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BANK CHARGE CARDS: NEW CASH OR NEW CREDIT

Roland E. Brandel* and Carl A. Leonard**

I. INTRODUCTION

BANK charge cards have become a subject of interest only recently, but that interest has been intense. They have provided the impetus for legislative inquiry and statutes at both the state and federal levels, and hearings and regulations by such agencies as the Federal Trade Commission and the Federal Reserve Board. Many articles are appearing in both the mass media and professional journals, not all of which, at the risk of significant understatement, have been flattering to the charge card industry. Urgings to suppress the “plastic menace” are not uncommon.

The entire concept of bank charge cards and interchange systems is novel, imaginative, and complex. Those who innovated learned rapidly, albeit painfully, from that best of teachers, experience. The early experiences have induced many changes in the business practices of the bank charge card industry. Because of the explosive nature of the growth of the industry, much of the material describing the industry and much of the legislation directed toward it has dealt with historical problems, not with the industry’s current condition. By the time the author of an article or a legislative proposal has accumulated the relevant facts and statistics, his data may no longer reflect the current status of the industry.

This Article will deal with one highly controversial aspect of the use of bank charge cards: the issue whether a consumer who purchases goods or services from a merchant and pays for them by using a bank charge card should be able to assert against the bank that issued the charge card legal defenses that he may have against the merchant. It will also describe, as of the present, the operations of the bank charge card industry’s highly sophisticated credit extension and payment system. More importantly, to stave off instant obsolescence, it will describe some discernible trends that should be con-

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The law firm with which the authors are associated represents banks and a regional service association involved in charge card programs. The authors have sought objectivity, but cannot guarantee the result as being free from bias. The views expressed are not necessarily held by any segment of the bank charge card industry.
sidered in arriving at a proper resolution of the principal issue under discussion, so that the resolution will serve as well the near term future as it does the present.

The issue is ripe for resolution. Most states have not yet dealt with the issue of the assertability of consumer defenses in the bank charge card context, but cases raising the issue are now being litigated. The Massachusetts legislature recently dealt with the problem, as did the National Consumer Act and the Uniform Consumer Credit Code, which took very different approaches to it. Legislation on the issue has been introduced in Congress and in the State of New York and is likely to be introduced in other state legislatures in the near future. The Federal Trade Commission has recently promulgated a proposed rule on the preservation of buyer’s defenses.

It is the premise of this Article that the bank charge card systems constitute a new, highly useful, and efficient payment and credit mechanism; that any decision-making body that promulgates a rule on the issue of the assertability of consumer defenses must carefully evaluate the true functions of bank charge cards, particularly their role as part of a sophisticated payment mechanism, and weigh the relative interests of the consuming public, merchants, and members of the banking industry to derive the best solution for society; that courts are ill-equipped to perform this function; and, that, given the national and international usage of bank charge cards, a uniform rule is imperative. The Article will first analyze each of these premises and then proceed to suggest a rule that seems effectively to balance the various interests involved.

II. OPERATIONAL ASPECTS OF BANK CHARGE CARD SYSTEMS

It is of little use to attempt to evaluate proposed rules relating to bank charge card systems unless one understands the processes involved and economic realities inherent in their operation. Wonderfully consistent and persuasive arguments can be constructed by
consumer advocates on the one hand and by commercial interests involved in bank charge card transactions on the other by simply ignoring some important aspects of the relationships between the many parties to a charge card transaction. What follows, then, is an analysis of how bank charge card systems operate and some indication of predictable future modifications of those systems.

Paramount among the several parties to bank charge card transactions is a bank (issuer) that issues charge cards to the public. The issuer establishes an account on behalf of the person (cardholder) to whom the card is issued, and the cardholder and issuer enter into an agreement that governs their relationship. The cardholder agreement establishes a line of credit under which the cardholder may incur obligations to the issuer by a purchase of goods or services or through a cash advance. Typically, it provides two options to the cardholder: he may either make payment in full within a specified period after being billed, free of finance charges, or he may defer payments. At the time of the transaction, the cardholder may not have decided which option he will use; his decision may readily be deferred until the time the initial payment is due. The cardholder must then decide whether to use his card as a mere medium of exchange or "convenience card," or whether to assume the role of a borrower with respect to the issuer.

Merchants enter into agreements with any bank (depositary bank), wherever located, that is a member of the interchange system to which the issuer belongs. These agreements enable them to accept evidences of obligations of the cardholder to the issuer (sales slips) as payment for goods and services. Typically, the merchant agreement will provide that the merchant must honor all charge cards issued by a member bank of the interchange system that are properly presented to him to pay for goods or services. The merchant must also perform certain routine clerical acts in filling out the sales slip. He will typically then deposit the sales slip in an ordinary checking account at

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5. Bank charge card transactions are referred to in this Article as multiparty: they involve a consumer, a merchant, and, frequently, two or more banks. This reference serves to distinguish them from seller charge card plans and tripartite plans such as Diners Club. Although the term "tripartite" has been used in some literature to distinguish bank charge card transactions from two-party, or seller, charge card plans, we will not refer to bank charge card transactions as tripartite in this Article. Such a reference would obscure an important point—that most bank charge card transactions are multiparty—which is crucial to a proper understanding of the relationship of the parties.

6. A cash advance involves a direct disbursement of cash to a cardholder by a bank.

the depositary bank with which he has a merchant agreement and will receive a credit to his account just as if he had deposited cash or a check. The depositary bank will clear and forward any sales slips deposited with it through an interchange system in much the same fashion that checks are cleared. The sales slip will be forwarded to the issuer to be charged to the account of the cardholder who incurred the obligation to the issuer in the transaction with the merchant. The issuer will then periodically bill its cardholder.

Banks become part of an interchange system by agreeing among themselves to abide by certain rules and regulations that prescribe the techniques and conditions under which the interchange process will operate. These rules and regulations serve the same function for charge card systems as the rules of the city check clearinghouse associations, the Federal Reserve Collection System, and article 4 of the Uniform Commercial Code provide for the check system.

The depositary bank and the issuer may be separated by thousands of miles, and the interchange clearing process may involve two or more regional clearing associations and several banks. For example, assume that an Ithaca, New York resident who is on vacation and who possesses a charge card issued to him by his local bank purchases goods from a Redding, California merchant who has entered into a merchant agreement with a depositary bank in Redding. The sales slip generated from that transaction would be deposited by the merchant in his account in the Redding depositary bank; the depositary bank would forward the sales slip to the western regional charge card association to which it belongs; the western regional association would transmit the slip to an eastern regional association, which in turn would forward the slip to the Ithaca issuer for debiting to the cardholder's account.

This wide-ranging consumer convenience has been made economically feasible by the establishment, within the framework of charge card systems, of an account for the consumer against which multiple drawings may be made and by the use of highly advanced technology in administering such systems. A charge card system must be highly efficient to exist: the cost per transaction must be low or the public could not afford to pay for the convenience offered.

8. See note 10 infra.


10. See generally Coha, Credit Card Pace Accelerates, BANKERS MONTHLY, Oct. 15, 1968, at 21; Fed. Reserve Sys., REP., supra note 7, at 9-10, 24-25; Franklin, Significance of Interchange for Bank Credit Card Plans, BURROUGHS CLEARING HOUSE, Aug. 1968, at 28; Stevens, The Expanding Role of Bank Charge Card Associations, BANKING, Nov. 1968, at 47. Clearing can be more involved when correspondent or affiliated banks are interjected into the process.
Costs within the systems may be decreased through economies that are administrative in nature. Only one review of credit-worthiness need be made—at the time the account is established—in contrast to separate credit inquiries that would have to be made if separate loans were involved in each transaction. Although several extensions of credit may have been charged against an account, only one billing per cycle need be made, thus affording the system the same operating economies as those achieved in services now offered to consumers wherein they can consolidate their separate debts.\textsuperscript{11}

The primary economies, however, are achieved by highly automated data processing systems used in clearing and accounting for charge card transactions. Such devices as optical scanners, encoders, readers, and computers are employed so that sales slips can be machine processed free of the interruption, errors, and high cost attributable to manual processing. Computers balance accounts automatically between banks, adjust cardholder accounts, and calculate any applicable finance charges; they also analyze rapidly, process, and disseminate information regarding abnormal activity in the use of a charge card, thereby lowering the potential for financial loss by users and operators of charge card systems resulting from criminal activity. The resultant smooth, low-cost flow of machine processable paper is a prerequisite for this consumer service.\textsuperscript{12} With rapid developments in the industry, however, even the sales slip is already becoming an anachronism because of the expense involved in its processing. Prototype equipment exists that would eliminate the transfer of documents; such equipment will soon allow a charge card transaction to take place electronically, instantly.\textsuperscript{13}

\section*{III. Use of Charge Cards Has Produced Significant Public Benefits}

Bank charge card systems are new: they achieved significant market impact as recently as 1959 with the advent of the BankAmericard.\textsuperscript{14} Master Charge cards followed in 1967. The operations of

\begin{footnotesize}
\begin{enumerate}
\item Bergsten, \textit{Credit Cards—A Prelude to the Cashless Society}, 8 \textit{B.C. IND. & COM. L. REV.} 485, 513-17 (1966-67).
\item See text accompanying notes 64 & 65 infra. Examples of the possibilities for discarding the sales slip are contained in the report of the Special Committee on Paperless Entries (SCOPE) appointed by the Los Angeles and San Francisco Clearing House Assocations, dated August 24, 1970, and a procedural guide prepared by that committee. Some of the first applications proposed therein, such as automatic payment of insurance premiums and utility bills, are already being contemplated as natural extensions of bank charge card use.
\item Comment, supra note 7, at 462.
\end{enumerate}
\end{footnotesize}
these two major bank charge card interchange systems are now international in scope.\textsuperscript{15} Banks belonging to the Master Charge interchange system, for instance, number more than 5,000, operating offices in forty-nine states and many foreign countries throughout the world.\textsuperscript{16} Banks issue cards in most of these jurisdictions and merchants in all of them accept the charge card as a medium of exchange in the same way they accept cash. In the Master Charge system alone, the merchants that will accept Master Charge cards now number approximately 625,000 and member banks have outstanding 36 million charge cards.\textsuperscript{17} During 1970, more than 6.1 billion dollars in sales in the United States were attributed to all bank charge cards in more than 320 million separate transactions.\textsuperscript{18}

Bank charge card services have received a truly phenomenal acceptance by the public in a short period of time. They have been viewed by many analysts as an innovation that will eventually replace the use of money or checks as a medium of exchange in consumer transactions.\textsuperscript{19} Our present system of cash payment, it is said, will soon be viewed as being as archaic as the barter system of days gone by now appears to twentieth century man. Even now it is apparent, both by virtue of the universal acceptance of bank charge cards and the advantages of their use, that they are a device of significant utility to consumers, businessmen, and banks alike.

In the near future, charge cards will be used to actuate electronic-input terminals at retail establishments, thereby eliminating the costly transfer of documents.\textsuperscript{20} Electronic-terminal devices are cur-

\textsuperscript{15} See, e.g., Fukushima, Japan Joins the Rush to Credit Cards, BURROUGHS CLEARING HOUSE, Nov. 1968, at 32; Matthews, French Succumbs to Credit Card Trend, BURROUGHS CLEARING HOUSE, July 1969, at 28; Main Money Cards for UK Residents, BANKER, Feb. 1970, at 230; Bank Credit Cards Going International, BURROUGHS CLEARING HOUSE, Aug. 1968, at 54; New Look in Credit Cards, FINANCIAL WORLD, Jan. 8, 1969, at 11; San Francisco Chronicle, July 13, 1970, at 18, col. 2.

\textsuperscript{16} Interbank Card Association, 1970 Fourth Quarter Statistical Summary, on file at the offices of the Michigan Law Review.

\textsuperscript{17} Id. Federally insured commercial banks had nearly 60 million credit cards outstanding at the end of 1969. Hearings pursuant to H.R. Res. 66 Before the Subcomm. on Special Small Business Problems of the Select Comm. on Small Business, 91st Cong., 2d Sess. 150 (1970).

\textsuperscript{18} See note 16 supra; San Francisco Chronicle, Feb. 10, 1971, at 59, col. 5. The number of separate transactions was derived by dividing total amount of sales revenue by an average transaction amount of $19.

\textsuperscript{19} See generally Chait, Marketing in the Money Card Society, CALIF. MANAGEMENT REV., Fall 1968, at 8; Dunne, Variation on a Theme by Parkinson or Some Proposals for the Uniform Commercial Code and the Checkless Society, 75 YALE L.J. 788 (1966); Weiss, Automatic Vendor Poises for Credit Card Blast-off, ADVERTISING AGE, Feb. 17, 1969, at 52; Describes Checkless Society of Future, Impact on Insurance, NATIONAL UNDERWRITER (Life and Health Insurance ed.), Nov. 2, 1968, at 15.

\textsuperscript{20} It has been estimated that, in 1967, nearly 20 billion checks were cleared at a
recently being tested in conjunction with food vending machines, airline reservation and charge systems, and self-service gasoline stations. These developments indicate that charge cards will, in the near future, play a principal role in the establishment of an electronic money-transfer system. It has been predicted that these developments will lower retail costs to the benefit of everyone.\footnote{21}

Consumers receive the major benefits to be derived from the use of interchange charge cards. They may carry a single charge card instead of many cards or money. A consumer using his card internationally is not subjected to the vexations of exchanging currency as he travels from one country to another; the card in that respect amounts to an internationally recognized unit of currency. A consumer is also provided with a well-documented record at the end of every month of goods and services that he has purchased during that month. Moreover, he need not worry about great personal financial loss as a result of theft, fire, or other misfortune, which loss would be a disaster if it involved money, but would be a mere inconvenience if it involved his charge card.\footnote{22} Nor need the consumer worry about the supply of cash in his pocket at a given moment in time as charge cards become more universally accepted as a medium of exchange. The consumer need no longer adjust his on-hand cash position daily; he need only balance his cash position on a cyclical basis, typically monthly.\footnote{23}

Cardholders seem to view most charge card transactions as replacements for payment in cash. A cardholder expects to receive goods and services upon presentment of his charge card just as he would upon presentment of cash, and he expects them upon the same terms. By using a charge card he is not subject to any of the inconveniences or costs associated with the use of secondary means of payment, such as travelers checks or personal checks, the latter of which may frequently be unacceptable even in the locality in which the cardholder resides and most certainly will be unacceptable on a national or international basis.

\footnote{21}{Weiss, supra note 19, at 58.}

\footnote{22}{Consumer responsibility for loss resulting from unauthorised use of his credit card is limited by federal legislation, 15 U.S.C. § 1643 (1970), and, in some cases, state legislation. See, e.g., CAL. CIV. CODE § 1718 (West Supp. 1971); ILL. ANN. STAT. ch. 121-1/2, § 381-82 (Smith-Hurd Supp. 1971).}

\footnote{23}{Davenport, supra note 11, at 961; Fed. Reserve Sys., Rep., supra note 7, at 87-88. National advertising for both the Bank Americard and Master Charge plans emphasizes the responsible use of the charge card and its utility as a money management device. AMERICAN BANKER, March 10, 1971, at 1, col. 3.}
Merchants also benefit from the acceptance of charge cards and are willing to treat a charge card transaction as a replacement for cash payment. They are typically protected by the terms of their merchant agreements from risks associated with accepting payment in a noncash form. For instance, they avoid certain risks associated with the acceptance of a check in payment, such as the risk of forgery or lack of funds in the purchaser’s checking account. The acceptance of a bank charge card may be even safer than acceptance of cash itself in that the merchant is also protected from the risk of counterfeit. A merchant knows that he will receive an immediate credit in his demand deposit account when he deposits a sales slip, just as he would if he deposited cash. Merchants are also freed from the risk of theft in a day when crime is increasing. So valued is this feature by some that certain businesses, which have traditionally been plagued by a high rate of theft, have begun to accept only correct change or charge cards during hours of special risk.

Finally, in those instances in which the cardholder purchases goods or services and then decides to exercise his option to repay in installments, the extension of credit is accomplished more economically than if the merchant had operated his own charge program or if the bank had extended a series of separate loans to cover the cost of the goods or services purchased. Such lower costs probably benefit the consumer in the form of lower prices for the products and services he purchases.

Such, then, is the business context in which the question arises whether a consumer should have the right to assert against the bank that issued his charge card defenses that he may have against a merchant. Because of the recentness and the uniqueness of bank charge card services, there is little statutory or case law that is directly applicable to the complex relationships that exist among the many parties to charge card transactions. Such relationships have thus far been governed primarily by agreement of the parties concerned. Discussion of the issue, therefore, particularly before the judiciary, has been characterized by attempts to analogize the credit card transaction to similar transactions.

26. Davenport, supra note 11, at 945-47; Bergsten, supra note 12, at 485; Comment, supra note 7, at 459; Comment, Bank Credit Plans: Innovations in Consumer Financing, 1 LOYOLA (L.A.) L. REV. 49, 50 (1968) [hereinafter Comment, Bank Credit Plans].
IV. THE CONSUMER’S POSITION

A consumer has the ability to assert defenses against a merchant’s attempts to collect amounts due and, therefore, enjoys a tactical advantage if the merchandise or services purchased on credit are unsatisfactory. The merchant must take the initiative; he must seek out the consumer for payment. If the consumer is forced to take the initiative to obtain a return of amounts paid, it is argued that he may not be able to assert effectively his rights against merchants because he may have insufficient knowledge or resources to do so. A consumer advocate may recognize the benefits obtainable through use of charge cards; yet he may view bank charge card transactions as a replacement for a direct extension of credit by a retail merchant. Therefore, he would argue that a consumer should possess the same rights against any party seeking to collect amounts due, whether the creditor is a merchant or a bank that has issued the consumer a charge card.

Consumer advocates argue that placing liability on banks will have the salutary effect of inducing banks to police merchants’ activities and that they are in a better position than the consumer to do so. Only financially sound merchants that sell high quality goods and services will be allowed to accept bank charge cards, and consumers will thereby have merchants screened on their behalf. Consumers will therefore presumably enjoy protection from any defect in merchandise purchased, from the bad faith of the merchant in settling a dispute, and from the merchant’s insolvency. Moreover, the mere association of the names and service marks of prestigious banks and their charge cards gives consumers a sense of confidence in the merchants accepting the bank charge cards, and banks should justify that expectation. Finally, the consumer advocate can rely on the seemingly irrefutable premise that banks can better absorb or spread losses than can individual consumers.

Unscrupulous merchants have used various techniques to place on consumers the onus of taking the initiative to resolve any dispute. These techniques have included the assignment to a related third party of the consumer’s obligation to the merchant or the negotiation to a third party of a negotiable instrument executed by the consumer. Such techniques have clearly been used in some instances to deny the

28. As used in this Article, “consumer advocate” refers not only to those persons who have presented the consumer’s position in the courts and the legislatures, but also to those who have presented it—possibly in a more objective manner—in law review articles.

consumer the ability effectively to assert defenses that he may have against a merchant. Such an assignment or negotiation would, in most jurisdictions, free the holder of the obligation from defenses as either an assignee for value or a holder in due course of a negotiable instrument.

Legislatures have taken steps to deprive merchants of these techniques for compelling consumers to bring an affirmative action by interjecting third parties into the merchant-consumer transaction. Simultaneously, courts, at a pace that has varied from jurisdiction to jurisdiction, have been developing theories to support the proposition that a consumer may assert defenses against certain parties who were not sellers, but who hold a promise to pay resulting from a consumer transaction and possess certain special relationships to the sales transaction. It is now being argued, before both judicial and legislative forums, that a consumer's rights in credit transactions should not depend on the form in which the credit is extended and that the consumer should be able to assert against any related party attempting to collect the debt created in a consumer credit transaction defenses he has against the seller. Consumer advocates suggest that the charge card transaction is in reality tantamount to an assignment for value to the bank of the consumer's obligation to the merchant. Characterizing the transaction in accordance with this "assignment theory," they would argue that the credit card sale should be subject to the same doctrines that are being used to penetrate the holder-in-due-course and assignee-for-value defenses in other consumer credit transactions.

The developing doctrines are numerous, but a brief examination of two will be sufficient to demonstrate the foundations upon which they are built. The most prominent of these doctrines is that of denying assignee-for-value or holder-in-due-course status to a financing institution that is too closely connected with the seller's business operations or with the particular sale at issue. A consumer advocate

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30. This doctrine assumes a waiver of such defenses by the consumer in favor of any assignee, a common feature in a sales contract involving consumer credit. See Navin, Waiver of Defense Clauses in Consumer Contracts, 48 N.C. L. REV. 505, 508 (1970).
31. UCC § 3-305.
32. See generally B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION 312-22 (1965).
34. See generally Bergsten, supra note 12, at 509-13; Comment, supra note 7, at 459.
35. See Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967); Commercial Credit Corp. v. Orange County Machine Works, 34 Cal. 2d 766, 214 P.2d 819 (1950); Commercial Credit Co. v. Childs, 199 Ark. 1078, 137 S.W.2d 260 (1940).

The principle to be gleaned from the "close connection" cases seems to be
would point to many indicia of a close business relationship between a bank and a merchant participating in a charge card program. The bank typically maintains a demand deposit account on behalf of the merchant and provides the merchant with machine processable sales slips of uniform size and content, advertising and other promotional material for the charge card program, an imprinter, and applications that customers can use to obtain charge cards. The bank regularly accepts for deposit sales slips generated in charge card transactions. In the case of many merchants, particularly small businessmen, it can be argued that no credit sales whatsoever would have been made in the absence of the bank charge card service because the small businessman simply would have insufficient resources to operate a credit plan.

A related theory that is used to deny the status of an assignee for value or a holder in due course in consumer credit cases is that of knowledge, on the part of the assignee or holder, of the defect in the underlying sales transaction that gives rise to the consumer defense.36 Both a theory based on knowledge and a theory based on close connection accomplish the same purpose, but the burden of proof to be borne by the consumer is substantially less if a close-connection doctrine is accepted. All that need be proved in the latter instance is the business relationship; the subjection of the holder to consumer defenses follows as a direct consequence. The consumer advocate would argue that a cardholder who can show that the bank had knowledge of the defect in his transaction that gives rise to a defense should, consistent with the assignment theory, be able to assert that defense against the bank. Realistically, the number of cases in which a consumer can make such a showing will probably be small since a theory based on knowledge may require that the consumer prove that the relationship between the bank and the merchant resulted in actual knowledge of the facts constituting the consumer defense. In that regard a battle has been fought for some time on the issue whether the proper test for such knowledge is an objective or sub-

The resolution of this question is important since the application of one test or the other would frequently mean a difference between success and failure for the consumer's cause. In at least one instance known to the authors, consumer advocates have argued that banks should be subject to liability for merchants' wrongs under a negligence theory. Such a theory proceeds from the premise that the merchant would not have been able to enter into the consumer transaction at issue absent the culpability of the bank in allowing his participation in a charge card plan; that it is the duty of the bank to investigate a merchant to insure that he is not engaging in questionable practices before allowing him to participate; and that if no investigation is conducted or if it is conducted negligently, the bank should be responsible to the consumer for the ensuing loss. Lender liability under arguably comparable circumstances is not unknown. The California supreme court, for instance, has held that a savings and loan association that provided financing to a contractor for the construction of residential housing could be held liable to home purchasers for defective construction.

A variation of the negligence theory would find a duty to allow the easily identifiable service marks associated with major charge card plans to be displayed only by merchants that have been thoroughly investigated. It has been argued that the display of the service mark places the bank in the position of an endorser. Such was found to be the case when it was held that the owners of the Good Housekeeping Seal could be liable to a consumer who had suffered injury while using a product under circumstances where the Seal appeared on the product or in advertising for the product.

This Article will not attempt to deal with a negligence theory, however, since the theory deviates significantly in its theoretical basis, in the remedy proposed, and in its potential for acceptance from those theories relating to the denial of the status of an assignee for value or holder in due course. A negligence theory would not oper-

37. See cases cited in Littlefield, supra note 36.
38. See Littlefield, supra note 36.
40. Connor v. Great Western Sav. & Loan Assn., 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968). The Connor doctrine received an inhospitable reception in California. The legislature subsequently limited the doctrine, CAL. CIV. CODE § 3434 (West Supp. 1970), and even the judiciary itself seemed to retreat as minor factual distinctions from the facts present in Connor were seized upon to reject the applicability of the Connor analysis. See Bradler v. Craig, 274 Cal. App. 2d 466, 79 Cal. Rptr. 401 (1969).
ate merely to prevent the cutting off of consumer defenses. Rather than providing a shield from the bank's attempts to collect money due resulting from an ability to assert defenses to collection, a negligence theory would operate as a sword by which persons might hold banks liable for personal injury or property damage caused by defective products. Furthermore, given the nature of multiparty charge card interchange systems, a negligence rule would work a curious result. It would not allow the consumer to assert defenses against the bank seeking to collect on the underlying obligation. The bank that would bear the duty arising from a negligence theory of liability would be the depositary bank, which usually would not be the institution seeking to collect amounts due. Hence, such a theory represents a separate and distinct development in consumer law outside the scope of this discussion.

V. THE CREDITOR'S POSITION

While a consumer advocate views a bank charge card transaction as different from a direct extension of credit by a merchant in form only and would advocate a complete disregard of that difference, a creditor advocate would hasten to point out that more than differences in form are at issue. He would note that significant differences exist in the relationships and expectations of the parties to a multiparty charge card transaction in contrast to typical direct credit extensions by a merchant in which the obligation is later assigned or negotiated to third parties.

While the consumer's position rests on the assignment theory discussed above, the creditor advocate would maintain that the assignment theory is simply not applicable to bank charge card plans. As described above, no obligation is created on the part of the cardholder to pay the merchant in a charge card transaction. The cardholder's obligation to pay for the goods or services purchased arises solely out of the cardholder agreement and accrues solely to

43. The term "creditor advocate," like "consumer advocate" (see note 28 supra) will be given an expanded definition in this Article to include those persons who have presented the creditor's position in law reviews as well as in the courts and legislatures.

44. See text accompanying note 34 supra.

45. This is not to say that the assignment theory is never used. Because local laws in some jurisdictions would not permit, as a practical matter, structuring of bank charge card transactions as direct obligations to the issuer, banks have been forced under some circumstances to adopt unwieldy procedures under which they are assigned "sales contracts." Such a situation existed in Utah, for example, where banks operated charge card programs under the state's revolving charge agreement provisions until Utah enacted the UCCC in 1969. UTAH CODE ANN. § 70B-1-101 to -9-103 (Supp. 1969).

46. See text accompanying note 6 supra.
the issuer. Hence, the merchant has no obligation to assign.\textsuperscript{47} The merchant does not evaluate the credit risk involved, assumes no credit risk, and sets no terms upon which credit is granted. To the contrary, he typically has knowledge of none of the terms of the agreement between his customer and the issuer, such as the terms of repayment, length of the free period, deferred-payment schedule, and finance charges. These terms are set forth solely in the agreement between the cardholder and the issuer. The merchant's relationship to the customer is only that of a seller of goods and services, and his responsibility relates only to the quantity and quality of those goods and services.

It is the issuer, frequently thousands of miles distant from the transaction, that sets the terms upon which credit may be obtained, that conducts an initial evaluation of the charge card applicant to determine whether to issue a card, and that conducts an on-going review of the account status. It is the issuer, not the merchant, that assumes the business risks associated with the extension of credit.

A "direct obligation" theory,\textsuperscript{48} then, the creditor advocate would urge, best describes the nature of a multiparty charge card transaction since it recognizes that the cardholder's obligation that is created on the making of a purchase is one owed "directly" to the issuer of the card in accordance with the terms of the cardholder agreement. The Uniform Consumer Credit Code, for instance, implicitly adopts this theory by placing bank charge card transactions in the category of direct loans by financial institutions to consumers.\textsuperscript{49}

Consistent with the direct-obligation theory is the creditor advocate's analogy of charge card transactions to letter-of-credit transactions, which are governed by article 5 of the Uniform Commercial Code.\textsuperscript{50} The multiparty bank charge card transaction appears to be a

\textsuperscript{47} Comment, \textit{supra} note 7, at 499. This assumes a charge card plan that is not specifically structured to accord with an assignment theory.

\textsuperscript{48} See generally Bergsten, \textit{supra} note 12, at 509-13; Comment, \textit{supra} note 7, at 499.

\textsuperscript{49} UCCC §§ 1.301(9), 3.106(3). The Federal Reserve Board came to much the same conclusion in characterizing only the bank, not the merchant, as a creditor in a bank charge card transaction. The merchant is not even viewed as an arranger of credit, much less a creditor, by federal truth-in-lending regulations. Fed. Reserve Bd. Reg. Z, 12 C.F.R. § 226.2(£) (1970). Section 2.407 of the NCA, while reaching a different result than the UCCC, does not appear to dispute this basic premise. It simply includes some direct-loan transactions in the category of credit sales in which the consumer will have a right to assert product related defenses against a creditor. See note 2 supra.

hybrid of the traveler's or "clean" letter of credit and the commercial or documentary letter of credit, although it more closely resembles the latter.51

A commercial letter-of-credit transaction typically involves three parties: issuer, customer-buyer, and seller-beneficiary.52 The rights and obligations of these parties are defined by three separate and independent agreements between buyer and seller, buyer and issuer, and issuer and seller.53 Under the terms of a letter of credit, the issuer engages that it will accept the seller's drafts drawn on the issuer, conditioned upon the seller's tender of document specified by the buyer. The buyer agrees to reimburse the issuer for the amounts of the drafts so presented.

In relying on the letter of credit, the seller-beneficiary looks to the credit of the issuer instead of that of the unknown buyer and typically has no knowledge of the terms of the reimbursement agreement between the buyer and the issuer. In accepting the seller's draft, the issuer must insist on the specified documentation, but it is not required to concern itself with the underlying sales transaction. Once the issuer has accepted the draft, the buyer is obligated directly to the issuer to pay the amount of the draft, regardless of how the contract of sale is performed by the seller.54 Even when only one bank, having contact with both the seller and buyer, is involved in

51. The cash advance feature of bank charge card plans, whereby cash may be obtained directly at the offices of member banks upon presentation of the charge card, performs the identical function of the traveler's letter of credit. Davenport, supra note 11, at 964-65.

52. A letter-of-credit transaction may also involve a fourth party, the confirming bank, which is located in the area in which the seller-beneficiary is domiciled. The confirming bank is instructed by the issuer to hold itself out to the seller as being responsible for the seller's drafts drawn in accordance with the credit. See W. Ward & H. Harfield, BANK CREDITS AND ACCEPTANCES 25-26 (4th ed. 1958). In this respect, the confirming bank performs the function of the depositary bank in charge card transactions.

53. See generally W. Ward & H. Harfield, supra note 52, at 21-35; H. Finkelstein, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT (1930); Davenport, supra note 11, at 963-77; Comment, LETTERS OF CREDIT, supra note 50, at 875-77.

54. UCC § 5-114(1) provides: "An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary." UCC § 5-104(4) states: An issuer's obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility:

(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or

(b) for any act or omission of any person other than itself or its own branch

See also W. Ward & H. Harfield, supra note 52, at 47-48.
the letter-of-credit transaction, letter-of-credit law has long recognized
that it would be impracticable to embroil the issuer in buyer-seller disputes.\textsuperscript{55}

The similarities between bank charge cards and letters of credit are striking,\textsuperscript{56} and creditor advocates have resorted to this analogy. The cardholder agreement performs the function of the customer-issuer agreement and requires the cardholder to reimburse the issuer for sales slips honored, provided certain conditions are met. The letter of credit itself is the agreement between issuer and beneficiary, and the combination of the charge card and the merchant agreement serves the same purpose in setting forth the terms under which sales slips will be accepted.\textsuperscript{57} The sales slip would seem to satisfy the definition of "a documentary draft or documentary demand for payment" in article 5 of the Uniform Commercial Code.\textsuperscript{58}

Not only is the nature of the various obligations of the parties in a letter-of-credit transaction strikingly similar to that in the bank charge card transaction, the purpose for which both modes of payment were created—substitution of the promise to pay of a recognized financial institution for that of the unknown customer—is precisely the same. Creditor advocates would argue that minor differences in these two methods of payment should not be allowed to obscure their important similarity: in both, the cardholder-custom-


\textsuperscript{56} Davenport, \textit{supra} note 11, at 967; Comment, \textit{Letters of Credit}, \textit{supra} note 50, at 875-79. Section 1.301(9) of the UCCC recognizes this similarity by providing: "'Lender credit card or similar arrangement' means an arrangement or loan agreement . . . pursuant to which a lender gives a debtor the privilege of using a credit card, letter of credit, or other credit confirmation . . . ." (emphasis added).

\textsuperscript{57} See Comment, \textit{Letters of Credit}, \textit{supra} note 50, at 877.

\textsuperscript{58} UCC § 5-102(1) provides:
This Article applies
(a) to a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and
(b) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and
(c) to a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

UCC § 5-102(b) provides:
A "documentary draft" or a "documentary demand for payment" is one honor of which is conditioned upon the presentation of a document or documents. "Document" means any paper including document of title, security, invoice, certificate, notice of default and the like.

See Comment, \textit{Letters of Credit}, \textit{supra} note 50, at 882-83.
er's obligation flows directly to the issuer and is independent of the underlying sales transaction.\textsuperscript{59}

The principles developed in letter-of-credit transactions throughout the years confirm that notice of infirmities in the underlying sale transaction, whether they be questions of breach of warranty or fraud in the inducement, should not affect the customer's obligation to its issuer.\textsuperscript{60} To hold otherwise would require banks to become experts in the quality and custom of hundreds of thousands of types of goods that are purchased with letters of credit, or bank charge cards, and to become involved in as many disputes. The issuer would be required, upon receipt of notice from its customer of an alleged defense, to act as an arbitrator in any dispute between customer and merchant—an onerous and expensive duty. It is a fundamental premise of such transactions that the bank ought not to concern itself with the quality of merchandise or standards of performance, but only with the financial aspects of the transaction as they appear from documentation.\textsuperscript{61}

Another analogy consistent with the direct-obligation theory to which creditor advocates resort is that of the personal check. In many respects charge card systems are functionally related to the check system. Under a bank charge card system the depositary bank furnishes the merchant with deposit forms and sales slips, documents upon which the fund transfer is recorded. The same bank furnishes the merchant with deposit forms and its customers with checks, which also serve to record the fund transfer when payment is made by check. The merchant itemizes charge card transaction sales slips on a deposit form and deposits them at his depositary bank where the amounts are credited to his checking account. He also itemizes checks on a deposit slip and deposits them with the same bank, which credits the amounts to the same account. The depositary bank forwards the sales slips through the charge card clearing system and is reimbursed by the issuer. Similarly, the merchant's depositary bank forwards checks through the check clearing system to the payor-drawee bank, which reimburses the depositary bank. The issuer receives sales slips chargeable to its cardholder's charge card,

\textsuperscript{59} Commentators have recognized the significance of the cardholder's direct promise to pay the issuer, irrespective of claims or defenses against the merchant: "It thus appears that the bank has an absolute right to receive payment from the cardholder for all purchases made with the card." Comment, Bank Credit Plans, supra note 26, at 60. See Davenport, supra note 11, at 974-75.

\textsuperscript{60} See note 55 supra.

\textsuperscript{61} Laudisi v. American Exch. Natl. Bank, 239 N.Y. 234, 146 N.E. 347 (1924). This principle has been codified in UCC § 5-114(2).
and if such slips are properly completed, charges the amount thereof to the cardholder’s account. The drawee bank receives checks drawn on its customer’s account, and if properly drawn, the amounts are charged to the drawer-customer’s account in accordance with the drawer-drawee agreement.

The relationship between the drawee bank and the customer may also involve an extension of credit if, for example, the drawee bank makes available a “check reserve” or “check credit” plan to its customers. Under such plans, the drawee extends a line of credit to the customer against which the customer may draw by writing checks that would otherwise overdraft his checking account. In many of these plans ordinary checks are used. The customer repays amounts in excess of those on deposit according to the check reserve agreement in the same manner that a cardholder would pay the issuer in a charge card plan; the customer has the option of repaying the total amount when billed or making payments according to a deferred-payment schedule.

When a check reserve plan is involved, the check system of payment is difficult to distinguish functionally from the charge card system. The merchant views both systems as simply a form of payment and is not concerned with the particular arrangement between his customer and the issuer or drawee bank. When a check is presented, the merchant has no way of knowing whether the customer has funds in his account against which the check will be charged, or whether the check will create an overdraft that will actuate a “loan” by the drawee to the customer pursuant to a check reserve plan. Moreover, if such a loan is made, the merchant will have no knowledge of the terms of repayment under the check reserve plan. Precisely the same situation exists in a charge card transaction—the merchant does not know whether a deferred payment will be elected by the cardholder on billing or not.

The idea that banks that process checks should be held liable for events occurring in an underlying purchase of goods or services would seem ludicrous, even if a loan under a check reserve plan were part of the transaction, but that is because checks have been accepted for many years as a form of payment and are subject to well-developed rules of law. The principles applicable to checks

62. Even absent the formal creation of such a credit arrangement, an ordinary checking account may involve the extension of credit. If a check creates an overdraft in a customer’s account, the bank has the option of dishonoring it and returning it to the depositary bank, or of charging the amount against its customer’s account and recovering from the customer. UCC § 4-401(4).

were developed with a view toward providing a convenient, safe form of payment beneficial to a wide range of users. Charge cards are now supplanting checks as a form of payment. Creditor advocates feel that the similarities in function between check and charge card systems argue for a similarity in the legal obligations and rights of the parties involved.

Further, the coming of the checkless and cashless society will involve a shift from the check or document system to an electronic-transfer system. It has been envisaged that in such a system the customer will transmit directly to the payor bank or issuer an order that a specified amount be transferred from the customer's account to the account of the merchant from whom the customer is purchasing goods or services. The "order" will be transmitted via electronic impulse initiated at a terminal in the merchant's establishment. The merchant will be paid at the instant of the cardholder's order transmital by means of a credit to his account; the cardholder's account will be debited at the same time.64

The concept of a direct order by the cardholder to the issuer through the use of a combination of the charge card and electronic terminal emphasizes the fact that documentation at the merchant level can easily be by-passed in the charge card system. An assignment theory becomes even more patently inapplicable to the charge card system when direct electronic transfers are used since then there will be no document for the merchant to negotiate or assign. The transfers from one account to the other will be the direct consequence of an order by the cardholder to the issuer, with the merchant interested only in the ultimate result.65

The functional concept of the direct electronic transmission of an order from cardholder to issuer and the legal concept of a direct obligation flowing from cardholder to issuer are mutually reinforcing. The direct-obligation theory seems not only to provide the legal framework most descriptive of charge card transactions as they are now taking place, but it also seems to hold the most promise for providing a realistic legal framework within which the commer-

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64. The terminal could be actuated by a charge card, and it has been suggested that, eventually, the input to the issuer may be initiated merely by the customer's voice. See generally Dunne, Variation on a Theme by Parkinson or Some Proposals for the Uniform Commercial Code and the Checkless Society, 75 YALE L.J. 788, 793 (1966).

65. A variation of such a paperless transaction is that contemplated by the SCOPE report, note 13 supra. Under such a plan merchants, such as utilities, would be pre-authorized by a consumer regularly to charge against the consumer's checking account. As pointed out above, such a transaction could easily result in an extension of credit, without the knowledge of the merchant, and, perhaps, without knowledge of the consumer.
cial-payment mechanism can undergo a smooth transition from a document system to an electronic-transfer system.

Not only does the direct-obligation theory espoused by creditor advocates call for banks to be free from involvement with the underlying sales transaction, practical considerations peculiar to multi-party charge card transactions dictate that same result. As was indicated earlier, the roles of issuer and depositary bank are usually occupied by different banks. In a high percentage of charge card transactions, the banks may not be located in the same geographic part of the United States; in a not insignificant number of transactions they may even be located in different countries. The issuer—the party against which defenses would be asserted—typically will have no knowledge of and no contact with the merchant honoring the charge card and, therefore, will have no way of evaluating that merchant’s performance or his financial status or anything else about him. Hence, even if the premise of the assignment theory were accepted arguendo, arguments concerning the quantity or quality of knowledge or contact under the close-connection and knowledge theories articulated above become tenuous at best in most transactions.

Nor would an issuer, thousands of miles removed from the merchant, have the ability to gather such information if a duty to evaluate merchants were imposed. Businesses accepting multiparty charge cards deal in literally millions of products and services and utilize widely varying sales techniques. Businessmen honoring such cards are dispersed nationally and internationally in jurisdictions having different business and legal standards. There is no existing institution inside or outside the banking community that is in a position to make nation- or world-wide investigations and qualitative determinations regarding each and every product, service, and business practice that is or may be defective or abusive. To require a subjective evaluation of business practices and products on such a grand scale and with a view to varying standards, a task no agency has ever accomplished or could possibly hope to accomplish, would be to impose an impossible duty on banks issuing charge cards.

66. See text accompanying notes 7 & 9 supra.

67. Western States Bankcard Association, a regional interchange association for the Master Charge system in seven western states, indicates that twenty-five per cent of all items processed involve an issuer or depositary bank that is not located in the western region of the United States. This does not take into account items upon which appear, for example, an issuer located in Los Angeles and a depositary bank located in San Francisco. Western States Bankcard Association, Significant Statistics Report, on file in the offices of the Michigan Law Review.

Furthermore, even if an issuer had reason to believe that a particular merchant had engaged in unsavory practices or sold goods or services that were not of high quality, it would have no way of preventing that merchant from accepting its charge cards. In order to protect itself, an issuer would have to join with the depositary bank that enabled the merchant to accept slips, and all other banks that might potentially enter into such a relationship with the merchant, to refuse jointly to deal with the merchant. Such conduct—a concerted refusal to deal—would likely be a per se violation of the Sherman Act. The fact that such concerted action may have been taken to protect consumers has been held to provide no defense under the antitrust laws.

Even depositary banks know little of the business practices or the quality of the merchandise sold by the tens of thousands of merchants with which they enter into depositary arrangements. The insignificance of any individual merchant's activities in relation to the total anticipated profit from all charge card transactions would not warrant a continuing investigation of the merchant as a matter of course. Merchants offer an almost infinite variety of goods and services. A bank cannot develop an expertise in all such areas and it would thus be unrealistic to expect a bank to monitor the practices of the merchants that accept bank charge cards. It would be as unfair and unrealistic to expect a depositary bank to make such an investigation of a merchant who had an agreement enabling him to accept charge cards as it would be of a merchant who maintained nothing more than an ordinary checking account with the bank.

Creditor advocates also note another practical problem if defenses were assertable against issuers. A cardholder-obligor could simply make allegations of dissatisfaction with the goods or services he received, whether or not the allegations were well founded, and refuse to pay debts he incurred directly to the issuer. The issuer might be located thousands of miles from the scene where the purchase took place. It would not be familiar with the substance of the transaction, nor with the local laws or business practices that control the transaction. To conduct an investigation to determine the facts would be prohibitively expensive. To avoid being placed in an untenable position, the issuer might insist in advance upon an ar-

71. See Bergsten, supra note 12, at 515-17.
rangement whereby it could charge back through the various clearing steps to the depositary bank any sales slips over which a dispute arose. The depositary bank would presumably then charge back such a sales slip to the merchant from which it originated. As a practical matter, every sales slip upon which an obligor chose not to make payment would then be charged back so long as he made representations that on their face would constitute a defense to an action to collect the amounts owed.

Such a system would shatter the legitimate expectations of merchants. If the sales slip were charged back to him, the merchant would have nothing except a sales slip. The consumer would have the merchandise involved in the transaction and an asserted defense of unknown validity to the obligation to pay for the merchandise. Merchants should not be left in such a position with little effective recourse.

The merchant could not rely on the banks as an intermediary under such a charge-back rule. Unlike the situation in which a single financing institution is involved in the transaction, the issuer in a multiparty charge card transaction has no incentive to become involved in a cardholder-merchant dispute if it may rid itself of the troublesome sales slip by charging it back. If a single financial institution is involved, it must be sensitive to the claims of both its merchant and its debtor, since it desires a continuing relationship with both. The bank in such a case is likely to promote an accommodation between the parties. This is not the case for the New York issuer whose cardholder refuses to pay for merchandise purchased from a California merchant. His goals are cardholder satisfaction and minimal costs, both of which can be achieved by charging back immediately at the first sign of a refusal to pay, without bothering to examine the merits of the dispute.

Given the merchant's vulnerability to any alleged dispute, creditor advocates could point to the potential for unfairness if defenses were assertable in all transactions. Consumer advocates focus on the harm caused by the unscrupulous merchant, but no less harm may befall the innocent merchant who becomes the victim of the unscrupulous consumer who learns that payments for purchases can be ignored once he raises an alleged defense and refuses to pay his issuer. Even assuming a good faith, but erroneous, dispute, the merchant is left with lost merchandise and little recourse. In most

72. Curiously, if defenses are not assertable against an issuer as a matter of right, and if no charge-back right exists, a bank will have an interest in maintaining cardholder satisfaction and may very well assist the cardholder in reaching some accommodation.
situations, a merchant does not choose his customers; the customers choose his establishment. A consumer has the opportunity to do business or not to do business with a merchant, as he sees fit. If proper payment is tendered, which includes, of course, the use of a charge card, a merchant does not have such an opportunity; he must do business with the consumer. The merchant relies on the promise of the bank to pay, not that of the cardholder. Creditor advocates maintain that to destroy that reliance—the basis upon which charge cards are accepted—by a rule that would result in a charge back of the transaction by the bank, which charge back could, as a practical matter, take place at the whim of the cardholder, could greatly diminish the utility of the bank charge card and its acceptance as a medium of exchange.

VI. A New Proposal

So much for the arguments now being advocated. The consumer advocate’s argument is attractive as a way to improve the lot of the individual consumer, but it ignores significant facts in its analogies and conclusions. Moreover, the social consequences may actually be adverse to consumers as a class as well as to others. The creditor advocate’s argument is difficult to rebut for its technical validity, but it fails to take into account new perceptions concerning the relationship of consumers to those who provide them with goods and services. Intense pressure is being brought to bear by consumer advocates on courts and legislatures to extend additional protection to consumers. A recent bill proposed by Senator Proxmire, for instance, would allow cardholders to assert defenses against issuers in all transactions. The issue is waiting to be resolved. A preliminary

73. Section 169 of the proposed Fair Credit Billing Act represents an interesting study in the development of legal principles in this area. S. 652, 92d Cong., 1st Sess. § 169 (1971). That section represents a new incursion into an area of the law previously left to the states. Senator Proxmire appears to be concerned about the effect on consumer rights of introducing a third party financier into consumer credit transactions, but he reaches a form of consumer credit that accounts for less than ten percent of the total. 57 FEDERAL RESERVE BULL. A54-55 (1971); Hearings pursuant to H.R. Res. 66 Before the Subcomm. on Special Small Business Problems of the Select Comm. on Small Business, 91st Cong., 2d Sess. 156 (1970).

step in the resolution process must be to identify the forum most able to fashion a workable rule on the issue.

A. The Problem Is Not Susceptible of Judicial Solution

The judicial system is not in a position to articulate a rule on the issue of the assertability of consumer defenses that will serve well the parties to bank charge card transactions. Courts must face such issues in the context of a particular fact situation as cases come before them. They are not given the opportunity adequately to consider the generalized experience in such transactions. The consumer advocate will, of course, choose as a case to advance his theory one that will have facts most appealing to a court. That case, however, may reflect a situation that is statistically insignificant and result in a rule adequate for that case but inadequate to govern the vast majority of cases.

In addition to being forced to consider issues of general applicability in the context of possibly unique factual constraints, the judicial process does not lend itself to a full development and exposure of data necessary to analyze the ramifications of such a problem. A legislature may wish to determine whether any harm is actually suffered by consumers as a class under the current law. It may also wish to inquire whether a charge card program is profitable to banks, for if it were shown that it is not, or that it is only marginally profitable, the legislature may not wish to impose further liabilities that could extinguish the infant consumer service. Information should also be gathered on the present practices of banks in evaluating and monitoring a merchant’s practices and

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74. See Bunting Says Profit Lag in Bank Cards Nears Crisis Stage, AMERICAN BANKER, April 7, 1971, at 1, col. 1; 1970 Losses for Bank Cards Top $115.3 Mil., Over 50% Higher Than ’69, AMERICAN BANKER, March 29, 1971, at 1, col. 1.
financial status, and on the practicalities of placing more onerous burdens on banks.

In weighing the relevant factors, the decisionmaker would have to place on either side of the scales the social benefits and social detriments to be derived from the present state of the law and compare them to those resulting if the state of law were altered as urged. A careful quantification is essential so that undue emphasis is not placed on factors present in a given case that may be unique or statistically insignificant in the universe of transactions that the proposed rule would govern. Such a quantification assumes the collection of massive data. Legislatures are clearly better equipped to undertake the necessary data-gathering effort than are courts, which must, in general, rely on data presented by the parties.76

In addition, the nature of the judicial process makes it difficult for a court to articulate a rule than can have the hard, precise delimitations of statutory language. A legislature might choose to extend liability concepts only under restricted circumstances, such as will be suggested below, or it might choose to provide consumer protection by attacking the complained-of transaction directly.76 A court does not have such a capability.

The role of the judiciary with regard to consumer protection has changed in the last decade. In the past, courts were justly concerned that consumers could not look to their legislators to protect
them and they took it upon themselves to adopt new theories to provide consumer protection in the absence of legislative concern. On the other hand, one need only cite to the various state retail installment sales acts, the Federal Truth-in-Lending Act, the Fair Credit Reporting Act, the proposed Fair Credit Billing Act, the Uniform Consumer Credit Code, and the myriad of congressional hearings and pending bills that deal with the subject of consumer protection to demonstrate that consumers are extremely well represented today in the halls of Congress, in state legislatures, and before governmental agencies. Senator Magnuson has stated, "The sixties have rightly been called the Decade of the Consumer." The seventies promise to see an acceleration of that decade's concern for the well-being of the consumer. It is evident that the consumer can expect continuing protection through the legislative process, which will provide a thorough and careful analysis of all aspects of the particular transaction at issue, to the benefit of consumers and commerce alike. Thus, the necessity for a court to formulate a new rule based on inadequate data no longer exists.

It seems clear that a legislative solution is indicated. A legislature would best proceed by making a careful analysis of the unique facts involved in the operations of bank charge card systems and by devising a unique solution to take those facts into account. It should not proceed by borrowing concepts designed to deal with dissimilar transactions.

Furthermore, the rule that governs this issue should be uniform in all jurisdictions, if possible. If the law varies from jurisdiction to jurisdiction, the task of accommodating the rights of the various parties involved will be difficult as members of America's mobile society engage in an increasingly large volume of interstate and inter-

77. See generally B. CURRAN, supra note 32.
82. See, e.g., 1 CCH CONSUMER CREDIT GUIDE, REP. No. 62, at 12, REP. No. 61, at 10, REP. No. 60, at 5 (1971).
83. PRACTICING LAW INSTITUTE, CONSUMER COMPLIANCE PROTECTION 11-12, 86-87, 189 (1970).
84. Id. at 189.
85. While this Article was being prepared, Congress and the Federal Trade Commission introduced measures dealing directly with this problem. S. 652, 92d Cong., 1st Sess. (1971); Proposed FTC Reg. § 433.1, 36 Fed. Reg. 1211 (1971). Furthermore, it is the understanding of the authors that several state legislatures in addition to New York will be considering the issue this year. See note 8 supra and accompanying text.
national charge card transactions. Hence, federal legislation that should pre-empt local law would appear to be the best solution, so that the parties would be subject to a uniform rule no matter in what state a party was located or a portion of the transaction took place. It could not solve the problems caused by use of charge cards internationally, but it would be a far better alternative than a myriad assortment of statutes passed by individual states.86

B. A Monetary Limit

Certain key features of bank charge card transactions must be given due weight in any statute that attempts to deal with the problem of the assertability of consumer defenses in this setting. The title of this Article, "New Cash or New Credit," highlights an issue to which few persons have addressed themselves in the context of arguing the viability of the insulation of creditors from consumer defenses as that doctrine pertains to bank charge cards. The issue is a vitally important one because the use of bank charge cards produces a mixture of transactions in which some represent merely the implementation of a new payment mechanism, while others are a replacement for more traditional credit extensions.

Thus, the characterization of a typical charge card sale as a credit transaction like those common in the past in the consumer field may be misleading. This is not to say that bank charge cards were not devised primarily as a method of extending a new form of credit. Using the best indicators available, consultants predicted to the banking industry certain market patterns that initially prompted banks to enter the field. They predicted that the ratio of persons purchasing goods and services and extending repayment over a period of time would be high in relation to those using the card as a new technique for immediate payment in lieu of checks or cash. The public proved the banks and their consultants to be incorrect in their estimates. In 1967, Andrew Brimmer pointed out that "[m]any holders of bank credit cards have used them primarily as a convenience in facilitating payments rather than as a means of increasing their debt balances."87 In other words, many cardholders do not contemplate deferred payments when they use their cards; they pay their entire balances as soon as billed.

The phenomenon noted by Mr. Brimmer now constitutes a fact of life that banks have begun to—and legislators should—take into careful consideration. At the time of the 1968 Federal Reserve Board study, transactions that were solely convenience-card or payment oriented in nature constituted between one-fifth and one-third of all transactions.\(^88\) There is evidence that such percentage increased by as much as forty per cent in the next two years.\(^89\) Figures assembled by one of the regional interchange associations indicate, for instance, that 538 million dollars in bank charge card sales and cash advances in 1970 gave rise to only a 45 million dollar increase in outstanding cardholder balances at the end of that year, as compared with 1969, when 368 million dollars in sales and advances generated a 48 million dollar increase in outstanding balances. These statistics indicate that the ratio of charge card usage in terms of dollars to corresponding credit balances generated increased from seven-to-one in 1969 to twelve-to-one in 1970, a period of just two years.\(^90\) One simply cannot, therefore, proceed from the premise articulated by the consumer advocates that bank charge card transactions represent simply another form of extending installment credit on a revolving basis.

In the light of these figures, characterizing a "typical" charge card transaction today is a difficult task, but surely current statistics relating to the ratio between those transactions that result in immediate payment on billing and those that involve a repayment out of future income should form an important basis upon which to construct legislation.

Statistics directly bearing on this phenomenon can be gathered, but the phenomenon can be deduced from other information as well. For example, the average dollar amount for all sales slips in 1968 was approximately sixteen dollars;\(^91\) the average now appears to be approximately nineteen dollars.\(^92\) From this fact it seems clear that in the great majority of transactions conducted with bank charge cards, the purchase is probably not of the type that is made because

\(^{88}\) Id.
\(^{90}\) Letter from E.H. Mackay, Executive Vice President, Western States Bankcard Association, San Francisco, California, to the authors, dated May 24, 1971, on file in the offices of the Michigan Law Review.
\(^{91}\) Wall St. J., March 15, 1968, at 24, col. 2 (western ed.). A survey made for Time magazine indicates that the approximate charges on all bank charge cards used by a family in an average month were between $20 and $50. Who Uses Bank Credit Cards, AMERICAN DRUGGIST, February 9, 1970, at 79. See Bergsten, supra note 12, at 515-16.
\(^{92}\) See note 16 supra. The average was derived by dividing $1.09 billion in Interbank member sales for the fourth quarter of 1970 by the 58 million sales slips processed for that period.
the purchaser does not have available funds and is anticipating paying for the purchase in installments out of future earnings. Rather, the purchaser simply finds it more convenient not to carry cash and to pay for all of his minor purchases at one time during a billing cycle.

The premise upon which to proceed by analogy for the convenience-card transaction is that of a cash sale. For these transactions, the charge card system, insofar as the merchant-cardholder relationship is concerned, replaces cash. This premise has been stated succinctly:

The retailer who accepts a credit card in payment does not normally think of the transaction as a credit transaction. Credit cards serve a function similar to that of checks. A retailer who accepts a check in payment for goods sold is thought of as engaging in a cash transaction even though his receipt of cash is delayed until payment of the check.63

As to such transactions, the cardholder should be in no better, nor worse, position than if he had paid for his purchase with cash. His recourse, just as if he had paid in cash, should be against the merchant.

The problem, of course, is that it is impossible to identify in advance those transactions in which the consumer uses his charge card in place of cash. It may well be, however, that practical economics should be determinative of the issue. A rule that would allow consumers to dispute the payment of obligations resulting from low-dollar-amount transactions would introduce severe diseconomies into a commercial transaction based on sophisticated processes. Charge card systems are an economically sound convenience for the public because of their capacity through a system that is highly dependent on electronic data processing to process a high volume of consumer transactions at a low cost per item.64 As a percentage of the dollar value of the transaction, the processing cost obviously is greater as the dollar value of the transaction is less. Low-dollar-value transactions are, therefore, a burden on the system that is tolerated primarily for the public convenience because they represent no profit potential even when no disputed transactions are involved.

Whenever manual processing must be introduced into the system, the cost of handling an item multiplies instead of increasing by some

64. Bergsten, supra note 12, at 515-17.
marginal amount.95 Every charge back resulting from an alleged dissatisfaction would necessitate costly manual clerical processing. Issuer bank personnel would have to contact the debtor and accumulate enough data to complete documentation and process a charge back through the interchange system. Such a charge back, even once it is in process in the system, would be an exceptional item requiring special handling, thereby giving rise to extraordinary costs as it flowed back to the merchant. Again, the burden on low-dollar-value items would be relatively greater.

Any right on the part of the consumer to assert defenses against the issuer will place burdens on the system; but if the right is granted in all transactions, no matter how small, those burdens will be aggravated and may even be intolerable, both because of the high cost in relation to the dollar value of the transaction and because of the enormity of the volume of bank charge card transactions, which number more than five million per week.96

The task of the legislature is to devise a technique that would differentiate between those transactions that are a replacement for cash and those that replace other forms of credit and to treat those distinguishable transactions accordingly. There appears to be no method available for easily distinguishing between a credit and a convenience sale with precision, particularly since the decision to repay in installments may not be made by the consumer until after billing. Hence any criterion used to treat transactions differently must be somewhat arbitrary.

An arbitrary dollar figure should be selected. As to transactions involving a sum greater than that figure, the cardholder should be given the ability to assert against banks defenses he has against a merchant. As to transactions involving a sum less than that figure, it should be assumed that the charge card was used as a payment mechanism to replace cash, and the cardholder should have recourse only against the merchant. The figure chosen could be seventy-five dollars; it could be fifty dollars. The selection of an appropriate amount should be supported by an accumulation of data indicating any relationship that may exist between the size of the purchase and the likelihood of the transaction being one in which the consumer is seeking to make extended payments.

Consumers do not seek credit through the creation of negotiable or assignable paper involving third party financial institutions for ten, fifteen, or twenty dollar purchases. Third party consumer credit

95. Id.
96. See note 18 supra.
is typically extended for the purpose of purchasing major appliances or other objects of comparatively high value. In those situations in which credit may be extended for smaller purchases, such as when a consumer may have a revolving charge account with a retailer, the consumer's obligation rarely, if ever, involves a negotiable instrument (other than a check) or the assignment of paper by the retailer to a financer. The party seeking to collect from the consumer in small-dollar-amount transactions will be the merchant against whom the consumer may assert defenses. Hence, it is not surprising that the issue of subjecting remote creditors to defenses in low-dollar-amount transactions has not been faced before and that little precedent exists in the consumer credit field for a technique of ascribing different rights to different dollar value transactions.

Such an accommodation between economic practicality and enhancement of the rights of the individual consumer is not totally without precedent, however. The National Consumer Center suggested a similar accommodation in its proposed National Consumer Act, perhaps the most consumer-oriented draft legislation promulgated to date. That Act would give consumers the absolute right to cancel a purchase of merchandise within three days of its purchase, no matter what the form of payment. The NCA limits that right, however, for economically sound reasons, to purchases of goods in excess of fifty dollars. Although the official comments give no indication of the rationale for the provision, it seems a safe assumption that the NCA's drafters determined that the societal costs involved in creating a rescission right with regard to purchases of less than fifty dollars were greater than the costs of making small-dollar-amount purchases final. If that decision is correct for transactions involving only two parties—a merchant and a consumer—it would seem that the costs involved in "unwinding" a complex multiparty transaction would a fortiori render it a socially unwise rule to allow assertion of defenses against banks in transactions involving less than fifty dollars. Thus, a similar differentiation of transactions by dollar value should be useful in devising a workable rule for bank charge card transactions. The differentiated treatment would solve the intensely practical problem discussed above by eliminating costly economic burdens in low-dollar-amount transactions in which the potential for significant economic harm to the consumer is minimal. Furthermore, it would relieve merchants from the possibility

97. NCA § 2.505(2)(b) (First Final Draft).
98. NCA § 2.501(1) (First Final Draft).
99. See text accompanying note 94 supra.
that collection costs would exceed the value of disputed merchandise so that it would not be profitable for them to attempt to collect from a consumer if the consumer chose to dispute payments. Thus, new consumer rights would be created and would accomplish the goal of consumer advocates without, however, economically stifling a new and revolutionary payment system.

C. A Geographic Limit

Most consumer credit is local in nature. The consumer, the merchant from whom he purchases, and the financing institution that grants credit either through a direct loan or by purchasing accounts receivable or negotiable paper from a merchant, are typically located in the same geographic area. Such is not the case, however, in bank charge card transactions. Distance, differences in local laws, and limitations on data processing capabilities all make disputes that arise between any of the three or more parties to a bank charge card transaction much less capable of economic resolution than the typical local credit transaction. Moreover, as was indicated above, the issuer and depositary banks are typically different institutions and may be separated by thousands of miles. Thus, the second major distinction between other forms of consumer credit and the bank charge card is the geographic and functional dispersion of the parties involved.

It has been suggested that it would be proper to subject the issuer to defenses in those situations in which functional dispersion does not exist—that is, when the issuer also performs the function of a depositary bank—but not in those situations in which two different banks are involved. When the bank involved has not only issued the charge card to the consumer but also has a contractual arrangement with the merchant, it would at least theoretically have an opportunity to investigate the merchant, whether or not it would have the practical ability to conduct such an investigation. Furthermore, if the issuer and depositary bank are the same institution, it is statistically more likely that the transaction will have been

100. See text accompanying notes 9 & 10 supra.

101. Bergsten, supra note 12, at 516. The NCA may have reached just that result: § 2.407(9) would subject a credit card issuer to defenses in those situations in which "the creditor is the issuer of a credit card which may be used by the consumer in the consumer sale or lease as a result of a prior agreement between the issuer and the seller or lessor." If this section is construed literally, it would allow consumers to assert defenses in lender charge card cases only when the depositary and issuer banks are the same institution or when organizations such as American Express or Diners Club are involved. A similar analysis can be made of the current Massachusetts legislation on this issue. See Mass. Ann. Laws ch. 255, § 12F (Supp. 1970).
local. Bank charge cards are most typically issued by local offices of banks to residents of the immediately surrounding community, and the bank, in its depositary-bank role, will also have arrangements with merchants in its immediate community. 102 Such geographic proximity facilitates contact by the bank with all parties to a potential dispute. The unfairness of depriving a merchant of his merchandise and requiring him to proceed against a cardholder located at some distant point would be minimized. If the bank were performing both functions, it would be more apt to promote an accommodation or to take action if it felt that either the merchant or the cardholder was being unfair. In effect it might act as an arbitrator to the dispute.

The major difficulty with treating transactions in which only one bank is involved differently from those in which two or more are involved is that of making adequate disclosure to consumers so that they might know at the time they engage in a transaction whether they have the right to assert defenses only against the merchant or whether they might also assert them against the issuer. If the right to assert defenses against the issuer has any significance, the consumer should know whether the right is available to him at the moment he enters into the transaction.

Traditionally, banks and other lenders, including merchants, seem to have granted consumer credit for major consumer purchases, such as automobiles, home appliances, major sports equipment, and major items of clothing. Such purchases are not usually made at points significantly distant from the consumer's residence for such reasons as high transportation costs and the consumer's lack of knowledge concerning terms of the sale being offered and the reputation of the seller. Particularly for low-income consumers the potential shopping area is limited. 103 A feasible alternative, then, may be to grant consumers the right to assert defenses against banks in all transactions in which the merchant and the cardholder reside in the same geographic area, as they are most likely to do in traditional consumer credit transactions. Because of the difficulties and costs that distance adds to dispute settlement, however, that additional right ought to be denied if the purchases are made from a merchant located at a point geographically distant from the consumer's residence.

A geographic boundary could be established by the use of state

102. An exception to the geographic proximity of merchants to their depositary bank arises when the merchant is a national concern such as a gasoline company, airline, or chain clothing store, which may have outlets located at great distances from the depositary bank.

boundaries, a circle surrounding the consumer's residence, or a combination of both. The alternatives would, just as with the selection of a dollar amount, necessarily be somewhat arbitrary. Each of the geographic limitations is based on the same practical premises, however. One premise is that the cardholder-issuer and merchant-depositary bank relationships tend to be local. If a rule requires that the cardholder-merchant relationship also be local before defenses can be asserted, the chances are good that all parties to a transaction will be located in the same geographic area. In fact, under such circumstances the statistical incidence of the issuer and depositary banks being the same institution would be greatly increased.

The other premise is that in local transactions the problem of merely establishing contact between the parties would be much easier to solve. The issuer may have a greater chance of evaluating the merchant. The merchant, if he has the sales slip charged back to him and therefore has been deprived not only of his merchandise but of his money as well, will at least be in a position easily to contact the cardholder or, if necessary, to seek relief through the courts. Under any of the suggested techniques for describing a boundary, the merchant is apt to have some familiarity with collection procedures, attorneys, and creditors' remedies, so that his position will not be as adverse as if the sale had involved a cardholder located across the continent. And if a lawsuit is necessary, both the merchant and the consumer will be reasonably close to the forum in which it will be conducted.

The differences between the alternative forms of defining the appropriate geographic area are not great. The state boundary alternative has the disadvantage of being the more arbitrary of the two, but has the advantage of being easier for a consumer to com-

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104. Restricting a consumer's right to assert defenses to transactions that occur within the boundaries of the state in which he lives is a technique that has received the imprimatur of the National Consumer Center. In December 1970, the Consumer Center promulgated a document containing changes it advocated for the UCCC in states where it was being considered. Proposed § 3.410 extends the concept contained in the official version of the UCCC to situations that could result in the assertion of defenses against some direct lenders. In doing so, however, the suggested amendment to the UCCC would draw a geographic boundary that would allow defenses to be asserted only for intrastate transactions. National Consumer Law Center, Proposed Amendments to the 1968 Official Text of the Uniform Consumer Credit Code § 3.410 (Publication #A192-50, Dec. 17, 1970).

105. The National Consumer Center predicated its suggested expansion of rights against lenders, which include the limitation to intrastate transactions (see note 104 supra), upon the desire to impose subjection to defenses “in circumstances where the extender of credit could reasonably be expected to know of the seller's manner of doing business and responsibility . . . .” Comment to Proposed New § 3.410, id.
prehend in making his marketing decisions. It also has the disad-
"advantage of treating states with large areas the same as states with
small areas. The distance between Redding and San Diego, Cali-
ifornia would span many states in other parts of the country. On
the other hand, insofar as legislation dealing with this issue may be
enacted by several states prior to the enactment of a federal statute,
the notion that a rule governing rights in a transaction will encom-
pass the entire state seems to provide a certain desirable simplicity.

A circle surrounding the consumer's residence is a more rational
method for defining the area, however, since it takes into account
the major factor that creates difficulties—distance. It would also
protect consumers who shop in major market areas that cross state
lines. If a reasonable radius is selected, such as seventy-five miles,
one would find encompassed such multistate metropolitan markets
as New York City, which services areas in New Jersey and Connecti-
cut; Washington, D.C., which services areas in Virginia and Mary-
land; Cincinnati, which services areas in Indiana and Kentucky; and
Chicago, which services areas in Wisconsin and Indiana, to name but
a few. The consumer would know in advance that he would be able
to assert defenses against his issuer provided that he made the pur-
chase within seventy-five miles of his residence. Unfortunately, as he
approached the geographic limit of the circle surrounding his resi-
dence, the consumer might not be certain whether he would still be
in the zone affording him such additional protection. To the extent
that the existence of such doubt is undesirable, the state border
alternative becomes more attractive.

The alternative of allowing the consumer to assert defenses
against the issuer regardless of the distance between his residence
and the merchant's establishment seems unacceptable. It would be
apt to cause serious limitations on the consumers' present ability to
use bank charge cards nationally and internationally. As indicated
earlier, \[106\] when a considerable geographic dispersion exists between
the cardholder and the merchant, and the cardholder disputes a
billing by a bank, the likely result is that the bank will not attempt
collection but will charge back the sales slip to the merchant, who
will be left with a difficult or impossible collection task. Being un-
able to evaluate consumers for good faith, merchants would thus
have an incentive to discontinue accepting offered charge cards from
consumers as payment for goods and services. On the other hand, a
rule limiting geographically the additional right to assert defenses
against banks is unlikely to be a burden on the consuming public

\[106. \text{See text accompanying note 72 supra.}\]
because most major purchases are undoubtedly made near the consumer's residence. Unscrupulous merchants would be in no position to use bank charge cards as a replacement for the creation of consumer paper in these local transactions in order to avoid the imposition of defenses. Since transactions in which consumer paper is generated are normally local in nature, a geographic limitation would not lessen the effect of foreclosing such a device to merchants seeking an unfair advantage.

VII. AN ACCOMMODATION IS NECESSARY

Legislatures must approach the issue under discussion with care and with a willingness to achieve a true understanding of the nature of a highly complex, sophisticated and, therefore, sensitive system. An unwise law may prove onerous to all parties involved. Unfortunately, there are no indicators of what the effect of an unwise rule would be. Extrapolating from those few jurisdictions that have extended to consumers the right to assert defenses against banks would be an erroneous method of forecasting since it is unlikely that consumers are even aware that they have such a right in those jurisdictions. Absent that awareness, statistical data on the experience to date under such a rule would be worse than useless—it would be misleading.

Some prediction of the possible results of an unworkable rule can be made. Banks will probably try to assure that they are indemnified for liability falling on them as a result of a merchant's activities since they will probably not be able to police the merchant's activities in the first instance. They may do business with only those businessmen with sufficient financial resources to insure that, if defenses were ever successfully asserted against the bank, the bank could always recover from the merchant. Second, they may require merchants to maintain significant amounts on deposit as a reserve against which they may charge off debts that consumers refuse to pay.

The effect of such measures, resulting from a rule exposing banks to consumer defenses in all transactions, would constitute a severe blow to this country's small businessmen since it would place them at an even greater competitive disadvantage than they suffer from today. Thus Congress, with its evident concern with the plight of small businessmen, 107 may have to fashion carefully a compromise solution that considers the position of both consumers and small

Small businessmen typically begin their business lives with a small amount of capital. However honorable they may be in their business techniques, and no matter what the quality of goods and services they offer, this fact alone tends to place them at a competitive disadvantage. Multiparty charge card programs have allowed small merchants who cannot establish their own card programs or revolving charge accounts to compete with larger businesses that have their own systems. If banks are made subject to consumer defenses, a bank may impose financial requirements on those who will be allowed to honor charge cards that small businesses may be unable to meet. A rule establishing across-the-board bank liability to consumer defenses could have, then, as one of its pernicious effects the exclusion of small businesses from bank charge card systems and their attendant benefits.

It could well be argued that if charge cards are becoming a new medium of exchange for the convenience of the public, if they are replacing cash and checks, their universal acceptance by all merchants, large or small, carriage trade or discount house, chain store or thinly capitalized "mom and pop" grocery store, is desirable. The freedom of the consumer to shop where he chooses depends on such universality of acceptance of the payment mechanism he chooses. Consumer advocates propose a broad rule of law designed to exclude certain merchants from bank charge card systems because of their business practices; but such a rule will likely exclude, for financial reasons only, many small merchants as well. Competitive disadvantage because of an inability to accept the financial burdens associated with a medium of exchange seems undesirable. Further, as charge card transactions assume an even larger share of total retail sales, the ability of a merchant to remain in business may one day depend on whether he accepts charge cards. When that day arrives, a reappraisal is likely to be made of a system that requires one private sector of the economy, the banking industry, to decide, in effect, whether a merchant must close his doors. The appropriateness of vesting that responsibility in the banking industry deserves careful consideration today, since such an effect is reasonably predictable.

In addition to having adverse effects on consumers and merchants, a broad rule could also work significant hardships on the banking industry. The highly regulated environment in which financing institutions operate renders them peculiarly vulnerable to any ill-con-

108. The New York Times, under the heading "Dealers Assail Legislation," described the unhappy experience of boat dealers under a recent legislative amendment in New York, which on its face affected only banks by permitting consumers to assert claims against the financing bank in boat sales. N.Y. Times, Jan. 24, 1971, § 12, at 1, col. 6.

109. See text accompanying note 29 supra.
ceived restructuring of risk allocation. As a matter of simple economics, lenders may not be proper parties to subject to consumer defenses in a broad range of cases since such an allocation would in turn force them to restructure their business relationship with both merchants and the consuming public. Moreover, the theory of risk shifting, when advocated to support imposition of liability on suppliers, assumes the ability of the supplier to raise prices and thereby redistribute a risk of loss from one consumer to many. Lenders, however, may not be able to distribute the risk through price increases. In most jurisdictions, their charges are controlled by statute. Thus, one of the foundations of extended notions of liability is not present when lenders are involved. For them, too onerous a rule can only result in the restructuring or elimination of the services now provided.

The complete elimination of charge card service by banks is not so unlikely a result if too onerous a rule is imposed. Rather than issuing charge cards, banks could rely more heavily on check overdraft and check guarantee plans, which would allow a consumer to write checks in excess of amounts on deposit with the bank with the excess charged against an open-end credit account. Under no theory yet advanced would a bank be subject to defenses assertable against a merchant who accepted a check drawn on an account in that bank. Ironically, consumers could obtain credit under such a plan, but they would have no right to assert defenses against the bank, even for major purchases. Moreover, the widespread use of

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112. See generally 1 CCH CONSUMER CREDIT GUIDE ¶ 510 (1971).

113. A recent study conducted by the Graduate School of Business Administration of the University of Washington examined the effects of the lowering of the maximum allowable interest rate in consumer credit transactions from 1 1/8 per cent to 1 per cent per month in the State of Washington. Sixty-six per cent of the retailers interviewed reported that they reject applicants for credit that they would have accepted prior to the lowering of the rate. The summary of findings concludes: "The low-income people who are marginal credit risks seem to have suffered the most so far from the enactment of Initiative 245." GRADUATE SCHOOL OF BUSINESS ADMINISTRATION OF THE UNIVERSITY OF WASHINGTON, THE IMPACT OF A CONSUMER CREDIT INTEREST LIMITATION LAW 25 (1970). That finding illustrates a likely result of the imposition of increased burdens on an industry that cannot raise its prices because they are legislatively controlled. Increased burdens may mean reduced net income, not loss shifting, to creditors. No business will operate for long at a loss. At some point, therefore, since income cannot be raised, reductions in the costs of operation of charge card services will be sought, perhaps through a restriction on the class of consumers serviced, as in Washington, or through a diminution in the value of the services offered.

114. See generally Comment, Bank Credit Plans, supra note 28.
check overdraft plans in lieu of credit card systems would have another untoward consequence for consumers. Merchants often will not accept checks as a replacement for cash without personal knowledge of the drawer. Instead of having a new form of payment available worldwide, the increasingly mobile consumer would be forced to less convenient mediums of exchange in most nonlocal transactions.

Thus a rule exposing banks to consumer defenses in all transactions could cause serious consequences to banks, merchants, and consumers. On the other hand, a rule insulating banks from consumer defenses in all transactions may place too heavy a burden on the consumer.

VIII. CONCLUSION

If the current movement to subject financers to defenses in transactions in which the seller initially extends credit to the consumer is soundly based, then some change in the current doctrine that insulates banks from consumer defenses is called for in bank charge card transactions. The judiciary should not undertake that task, however. For purposes of uniformity, Congress would be the best body to deal with the issue. It is clear, however, that Congress must proceed with a full awareness of the special nature of the transaction involved.

This Article has discussed the nature of bank charge card transactions, with emphasis on two factors deemed of particular importance in determining whether the consumer should be permitted to assert against the issuing bank defenses that he has against the seller. The first factor is the extent of geographic and functional dispersion among the parties to the transaction; the second is the relation between the amount of a particular transaction and the economic feasibility of providing an alternative party against whom the consumer can assert defenses arising out of the sale. A practical reason that these factors are important to the resolution of the issue under discussion is the burden that the indiscriminate assertion of consumer defenses against issuing banks would place on the charge card system. The consumer may, of course, assert claims against the merchant from which he purchased goods or services. However, the societal costs of providing the consumer with the option of asserting defenses against the bank attempting to collect an amount due, thereby giving him the tactical advantage of not having to assume the initiative in advancing his claim against the merchant, are
simply prohibitive in small-dollar-amount transactions and in those transactions geographically distant from the cardholder's residence.

A second reason for the importance of these factors is conceptual in nature and rests on the notion that the charge card transaction will be substituting for either a cash transaction or a traditional consumer credit transaction. It is clear that one cannot definitively ascertain in any particular transaction which role the credit card is playing. The best that can be done in any resolution of the question is to formulate presumptions based on observable facts associated with the particular sale and typically connected with one type of transaction or the other. Although any lines would to some extent be arbitrary, the need for consistency and predictability within commerce makes them necessary. Such lines, embodied in the monetary and geographic tests set out above,115 rest on two assumptions. First, sales over a certain monetary limit will, more often than not, represent credit rather than cash transactions. Second, the kinds of items that are generally bought by means of consumer credit are of such a nature that typically they will not be purchased at a significant distance from the consumer's residence. If it is determined from these factors that the charge card transaction was equivalent to a credit sale, the consumer's right to assert defenses should not be diluted merely because the issuing bank, rather than the merchant, is in the position of creditor vis-à-vis the consumer. Likewise, if it is determined that the transaction is equivalent to a cash sale, there seems to be no reason to enlarge the consumer's options beyond what they would be in an ordinary cash sale by permitting him to assert defenses to the issuing bank's attempted collection of amount due.

This is not to say that the inquiry should end with a disposition of these issues. Many segments of the business, financial, and consuming communities will assuredly raise additional issues at legislative hearings now in progress.116 This analysis, it is hoped, will help promote an understanding of bank charge card systems and provide a first step toward the accommodation of conflicting interests that must be served in any legislation dealing with this dramatic innovation in payment mechanisms and credit-granting techniques.

115 See text accompanying notes 87-98 and 100-07 supra.

116 Such additional issues may include matters such as the maximum amount owed to an issuer by an obligor on a series of transactions against which an obligor can assert a defense arising out of a single transaction, whether a time limit should be imposed on the consumer's right to assert defenses, and whether the consumer should be required to demand an adjustment from the merchant before asserting a defense against the bank. As to the first issue, Idaho, in recently adopting the UCCC, included a FIFO rule that would allow defenses to be asserted only against amounts outstanding on the particular transaction involved. Ch. 299, § 2.404, [1971] Idaho Acts (1 CCH CONSUMER CREDIT GUIDE § 4805, at 5396 (1971)).