regulation; the second looks into m-content regulation in the pre-2009 regulatory regime; and the third discusses the current regulatory situation in the post-2009 regulatory regime.

## 2. REGULATORY PRINCIPLES/OBJECTIVES

Regulating any commercial activity is important insofar as it promotes the interests of the consuming public, the merchants and the authorities (e.g. tax revenue)<sup>3</sup> and these interests are occasionally, but not always, compatible. One overriding objective in the m-commerce context is to promote and sustain an open and competitive market which is in the interests of all three interest groups. This overriding objective can in turn be advanced by providing certainty and predictability in the regulation (so that both businesses and consumers know their respective rights and obligations) and by providing adequate consumer protection (to enhance consumer confidence in the market), and lastly, by providing technology neutral regulations (to provide a level playing field as well as to future prove any regulation).<sup>4</sup>

These three objectives have been recognised as key considerations by the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions in *Towards a New Framework for Electronic Communications Infrastructure and Associated Services: the 1999 Communications Review*<sup>5</sup> which was designed to answer the need to create a “coherent regulatory regime” for the increasingly converging telecommunications, broadcasting and

<sup>1</sup>See statistics provided by OFCOM, PHONEPAYPLUS MOBILE PHONE-PAID SERVICES AND THEIR MARKETING (2008).

<sup>2</sup>C. Scroggs & R. Nugent, *M-Commerce: Payments and Security*, 13 COMPUTERS & L. 42 (2003).

<sup>3</sup>R. GOODE, *COMMERCIAL LAW* 10 (3d ed. 2005).

<sup>4</sup>See also C. Reed, *The Law of Unintended Consequences – Embedded Business Models in IT Regulation*, JOURNAL OF INFORMATION LAW AND TECHNOLOGY (Nov. 22, 2007), [http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2007\\_2/reed](http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2007_2/reed); C. Reed, *Taking Sides on Technology Neutrality*, SCRIPTED (2007), <http://www2.law.ed.ac.uk/ahrc/script-ed/vol4-3/reed.asp>.

<sup>5</sup>at 14–16, COM (1999) 539 final (Oct. 11, 1999).

IT sectors.<sup>6</sup> The Review was implemented by the Framework Directive,<sup>7</sup> which deals with issues such as bandwidth, frequency and infrastructure, but does not cover the content of the services. While this paper deals with the regulation of the content of the services, it may safely be assumed that the same three objectives should also extend to it. Furthermore, the same objectives underpinned the enactment of the Electronic Commerce Directive<sup>8</sup> and the Distance Selling Directive.<sup>9</sup> For example, recital 10 of the Electronic Commerce Directive states: “... the Directive must ensure a high level of protection of objectives of general interest, in particular the protection of minors and human dignity, *consumer protection* and the protection of public health.”<sup>10</sup>

Thus the three objectives may confidently be taken to represent European Union policy within the field of electronic communications. This paper examines these three stated objectives and examines whether and, if so, to what extent, they are met by the law and regulation in place to deal with m-content transactions in the UK. Although the paper assumes that these objectives are correct, (or at least are the currently accepted ones), it should be pointed out that there are also counter-availing arguments and competing interests, which may impinge upon them.<sup>11</sup>

### 3. PRE-2009 REGULATORY REGIME

#### 3.1. E-Money under the E-Money Directive 2000

In a 2005 Consultation Paper, EU member states and the European Commission commented that prepaid mobile phone cards, when used to pay for third party products, are likely to be a form of electronic money<sup>12</sup> because this method fulfilled the criteria set out in the definition of e-money provided by the Electronic Money Directive 2000 (EMD2000). Article 1(3)(b) of the Directive defines e-money as a monetary value represented by a claim on the issuer, which is:

- stored on an electronic device;
- issued on the receipt of funds of an amount not less than the monetary value issued; and
- accepted as a means of payment by undertakings other than the issuer.

The method adopted when using prepaid phone credit as a form of payment involves as a first step the purchase of prepaid credit. This can be purchased in different ways, either through top-up scratch cards, e-top-up cards or directly through the network or through the internet using the mobile network operator's (MNO) website or top-up vouchers or through ATMs etc.<sup>13</sup> The prepaid

<sup>6</sup>The purpose of this new regulatory framework in the words of the EU is designed to:

[R]espond to the dynamic and largely unpredictable communications markets that are characterized by a significant increase in the number of market players. In light of increasing convergence between services, networks and technologies, the regulatory framework has evolved from a traditional telecommunications-oriented framework to a more flexible framework that regulates all electronic communications infrastructure and associated services in a consistent manner.

*Summary of the EU Framework Directive*, ICT REGULATION TOOLKIT, <http://www.ictregulationtoolkit.org/en/toolkit/notes/PracticeNote/514> (last visited Sept. 17, 2014).

<sup>7</sup>Council Directive 2002/21, 2002 O.J. (L 108) 33 (EC).

<sup>8</sup>Council Directive 2000/31, 2000 O.J. (L 178) 1 (EC), on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market.

<sup>9</sup>Council Directive 1997/7, 1997 O.J. (L 144) 19 (EC), on the protection of consumers in respect of distance contracts.

<sup>10</sup>*Supra* note 8 [emphasis added].

<sup>11</sup>For example: whether certainty or predictability is an appropriate benchmark for analysing existing law; whether technology neutral regulation is obtainable or desired; or, whether MNO enabled m-commerce consumers are in need of protection or is it better to have contractual autonomy. See B. Koops, *Should ICT Regulation be Technology-Neutral*, in *STARTING POINTS FOR ICT REGULATION: DECONSTRUCTING PREVALENT POLICY ONE-LINERS* (B. Koops et al. eds., 2006); *The Law of Unintended Consequences*, *supra* note 4; *Taking Sides on Technology Neutrality*, *supra* note 4 at 263; C. COTÉANU, *CYBER CONSUMER LAW AND UNFAIR TRADING PRACTICES* 18–19 (2005).

<sup>12</sup>*Consultation paper on the treatment of mobile operators under the E-Money Directive*, EUROPEAN COMMISSION, Jan. 18, 2005, [http://ec.europa.eu/internal\\_market/bank/E-Money/index\\_en.htm](http://ec.europa.eu/internal_market/bank/E-Money/index_en.htm) (last visited Nov. 19, 2006) [hereinafter *Consultation*].

<sup>13</sup>There are different ways by which a customer can purchase prepaid phone credit, these forms may have different names depending on the MNO however, they are all essentially the same. These types of purchase methods can be found in each respective MNO website (e.g. *Top Up*, O2, <http://www.o2.co.uk/topup> (last visited Sept. 15, 2006)). Scratch cards have airtime value associated with them, they can be purchased at nearly every grocery store or supermarket, and these scratch cards offer pre-set denominations. Once the card is purchased by the consumer but before it is used, it has many of the characteristics of cash as it has a value equivalent to its denomination and if lost or stolen it is usually the same as losing cash. The consumer who buys the card can only obtain value by

method of payment when used to pay for third party products is arguably a form of e-money for the following reasons.<sup>14</sup> The credit is issued on the receipt of funds paid by the purchaser, the credit issued is kept, (depending on the method used by the MNO), either on the MNO's computer network where all user credit is stored or on the user's subscriber identity module (SIM) card. Then whenever the user uses the credit, it is deducted from the credit stored on the network or the SIM card. Thus, both issuing and storing prepaid mobile phone credit is in line with both the first and second criteria provided in the above definition.<sup>15</sup>

The third criterion is fulfilled when the mobile owner purchases mobile content from a third party. When the customer purchases the mobile content, the cost is deducted from his prepaid credit.<sup>16</sup> Despite the various disagreements on the nature of e-money and its application to m-payment, all critics are in agreement that m-payments can only, (if at all), be a form of e-money when they are used to purchase products from third parties, rather than from the MNO.<sup>17</sup> The Commission in the Guidance Note states: "E-Money is created when the monetary value stored on a prepaid card is accepted as payment by a third party merchant in line with Article 1.3(b) (iii) of the Directive. The Commission services support this view."<sup>18</sup> Where the provider is the MNO, the monetary value has simply been transferred via the prepaid method to the MNO before the purchase of the product (i.e. there was a prepayment of the goods to the party who supplied the goods). However, where the merchant is a third party, the prepaid method of m-payment appears to create monetary tokens that have a wider general currency typical of money generally

#### Footnote continued

scratching the card and entering the serial number into a dedicated IVR (Interactive Voice Response) line with the MNO mainframe. When this is done, the card ceases to have any value and can be thrown away. The moment a scratch card is successfully associated with an individual's account, the user is sent a text confirming successful top up. However, this method is costly to the MNO in comparison with the E-Top up method due to the cards production and distribution, and most likely will cease to exist in a few years time. E-Top up is considered the predominant method of purchasing prepaid mobile credit; it utilizes a plastic card with a magnetic strip. This card itself has no value, and if lost or stolen, there is no value lost and the consumer can get another one without cost. The only purpose of this card is to associate a cash payment to a retailer with a phone account and to associate the plastic card number with the mobile phone account which is done by calling an IVR and entering the card number, then the required amount is entered and payment is received by the retailer. The retailer does not take control of the airtime value at anytime during this method. Another method is Direct to Network Top-up, which does not involve any cards produced by the MNO. This method requires from the customer to call an IVR line and enter the amount he would like to purchase then enter his debit or credit card details.

<sup>14</sup>I. Schuderlaro, *To Be or Not to Be Electronic Money, That's the Question*, 12 INFO. & COMM'N TECH. L. 49, 50 (2003).

<sup>15</sup>It has been argued that the prepaid method of payment does not fall within the criteria provided for by the definition. The first criterion of the Directive's definition is that it must be "stored on an electronic device." It is argued that, although credit is stored either on the MNO's network or directly on the SIM card, this is not what is intended by the phrase "electronic device." This kind of storage, some argue, is more similar to bank account details stored on the bank's computer network or on magnetic tape which only display what the customer has used or how much credit is remaining; these types of storage are not considered "electronic devices" for the purposes of the Directive. See The Mobile Data Association (MDA), The Mobile Entertainment Forum (MEF), and GSM responses to the Consultation, *supra* note 12; Schuderlaro, *supra* note 14, at 51.

<sup>16</sup>It has been argued that the third criterion of the standard "accepted as a means of payment by persons other than the issuer" does not apply, as there is no actual transfer of the units. Penn comments that the transfer of e-money is fulfilled for the purposes of the Directive if the transfer is done indirectly through the MNO. This is when the issuer (the MNO) simultaneously debits the purchaser's storage credit or account and credits the storage credit or account of the seller. However, this is not the case in regards to this method of payment, as the seller is paid by the issuer on a later date. Only the credit amount remaining is usually stored on the SIM card and there are no units transferred to the payee, where he has later to go to the issuer with these units to be redeemed with bank notes or coins. In the prepaid method of payment the used units are erased by the MNO, thus, they are not accepted by anyone except the issuer, and the payee is later paid through traditional means by the MNO. In a transaction involving e-money, the third party accepts electronic monetary value issued by the electronic money issuer (ELMI) as a means of payment. However, in an m-commerce transaction the third party accepts just an indication of a disposition by the MNO to accept an invoice for the sum quoted, in the form of a notification that a transaction has occurred between the customer and the MNO, which is in form of either an SMS delivery or receipt report. This should not be confused with an issuing of an e-money token, as this notification is comparable to a reseller's order than of the passing of e-money. Thus, the goods or services are supplied on a risk basis to the customer by the third party prior to being paid. In other words, Penn states that in this situation the seller does not accept the monetary value issued but accepts a notification by the issuer (the MNO) that a transaction has occurred and a "promise" that the issuer will pay him later; a situation according to Penn does not qualify as an e-money transaction. See B. Penn, *Commission Consults on the Revision of the European Electronic Money Regime*, 13 J. FIN. REGULATION & COMPLIANCE 347 (2005).

<sup>17</sup>See the MEF response to the Consultation, *supra* note 12; Schuderlaro, *supra* note 14, at 54.

<sup>18</sup>EU COMMISSION, DG INTERNAL MARKET E-MONEY AND MOBILE OPERATORS — COMMISSION GUIDANCE NOTES (2005).

(i.e. the consumer has tokens of value that are transferable to a number of actors who were not party to the initial issue of money).

For these reasons, it was argued, that EMD2000 should be applicable to MNOs.<sup>19</sup> But the disagreements amongst academics, market players and regulators on the applicability or inapplicability of the EMD2000 to MNOs, was not just related to the definition of e-money but also to the purposes and objectives of the Directive.<sup>20</sup> As acknowledged by the Commission,<sup>21</sup> applying the provisions of the EMD2000 to MNOs was, as discussed below, contrary to a number of key objectives of the Directive (providing legal certainty and harmonizing the laws of member states). Also, the Directive was not designed to deal with the transactional aspects of e-money payments, but to provide the regulatory framework for the new financial e-institutions—comparable to the traditional banks, insurance industry and pension funds—to ensure their stability and viability of the industry and protect the e-money market. This regulation was in principle aimed at institutions whose main businesses it is to provide financial services (unlike MNOs). So, these provisions caused great unrest in the mobile phone sector,<sup>22</sup> given their potentially severe implications for the development and even the existence of m-commerce, as many commentators agreed. Walker stated that, “compliance with this strict regime could have made much existing and planned m-commerce unviable.”<sup>23</sup> Brown observed that applying the Directive to MNOs would have led to them being subjected to financial style regulation entirely alien to them, and would have affected their progress.<sup>24</sup> By the same token, Hardy commented that the Directive imposed requirements on liquidity and capital<sup>25</sup> and these obligations could have been a real deterrent for MNOs in developing this sector.<sup>26</sup> In addition, as several of the market players suggested, the redeemability requirement provided for in the Directive<sup>27</sup> imposed difficulties on the liquidity reserves of the MNO, which, (MNOs suggested), could lead them to withdraw from the sector entirely.<sup>28</sup>

### 3.2. The consequences of MNOs being electronic money issuers

By far the most controversial issue surrounding the EMD2000 generally was its application to MNOs<sup>29</sup> at the time when the mobile phone market was expanding exponentially. As indicated above, the Directive, in an attempt to create a stable, confidence-inducing e-money industry, imposed several requirements in relation to liquidity reserves, capital requirements and business limitations on electronic money institutions (ELMI). For example:

- Article 1 (4)(5) prohibited anyone but ELMIs from issuing e-money.
- Article 4 provided set requirements on the initial capital and the liquidity reserves of ELMIs.
- Article 5 restricted the ELMI from undertaking other business activities, except closely related financial and non-financial services and the storing of data on behalf of other undertakings or public institutions. It further provided for set limitations on the liquidity reserves of ELMIs.<sup>30</sup>

<sup>19</sup>*Id.*

<sup>20</sup>Prepaid phone credit as a form of e-money, is supported mostly by non-MNOs. See the responses of the European Savings Bank Group, PayPal and other banks to the *Consultation*, *supra* note 12. Others do not see prepaid phone credit as a form of e-money, a view mainly supported by MNOs and mobile telephone associations. See the MED, GSME, Mobile Broadband Group and MDA responses to the *Consultation*, *supra* note 12; see also Schuderlaro, *supra* note 14, at 49; see also Penn, *supra* note 16; see also C. Walker, *E-money Three Years On: EU Commission Urges Light Touch*, 7 E-COMMERCE L. & POL’Y 4 (2005); see also A. Brown, *EU Commission Consults on M-Payment Regulation*, 6 E-COMMERCE L. & POL’Y 15 (2004).

<sup>21</sup>Commission Staff Working Document on the Review of the E-Money Directive, at 8, SEC (2006) 1049 (Sept. 19, 2006) [hereinafter *Review*].

<sup>22</sup>*Id.*

<sup>23</sup>Walker, *supra* note 20, at 5.

<sup>24</sup>Brown, *supra* note 20, at 15.

<sup>25</sup>Council Directive 2000/46, art. 4 (EC).

<sup>26</sup>A. Hardy & H. Rowe, *When it is and isn’t a Mobile*, 20 COMPUTER L. & SEC. REPORT 400, 401 (2004).

<sup>27</sup>Council Directive 2000/46, art. 3 (EC).

<sup>28</sup>MDA & MEF responses to the *Consultation*, *supra* note 12.

<sup>29</sup>The Commission Staff Working Document States: “The most controversial issue in this context [applicability] is the question of the [Directives’] applicability to MNOs.” *Review*, *supra* note 21.

<sup>30</sup>For an overview into these restrictions and their implications on ELMIs, see M. Kohlbach, *Making Sense of Electronic Money*, 1 J. INFO. L. & TECH. (2004).

To meet the requirements of Article 1 and Article 5, the MNOs would have either had to change their core business practice from functioning as mobile telephone network providers to ELMIs or set up subsidiaries whose sole activity would have been to manage e-money issuance and related matters.<sup>31</sup> This would have required MNOs to withdraw from the market and no longer provide this service to their customers (paying for third party products by prepaid credit) or to take on further costs by setting up subsidiaries. These extra costs could have been passed onto the consumers by increasing the price of the products – a matter problematic given the importance of this method of payment to m-commerce transactions and the fact that one of the driving factors of the m-commerce transactions was the low cost of the products.

Furthermore, with regard to restraints on the ELMIs' liquidity, for MNOs to meet this requirement they would have had to lower the amount of investments in the developing of the m-commerce sector.<sup>32</sup> The purpose of these restrictions was to ensure that ELMIs had sufficient backup liquidity in case of bankruptcy and to limit the possibility of money laundering.<sup>33</sup> However, there was no actual evidence of harm done to m-consumers or to the stability and proper functioning of payment systems as a result of the issuance of e-money by MNOs.<sup>34</sup> Therefore, applying these provisions to MNOs would have had severe implications on the m-commerce market and caused unnecessary burdens on the MNOs, without any proof of any actual or threatened harmful conduct.<sup>35</sup> Indeed, the Commission accepted that these requirements certainly did not seem in proportion to the perceived evil: "[W]ithout a detailed risk analysis, it is difficult to see that the requirements imposed by the Directive are proportionate to the risks undertaken by either the operators themselves, or prepaid consumers of third-party services."<sup>36</sup>

A further problem faced by MNOs was created by Article 3 of EMD2000 which required that e-money be redeemable by the ELMI. As the European Commission commented, the "issue of redeemability at par value ... would appear to pose problems for MNOs ... if they fall within the scope of the Directive."<sup>37</sup> This would occur because for the MNOs to redeem prepaid phone credit, the MNOs would have to implement a two-way payment mechanism, which would lead to resultant calls on their liquidity reserves becoming too onerous.<sup>38</sup> The implication of this, according to MNOs, could have motivated the MNOs' withdrawal from providing this service, which would have had damaging consequences on the mobile content industry and in turn m-commerce transactions. In addition, it may have resulted in the MNOs decreasing their investments in future developments of the sector.<sup>39</sup> Also, as Walker commented, product providers, (as the ultimate beneficiaries of the e-money), may not be aware of their duties, given that it is difficult for the product provider at the time of purchase to identify what type of payment method was used. This in turn might lead to product providers hesitating to provide this service as they will not be able to recognise which rules apply.<sup>40</sup>

### 3.3. The Directive's objectives in light of MNO inclusion

Generally, the Commission admitted that the problems raised by the application of the EMD2000 to MNOs would result in the Directive failing some of its key objectives, such as achieving legal certainty necessary to encourage new market entrants; encouraging competition; and contributing to the development of e-commerce.<sup>41</sup> However, in relation to MNOs being subject to the Directive's regime, the Commission noted: "[Q]uestions about if and how the legal framework should apply to

<sup>31</sup>Technical advice from the Committee of European Banking Supervisors to the Commission Working Staff. *Review*, *supra* note 21.

<sup>32</sup>MDA response to the *Consultation*, *supra* note 12.

<sup>33</sup>*Review*, *supra* note 21.

<sup>34</sup>The Commission comments that "it would appear difficult to justify the imposition of all elements of the Directive (including the redeemability requirement and a limitation on investments) from a 'proportionality' point of view." DG INTERNAL MARKET E-MONEY AND MOBILE OPERATORS – COMMISSION GUIDANCE NOTES, *supra* note 18, at para. 16.

<sup>35</sup>M. McCartney, *E-money – Mobile Operators Beware?*, 6 ELEC. BUS. L. 8 (2004); *see also* Walker, *supra* note 20, at 6.

<sup>36</sup>DG INTERNAL MARKET E-MONEY AND MOBILE OPERATORS – COMMISSION GUIDANCE NOTES, *supra* note 18, at para. 16.

<sup>37</sup>*Review*, *supra* note 21, at 12.

<sup>38</sup>MDA response to the *Consultation*, *supra* note 12.

<sup>39</sup>MDA & MEF responses to the *Consultation*, *supra* note 12.

<sup>40</sup>Walker, *supra* note 20, at 5.

<sup>41</sup>Council Directive 2000/46, recitals 4 & 5 (EC).

certain schemes (certain account-based schemes, electronic vouchers) and issuers (MNOs, transport providers) have led to a considerable degree of legal uncertainty.”<sup>42</sup>

Another objective of EMD2000 was to harmonise the laws, regulations and administrative provisions of member states relating to e-money.<sup>43</sup> Yet, in the Evaluation of the E-Money Directive,<sup>44</sup> it was reported that several member states (Czech Republic, Denmark, Estonia, Finland and UK) had followed paragraph 14 of the European Commission Guidance Note on Art. 1, which allowed member states to maintain those models that do not include a direct debtor-creditor relationship between the third party merchant and the customer, outside the definition of e-money. Thus, in those countries MNOs were exempt from the E-Money Directive as long as this condition was met.<sup>45</sup> In the UK this point of the Guidance Note was incorporated into the Financial Services Authority (FSA) rulebook.<sup>46</sup> Several other member states (France, Germany, the Netherlands, Poland and Portugal) reported that they also had decided not to apply the Directive to MNOs for the time being, but were awaiting further guidance and clarification at the EU level given the legal ambiguity of the situation.<sup>47</sup> As for Belgium, all prepaid schemes were classified as e-money under the Directive.<sup>48</sup> Therefore, the Directive resulted in inconsistent regulation throughout the EU, far from creating harmonization amongst the member states on this matter.

Another objective of the Directive was to create a level playing field between credit institutions and ELMIs.<sup>49</sup> However, if the EMD2000 was to be applied to MNOs, the Directive’s fulfillment of this objective would have been highly controversial in terms of the business restrictions and capital and liquidity requirements imposed on MNOs. The Commission states:

The question of whether the [Directive] has created a level playing field for all issuers of E-money is, according to the consultants’ report, highly controversial. The most important concern in this regard is the appropriate treatment of the prepaid services of MNOs. While the limited practical experience to date makes it difficult to assess whether a level playing field exists between ELMIs and traditional credit institutions, there are concerns that some of the requirements and restrictions for ELMIs may be excessive.<sup>50</sup>

It can be seen from the text above that applying the E-Money Directive to MNOs would have caused many problems with severe implications on m-commerce. These problems would not only have affected MNOs but also the merchants and consumers. Furthermore, applying the Directive to MNOs may have led to the main objectives of the Directive not being met.

### 3.4. Lack of technological neutrality

The reason for these problems was that the EMD2000 was not truly *technologically neutral* despite stated intentions. Reed commented that although on the face of it the wording of the EMD2000 was technologically neutral, elements of an inappropriate business model were unconsciously embedded in the regulation.<sup>51</sup> These regulations were based on types of e-money schemes available at the time of implementation, which differ from business models developed after that. Therefore, compliance with the regulation of new business models was problematic; hence, the drafters did not succeed in “future proofing” the Directive as it intended.<sup>52</sup> The Evaluation of the E-Money Directive Report on the Directive states, “[t]he Directive represented a response to the emergence of new prepaid electronic payment products.”<sup>53</sup> Clearly, the Directive at the time of adoption was a response to “new prepaid” electronic schemes at that time. Based on the

<sup>42</sup>Review, *supra* note 21, at 8.

<sup>43</sup>Council Directive 2000/46, recital 4 (EC).

<sup>44</sup>EU COMMISSION, EVALUATION OF THE E-MONEY DIRECTIVE (2000/46/EC) FINAL REPORT (2006).

<sup>45</sup>*Id.* at 65.

<sup>46</sup>The Financial Services Authority’s Handbook of Rules and Guidance (ELM 4.4.1R) [hereinafter FSA Handbook].

<sup>47</sup>*Id.*

<sup>48</sup>The Belgian authorities take what they consider a teleological approach to the issue of the e-money Directive applicability to MNOs, and have interpreted that even in prepaid schemes where there is allegedly no direct relationship between customer and a third party merchant, such products would have to be classified as e-money. See EVALUATION OF THE E-MONEY DIRECTIVE (2000/46/EC) FINAL REPORT, *supra* note 44, at 67.

<sup>49</sup>Council Directive 2000/46, recital 12 (EC).

<sup>50</sup>Review, *supra* note 21, at 6.

<sup>51</sup>To reach this conclusion Reed uses a number of regulations, such as the E-Money Directive and the E-Signatures Directive. *The Law of Unintended Consequences*, *supra* note 4.

<sup>52</sup>*Id.*

<sup>53</sup>EVALUATION OF THE E-MONEY DIRECTIVE (2000/46/EC) FINAL REPORT, *supra* note 44, at 17.

evaluation of the E-Money Directive,<sup>54</sup> (a report made for the DG Internal Market), the main new schemes at that time were Damont, Mondex, Proton and Primeur Card. They received attention because they were developed by non-banks and soon banks also issued cards of their own, which led to an increasing interest by national central banks and finance ministries. As they had to face this emergence of e-money issuers and were unsure of the implications that would or could result from widespread use of it on monetary policy, the demand for measures to be taken to regulate the issuance of e-money increased.<sup>55</sup> The perceived urgency of regulatory intervention gave rise to the Directive modeled on the obvious e-money issuers at the time and there appeared to be no e-money schemes that involved issuers whose core business was not a financial business, as the whole area of e-money was just emerging.

As noted above, the provisions of EMD2000 were not “future proof” because, at best, they did not anticipate the development of the market and, at worst, they failed to take account of the existing market beyond the main e-money issuers. The Commission noted that, “[t]he E-money market has ... evolved in ways which were not foreseen at the time of the Directive’s adoption.”<sup>56</sup> The Commission further stated in the Guidance Note that the Directive, “[a]lthough a recent piece of legislative work, was arguably conceived at a time when it was difficult to foresee the potential for widespread and innovative uses of electronic purses.”<sup>57</sup> It is not clear why the Commission was unable to foresee the potential development of the market, given especially that at the time MNOs were already providing premium rate services (PRS) with the prepaid method, albeit on a much smaller scale.

However, the Directive was most likely not intended to cover such kinds of transactions nor to be applied to MNOs. Also, MNOs might have been “missed” because they are not solely or even mainly e-money issuers, but are instead what might be described as “hybrid” issuers and the Directive was not intended to be applied to them or other hybrid issuers. Although the Directive itself does not recognize the concept of hybrid issuers, the Commission in the Guidance Note implicitly did when it stated that “one of the primary purposes of EMD2000 was to ensure fair competition between the banking sector and ‘non-hybrid’ electronic money issuers.”<sup>58</sup> Thus, one of the primary purposes of the Directive was not to establish a level playing field between all e-money issuers (hybrids or otherwise) but only between traditional financial institutions and non-hybrid e-money issuers. There is no indication of the likely controversial outcome and applicability of the Directive on MNOs in the draft of the Directive and the recommendations made in its wake.<sup>59</sup>

This point is further strengthened in view of the liquidity and investment restrictions imposed on the e-money issuer in the Directive, in addition to the restrictions on their activities.<sup>60</sup> It would be hard to imagine that these Articles were laid down if hybrid issuers had been taken into account at that time. Thus, applying blanket regulations tailored for other industries proved to be problematic in the m-commerce context.

### 3.5. Summary

Prior to 2009, the regulation of m-payments for m-content caused confusion and discrepancies in the market by applying different sets of regulation to similar types of transactions, differentiated only by the method of payment and who the m-content provider was. Depending on whether the consumer used the postpaid or prepaid method of payment and depending on whether one bought from the MNO directly or the merchant, the transactions would be regulated by different regimes (in addition to the contractual agreement and the PhonepayPlus Code of Practice). Specifically, if the consumer used the prepaid method of payment and bought the m-content from a third party, the E-Money Directive would come into play, giving the consumer in these types of

<sup>54</sup>*Id.* at 18.

<sup>55</sup>*Id.*

<sup>56</sup>*Review, supra* note 21, at 3.

<sup>57</sup>DG INTERNAL MARKET E-MONEY AND MOBILE OPERATORS — COMMISSION GUIDANCE NOTES, *supra* note 18, at para. 6.

<sup>58</sup>*Id.* at para. 8.

<sup>59</sup>For the recommendations on the Directive and the draft, see *Proposal for a European Parliament and Council Directive on the taking up, the pursuit and the prudential supervision of the business of electronic money institutions*, PRELEX, [http://ec.europa.eu/prelex/detail\\_dossier\\_real.cfm?CL=en&DosId=134659](http://ec.europa.eu/prelex/detail_dossier_real.cfm?CL=en&DosId=134659) (last visited Nov. 21, 2006).

<sup>60</sup>Council Directive 2000/46, arts. 1, 4 & 5 (EC).

transactions more protection (e.g. the requirement of liquidity reserves guarded against loss arising out of insolvency of money issuers and, on a more practical level, the option of redeeming credit by the MNO).

Furthermore, with specific focus on the regulatory objectives used in this paper, the pre-2009 regulation of m-payments for m-content would neither have provided legal certainty to the market players nor were they technologically neutral. First, the question of whether the EMD2000 was applicable to MNOs was creating uncertainty on a huge scale. Although states were left with some discretion as to whether or not to apply the Directive to MNOs, if states had chosen to do so, its applicability would have had several effects on the m-commerce market, and as explained above, might have led to the MNOs' withdrawal from the market and decreased the development of the market and/or raised the price of m-content, not forgetting that the low price of m-content/commerce is an essential factor in the market's progression. Moreover, the EMD2000 lacked technological neutrality, as it was difficult to implement on new forms of e-money, and if implemented on MNOs would require them to modify their practices.

#### 4. POST-2009 REGULATORY REGIME

In 2009, the EU adopted the new Electronic Money Directive<sup>61</sup> (EMD2009) which repealed EMD2000 and the Payment Services Directive<sup>62</sup> (PSD). EMD2009 was implemented in the UK by the Electronic Money Regulations 2011<sup>63</sup> and the PSD by the Payment Services Regulations 2009.<sup>64</sup> The following section gives a brief overview of each Directive and discusses how their exclusion of m-commerce transactions for m-content has resolved the problems that faced the m-commerce market before their introduction.

##### 4.1. The Payment Services Directive 2009 and the E-Money Directive 2009

The Payment Services Directive has two main objectives, first, to enhance competition between national payment markets by opening up markets to all appropriate providers and ensuring a level playing field and, second, to provide a simplified and fully harmonised set of rules on information requirements and the rights and obligations of users and providers related to the provision and use of payment services.<sup>65</sup> The scope of this Directive applies to all retail payment instruments, including both national and cross-border transactions but excludes transactions distant to, or arriving from, third countries.<sup>66</sup> The Payment Services Directive focuses on credit transfers, direct debits, card payments and other payments made by electronic means, and applies to issuers and hybrid issuers of e-money.<sup>67</sup>

The E-Money Directive 2009 was adopted in response to the emergence of new pre-paid electronic payment products and was intended to create a clear legal framework designed to strengthen the internal market while ensuring an adequate level of prudential supervision. This occurred because, in its review of EMD2000, the Commission highlighted the need to revise that Directive since some of its provisions were considered to have hindered the emergence of a true single market for electronic money services and the development of such user-friendly services.<sup>68</sup> The adoption of the Directive was also intended to clarify the situation regarding new types of e-money schemes (such as m-payments).<sup>69</sup> A further reason for introducing EMD2009 was, according to the Commission, to bring the prudential regime for electronic money institutions, into line with the requirements for payment institutions in the Payment Services Directive.<sup>70</sup>

<sup>61</sup>Council Directive 2009/110 (EC) on the taking up, pursuit and prudential supervision of the business of electronic money institutions, amending Directives 2005/60 (EC) and 2006/48 (EC) and repealing Directive 2000/46 (EC).

<sup>62</sup>Council Directive 2007/64 (EC) on payment services in the internal market amending Directives 97/7 (EC), 2002/65 (EC), 2005/60 (EC) and 2006/48 (EC) and repealing Directive 97/5 (EC).

<sup>63</sup>SI 2011/99.

<sup>64</sup>SI 2009/209.

<sup>65</sup>at 2–4, COM (2005) 603 final (Dec. 1, 2005).

<sup>66</sup>Council Directive 2007/64, recital 17 (EC).

<sup>67</sup>Council Directive 2007/64, arts. 6 & 7 (EC).

<sup>68</sup>Council Directive 2009/110, recitals 1 & 2 (EC) on the taking up, pursuit and prudential supervision of the business of electronic money institutions, amending Directives 2005/60 (EC) and 2006/48 (EC) and repealing Directive 2000/46 (EC).

<sup>69</sup>Council Directive 2009/110, recital 1 (EC).

<sup>70</sup>See *E-Money*, EUROPEAN COMMISSION, [http://ec.europa.eu/internal\\_market/payments/emoney/index\\_en.htm](http://ec.europa.eu/internal_market/payments/emoney/index_en.htm) (last visited June 22, 2009).

#### 4.2. Inapplicability of M-Content transactions

The E-Money Directive 2009 amended the definition of e-money<sup>71</sup> and also created the concept of hybrid issuers<sup>72</sup> of e-money, which are subject to the requirements of the Directive (some of which have also changed e.g. lower initial capital requirements<sup>73</sup> and different redeemability requirements.)<sup>74</sup> Pursuant to the definition of both e-money and e-money issuers, MNOs still fall within the scope of the regulatory regime,<sup>75</sup> as the definition of e-money and e-money issuers have been modified.<sup>76</sup>

However, both the EMD2009 and PSD contain exemptions which MNOs can rely upon to escape the provisions of the Directives. The PSD is not applicable to m-commerce transactions for m-content by virtue of Article 3(i) of the Directive that deals with transactions outside the scope of the Directive and includes:

[P]ayment transactions executed by means of any telecommunication, digital or IT device, where the goods or services purchased are delivered to and are to be used through a telecommunication, digital or IT device, provided that the telecommunication, digital or IT operator *does not act only as an intermediary* between the payment service user and the supplier of the goods and services.

As the PSD, (the more general instrument), and the EMD2009, (the more specific instrument), are designed to work hand in hand, the exception for MNOs provided in the former extends to the regulatory regime of the latter, as implemented in the UK Regulations, both of which create exemptions for MNOs.<sup>77</sup>

According to the FSA, the MNO “does not act only as an ‘intermediary’ if it adds value to the transaction.”<sup>78</sup> “Adding value” by the MNO to goods or services supplied by a third party may take the form of, for example, providing access (including to an SMS centre).<sup>79</sup> In fact, the touchstone of exemption in the form of “intrinsic value adding” is explicitly included in Recital (6) of the EMD2009:

It is also appropriate that this Directive not apply to monetary value that is used to purchase digital goods or services, where, by virtue of the nature of the good or service, the operator *adds intrinsic value to it*, e.g. in the form of access, search or distribution facilities, provided that the good or service in question can be used only through a digital device, such as a mobile phone or a computer, and provided that the telecommunication, digital or information technology operator *does not act only as an intermediary* between the payment service user and the supplier of the goods and services. This is a situation where a mobile phone or other digital network subscriber pays the network operator directly and *there is neither a direct payment relationship nor a direct debtor-creditor relationship between the network subscriber and any third-party supplier of goods or services delivered as part of the transaction.* [emphasis added]

So both Directives exempt MNOs if their role as payment/money supplier is not their only role in the transaction. The fact that the MNO provides access to the third party merchants which can only be used through the digital device and that the MNO receives the payment from the subscriber, are examples of the added value provided by the MNO.

The European Commission reasoned that the MNO exemptions from the regulatory regime are justified simply on the basis that the regulations are not needed and would in fact be excessive in light of the demands of m-commerce:

<sup>71</sup>Council Directive 2007/64, art. 2(2) (EC) states that “‘electronic money’ means electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions as defined in point 5 of Article 4 of Directive 2007/64 (EC), and which is accepted by a natural or legal person other than the electronic money issuer.”

<sup>72</sup>See, e.g., Council Directive 2007/64, arts. 6 & 7 (EC).

<sup>73</sup>Council Directive 2007/64, art. 4 (EC).

<sup>74</sup>Council Directive 2007/64, art. 11 (EC).

<sup>75</sup>Some commentators point out that future models of m-commerce may result in EMD2009 becoming applicable and this may cause tension with MNOs especially in respect of the redeemability requirement. R. Halpin & R. Moore, *Developments in Electronic Money Regulation – the Electronic Money Directive: A Better Deal for E-money Issuers?*, 25 COMPUTER L. & SEC. R. 563 (2009).

<sup>76</sup>Council Directive 2007/64, arts. 2(2) & 2(3) (EC).

<sup>77</sup>This exception to the Directive is implemented in reg. 3 of the Payment Services Regulations 2009 and in sch. 2 part 2 of the E-money Regulations 2011.

<sup>78</sup>FSA Handbook PERG 15, annex 3, Q 23.

<sup>79</sup>*Id.*

[C]onsumers seem to have confidence in using them. Consumers appreciate their simplicity and convenience and in exchange are willing to receive less information and enjoy less protection than would be the case if the same payment were made from a classical bank account. Since such instruments are designed to be used mainly for the frequent purchase of low-priced goods and services, in the interest of simplicity and convenience, the Directive allows them to be used without being overburdened by excessive requirements.<sup>80</sup>

Recital 6 was included in response to a recommendation by the Mobile Broadband Group<sup>81</sup> to put the inapplicability of the Directive to MNOs beyond any doubt<sup>82</sup> and avoid any future confusion in the market.

As a final note, even if the prepaid credit is used to purchase items which are not m-content (e.g. to buy tickets or pay for parking meters) the transaction does not fall within the scope of the Payment Services Regulations 2009. This is because, although these types of transactions fall within the remit of payment services, the Commission gave member states the option to waive the safeguarding measures described in PSD due to their low value and in the interest of simplicity.<sup>83</sup> The UK has adopted this option; Reg 53 of the Payment Services Regulations 2009 exempts certain regulations, as long as the transaction:

(a) [C]an be used only to execute individual payment transactions of 30 euro or less, or in relation to payment transactions executed wholly within the United Kingdom, 60 euro or less; (b) have a spending limit of 150 euro, or where payment transactions must be executed wholly within the United Kingdom, 300 euro; or (c) store funds that do not exceed 500 euro at any time.

This is in line with the current business practices adopted by the MNOs, since they do not permit their customers to have prepaid credit of more than £200, and the cost of such services cannot exceed £30.<sup>84</sup>

#### 4.3. Results of the inapplicability of the Directives

The inapplicability of the two Directives has, directly and indirectly, had a positive impact on the regulation of m-commerce transactions for m-content. One direct positive result is that the controversy of whether paying for third party m-content by the prepaid method of payment is subject to the e-money regulation has been finally settled, as the Commission has explicitly stated that they do not. Removing the threat of the EMD2000 has meant a return of confidence in the m-commerce market as well as in the development of future m-commerce models. It also means that m-commerce transactions for m-content have been removed from the grasp of a non-technology neutral regulatory regime (i.e. e-money), as it was nearly impossible to be implemented by MNOs, and if implemented, would have required MNOs to make drastic modifications to their business models. Furthermore, the inapplicability of the Directives also removes the discrepancies in the applicable regulation that resulted from applying different sets of regulation depending on the method of payment used and/or who the m-content provider was. Now all m-commerce transactions for m-content are simply regulated by the contractual agreements, relevant commercial law, and by the PhonepayPlus Code of Practice.

<sup>80</sup>Memorandum 07/152 from the European Commission.

<sup>81</sup>Mobile Broadband Group consists of the six leading UK MNOs: O2, 3, Vodafone, Orange, Virgin and T-mobile.

<sup>82</sup>*Consultation on the revision of the E-money Directive: A Response from the Mobile Broadband Group*, MOBILE BROADBAND GROUP, [http://www.mobilebroadbandgroup.com/documents/mbg\\_emd\\_rev\\_140409\\_f.pdf](http://www.mobilebroadbandgroup.com/documents/mbg_emd_rev_140409_f.pdf) (last visited Aug. 1, 2011).

<sup>83</sup>Council Directive 2009/110, art. 9(4) (EC). See also Memorandum 07/152, *supra* note 80, at n.2, where it states:

In some situations (e.g. prepaid telecom instruments) only a small portion of the amount of the funds available are typically used in practice for future payment transactions. In such cases, Member States may decide to apply the safeguarding requirement only to the part of funds typically used to make payments falling under the Directive. An example may make this clear. On average say 90% of funds on a prepaid telecom card are used for making telephone calls. These payments do not fall under the Directive. Only 10% are used on average for making payments falling under the Directive, e.g. purchasing confectionaries or drinks, paying for a taxi. Then if such a user had a 600 EUR prepaid card, only 10% or 60 EUR would require safeguarding. Alternatively, in the interests of simplicity, Member States may waive these safeguarding requirements provided the total funds on the prepaid card do not exceed 600 EUR.

<sup>84</sup>PhonepayPlus Code of Practice, 11th ed., para. 7.10.3.

#### 4.4. PhonepayPlus Code of Practice

The reason for applying the provisions of the PhonepayPlus Code of Practice is that m-content transactions are a form of Premium Rate Services (PRS). PRS are regulated in the UK by PhonepayPlus. The advantage of this is it makes the m-content regulatory environment in many ways a much more controlled and controllable commercial space. This is because, in the broadest terms, m-content and e-commerce transactions may be compared to the difference between the interactions of users of a private and a public road. In an e-commerce transaction the ISP provides the user with access to the “public road” where the user may meet innumerable, self-selected online merchants, about whom the ISP knows nothing and over whom it has no control. In contrast, m-content transactions (other than ordinary internet transactions) the MNO provides the user with access to the “private road,” namely to service providers who the MNO has pre-selected. In other words, in m-commerce transactions for m-content there is not just a pre-established relationship between the user and the middleman, but also between the middleman and the content provider.<sup>85</sup>

There has to be an agreement made between the MNO and the content provider.<sup>86</sup> In this agreement, the MNO has to technically facilitate the ordering and receiving of the service (m-content) between the consumer and the service provider. The MNO also requires the payment of the service (m-content) and pays the provider at later date after keeping some of the money for themselves. Additionally, within the provisions of the contract the content provider has to adhere to the provisions of the PhonepayPlus Code of Practice. Furthermore, the service providers have to be licensed by PhonepayPlus to be able to sell their services/products in the UK.<sup>87</sup> Hence, it is a more controlled and controllable commercial space, and thus, is more adequate to regulate m-content transactions than general e-money regulation.

#### 5. CONCLUSION

M-payments are an important ingredient of any m-commerce transaction and thus, for the existence and development of m-commerce market. Therefore, it is important that they are regulated in an efficient manner, taking into account the three regulatory objectives of certainty, technological neutrality and consumer protection. These three regulatory objectives/principles, but in particular the first two, were challenged by pre-2009 regulation of the prepaid method of m-payments. However, the introduction of the EMD2009 and the PSD and their inapplicability to m-payments has paved the road to a much more efficient regulatory environment which is dominated by the private arrangements between the parties and the PhonepayPlus Code of Practice. The fact that the European Commission expressly acknowledged that the far more elaborate regulatory regimes were entirely unnecessary for m-commerce bears testimony to the well-functioning of the current m-commerce model and is a reminder that on the “private road” of m-commerce the transactional environment is intrinsically much more tightly controlled and in need of less governmental supervision than the public road of e-commerce.

<sup>85</sup>PhonepayPlus Code of Practice 11th ed. intro. & para. 2.3.

<sup>86</sup>PhonepayPlus Code of Practice 11th ed. para. 2; Communication Act, 2003 § 120 (10) (11) (Eng.).

<sup>87</sup>PhonepayPlus Code of Practice 11th ed. para. 5.1.