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THE BANK CREDIT CARD AND THE CONSUMER: PROGRAMMING JUSTICE INTO THE CASHLESS SOCIETY

INTRODUCTION—AN OVERVIEW

During the past decade, the American consumer economy has been retooling for the advent of the "cashless society." The most significant effort in this regard has been the development of the multipurpose bank card plans, the two most conspicuous of which have been the current Master Charge and Bank Americard systems. By 1971, bank card billings amounted to over 35 percent of total outstanding consumer credit held by commercial banks, amounting to $4 billion by early 1972. Over 60 million credit cards issued by federally insured banks were outstanding by the end of 1969.

While the advantages of bank cards have been pointed out by a number of writers, dissatisfaction has developed within consumer protection ranks concerning the insulation of the banks participating in the plans from liability arising out of the underlying sales transactions. By use of a waiver-of-defense clause, and by structur-

1. Bergstein, Credit Cards—A Prelude to the Cashless Society, 8 B.C. IND. & COMM. L. REV. 485 (1967); Survey, Toward a Less-Check Society, 47 NOTRE DAME LAW. 1163 (1972). An excellent condensed history of the development of the industry prior to 1967 may be found in Davenport, Bank Credit Cards and the Uniform Commercial Code, 1 VAL. U.L. REV. 218 (1967).

2. By 1972, according to Wisconsin's Senator Proxmire, these two plans accounted for over 95 percent of all bank card business. 118 CONG. REC. S6894 (daily ed. April 27, 1972).


5. Brandel & Leonard, Bank Charge Cards: New Cash or New Credit, 69 MICH. L. REV. 1033, 1038 & n.17 (1971). All indications are that this number is continuing to grow substantially. Senator Proxmire has pointed out that during the past three years, outstanding billings on bank credit cards have grown from $1 billion to $4 billion, and some bankers foresee that a majority of all consumer credit will be bank credit card within the next few years. 118 CONG. REC. S6894 (daily ed. April 27, 1972).


8. Master Charge utilizes the following waiver:
Issuer shall have no responsibility for merchandise or services purchased through use of a card. Any dispute with respect to such merchandise or services shall be settled.
ing the transaction as a direct loan, the present bank cards have effectively circumvented the current attack on holder-in-due-course protections for the creditor.10 Basically, in most states,11 the con-

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9. Generally, the banks have prevailed in viewing the credit card transaction as a direct loan. The Uniform Consumer Credit Code treats the bank card as a loan, per §§ 2.104(2)(a) and 3.106(3).


11. Massachusetts has made credit card issuers liable to debtors’ defenses when “the creditor was the issuer of a credit card which may be used by the consumer in the sale or lease transaction as a result of a prior agreement between the issuer and the seller or lessor.” Mass. Ann. Laws ch. 255, § 12F (Supp. 1971). At the very least, this will cover those situations where the same bank deals with both consumer and merchant. If an argument is made that “issuer” as used in the statute refers to the particular bank card system (e.g., Master Charge) as a whole, the effect of the statute will be much broader. California protects con-
sumer who uses the bank credit card is isolated as the sole risk-bearing party when merchandise is delivered in a defective condition or when the merchant fails in some other way to perform his obligation. For example, in the situation where the consumer uses his credit card to purchase a camera and upon using it finds it to be defective in some way, the bank will demand payment in full regardless of such defect. By signing the sales slip at the time of purchase, the consumer has bound himself to pay the bank independent of any claims he may have against the merchant regarding the underlying sale. As against the merchant, the consumer soon finds that legal redress is more costly than the original expenditure he made for the camera, and even if the consumer believes he will recover the costs of his suit, he still faces the problem of paying his legal costs prior to recovery. Clearly, unless the consumer has an unusually sound financial base and an inordinate amount of perseverance, he will be obliged to pay for the camera even if it never works, or is never even delivered to him.

That such a situation has developed is due in large part to the tendency of legal writers to force the credit card concept into some consumer defenses if the purchase price exceeds $50, the purchase is within the state, a good faith effort has been made by the cardholder to obtain satisfaction from the merchant, and cardholder notifies the card issuer of the existence of the dispute and its particulars. Cal. Civ. Code § 1747.90(a)(2) (Supp. 1972). Arizona preserves consumer defenses for non-perishable consumer goods purchased within the state. Ariz. Rev. Stat. Ann. § 44-145(A), (B)(1), (B)(2) (Supp. 1972).

12. Credit cards are a great facility for the true con artist. Payne v. United California Bank, 23 Cal. App. 3d 352, 100 Cal. Rptr. 672 (1972), shows the speed with which the fast operator can work when aided by the credit card plan. There, a vacuum cleaner sales plan discounted over $23,000 worth of sales slips in less than a month-and-a-half, prior to being terminated by the issuing bank. See Note, supra note 3, at 292-94. The California Supreme Court affirmed the dismissal of the Payne case for failure to establish a proper class for a class action suit. Payne v. United California Bank, supra.

13. See note 8 supra. Notice that even those purporting to represent the creditor's interests will admit that such a clause is hardly the result of "bargaining" as the term is generally accepted: "The one thing certain about the typical consumer's execution of a purchase contract with a waiver of defense clause is that he is unaware of the consequences of signing. The instrument is a contract of adhesion." Kripke, Consumer Credit Regulation, a Creditor-Oriented Viewpoint, 68 Colum. L. Rev. 445, 472 (1968).

14. An interesting account of the difficulties encountered when a consumer pursues such a claim is found in Schrag, Bleakhouse 1968: A Report on Consumer Test Litigation, 44 N.Y.U.L. Rev. 115 (1969). Although the financial institutions in that case may have been somewhat more zealous than the ordinary merchant would be expected to be, it is quite clear that a suit of any consequence will be economically unsound even if the consumer is assured that he will prevail.

established legal theory. Thus the credit card has been likened to assignments of commercial paper, letters of credit, conventional checks, secured transactions and direct loans. The problem is that none of the existing legal theories were developed with the credit card in mind; the result has been that each of the pre-existing theories or classifications has failed to cover the entire spectrum of relationships involved in the credit card transaction. Moreover, since the banks generally make the decision as to which of the existing legal theories shall be applied, the tendency has been to utilize those theories which provide the greatest protection and profit for the commercial interests. The consumer has little choice but to accept the card as presented or forgo for the time being the advantages of the "cashless society."

THE MECHANICS OF THE MULTIPARTY CHARGE CARD

The history and development of the credit card phenomenon has been fully discussed elsewhere. For the purposes of this note, a description of the multiparty charge card and the bank interchange system will be sufficient. Under these arrangements, there are four primary parties to the typical transaction: the cardholder, the issuing bank, the merchant and the depository bank.

16. See, e.g., Clontz, Bank Credit Cards under the Uniform Commercial Code, 87 Banking L.J. 888 (1970); Cooper, The Bank Credit Card Revolution and Articles 4 & 5, 24 Bus. Law. 133 (1968); Davenport, supra note 1; Note, supra note 6.
18. Davenport, supra note 1, at 234-40; Note, supra note 6, at 391-96.
20. Clontz, supra note 17, at 894-904.
21. See note 9 supra.
22. Clontz, supra note 17, at 891: "One of the difficulties in applying the U.C.C. principles to Credit Card plans of the Cardholder-Bank agreement type is that neither the U.C.C. nor the plans took each other into consideration in their respective formation."
23. Thus, banks in New Jersey which have traditionally operated under the direct loan theory may face a situation where, by restructuring their credit card plans to the purchase of accounts theory, they would be able to raise interest rates significantly. Predictably, given this choice, the banks will "change theories" in order to avail themselves of the higher rates. Panel Discussion, Bank Credit Cards—Problems under Regulation Z, and Possible Problems as a Result of Future Developments under Proposed Consumer Legislation, 27 Bus. Law. 111, 113-14 (1971). The changeover would have little effect on the functional aspects of the system, merely requiring a restructuring of the sales slip. From the consumer's vantage, at least, this is just "old milk in new cans." It is hard to see what it is about the "new" system which would make it more deserving of the higher rate. For the consumer, the only clear change is that the new system costs more.
24. See Davenport, supra note 1; Survey, supra note 1, at 1178-84.
25. Regional banks may increase the actual number of parties involved, but, for the
The consumer applies for and obtains a card from a local bank, termed the issuing bank. By accepting and using the card, the consumer agrees to pay the issuing bank for all purchases made with the card prior to its return to the issuer, or notice of loss of the card. The issuing bank in turn communicates, via an interchange system, with thousands of other banks. These banks solicit merchants to participate in the system, as may the issuing bank. When the merchant enters the system, he deals with the bank which solicited him, which bank becomes his depository bank. This bank agrees to exchange cash credit at a discounted rate for all sales slips generated by the use of the charge cards. The depository bank becomes the sole contact between the merchant and the bank card system insofar as redemption of sales slips is concerned.

When the consumer uses his charge card, a sales slip is imprinted with certain information contained on the face of the card identifying, among other things, the consumer and the issuing bank. The slip also carries a description of the merchandise sold, the price of each item and a restatement of the cardholder's promise to pay the issuer the total shown on the slip. This slip is deposited by the merchant with his depository bank. The depository bank credits the account of the merchant with the appropriate percentage of the face value of the slip, and the slip is then processed through the interchange system and billed to the customer by the issuer.

DEFENSE CUTOFFS—AN UNNECESSARY AND INDEFENSIBLE BURDEN ON THE CONSUMER

As indicated, the two major bank credit card systems concep-
tualize use of their credit cards as a direct loan transaction. By doing so, the banks not only avoid reliance on the somewhat precarious holder-in-due-course doctrine, but they also are able to avoid many of the current statutes designed to invalidate waiver-of-defense clauses in consumer installment sales contracts. According to the bank viewpoint, the user of the bank card stands in the same shoes as the person who goes directly to the bank for a loan and then makes an independent cash purchase. Hence, according to the banking interests, the consumer should have no better right against the bank for merchant failures under the credit card purchase than he would have if he had actually taken out an independent loan; since the bank would be free of liability in the loan situation, so should it be in the credit card situation.

This latter attitude evidences a distinct philosophical approach to the advent of the cashless consumer economy which is shortsighted and offensive. The argument implies that the unavailability of a practical remedy in the cash sale/direct loan transaction for defective or undelivered merchandise is a positive, or at least a neutral characteristic of the present system. This approach would certainly negate much of the progress made by consumers in the negotiable instrument situation and in the credit and secured sales transactions as defined under the Uniform Consumer Credit

31. See note 9 supra. It is interesting to note that the banks reinforce this legal conceptualization in their advertising campaigns. Bank Americard has adopted the slogan "Think of it as money." One wonders if this slogan is meant for the consumers or for the lawmakers.

32. See note 10 supra.

33. The Uniform Consumer Credit Code is a good example. Under the UCCC, the waiver of defenses may be invalidated as to "credit sales" as defined under section 3.106 of the Code; however, the Code does not restrict the right to use waiver-of-defense clauses in the bank card transaction, which it defines not as a credit sale, but as a loan. Uniform Consumer Credit Code §§ 1-301(9), 3-106(3).

34. But see Note, Direct Loan Financing of Consumer Purchases, 85 Harv. L. Rev. 1409, 1421 (1972): "[A]ny similarity between credit card purchases and cash sales is irrelevant. The costs of seller misconduct in cash sales fall on the buyer by necessity rather than by design."

35. See note 10 supra.

36. See note 33 supra.

37. The UCC, adopted in all states except Louisiana, remains relatively neutral on waivers-of-defense in secured transactions, providing in the comments to 9-206 that: "This Article takes no position on the controversial question whether a buyer of consumer goods may effectively waive defenses by contractual clause or by execution of a negotiable note." UCC § 9-206 provides in part:

(1) Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense he may have against the seller or lessor is
Code and Uniform Commercial Code, since the protections being developed in current code drafts may be held inapplicable to the direct loan transaction.

More importantly, under the present bank card practices, the merits of a great majority of consumer complaints will never be tried. Since the burden is on the consumer to assert his claim, and since assertion of most claims is economically unsound when a lawyer is involved, verbal protest is the best (if not the only) remedy available to the complaining consumer. Indeed, if the present situation is to be defended, that defense must accept the premise that merchants will have near-absolute discretion to determine whether particular claims should be remedied. Merchants, as a practical matter, will be the final arbiters of their own adversary disputes.

Why should this be so? Commercial banking interests are quick to point out that if the risk of nonperformance by merchants were shifted to them, the costs of policing thousands of merchants would be prohibitive. The prospect of massive consumer abuse of the privilege of asserting defenses is also relied upon. The banks argue that once the consumer takes possession of the merchandise, the temptation will be to utilize the cost of litigation as a lever in negotiations with collecting banks. Since banks will no longer be able to avoid consumer defenses, they will face the unenviable choice between the expense of an uncollectable account or the expense of legal fees and court costs in excess of the amount ultimately recovered.

Though appealing at first, the argument that the banks will be unduly burdened is fallacious for several reasons. First, the banks

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38. See note 14 supra.
39. The latest Master Charge application boasts of 500,000 businesses in 44 countries who welcome the Master Charge card.
40. The examples given typically involve the issuing bank attempting to police all 500,000 merchants, or one merchant thousands of miles distant. See, for example, the problem set out in Panel Discussion, Bank Credit Cards, supra note 23, at 117-18. The fallacy in such reasoning is discussed in the text; see notes 49-51 infra and accompanying text.
have a contractual right to charge back sales slips to the original merchant whenever a cardholder raises a defense related to the underlying sale.\textsuperscript{41} Furthermore, the merchant has agreed in his contract to indemnify the depository bank and the card system from liability arising out of any sale.\textsuperscript{42} Clearly, the banks have provided themselves ample protection by shifting the burden entirely to the merchant.

A third weakness in the banking position is that abuse may be simply avoided if statutory provision is made for collection of attorney's fees by the prevailing party in any suit involving a disputed billing.\textsuperscript{43} This would screen out patently frivolous defenses, if only because most attorneys will recognize such defenses and will realize that their own prospects for recovery of fees will be significantly diminished when the court has assessed the fees of the opposing party upon the complaining consumer-client.

Most importantly, by placing the consumer in a position to assert his legitimate defenses against the suing bank, or by shifting the burden of initiating suit to the merchant if the sales slip is

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\textsuperscript{41} Master Charge utilizes the following clause in its Merchant-Bank agreement form:

\textsuperscript{14} Town & Country may refuse to accept any sales slip, or revoke its prior acceptance thereof, and in the event of such revocation Member agrees to repay Town & Country the total face amount of such sales slip, in any one or more of the following circumstances:

(a) The Charge Card sale giving rise to such sales slip was not made in compliance with all the terms and conditions of this Agreement (including the provisions of Paragraphs 4 and 5, unless such provisions were waived by the appropriate Authorization Center in accordance with Paragraph 6), as well as all applicable laws and regulations of any governmental authority.

(b) The Cardholder of the Charge Card used in such sale disputes his liability to the Issuer on any one or more of the following grounds:

(i) that the merchandise or services covered by such sales slip were returned, rejected or defective in some respect, or Member has failed to perform any obligation on its part in connection with such merchandise or services, and Member has refused to issue a credit slip in the proper amount; or

(ii) that the signature on the sales slip was not that of the Cardholder or any Authorized User, and Town & Country in good faith believes that Member should have discovered this fact by examination of the signature appearing in the signature panel on the reverse of the Cardholder's Charge Card (unless the appropriate Authorization Center waived this defect in accordance with Paragraph 6).

\textsuperscript{42} The Master Charge contract reads:

All disputes between Member and any purchaser relating to any Charge Card sale shall be settled between Member and such purchaser. Member agrees to indemnify and hold Depository Bank and Town & Country harmless from any claim or liability relating to any such sale.

\textsuperscript{43} See notes 82 and 83 \textit{infra} and accompanying text.
charged back, such a system would encourage a trial of the merits of most substantial consumer-merchant disputes. Surely this will result in added costs for some merchants, and most probably these cost increases will be reflected in prices charged to consumers generally. Equally certain will be an added burden on the banks, even if they adopt a policy of charging back all disputed slips; \(^44\) these costs will also be passed on to the consumer. But this result is not alone persuasive that the system is best left in its present state.

It is important to keep in mind the precise comparison to be made if these added costs are to be taken into consideration. Elementary contract law will illustrate that, in the simplest analysis, a judgment has been made that consumers should not have to pay for defective or undelivered merchandise. If this is so, the proper economic comparison is not between the costs of the present system as against the foreseeable costs of a system where consumer defenses are preserved, but rather between the projected costs of adjudication of all substantial claims under the present system, and the costs of similar adjudication under the proposed new system.

Viewed from this perspective, the elimination of the present insulation of banks from consumer defenses presents several advantages. Initially, the bank will be expected to file fewer suits, since the obvious alternative of charging back will prevail when preliminary investigation indicates a successful defense. Merchants may be expected to avoid filing suit in many instances where settlement presents a more economical solution. \(^45\) In the event that they do sue, the costs of initiation of the suit may be expected to be less for the retained attorney of the merchant, who is familiar with such proceedings, than for the average attorney hired by the consumer for a particular suit. \(^46\)

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\(^44\) See Panel Discussion, Bank Credit Cards, supra note 23, at 119 & n.15. The note indicates that the estimated "clerical costs alone" of processing an undisputed chargeback within the same regional area exceeds $10 per slip. This is somewhat hard to accept, since it represents between two and three full hours of clerical work. No doubt, a chargeback represents some additional costs, however, and to that extent, there will be added costs within the system. One possible solution, from the bank viewpoint, would be to charge the merchant an additional fee for slips charged back.

\(^45\) Presently, of course, settlement is never an economically sound solution in a pure sense, since the merchant who is confronted under the existing system will have been paid already and will usually be justified in presuming that the complaining consumer will not make the investment necessary to sue. See Mueller, Contracts of Frustration, 78 Yale L.J. 576, 577 & n.8 (1969).

\(^46\) See Schrag, supra note 14. It would appear that specialization has its economies in the law of retail sales. At the very least, the lawyer who only occasionally handles such
Moreover, even if the merchant does assume an additional burden by being forced to initiate suits, he still enjoys several significant advantages. Default judgments will still be available in a great number of cases. For many consumers, particularly in low income areas, the legal system is viewed with great apprehension and cynicism. While such people may be willing to withhold payments, they will not appear in court to assert defenses available to them.\textsuperscript{47} Nor will many of those who are familiar with the consequences of a blemished credit report be willing to risk such a blemish by absolutely refusing to pay.\textsuperscript{48}

Finally, it should be remembered that the burden will still be on the consumer to substantiate his claimed defense. Mere assertion of a consumer's dissatisfaction will not present a significant obstacle to recovery by the merchant who has performed his obligations. The only significant disadvantage the merchant will face under the proposed system will be that he will have to confront claims more often than under the present circumstances, in which the bank card system becomes the bill collector. It is contended that this is a legitimate cost of doing business in an economy in which the consumer should be afforded meaningful protection against merchant fraud and sale of defective merchandise.

In those cases where the merchant whose performance is being challenged is unavailable for charge back of the slip by the bank, as by insolvency, the bank system will be forced to sue on the slip and to meet the defenses asserted by the consumer. In this circumstance, the banking interests point out that the burden is an unfair one since the issuing bank presently faces the burden of pressing the claim.\textsuperscript{49} They point out that the issuing bank has no way of monitoring the activities of a merchant with whom the issuing bank has had no regular dealings. This argument presumes that the depository bank, which solicited the merchant and brought him into the plan, is not a party to the lawsuit and cannot be reached to share in any liability arising out of the sale.

It must be kept in mind that the bank credit card is the product

\textsuperscript{47} Ecovaldi & Gestrin, supra note 15, at 282-85; Mueller, supra note 45, at 579.
\textsuperscript{48} Mueller, supra note 45, at 472 n.7.
\textsuperscript{49} See note 40 supra.
of an integrated system. If the depository bank is isolated from liability it is because the system determines that it should be. Quite simply, the system may provide for charging of losses suffered as a result of merchant misconduct to the bank responsible for bringing the offending merchant into the program. This would place the risk of seller misconduct where it should be: with the party which has the greatest opportunity to monitor the activities of the merchant involved. Such a bank may have continuing access to the financial status of the merchant,\textsuperscript{50} and should the merchant appear to be approaching financial insolvency, only this bank has the wherewithal to discover this promptly and to remove such a merchant from the bank card system.\textsuperscript{51}

The ultimate result, regardless of which bank absorbs the particular loss, is that the economic burden is subsumed into the costs of the system as a whole. Such a result is desirable since the system is able to spread the loss over the entire range of responsible participants in the credit card transaction: the consumers, the merchants and the banks. The delegation of some risk to the banks involved is justifiable in light of the fact that bank card credit is often a catalyst for increased consumer spending. Further, since the banks determine which merchants benefit by these sales, the banks should properly take responsibility for fraud assignable to such merchants. This is especially so when it is realized that many of the merchants participating in the plan could not otherwise offer sales on credit. Finally, by placing the responsibility for merchant misbehavior with those who are responsible for, and profit from, the operations of the

\textsuperscript{50} The Master Charge contract provides:
13. Member agrees that:
(b) Representatives of Town & Country or any Issuer may, during normal business hours, inspect, audit and make copies of Member's books, accounts, records and files pertaining to Charge Card sales and refunds or adjustments thereon, and Member agrees to preserve its records of any Charge Card sale and any refund or credit adjustment thereon for at least one year from date of such refund or adjustment. It is assumed that the depository bank would be a "representative" of Town & Country as contemplated by this clause. If not, it is because the Town & Country system determines that the depository bank should not be. Obviously, there would be no barrier to the appointment of the depository bank as representative if Town & Country determined to do so.

\textsuperscript{51} Brandel & Leonard, \textit{supra} note 5, point out that the only positive way to keep a merchant out of the system would be for all depository banks to conspire to keep him out. But then, the authors point out, the banks may well be in violation of the Sherman Act. Short of conspiracy, however, local banks may exchange information about merchants excluded by any local bank. While this would not preclude a bank from taking on a merchant previously dropped by another bank, it would notify the bank soliciting the merchant of the risks involved in doing so.
merchants under the plan, the bank card system will fulfill the justifiable expectations of those who use the cards as consumers.

**Senate Bill S.652**

It is contended that the present situation is not acceptable in that, as a practical matter, no avenues exist for the aggrieved consumer to present the merits of his case to anyone other than his immediate adversary, the merchant. As a result, the cashless consumer economy, at least in its embryonic stage, is morally out of balance. It provides no effective means to allocate economic losses to the parties at fault when the merchant fails in the underlying sales obligation. True enough, the same problem presently exists as to the cash sale, but it would seem shortsighted not to explore possible solutions to this problem in the credit card transaction merely because no practical solution exists for the cash transaction. Even the most ardent advocate of the banking and business interests would not contend that a consumer with a valid claim or complaint *should* be denied an opportunity to present the merits of his claim. The problem, of course, is in balancing the general interests of other consumers, merchants and banking interests in the convenience and economy of the charge card transaction against the interests of those consumers who are victims of merchant abuse.

Senate bill S.652, recently introduced by Senators Proxmire and Brooke,\(^2\) represents the most recent legislative attempt to balance the competing interests referred to above. The provision of that bill which deals with the preservation of consumer defenses in the credit card sale was defeated by a vote of 46 to 35 on April 27, 1972.\(^3\) That bill, in pertinent part, provided:

A card issuer who has issued a credit card to a cardholder pursuant to an open-end consumer credit plan shall be subject to all claims (other than tort claims) and defenses arising out of any transaction in which the credit card is used as a method of payment or extension of credit if (1) the obligor has made a good faith attempt to obtain satisfactory resolution of a disagreement or problem relative to the transaction from the person honoring the credit card; (2) the amount of such initial transaction exceeds $50; (3) the place where the initial transaction occurred was in the same

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53. *Id.* at 6900-01.
State as the State in which the card issuer maintains a place of business; and (4) the amount of claims or defenses asserted by the cardholder does not exceed: (a) the initial amount of credit extended in connection with the initial transactions giving rise to the claim or defense provided the cardholder notifies the card issuer or person honoring the card of such claim or defense within three months from the date of such transaction; or (b) if the cardholder notifies the card issuer or person honoring the card of such claim or defense later than three months following the date of such transaction, the amount outstanding with respect to such transaction at the time of such notification. For the purpose of determining such amount outstanding in the preceding sentence, the payments and credits to the cardholder's account are deemed to have been applied, in the order indicated, to the payment of: (i) late charges in the order of their entry to the account; (ii) finance charges in order of their entry to the account; and (iii) debits to the account other than those set forth above, in the order in which each debit entry to the account was made.

Objections to the bill, expressed during the debates which took place in the Senate, indicated five major problems:

(1) The change to the cashless economy would be impeded. Senator Tower, fearing that any added burdens on the bank card plans might jeopardize their continued existence, pointed out that the plans "improve the delivery of purchasing power throughout the economy"54 by releasing "large sums of capital that are tied up in the mechanics of cash use, storage, and transfer."55 Further, Senator Tower pointed to the usefulness of the cashless economy in preventing or deterring "violent economic crimes."56 Neither of these advantages is to be underestimated. However, there are concomitant disadvantages in the bank card transaction. The cash transaction has two inherent consumer protections which will be lost with the transition to the credit card economy. In a cash sale, the economic limitations of a given consumer are a natural bar to overreaching by that consumer: if he has no cash, he cannot buy anything. More-

54. Id. at 6896.
55. Id.
56. Id.
over, even if he has a very strong urge to make a purchase, and
determines to borrow money to do so, the mechanics of the true
direct loan transaction provide a built-in "cooling off" period during
which the consumer is likely to give some consideration to his total
financial capabilities. The credit card transaction provides no such
deterrent to overreaching by the consumer.

(2) It is not reasonable or practical to require banks to police
the business practices of merchants. Senator Brock objected to the
Proxmire bill on the basis that it could not adequately protect con-
sumers. Senator Brock presented a hypothetical situation involv-
ing a small issuing bank in Mountain City, Tennessee and a mer-
chant in Memphis, commenting that the Mountain City bank "can-
not exclude that merchant because he does not know him, never
heard of him, never saw him, and never will." Here it may first be
pointed out that it is not the card-issuing bank (which may be
thousands of miles away) that must face the burden of enforcing
standards of business practice upon the merchant. Rather, as indi-
cated above, it may be the depository bank which brought the
merchant into the bank card plan and which has a contractual right
to review the books of the merchant at any time. Furthermore,
even the depository bank is not necessarily bound to spend an inor-
dinate amount of time reviewing sales procedures, since that bank
retains the option of charging back sales slips to which consumer
defenses have been asserted. It is only when the merchant involved
is insolvent or otherwise unavailable that the depository bank must
stand the loss resulting from the successful consumer defense, and
even this possibility may be largely avoided by requiring an ade-
quate reserve account to be left on deposit by those merchants
whose financial standing may seem questionable. Finally, since
the depository banks require by contract that associated merchants
meet certain sales standards, the bill would do no more than re-
quire the banks to enforce their own contracts.

57. See Note, A Case Study of the Impact of Consumer Legislation: The Elimination
59. Id.
60. See Brandel & Leonard, supra note 5, at 1046.
61. See note 50 supra and accompanying text.
62. See note 50 supra.
63. See note 41 supra.
64. See Note, supra note 3, at 297 & n.42.
65. The Master Charge Merchant-Bank agreement provides: "12. Member shall estab-
(3) **This is a state problem and may have different ramifications for different states.** Senator Tower, speaking in opposition to the bill, indicated that the "area of consumer remedies against merchants is normally one governed by State statutory and common law . . . ." Senator Tower further stated that "it would be wiser to continue to allow the States to control the law in this area and to shape it according to their own respective needs and concerns." Anticipating this objection, Senator Proxmire made a rather clear showing of the national scope of the bank credit card business in presenting his bill to the Senate. Charge cards are used and accepted in all 50 states, and Proxmire pointed out the "confusing and chaotic" situation which exists and will continue to exist while each state maintains a separate policy regarding use of the cards and the legal relationships resulting. In the last analysis, it may be said with some certainty that no state will have or assert an interest in continuation of consumer fraud. If national legislation is drafted which will limit or reduce such fraud while protecting the continued existence of the bank card system in some meaningful way, no peculiar state interests will be threatened.

(4) **Preserving defenses will require a tightening of standards for cardholders and merchants, thus prejudicing the little guy and the small businessman.** Senators Brock and Tower pointed out that credit card financing is critical to many small businesses and that it is these businesses that serve consumers lowest on the socioeconomic scale. According to the Senators, it would be these marginal credit risk consumers who would suffer as a result of the proposed legislation. It is submitted that the requirements for participation in the plans by cardholders are not likely to change in any significant way as a direct result of preservation of consumer defenses. The issuing bank is basically interested in the ability of the prospective cardholder to meet his obligations as they come due. There is no reason to believe that preservation of defenses will affect this primary consideration, particularly since the "little guy" referred to by Senator Tower is the least likely of all cardholder applicants to be

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lish and maintain a fair policy for the exchange or return of, or adjustment on, merchandise or services sold in Charge Card sales."

67. Id.
68. Id. at 6894.
69. Id.
70. Id. at 6898.
71. Id.
aware of his rights, or to use them even if defenses are maintainable.\textsuperscript{72} There is, however, likely to be some tightening of requirements for merchant participation in the plans, at least with respect to the financial reserves necessary to enter the system and deposit reserves necessary to remain there.\textsuperscript{73} The banks will naturally be interested in limiting the number of merchants in their plan who become insolvent.\textsuperscript{74}

(5) \emph{This should be viewed as a direct loan/cash sale.} Senator Bennett, arguing against any analogy to the holder-in-due-course situation, characterized the bank card sale as a direct loan/cash sale transaction.\textsuperscript{75} The analogy to the cash sale has been touched upon previously.\textsuperscript{76} The analogy is objectionable both in terms of its accuracy and in terms of its philosophical underpinnings. In the true direct loan transaction there is, as pointed out above, a built-in "cooling off" mechanism. Moreover, in the credit card situation, only selected merchants may honor the card, and these merchants are at least tacitly endorsed by the bank card system with which they affiliate.\textsuperscript{77} The system determines where the "new money"\textsuperscript{78} may or may not be spent, and the system has continuing contractual control of the financial and sales policies of the merchants which will honor the "new money." The bank which makes a true direct loan has no such control over the merchants to be patronized with the proceeds of the loan, and makes no such endorsement of particular places of business. Furthermore, the fact that consumers have no practical remedies in the cash sale does not sanctify this disparity in bargaining power. It is a necessary evil of the cash sale transaction, and there is no requirement that the "cashless society" re-

\textsuperscript{72} See note 47 supra.

\textsuperscript{73} These requirements are not likely to be unreasonably high, however, since the statistical risk of merchant misconduct \emph{and} insolvency coinciding should not be expected to amount to an overriding consideration when weighed against the benefits of increased participation in the system.

\textsuperscript{74} The resulting scrutiny will avoid allowing the card plans to become a device for the shady operator to ply his trade with a minimum of personal risk, as may presently be the case. See note 12 supra.

\textsuperscript{75} 118 \textsc{Cong. Rec.} \textsc{S}6900 (daily ed. April 27, 1972).

\textsuperscript{76} See notes 31-38 \textsuperscript{supra} and accompanying text.

\textsuperscript{77} In fact, one of the theories used in Payne v. United California Bank, 23 Cal. App. 3d 352, 100 Cal. Rptr. 672 (1972) (discussed in note 12 \textsuperscript{supra}) was negligent misrepresentation for this very "endorsement." Plaintiffs there relied on Hanberry v. Hearst, 276 Cal. App. 2d 820, 81 Cal. Rptr. 519 (1969), a case involving the Good Housekeeping Seal, where the endorsement of defective shoes resulted in liability for the endorser.

\textsuperscript{78} See note 31 \textsuperscript{supra}.
tain these inequities. It seems incredible that this fact is asserted as a *justification* for imposing defense cutoffs under the new system. This is particularly so if, as predicted, the credit card replaces those financing arrangements in which the consumer is now protected.\textsuperscript{79} For the consumer, such a "cashless society" would be bittersweet, at best.

**A Proposed Statute**

It is clear that some solution must be found that will reasonably protect the consumer in the bank card sale, but will at the same time be acceptable to the commercial interests and compatible with the continued growth of the bank card phenomenon. With this in mind, the following statute is offered for consideration:

A. A card issuer who has issued a card to a cardholder pursuant to an open-end consumer credit plan shall be subject to all claims (other than tort claims) and defenses arising out of any transaction in which the credit card is used as a method of payment or extension of credit for the purchase or rental of durable consumer goods if:

(1) The obligor has made a good faith attempt to obtain satisfactory resolution of a disagreement or problem relative to the transaction from the person honoring the credit card by promptly notifying that person of the details of the complaint and by offering to return the purchased item for full refund;

(2) The obligor has promptly notified the issuing bank or association of the details of the dispute;

(3) The amount of claims or defenses asserted by the cardholder does not exceed: (a) the initial amount of credit extended in connection with the initial transaction giving rise to the claim or defense, provided the cardholder notifies the card issuer and the person honoring the card of such claim or defense within three months from the date of such transaction; or (b) if the cardholder notifies the card issuer and person honoring the card of such claim or defense later than three months following the date of such transaction, the amount outstanding with respect to such transaction at the time of such notification. For the purpose of determin-

\textsuperscript{79} See notes 10, 33, 37, *supra*.  

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ing such amount outstanding in the preceding sentence, the payments and credits to the cardholder’s account are deemed to have been applied, in the order indicated, to the payment of: (i) late charges in the order of their entry to the account; (ii) finance charges in order of their entry to the account; and (iii) debits to the account other than those set forth above, in the order in which each debit entry to the account was made.

B. It is further provided that: (1) the prevailing party in any action in which claims or defenses are raised pursuant to this section may, in the sound discretion of the judge, be awarded costs of litigation and incidental costs; and (2) if as a result of notification of the card issuer of the details of the dispute, the card issuer, through its associate institutions, charges back the obligation to the person honoring the card, that person may, if he prevails in a suit on the obligation against the cardholder, recover attorney’s fees and incidental costs, including any chargeback fees, which fees and costs may be awarded in the sound discretion of the judge.

The proposed statute is patterned after the Proxmire-Brooke bill with several significant alterations and additions. For convenience, the provisions of the bill will be discussed in the order in which they appear.

The language of the first paragraph has been retained virtually intact except for the addition of language limiting the application of the bill to transactions involving the purchase or rental of durable consumer goods. Liability for any tort claims is specifically excluded, as it was in the Proxmire bill, to avoid the possibility of any products liability actions involving the credit card plans. The limitation to durable goods avoids unmanageable controversies involving dissatisfaction with food, motel accommodations and personal services. Though there may be situations involving nondurable goods or services which would lend themselves to the suggestion that the card systems should shoulder some responsibility in these areas as well, it is believed that a more moderate approach in the initial stages is warranted. If, after the card plans have operated under the proposed statute for some significant period of time, it becomes clear that a specific type of nondurable good or service presents a problem of continued abuse, properly limited and specific
extensions of liability may be considered. The proposed statute is not intended to be an ultimate cure-all, but rather a reasonable and manageable first step in protecting the consumer in the majority of credit card transactions.

Paragraph A (1) represents an amended version of the same paragraph in the Proxmire bill. The concept of "good faith attempt" is embellished in two significant respects, however. The requirement of prompt notification is intended to limit the liability of the bank card system to those claims pursued with reasonable diligence. Under no circumstances will claims or defenses be protected when the consumer has prejudiced any party involved by careless or undue delay. Similarly, by requiring the consumer to offer to return the disputed merchandise for a refund, the statute avoids placing the depository bank or merchant at an unconscionable disadvantage when dealing with a consumer located some distance away. The merchant always has the relatively inexpensive option of treating the transaction just as any other "return" transaction if he so chooses. Moreover, those consumers who intend to bilk the merchant or card system by keeping the merchandise and conducting sham negotiations are unlikely to be inclined to offer an immediate return of the merchandise as the first step in their plan. If they do not do this, however, they are not covered by the statute and stand in the same position as they would today. Thus the paragraph in large measure screens out the more common opportunities for consumer abuse of the statute.

Paragraph A (2) requires prompt notification to the issuing bank of the details of any dispute in which the cardholder intends to withhold payments. Such notification allows the card system to look into the dispute as promptly as possible and to avoid any undue accumulation of identical problems in the case of the more obvious merchant abuses. Prompt notification will facilitate an early discovery of such practices and a more efficient "weeding out" process by the card system involved. It also allows the bank card system to enter or facilitate any negotiations for settlement at their very incep-

80. Clearly, most consumers, even the dishonest ones, will be unaware of the right to assert defenses under the statute. Those who do take the time to read and digest the provisions of the statute will be aware that sham tactics will result in forfeiture of any rights provided by the statute and will in addition subject them to liability for legal fees. In either case, the statute will not encourage consumer abuse; indeed it may reduce some kinds of abuse.
tion, and to exert whatever influence they can toward a proper compromise.\textsuperscript{81}

Paragraph A (3) is adopted verbatim from the Proxmire bill. In essence, it limits liability under the statute to those defects which are immediately apparent to the consumer, or nearly so. For the considerable number of bank card holders who routinely pay bank card billings within the billing period or within a period of 90 days or less, there is, in effect, a three month statute of limitations for the assertion of any claims whatever against the card issuer. In such cases, only the very obvious and outrageous instance of merchant abuse, such as failure of delivery, delivery of substituted goods or delivery of obviously defective goods is likely to prompt the consumer to give required notice and proceed with a lawsuit. Even in those cases in which payments are extended over the longest possible period, the average transaction will be paid up within a relatively short time since minimum payment requirements assure that at least ten dollars will be paid on account each month.\textsuperscript{82} Quite plainly, the card system is not being placed in the position of warrantor of consumer goods, but is rather being required to take some responsibility for only the most obvious and immediately apparent merchant abuses.

Section B (1) provides for recovery of costs of litigation when the judge deems it appropriate. This provision should have a substantial effect on the amount of consumer abuse of this statute. For example, if a consumer decides to refuse to pay for a given purchase without any substantial defense, the bank may initially threaten litigation and point out the cost recovery provision to the reluctant consumer. If this does not have any effect, the filing of a lawsuit will in most cases result in a default judgment just as it does now. In order to avoid default, the consumer will have to consult an attorney. That attorney may be expected to be quite reluctant to invest any significant amount of his own time on anything other than a cash-in-advance basis when the total amount in controversy is less than the legal fees he expects to generate. At that point in time the consumer may be expected to come to grips with the economic

\textsuperscript{81}. The bank is likely to be an impartial mediator in these situations, since it stands to profit from continued association with both parties; the mere presence of the bank card system in negotiations will also prompt those merchants and cardholders who value the credit card privilege to negotiate earnestly and in good faith.

\textsuperscript{82}. Both Master Charge and Bank Americard require minimum payments of $10 or five percent of the outstanding balance, whichever is the greater amount.
shortcomings of his original plan. Given the choice of defaulting and thus being forced to pay, or making voluntary payment with a view to reconciliation with the card issuer (if only to keep the card long enough to refine his scheme), a good number of these originally reluctant consumers may be expected to pay voluntarily.

Section B (2) provides that the merchant who has a bank card billing charged back to him may also recover costs of suit in appropriate instances, and again the purpose of the provision is to make the pursuit of just claims economically feasible and to insure against consumer abuse of the privilege of asserting defenses. In addition, by providing for recovery of chargeback costs, if any, the statute provides a mechanism for recoupment of some portion of the administrative and clerical costs of the chargeback process when the merchant is not at fault in the dispute.

It will be noticed that the limitation of claims to those of $50 or more in value has not been included in the proposed statute. Since the average credit card transaction is for an amount of about $20, such a limitation would exclude the vast majority of credit card transactions from the provisions of the statute. More importantly, such a limitation would take the small-scale swindle out of the range of the statute, even when joinder of claims or the establishment of a proper class of plaintiffs would place hundreds or thousands of dollars in controversy. It would seem that a more reasonable approach to the problem of the smaller transaction lies in the provisions for recovery of litigation expenses as opposed to any arbitrary dollar limitation. Given the rather persuasive economics involved in asserting a claim or raising a defense in a court of law, it is extremely unlikely that individuals will be utilizing the statute in small transaction situations unless the merchant abuse has been extreme or aggregation of claims has taken place.

Similarly, the proposed statute contains no geographical limitation. As indicated above, allocation of responsibility for merchant abuses to the depository banks within the charge card system will eliminate problems which would ordinarily be faced if the issuing banks were responsible. When disputed billings are charged back to merchants located a considerable distance from complaining consumers, the provision for recovery of fees and costs will allow pursuit of justifiable claims by those merchants. Finally, the merchant has

83. Brandel & Leonard, supra note 5, at 1038.
the option of avoiding any litigation by accepting the consumer's offer to return the merchandise for a refund. Given these alternatives, both the bank card system and the merchant have the means to prevail in those cases in which they are innocent of any wrongdoing.

In total effect, the proposed statute provides a mechanism for innocent parties in a charge card dispute to transfer losses to those parties most nearly responsible. On a theoretical level the proposed statute, unlike the existing arrangement, provides a fair result in every situation in which the offending party is present and amenable to suit. It further provides an incentive for those within its provisions to limit abuses, and by doing so, promotes a more healthy and honest business climate for the developing credit card economy. Most importantly, it complies with those fundamental notions of justice universally understood by the lay public, and thus promotes respect for our economy and our laws, a distinction neither claimed nor enjoyed by the present legal concepts.