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COMMENTS

BANK CREDIT CARDS—CONTEMPORARY PROBLEMS

I. Introduction

Credit cards have existed as commercial instruments for fifty years. During this period the use of these instruments has grown to such an extent that many commentators predict that in the not too distant future ours will be a "cashless and checkless society."[1] The recent and very widespread intrusion of banks into this area of credit financing must be cited as the impetus for such predictions.[2]

A. *History*

The forerunner of the credit card, the credit coin, first appeared in 1915. These coins were issued primarily by department stores to their regular customers as a convenience for prompt service on credit sales. The potential provided by this device was soon recognized by railroads and airlines which began issuing all-purpose credit cards, thereby allowing the holder to purchase any service or product which the issuer or its affiliate might offer.[3]

In 1950 the first independent credit card emerged under sponsorship of the Diners Club, Inc. This plan involved a credit *and* collection service for its members. Diners Club would enter two separate agreements, one with the cardholder-member and one with a merchant-member. The success of this plan led to the development of similar programs by American Express in 1958, and Carte Blanche in 1959.[4]

The First National Bank of Long Island is credited by many to have been the first bank to adopt such a plan. The Bank of America and Chase Manhattan later entered the field and have developed the first international all-purpose systems of consumer credit financing.[5] Today over 10,000 banks participate in the field either on a smaller level with their own plan, or, as is more often the

1. See Barnes, The Law, The Credit Card and the Coming of the Checkless Society, 6 Am. Bus. L.J. 641 (1968); Bergsten, Credit Cards—A Prelude to the Cashless Society, 8 B.C. Ind. & Com. L. Rev. 485 (1967) [hereinafter cited as Bergsten]; Brandel & Leonard, Bank Charge Cards: New Cash or New Credit, 69 Mich. L. Rev. 1033, 1038-39 (1971) [hereinafter cited as Bank Charge Cards].

2. See, e.g., Petherick, Bank Credit Cards and the Usury Laws, 4 U. Cal. Davis L. Rev. 335, 335-36 (1971) [hereinafter cited as UCD].

3. For a general discussion of the historical development of credit cards see Bergsten 485-86; Clontz, Bank Credit Cards Under the Uniform Commercial Code, 87 Banking L.J. 888, 888-91 (1970); Davenport, Bank Credit Cards and the Uniform Commercial Code, 1 Val. L. Rev. 218, 218-20 (1967).

4. These three companies were the major independent issuers of credit cards until the entry of major banks into the field in 1959. Primarily used by businessmen, they came to be known as "T & E cards" (travel and entertainment). A. Griffin, The Credit Jungle 4-19 (1971) [hereinafter cited as Griffin].

5. For a more detailed discussion of this development see sources cited note 3 supra; Griffin 21-22.

case, as a member of a national plan such as the Bank Americard or Master Charge system.[6]

B. *The System*

The most important of the many parties to such a system is the bank which issues the charge cards to the public. The issuer-bank establishes an account on behalf of the person to whom the card is issued, and the two enter into an agreement which governs their relationship. This agreement establishes a line of credit under which the cardholder may incur obligations to the issuer by a cash advance or through a purchase of goods or services from one of the merchant-members.

These merchants also have an agreement with the banks requiring them to honor all charge cards issued by a member-bank, and enabling them to deposit slips evidencing sales to cardholders in an ordinary checking account at the bank with which he has reached an agreement in return for a discounted credit to that account. These slips are then cleared and forwarded through an interchange system to the member-bank which originally issued the card and from which the cardholder will be billed periodically. The cardholder must then decide whether to make payment in full within a specified period, free of finance charges, or to defer payment and ultimately be charged an extra percentage of the amount billed.[7]

C. *Assets and Liabilities*

The popularity of these plans is reflected in the more than twenty-four million accounts that have been established in a little over ten years.[8] They enable the consumer to carry a single card instead of many cards or cash; to simplify his personal bookkeeping chores (payments for all charge purchases are made upon a single monthly billing); to maintain a continued indebtedness without the anxiety and inconvenience caused by continuous contract signings; and when short of cash to take advantage of market opportunities at the lowest consumer rates available to the small borrower. The merchant also benefits by obtaining immediate cash for credit sales, thereby freeing himself from the worries of collection and bad debt. Moreover, the merchant-member may attract customers through the acceptance of credit that he himself could never have financed. The bank, of course, has tapped a tremendous new source of income, both from the discounts accumulating from the merchants and the charges on cardholder

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6. This is a very conservative estimate, based only on statistics available for the Bank Americard and Master Charge plans. See Griffin 38-39; UCD 335.

7. See generally Bank Charge Cards 1034-37; Davenport, supra note 3, at 224-32; Comment, Credit Cards—A Survey of the Bank Card Revolution and Applicability of the Uniform Commercial Code, 16 DePaul L. Rev. 389, 390-92 (1967). For a variation on this system see Clontz, supra note 3, wherein the author describes a plan he developed for the First Union National Bank of North Carolina.

8. UCD 335. This figure is also a conservative estimate, i.e., not taking into account expansion since 1970.

accounts, as well as from the business opportunities arising from the contracts provided by the two agreements.[9]

However attractive this system may appear, the bank card does suffer several shortcomings. The cardholder is faced at times with a temptation too great to resist—to over-spend and thereby over-extend his ability to meet the charges which time amasses. More recently, he is also discovering that he is no match for the computers with which this large system of credit requires him to deal. The merchants complain that discounts charged by banks are severe, and that personal contact with customers is lessened. Moreover, they recently have been faced with the problem of dealing with losses accruing from fraudulent misuse of the cards. Banks, on the other hand, often complain that when the consumer refuses to pay they are held responsible for the shoddy merchandise sold by some merchants, especially when dealing with smaller accounts which it does not pay to pursue.[10]

It will be the purpose of this comment to examine three of these problems: (1) the applicability of usury statutes to charges levied by the banks on cardholders; (2) the right of cardholders to assert against the bank any defenses available to them against the merchant on the contract of sale; and (3) the fraudulent use of credit cards.

II. Usury

Historically, the existence of usury statutes reflected the rather ancient and agrarian moral notion that debt was sinful.[11]

> Righteous people went to the moneylenders only when forced to. The "borrowing class" consisted for the most part of the destitute and the oppressed who, either from calamity of nature or ungodly foolishness, were driven to borrowing in order to save themselves, their families and, as often as not, their farms. In this condition, they were at the mercy of the unscrupulous moneylender . . . . The remainder of the "borrowing class" was made up of . . . all immoral souls.[12]

The borrowing class therefore was in need of protection, and usury laws were the traditional means by which it was provided.

As the industrial revolution and Protestant ethic took hold in Western society, the preservation of these statutes was defended as necessary to insure the availability of credit at a fair and reasonable rate.[13] However, the logic of this argu-

9. See generally Bank Charge Cards 1038-40; Davenport, supra note 3, at 233.

10. See note 9 supra; Griffin 6-12, wherein the author relates several graphic examples of consumer-computer disputes.

11. See Shanks, Practical Problems in the Application of Archaic Usury Statutes, 53 Va. L. Rev. 327, 327-31 (1967) [hereinafter cited as Practical Problems]; UCD 341-42; 69 Mich. L. Rev. 1368, 1370-71 (1971).

12. Practical Problems 327.

13. See Frierson, Changing Concepts on Usury: Ancient Times Through the Time of John Calvin, 7 Am. Bus. L.J. 115, 123-25 (1969), wherein the author relates the details of efforts made by Calvin to distinguish away the ancient and strict Catholic ban on interest to allow for the use of accumulated wealth within the bounds of justice and fairness, i.e., as regulated by state usury legislation. See also sources cited note 11 supra; Com-

ment within a free market was soon questioned. In a market with effective competition and without price controls, usury laws should not be allowed to limit the rate of interest otherwise required by the economies of supply and demand. The prospective lender need only move to an unregulated jurisdiction or use another mode of investment to realize a higher rate of return. Thus, if usury laws are obeyed they result only in cutting off the free flow of credit which proponents of the statutes admit to be necessary.[14] This unsatisfied demand would, moreover, encourage the unscrupulous lender to charge even more than an open market would dictate.[15]

As a result, one jurisdiction within the United States has repealed its usury statutes[16] while others have riddled them with exceptions. The simplest and most obvious way of dealing with the problem has been to raise the maximum rates high enough to avoid conflict with the competitively determined rate. For example, most states allow for higher rates of interest when dealing with certain types of written contracts[17] and several provide for increased rates when dealing with judgments.[18] Some jurisdictions have also reduced penalties for those found guilty of exceeding the statutory rate. In Pennsylvania, for instance, the only penalty remaining for usury is forfeiture of any interest paid in excess of the legal maximum.[19] A third, and more widely accepted "exception" concerns corporations, which have, as a general rule, been precluded from raising usury as a defense.[20]

The final major exception—the time-price doctrine—was judicially created. Originating in the case of *Beete v. Bidgood*,[21] it deals exclusively with credit

ment, Judicial and Legislative Treatment of "Usurious" Credit Sales, 71 Harv. L. Rev. 1143, 1143-44 (1958).

14. Provident Life & Trust Co. v. Fletcher, 237 F. 104, 110 (S.D.N.Y. 1916), aff'd, 258 F. 583 (2d Cir. 1919). "[T]he supposed protection to [borrowers] foils itself; they become incapable of [borrowing] when they need to [borrow]." Id.

15. Practical Problems 329, wherein the author draws a similar conclusion from the fact that the applicable usury statute had made it quite difficult to obtain a residential mortgage in Virginia during the early to mid-sixties.

16. Massachusetts repealed its usury statute in 1867. See F. Ryan, Usury and Usury Laws 60-61 (1924).

17. E.g., in California the general legal rate of interest allowable is 7%, whereas with a written agreement it is 10%; see Interest—Usury, 1 CCH Consumer Credit Guide ¶ 510, at 1302-07 (1972). Some states, New York included, allow for higher rates when dealing with retail installment contracts; see Open End Credit, 1 CCH Consumer Credit Guide ¶ 630, at 2502-08 (1972).

18. E.g., in Kansas the generally allowable rate of interest is 6% whereas on a judgment the allowable rate is 8%. But in Louisiana the legal rate is 7% while the judgment rate is 5%. See Interest—Usury, supra note 17, at ¶ 510.

19. Id. at ¶ 1306. This result is unfortunate, for the effect of lowering the penalties is to encourage businessmen and others to violate the law. It would be much simpler to merely raise the allowable rates.

20. Several states (e.g., Florida), rather than precluding corporations from raising usury as a defense, allow for a much higher rate (15% as compared with the general 6% limit) in corporate transactions. See Interest—Usury, supra note 17, at ¶ 510.

21. 108 Eng. Rep. 792 (K.B. 1827).

sales. In *Beete*, the King's Bench distinguished between interest charges on loans and higher prices for deferred-payment sales of property. Thus, a seller was permitted to offer an article at two different prices, a cash price and a credit or time price. It was immaterial that the time price might exceed the cash price by more than the rate allowable on a loan in that amount for a similar period of time.[22] Although the increased price paid might seem to be consideration for the forbearance of a debt, and therefore to be interest on a loan and subject to the usury regulations, our courts have found such a conclusion to be erroneous.[23] The transaction is viewed basically as a sale.

This doctrine contributed greatly to the relatively recent boom in the consumer products market.[24] The average consumer presented too great a risk and provided too small a return to permit standard loans for the purchase of such items as televisions, washing machines and air conditioners. Only the installment contract, outside the purview of the usury statute, allowed retailers to extend credit on profitable terms to willing consumers.

However, it was early forewarned that this doctrine bore limitations in the attraction it presented as a cloak to cover what is in reality a usurious loan.[25] For this reason the courts have removed certain factual situations from the protection of the doctrine. Usury has sometimes been found when the buyer and the finance company agree prior to the sale that it will be financed by a purchase of the contract from the seller.[26] Such a transaction, it has been determined, is a loan, even if there is an assignment of the installment contract from the seller to the finance company. Certain jurisdictions have also characterized as usurious transactions where there were close contacts between the finance company and

22. Id. at 794.

23. Hogg v. Ruffner, 66 U.S. (1 Black) 115, 119 (1861). "To constitute usury, there must either be a loan and a taking of usurious interest, or the taking of more than legal interest for the forbearance of a debt or sum of money due. . . . But it is manifest that if A propose to sell B a tract of land for $10,000 in cash, or for $20,000 payable in ten annual instalments, and if B prefers to pay the larger sum to gain time, the contract cannot be called usurious. . . . Such a contract has none of the characteristics of usury; it is not for the loan of money, or forbearance of a debt." Id. at 118-19.

24. See Comment, Judicial and Legislative Treatment of "Usurious Credit Sales", supra note 13, at 1144-45.

25. See, e.g., Seebold v. Eustermann, 216 Minn. 566, 13 N.W.2d 739, 744 (1944). "There are three essential elements entering into and furnishing the tests of whether there is usury in a given case, viz.: there must be (1) a loan or forbearance of money; (2) an agreement for return of money at all events; and (3) an agreement to pay more than the legal rate of interest for its use . . . . Whether a particular transaction is usurious is ordinarily one of fact, not to be determined by 'any hard and fast test,' nor 'by what the parties represent the transaction to be, but by considering the whole evidence . . . . The process involves looking through the form to the substance. No device or shift may be employed to conceal the true character of the transaction.'" Id. at 573, 13 N.W.2d at 743-44 (citations omitted); State Bank v. N.W. Security Co., 159 Minn. 508, 199 N.W. 240 (1924).

26. See State ex. rel. Beck v. Associates Discount Corp., 162 Neb. 683, 77 N.W.2d 215 (1956); cf. Hare v. General Contract Purchase Corp., 220 Ark. 601, 249 S.W.2d 973 (1952).

the seller, *e.g.*, the seller's use of forms and rate charts provided by the finance company in return for partial rebates.[27]

A third exception has been developed rather recently by courts in several jurisdictions which have examined credit transactions to determine whether the transaction involved a "bona-fide-time-price" differential. As part of this "purge" there has been close scrutiny of service charges (generally 1½ percent per month) billed to credit-card holders on amounts for which they chose to delay payment. In several instances these charges have been found to be usurious.[28]

The most dramatic and frequently cited of these decisions was a Wisconsin Supreme Court case, *State v. J. C. Penney Co.*[29] While this decision dealt with a two-party department store credit card, the reasoning adopted by the court might very well be applied to the bank credit card. The court held that when a sale is made and the purchaser fails to pay for the goods upon their receipt a debt is created.[30] The fact that there was a prior agreement between the consumer and the bank to finance all such purchases was discounted, as the court stated that forbearance actually takes place upon the consummation of each sale not directly paid for.[31] Moreover, it was pointed out by the court that for the time-price doctrine to apply, there must have been a clear and obvious presale disclosure of the total obligation. Under a credit card system, whether it be a two or three party transaction, the consumer becomes aware of the ultimate price only upon deciding how many months he will prolong payment.[32] Respondent, J. C. Penney, also argued that the 1½ percent charged per month merely constituted a "service charge." The court refused to accept this argument, stating that the so-called " 'service charge' is not a fixed amount, independent of the amount owed . . . . Rather it is a percentage of a balance of indebtedness and is computed monthly."[33]

In thus finding the Penney credit card system to be subject to the state usury

27. See, e.g., Jackson v. Commercial Credit Corp., 90 Ga. App. 352, 83 S.E.2d 76 (1954); Nazarian v. Lincoln Fin. Corp., 77 R.I. 497, 78 A.2d 7 (1951).

28. See State v. J. C. Penney Co., 48 Wis. 2d 125, 179 N.W.2d 641 (1970); McNish v. General Credit Corp., 164 Neb. 526, 83 N.W.2d 1 (1957); Hare v. General Contract Purchase Corp., 220 Ark. 601, 249 S.W.2d 973 (1952). Arkansas is one jurisdiction where the time-price doctrine has been completely eliminated. See Sloan v. Sears, Roebuck & Co., 228 Ark. 464, 308 S.W.2d 802 (1957).

29. 48 Wis. 2d 125, 179 N.W.2d 641 (1970). This action was brought by the Attorney General of Wisconsin against the J. C. Penney retailing chain for an injunction against any further charges of 1½% per month on the declining balance of its revolving charge accounts. The state alleged that anything in excess of 1% per month was a violation of the $12 per $100 annual usury ceiling established by the legislature. The trial court, in finding for Penney, had refused to apply the time-price doctrine, holding that " 'the right to assert the violation . . . is a right personal to the persons who contract with defendant . . . .' " Id. at 130, 179 N.W.2d at 643. This holding was reversed on appeal and the injunction issued.

30. Id. at 134-35, 179 N.W.2d at 646.

31. Id.

32. Id. at 148, 179 N.W.2d at 653.

33. Id. at 147, 179 N.W.2d at 652.

statute, an analogy was drawn by the court to the bank credit cards issued in the state, which, to a certain extent, had voluntarily complied with the statute.

> Similarly with the distinction between bank charge cards and department store charge cards. It seems universally accepted that the bank can charge no more than one percent per month on the unpaid balance. Yet what is the practical distinction between the two? . . . The assumption that [either] Agreement constitutes a true "credit sale" or "time-price sale" as it has come to be defined in the law, is incorrect.[34]

Dealing more directly with the bank credit cards, the Attorneys General of Oregon[35] and Idaho[36] have registered opinions which would follow the *Penney* court and hold the plans accountable under their respective usury statutes. In Oregon, the First National Bank of Oregon, an issuer of Bank Americard, claimed that permitting the consumer to extend the time of payment for purchases made with their card and accepting and crediting merchants' accounts upon the receipt of the sales slips used in these purchases was analagous to a purchase of receivables, which the state courts had found not to be a loan of money and therefore not subject to interest limitations.[37] The Oregon Attorney General found this position to be untenable, stating that the merchant had no proprietary interest in the sales slips to assign or sell to the bank; the slips were payable to the bank or its order and not to the merchant.[38] It was determined that a loan did not necessitate the delivery of money. The Attorney General pointed out that when purchasing an item the consumer signed a sales slip provided to the merchant by the bank, and in doing so requested from the bank a loan of money which he promised to repay.[39] In considering similar arguments the Attorney General of Idaho found that by using the card provided by the bank the consumer was exercising dominion over money loaned to him by the bank.[40] He felt that the form of the transaction had to be ignored in light of its substance, and that in so doing, no other conclusion could be reached than that the charges levied by issuer-banks were interest charged for forbearance on the collection of a debt and, therefore, subject to the usury statute.[41]

Thus, in those states where credit card transactions are not covered by special retail installment legislation,[42] it would seem that the trend in the courts will be to apply the normal usury rates.[43] The question therefore presents itself whether,

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34. Id. at 137, 179 N.W.2d at 647.

35. Op. Att'y Gen. Ore. No. 6250, Mar. 8, 1967.

36. Op. Att'y Gen. Idaho, Sept. 16, 1969. The discussion of this opinion is adopted from UCD 344-45.

37. Op. Att'y Gen. Ore. No. 6250, Mar. 8, 1967, at 164.

38. Id. at 164-65.

39. UCD 345.

40. Id.

41. Id. at 345-47.

42. E.g., New York, where the Retail Installment Sales Act provides for an increased rate of interest for sellers or other holders of retail installment contracts. N.Y. Pers. Prop. Law § 404 (McKinney 1962).

43. In addition to Idaho, Oregon and Wisconsin (see notes 29-41, supra, and accompanying text), Arkansas (see note 46, infra, and accompanying text), Montana (see Con-

despite any distinctions between form and substance, bank credit cards deserve the protection of the time-price doctrine. For as has been pointed out by several commentators, when the *Penney* court exposes the credit card as an imposter in seeking its protection, "[i]n point of fact . . . unassailable logic leads to the inescapable conclusion that the *entire* time-price doctrine is a fiction."[44] What then will be the result of "fictionally" removing the bank credit card out from under the "fiction" of the time-price umbrella?

In dealing with this question it will be assumed that the benefits of the bank credit card outweigh its disadvantages. Thus, the only real issue is whether banks can and will continue to perform these services if subjected to strict enforcement of usury statutes. An empirical study has been conducted by the students of the University of Illinois Law Forum on this question.[45] The students examined the effects of an Arkansas decision, *Sloan v. Sears, Roebuck & Company*,[46] which reached the same conclusion as the *Penney* court, on the economic climate in that state. It was found that although institutions in Arkansas continued to provide consumer credit, now at a much lower rate, the standards imposed for availability were considerably more stringent.[47] As a result, many of those who

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sumer Credit and Truth-in-Lending Compliance Report, Finance Charges on Montana Sales, Aug., 1972 at 2), Connecticut (Donnelly v. Sears. Roebuck & Co., 1 CCH Consumer Credit Guide ¶ 99,570, at 87,525 (Conn. Ct. C.P. Dec. 2, 1970)), Minnesota (see Consumer Credit and Truth-in-Lending Compliance Report, Revolving Accounts Usurious in Minnesota, May, 1971, at 2), South Dakota (id.), and the District of Columbia have imposed interest rate restrictions upon credit card transactions. But cf., Iowa (see Consumer Credit and Truth-in-Lending Compliance Report, All Iowa Sales Exempt from Usury Law, Aug., 1972, at 1) and Maine (see Consumer Credit and Truth-in-Lending Compliance Report, Retailers May Charge 1.5 Percent in Maine, Apr., 1972, at 2-3) have refused to apply such restrictions.

44. 69 Mich. L. Rev. 1368, 1377 (1971). See also McEwen, Economic Issues in State Regulation of Consumer Credit, 8 B.C. Ind. & Com. L. Rev. 387, 390-91 (1967), wherein the author correctly points out that consumer credit comes into existence whenever an individual acquires goods or funds for the purchase of goods for personal use in return for a promise to pay for the same in the future. There would thus seem to be no reason for distinguishing between the two with regard to interest regulation.

45. Comment, An Empirical Study of the Arkansas Usury Law: "With Friends Like That . . ." , 1968 U. Ill. L.F. 544. See also G. Gordon, J. Wheatley, G. Gaedeke, H. Hallaq, & D. McNabb, The Impact of a Consumer Credit Interest Limitation Law, Washington State: Initiative 245 (1970).

46. 228 Ark. 464, 308 S.W.2d 802 (1957). In this case Sears had sold Sloan merchandise on credit with a carrying charge of over 10%. Sloan sued to have the contract declared void for usury. The court held that normal interest limitations applied to the sale of merchandise. "[I]f we should hold that this contract is not usurious, it would be a precedent by which all the sellers of merchandise of every kind and description could add any amount to the cash price as interest, carrying charge, differential or what not, that those whom the Constitution and statutes were designed to protect would of necessity agree to pay." Id. at 473, 308 S.W.2d at 808.

47. Empirical Study, supra note 45, at 587. The author, in comparing the availability of credit in Arkansas, where the time-price differential had been discarded, and Illinois, where it had not, made the following observation: "An Arkansas borrower who has only

most benefited from the old time-price doctrine were being denied credit.[48] Furthermore, it was reported that some lenders were now engaging in what might be considered disreputable practices in order to avoid the new policy. For example, excessive credit insurance charges, failure to return prepaid but unearned charges and an increase in loan sharking were discovered.[49] It was also discovered that retailers would charge higher cash prices in addition to extra credit costs,[50] thus extending the effects of the court's decision to cash as well as credit purchasers.

Whether the taking of such steps was necessary for the economic survival of Arkansas lenders or whether their reactions were prompted by a desire to maintain the earlier margin of profit is an open question. There is some evidence that ratios of costs to revenues from credit operations for revolving charge accounts are lower than for installment sales.[51]

The National Retail Merchants Association has also determined from studies of revolving charge accounts that for the average active account total credit costs exceed revenues from service charges.[52] There is no comparable data available for bank credit card plans;[53] however, even were it to be found that their profitability rates were much higher, the probable effects of an artificially low ceiling provided by usury statutes would be to dampen seriously the consumer's, and therefore the merchant's, economic position. The Nebraska Legislature, foreseeing that such results would follow from a *Penney*-like decision by their Supreme Court,[54] responded quickly by amending the state constitution[55] and by enacting

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limited service at his present employment, is new in the city, does not have a telephone or is a laborer would almost certainly encounter difficulties obtaining a loan. The same type of borrower in Illinois, however, would probably be considered an average, if not a good, credit risk." Id. at 586-87. Thus the effects of the Sloan decision seem to have been felt most severely by those who could least afford it, i.e., the lower and middle income poor to average credit risks.

48. Id.

49. Id. at 588.

50. Id.

51. Id. Cash prices were found to be four to seven percent higher in Arkansas than in neighboring states as a result of the Sloan decision.

52. National Retail Merchants Ass'n, Economic Characteristics of Dep't Store Credit 16 (1968). It was determined that for all stores included in the study total costs of revolving credit exceeded revenues by 1.78%. Id.

53. But see Hearings on H.R. 12646 Before the House Comm. on Banking and Currency, 90th Cong., 1st Sess. 10 (1967), wherein Andrew Brimmer, member of the Board of Governors of the Federal Reserve System, testified 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." There is evidence that as much as 40% of bank credit card transactions are solely convenience-card or payment oriented in nature. N.Y. Times, Sept. 23, 1970, at 66, col. 7. It is evident, therefore, that on the whole banks are not receiving 1½% per month for their services.

54. Lloyd v. Gutgsell, 175 Neb. 775, 124 N.W.2d 198 (1963), wherein the court held that "[w]here a time sale price is determined by applying a certain schedule of rates or charges to the cash price, the resulting product is interest." Id. at 782, 124 N.W.2d at 204.

55. Neb. Const. art. III, § 18.

legislation which specifically protected revolving and installment credit.[56] It is only the earlier lack of legislative effort which has allowed the courts to be so "creative" in their treatment of consumer credit. One hopes that other states take heed of the judicial mood and begin to take action to protect the viability of bank credit cards.

III. Defenses

Another issue in the law of credit cards where the potential for innovation is great is whether defrauded or disappointed cardholders can assert defenses available as to the merchant against the collecting bank. In a normal two-party transaction, a consumer has the ability to assert such defenses in an action brought by a merchant to collect amounts due, thereby enjoying a tactical advantage if the goods are below standard by forcing the merchant to take the initiative.[57] The consumer would argue that he should be equally protected from any defect in merchandise in a three-party credit card transaction.

The major argument in favor of relieving the banks of the debtor's defenses is one of cost. Any controversy which disturbs the orderly receipt of monthly checks impedes administrative efficiency and increases costs.[58] The banks also claim that it is the purchaser's obligation, not theirs, to police a merchant's activities. Therefore, the normal card-holder-bank agreement contains a clause denying the consumer the right to raise these defenses against the issuer.[59] Until quite recently it had not been decided whether such a contract should or could be enforced.

In dealing with the legal issues involved, creditor advocates maintain that the issuer of a card is an assignee for value of an obligation owing to the merchant and can therefore rely on a waiver of defenses clause.[60] This argument has in part been accepted and codified within the Uniform Commercial Code. Section 9-206 provides:

> (1) Subject to any statute or decision which establishes a different rule for buyers . . . of consumer goods, an agreement by a buyer . . . that he will not assert against an assignee any claim or defense which he may have against the seller . . . is enforceable by an assignee who takes his assignment for value, in good faith and without notice

56. Neb. Rev. Stat. §§ 45-204 to -208 (1968).

57. See notes 84-88 infra and accompanying text. See also Bergsten 514-15 for a detailed discussion of the tactical problems involved; Barnes, supra note 1, at 649-50; Bank Charge Cards 1041-45.

58. Bergsten 513.

59. See, e.g., the form of agreement employed in the Midwest Bank Credit Card plan, where the holder must agree that the "[i]ssuer has no responsibility for merchandise or services purchased by Customer . . . and Customer agrees to pay issuer for all credit purchases even though a dispute may exist." Davenport, supra note 3, at 247. See also Bergsten 509.

60. See Bergsten 509-12; Bank Charge Cards 1043-44. But see Davenport, supra note 3, at 241-42; Clontz, supra note 3, at 900, where this approach is criticized. See also Uniform Consumer Credit Code §§ 3.102 & 3.104 [hereinafter cited by section as UCCC] which classify such a transaction as a loan.

of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course . . . .[61]

It has also been claimed by creditor advocates that the issuer is in effect a holder in due course of an obligation owing to the merchant evidenced by a document which comes under the protection provided by UCC sections 3-805 and 3-305 (*i.e.*, the sales slip).[62] The sections provide in pertinent part:

> To the extent that a holder is a holder in due course he takes the instrument free from (1) all claims to it on the part of any person; and (2) all defenses of any party to the instrument with whom the holder has not dealt . . . . [3-305].
>
> This Article applies to any instrument whose terms do not preclude transfer and which is otherwise negotiable within this Article but which is not payable to order or to bearer . . . . [3-805].[63]

Consumer advocates have little trouble in dealing with these arguments. As for the assignee of instruments theory, they would first refer to that clause in section 9-206 which states that both state legislatures and courts might alter this rule when dealing with purchasers of consumer goods.[64] This is definitely a sign that the drafters felt the need for special protection of consumers. Moreover, although there are cases in which it has been held that the issuer of a credit card was an assignee of the merchant,[65] a trend has begun to emerge in several jurisdictions whereby the protection normally provided by this status and that of a holder in due course has been denied in cases involving consumers and third parties to the sales transactions. It may be argued that these developing doctrines should be applied to credit card transactions.

The most prominent of these judicially imposed limitations is that of denying assignee for value or holder in due course status to a financing company that is too closely connected with the merchant's operations or with the particular sale at issue.[66] This type of connection is obviously present between a bank and a

61. N.Y. U.C.C. § 9-206 (McKinney 1964) [hereinafter cited by section as UCC].

62. See Bank Charge Cards 1041-42.

63. UCC §§ 3-305, -805.

64. See note 61 supra and accompanying text.

65. See Gulf Refining Co. v. Williams Roofing Co., 208 Ark. 362, 186 S.W.2d 790 (1945) (stolen credit card); Diners' Club, Inc. v. Whited, Civ. No. A 10872, Los Angeles Super. Ct., Aug. 6, 1964 (the Los Angeles Superior Court held that even if the obligation arose out of an assignment it would be construed as being conditional upon the merchant's fulfillment of his obligations under the contract of sale); Bergsten 509-10 (where the author discussed the Whited holding).

66. See Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967), wherein it was held that a partnership which had been formed solely for the purpose of financing the conditional seller of consumer goods and which exercized extensive control (i.e., credit qualifications, forms for notes and contracts and other administrative procedures) over the seller's entire business operations, did not have the status of a holder in due course with respect to a note executed by a conditional buyer and assigned to the partnership by the seller. Therefore, it was held in this action brought on a note by the partnership that the buyer could assert the defense of failure of consideration for lack of delivery against the partnership. See also Commercial Credit Corp. v. Orange County Machine Works, 34 Cal. 2d 766, 214 P.2d 819 (1950); Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940).

seller participating in a credit card plan. Under most plans the bank maintains a demand deposit account on behalf of the merchant and provides the merchant with sales slips, promotional material, an imprinter and applications to be distributed to customers who wish to join the program. It might also be argued in this vein that inasmuch as many consumers are attracted by the convenience provided by merchants accepting the bank credit card, many sales would not be made in the absence of the agreement. Other courts have adopted a theory which denies protected status in consumer credit cases if there is knowledge on the part of the third party financing institution of the defect which gave rise to the consumer's defense.[67] Although imposing a considerably heavier burden of proof, this theory might also be applied in bank credit card cases. If it can be shown that the particular merchant involved has regularly been dealing in defective goods and that the bank knew or should have known, because of past collection problems, that the problems would continue to arise, this theory might be combined with an affirmative cause of action (or set-off) brought by the consumer in negligence.[68]

Lender liability under such circumstances is not completely unknown. For example, the California Supreme Court has held that a bank which provided financing to a contractor for the construction of homes would be liable to the purchasers of these homes for defective construction.[69] Precedent for such a finding in the credit card area might also be found in a California decision, *Hanberry v. Hearst Corporation*,[70] where it was held that the owners of the Good House-

67. See Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967); Littlefield, Good Faith Purchase of Consumer Paper: The Failure of the Subjective Test, 39 S. Cal. L. Rev. 48 (1966).

68. See Bank Charge Cards 1044, wherein the authors discuss one instance where a negligence cause of action was attempted, in a bank credit card case.

69. Connor v. Great Western Sav. & Loan Ass'n, 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968). There an action was brought by purchasers of a single family house against various parties involved in the development of the residential tract, including the savings and loan association which financed the development. The court determined that despite the lack of privity of contract (for construction) with the plaintiff, the fact that the success of the development depended on the lender's ability to induce plaintiff and others to have the defendant finance their purchases, that the defendant knew or should have known that persons in charge of the construction companies were operating on thin capitalization thereby creating risks of cutting corners in construction, and that the purchasers were unable to discern any structural defects was sufficient to impose upon the defendant the duty to exercize reasonable care to prevent the construction and sale of seriously defective homes.

70. 276 Cal. App. 2d 680, 81 Cal. Rptr. 519 (1969). The case was brought by the purchaser of a pair of shoes for personal injuries sustained when she slipped on the vinyl floor of her kitchen while wearing shoes guaranteed by Hearst Corporation through the consumer guarantee service of one of its publications. Liability was imposed as a matter of public policy, "Having voluntarily involved itself into [sic] the marketing process, [and] having . . . loaned its reputation to promote and induce the sale of a given product . . . we think [the] respondent . . . has placed itself in the position where public policy imposes upon it the duty to use ordinary care in the issuance of its seal and certification of quality so that members of the consuming public who rely on its endorsement are not unreasonably exposed to the risk of harm." Id. at 684, 81 Cal. Rptr. at 522.

keeping Seal could be held liable to a consumer who was injured while using a product under circumstances where the Seal appeared on the product or in advertising for the product.

Banks, however, are not limited to the assignment and holder in due course theories in attempting to exclude themselves from consumer defenses. The position has also been taken that when signing the sales slip upon reaching an agreement with a merchant, the consumer has assumed a "direct obligation" to the bank to pay for the merchandise in accordance with the cardholder agreement.[71] The Uniform Consumer Credit Code, for instance, implicitly adopts this theory by characterizing bank credit card transactions as direct loans to consumers by banks.[72] Lenders, of course, are not subject to any defenses which the borrower has against the seller for goods purchased with the borrowed money.[73]

An outgrowth of this theory is the position taken by several commentators that the bank credit card transaction is so similar to a letter of credit arrangement that it should also be governed by Article 5 of the Uniform Commercial Code.[74] A letter of credit is defined as "an engagement by a bank or other person made at the request of a customer . . . that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit."[75] As with a credit card, the purpose of a letter of credit is to substitute the financial responsibility of a bank for that of a party to a commercial transaction. A seller, generally one at a distance, will insist upon a provision in a sales agreement compelling the buyer to produce a letter of credit issued by a reputable bank. The buyer will then obtain the letter of credit by a written application to the issuer in which he promises to reimburse the issuer for payments made pursuant to the letter of credit. The letter guarantees that the seller will be paid when a draft drawn by him is pre-

71. See Bank Charge Cards 1045-47; Bergsten 509-10.

72. See UCCC § 3.104. A "'consumer loan' is a loan made by a person regularly engaged in the business of making loans in which (a) the debtor is a person other than an organization; (b) the debt is incurred primarily for a personal, family, household, or agricultural purpose; (c) either the debt is payable in instalments or a loan finance charge is made; and (d) either the principal does not exceed $25,000 or the debt is secured by an interest in land."; UCCC § 3.106 ("'Loan' includes (1) the creation of debt by the lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor; (2) the creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately; (3) the creation of debt pursuant to a lender credit card or similar arrangement. Id.); UCCC § 3.106, Comment, provides that "[a] loan is made . . . by paying a retailer or other person the obligation incurred by the holder of a lender credit card . . . ."

73. See Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967), wherein the court, in keeping with this proposition, determined that an exception should be created and the creditor's rights be made subject to consumer defenses when the creditor and retailer were closely related. See also note 69 supra.

74. See Bank Charge Cards 1046-50; Bergsten 512-13; Clontz, supra note 3, at 890-93; Davenport, supra note 3, at 234-40; Comment, the Applicability of the Law of Letters of Credit to Modern Bank Card Systems, 18 U. Kan. L. Rev. 871 (1970).

75. UCC § 5-103(1)(a).

sented through banking channels to the issuer. By honoring drafts complying with the terms of the credit, the issuer is entitled to immediate reimbursement of any payment made.

The similarities between this system and a bank credit card plan are striking.[76] Most important to the creditor advocate, however, is section 5-109 of the Uniform Commercial Code which provides that:

> (1) 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 . . . .[77]

Because of their basic similarities it has been argued that this provision should also apply to a bank's liability in a credit card transaction.[78]

However, as was pointed out earlier,[79] the courts have been moving closer to absolute rejection of these arguments in the area of consumer credit. Furthermore, the legislatures of certain states are beginning to act. California has recently enacted a statute whereby:

> [t]he right of a card issuer to recover any credit extended through use . . . of a credit card . . . shall be subject to the defenses which the cardholder has as a buyer against the retailer from whom the cardholder made the purchases . . . .[80]

The New York Legislature considered a similar bill during its last session;[81] it died in committee but is to be resubmitted during the coming session.[82] Similar action is being contemplated in other states.[83] Thus, the future of a waiver of defenses clause in bank-card-holder agreements would seem to be bleak indeed.

The question remains as to whether the advantages such an approach provides to the consumer are worth the costs accruing to the banks and whether the banks will, as a result of this trend, continue to be so enthusiastic in their development of these programs. Practically speaking, most consumers are satisfied with the goods and services they purchase. If they are not, the merchant is, in most cases, more than willing to remedy the defect by either adjusting the price, allowing for an exchange, or crediting the consumer's account for the returned merchandise.[84] A problem arises only if the merchant refuses to acknowledge or satisfy a justified consumer complaint or if the merchant becomes insolvent or moves away.

76. See generally Comment, supra note 74.
77. UCC § 5-109.
78. See sources cited note 74 supra.
79. See notes 64-74 supra and accompanying text.
80. Cal. Civ. Code § 1747.90 (West Supp. 1972).
81. N.Y. Legis. Doc., Sen. No. 6483-A, Apr. 22, 1971.
82. This information was obtained in a telephone conversation with an aide to Senator Brydges, Chairman of the Senate Rules Committee. See also National Consumer Act § 2.407.
83. National Consumer Act § 2.407.
84. See Bergsten 514-18.

As for the first situation, it has been stated that "[e]ven though this attitude is confined to only a few merchants, it exists, and it seems to exist in undue concentration in lower-income areas."[85] Absent the merchant's cooperation, the less well-off consumer would probably be forced to allow his legal rights to lapse. He may not be aware of his right to sue the retailer for breach of warranty, and even if this were not the case, he may be unable to afford the immediate cash outlay necessary to pay the issuer and retain an attorney. Even those who could afford to do so might choose not to if the amount in question were small.[86] If, however, the buyer were permitted to resist payment to the issuer-bank, his leverage with the merchant would be increased, for it would then be to the issuer's advantage to encourage merchants to satisfy the complaints of cardholders. In the long run, if customers continued to complain about and withold payment on accounts of a particular merchant, banks would either increase the discount on that merchant's deposits or terminate his participation in the program. With the prevalence of those who prefer to make credit card purchases the merchant could ill afford such a loss. Under such a system the cost to a bank would not be oppressive, for it could: (1) be more discriminating in choosing the merchants with which it dealt;[87] (2) recoup losses through a higher rate; or (3) cut off a merchant before the losses which he could precipitate became too great. The advantages to the consumer are obvious. In the second situation—the insolvent or disappearing merchant—one is presented with a rather simple policy decision. It is impossible to expect that a consumer would be willing or able to chase such a merchant on any particular sale, and it would be ludicrous to expect him to investigate the stability of each retailer with whom he deals. However, banks are able to do so, and, as discussed above, should be required to exercise such care before allowing their cards to be used as lures by a merchant.[88]

It would seem, therefore, that the statutory scheme adopted in California is the best solution and should be seriously considered in other jurisdictions.[89]

85. Id. at 514. See also James, New Deal in Cards, Wall St. J., Jan. 17, 1967, at 1, col. 8: "Bank (credit) cards are issued largely to lower-income consumers, who use them mostly to charge purchases at retail establishments, many of which are small;" note 53 supra and accompanying text; note 90 infra.

86. See Griffin 1-25 for a discussion of the problems encountered by those who have attempted to challenge banks in spite of those risks discussed in the text accompanying this note.

87. A problem arises in an interchange or national card system where an issuing bank is held responsible for a merchant who was brought into the system by another member bank. This can be avoided either by establishing minimum standards throughout the system or by setting a geographic limit on the rights of consumers to raise defenses. See Bank Charge Cards 1064-68.

88. See notes 69 & 70 supra and accompanying text.

89. The New York proposal and the California statute both include a monetary limit; i.e., that there must be a claim of at least $50 before the defense can be raised. This provision is defended in Bank Charge Cards 1059-64. The authors justify the limitation by arguing that when a purchase of less than $50 is made, the bank, substantively speaking, is involved in a loan of cash, and that in a direct loan situation defenses are never available. Moreover, they point out that "[a]ny right on the part of the consumer to assert defenses against the

IV. Unauthorized Use of Credit Cards

Accompanying the meteoric rise in the use of credit cards has been the creation of a new and very expensive business risk—credit card fraud. The practice of honoring a credit card without requiring identification other than a signature or the card itself made it relatively easy for someone to purchase goods or services by holding himself out as the authorized holder of the card.[90] The resultant losses have been estimated to run anywhere from 20 to 200 million dollars a year.[91] The distribution and minimization of such losses, therefore, become matters of great public concern.

Until recently the allocation of these losses has been left to the card issuers. In an attempt to protect themselves, issuers included specific contract clauses in agreements shifting, wherever possible, the burden of the loss to the cardholder.[92] The earliest of such provisions provided basically that the cardholder would be liable for all purchases made with his card until it was surrendered to the issuer.[93] There are but two reported cases in which such a clause has been interpreted.

The first of these was the 1943 decision of *Magnolia Petroleum Co. v. McMillan*.[94] In that case the cardholder had loaned his card to two friends without reporting its misuse to the issuer. The Texas court, ignoring the issue of negligence, based its decision upon a strict application of the agreement, *i.e.*, the cardholder was held liable solely on the basis of his agreement to be responsible for all purchases made with his card prior to its surrender.[95] The Supreme Court of Arkansas, however, reached a contrary result in a 1945 case, *Gulf Refining Co. v. Williams Roofing Co.*[96] There the court emphasized the presence of negligence and bad faith in determining how liability should be assigned. As the evidence clearly pointed to specific acts of collusion between the fraudulent party

issuer will place burdens on the systems; but if the right is granted in all transactions no matter how small, those burdens will be aggravated and may even be intolerable." Id. at 1062. But cf. text accompanying notes 83-88 supra. To limit the right to bring a defense to purchases of $50 or less would defeat the purpose of allowing it to be brought at all, for as the authors of Bank Charge Cards point out, "the average dollar amount for all sales slips in 1968 was approximately sixteen dollars . . . ." Bank Charge Cards 1060.

90. See Bartlett & Reed, Retail Credit Practice 134-38 (1928); Maidenberg, Personal Finance: Holders of Credit Cards Are Warned that Losing Them Can Prove Costly, N.Y. Times, Sept. 18, 1967, at 69, col. 3.

91. See Maidenberg, supra note 88, at 84 (estimated losses to be $20-$50 million); H.R. Rep. No. 1500, 91st Cong., 2d Sess. 7-10 (1970) (Mr. Howard of Polaroid Corp., testifying on the development of photographic products to be used in the battle against credit card fraud, estimated losses to be $200 million).

92. See, e.g., Magnolia Petroleum Co. v. McMillan, 168 S.W.2d 881 (Tex. Civ. App. 1943). The following clause was found in a gasoline credit card: "'[t]he named holder shall be responsible for all purchases made by use of this card, prior to its surrender to the issuing company, whether or not such purchases are made by the named holder . . . .'" Id. at 881.

93. See note 100 infra.

94. 168 S.W.2d 881 (Tex. Civ. App. 1943).

95. Id.

96. 208 Ark. 362, 186 S.W.2d 790 (1945).

and the merchants who honored the card, the court refused to enforce the contract as written.[97] Rather, it held that a retailer's negligence or bad faith would defeat an issuer's claim for the strict enforcement of a surrender clause against a holder.[98]

Perhaps hoping for a more consistent and receptive judicial attitude, issuers subsequently altered the agreements to include a liability-until-notice clause.[99] Much less one-sided than the surrender clause, this provision placed the risk of unauthorized purchases on the holder until the issuer received written notice that the card had been lost or stolen.[100] Again, however, two separate and distinct lines of judicial thought developed as to when such a clause should be strictly enforced.

The strict contract approach is best exemplified by the decision in *Texaco, Inc. v. Goldstein*.[101] There the issuer sought a judgment for purchases made on the defendant's card after the card was stolen and before they had been notified of the theft. In holding that the credit card contract would be decisive on the question of liability, the New York court refused to recognize as a valid defense either the negligence of the retailer or the fact that the notice clause had not been properly drawn to the holder's attention.[102] This approach was completely rejected by the Supreme Court of Oregon in the case of *Union Oil Co. v. Lull*.[103] In this, another stolen gasoline card case, a liability-until-notice clause was interpreted as subjecting the holder to liability *only* if due care was exercized by the merchant and its agents in determining the authority of the person presenting

97. Id. at 370, 186 S.W.2d 793-94. One of the plaintiff's agents had stolen the defendant's credit card and had used it to make purchases at several of plaintiff's outlets. Agents representing plaintiff at these outlets permitted the purchases to be made without following the normal identification procedures (e.g., taking the purchaser's automobile license number and requiring that he sign a receipt). This conduct was found by the court to be in breach of "[the] broad guaranty that the person extending credit must do so in good faith." Id. at 369, 186 S.W.2d at 794.

98. Id. at 370, 186 S.W.2d at 795.

99. See Richey, The Apportionment of Credit Card Fraud Loss, 4 U. Cal. Davis L. Rev. 377, 384-85 (1971); Macaulay, Private Legislation and the Duty to Read—Business Run by IBM Machine, The Law of Contracts and Credit Cards, 19 Vand. L. Rev. 1051, 1089-98 (1966); Comment, Credit Cards: Distributing Fraud Loss, 77 Yale L.J. 1418, 1420 (1968).

100. Texaco, Inc. v. Goldstein, 34 Misc. 2d 751, 752, 229 N.Y.S.2d 51, 53 (N.Y.C. Mun. Ct. 1962). The clause at one time employed by Texaco in their gasoline credit card read: "Such [cardholder] assumes full responsibility for all purchases made hereunder by any one through the use of this credit card prior to surrendering it to the company or to giving the company notice in writing that the card has been lost or stolen." Id.

101. Id.

102. The New York court stated "With the increasing use of the credit card and its growing importance to the economy, the imposition of a high duty of diligence upon the major oil companies in general, most of whom use the same or similar systems of credit card transactions, would result in an impairment of an important segment of our economic structure." Id. at 754, 229 N.Y.S.2d at 55. See also Uni Serv Corp. v. Vitiello, 53 Misc. 2d 396, 278 N.Y.S.2d 969 (N.Y.C. Civ. Ct. 1967).

103. 220 Ore. 412, 349 P.2d 243 (1960).

the card to do so.[104] Moreover, the court placed upon the issuer the burden of proving that it had exercized this standard of care.[105]

The coexistence of the two divergent lines of case law created a situation which proved to be unworkable. If it were assumed that liability should be placed on the cardholder, the inability to specify the conditions under which such liability would attach, and the resultant uncertainty of all the parties involved, would make such a choice intolerable. Furthermore, in terms of the efficient minimization of loss, optimal results could be achieved only if liability were imposed upon the issuer.

From the viewpoint of the cardholder, the overall costs of fraud loss are incomprehensible, and without the degree of care this knowledge would impart, losses cannot be minimized.[106] Even if the necessary information were available to him, an individual cardholder does not have the control necessary to meaningfully alter the large systems presently in existence.[107] This is particularly true where the tripartite systems of bank credit cards are concerned. The issuer, however, because he is constantly handling such a large volume of credit transactions, is capable of determining the cost of credit card fraud. Moreover, because of his control over the operation, including the system of identification utilized, the issuer is in a position to effectively decide whether to take preventative measures, *i.e.*, by the use of pictures, fingerprints, code devices, etc.[108] Thus, only by im-

104. Id. at 427-28, 349 P.2d at 250. This ruling was based primarily on the court's interpretation of a credit card transaction as a surety contract, making the cardholder a gratuitous indemnitor. "[T]he essentially gratuitous character of the indemnitor's promise [to pay for all purchases prior to notice is a basis] for treating the contract as embodying an implied promise on the part of the indemnitee to exercise reasonable diligence to protect the indemnitor in transactions which may create indemnity liability." Id. at 427, 349 P.2d at 250.

105. Id. at 436, 349 P.2d at 254. See also Allied Stores v. Funderburke, 52 Misc. 2d 872, 277 N.Y.S.2d 8 (N.Y.C. Civ. Ct. 1967).

106. See Comment, Credit Cards: Distributing Fraud Loss, supra note 99, at 1421-26.

107. See, e.g., the discussion in Allied Stores v. Funderburke, 52 Misc. 2d 872, 277 N.Y.S.2d 8 (N.Y.C. Civ. Ct. 1967). "While it may be imperative in this age of modernization for mercantile establishments to embrace, compress and sort information from differing departments through the use of electronic data-processing equipment, it is manifestly unfair to shift the burdens of its inadequacies or failures to the innocent consumer whose status, in this modern day, remains unchanged. It is immaterial whether the defendant is the sole customer or is one of one and a half million customers to whom credit cards have been issued . . . ." Id. at 878, 277 N.Y.S.2d at 15.

108. See 15 U.S.C. § 1643(a) (1970); Murray, A Legal-Empirical Study of the Unauthorized Use of Credit Cards, 21 U. Miami L. Rev. 811, 836 (1967), wherein the author suggests that all credit cards should bear a colored photograph of the holder embedded in "tamper-proof" plastic. In discussing the expense this would impose upon issuers, the author explains that "on a mass production basis the cost per card should be less than thirty cents exclusive of the cost of the colored photograph which would be furnished by the applicant for the card. . . . If one considers that one improper use of an existing card for $10,000 is equal to what is [sic] would cost to produce over 33,000 cards, the advantages would seem obvious." Id. at 837 (footnote omitted). Such a system would, moreover, be simple enough to institute. "Thousands of high schools and colleges in the United States have been issuing credit-card size identification cards with photographs for years, hence

posing the burden of loss upon the party most capable of reacting will these losses be minimized.

Faced with this realization, Congress and the state legislatures were forced to act. Consequently, the relevant sections of the federal Truth-in-Lending Act were amended to read, in pertinent part:

(a) A cardholder shall be liable for the unauthorized use of a credit card only if . . . liability is not in excess of $50, the card issuer gives adequate notice to the cardholder of the potential liability, the card issuer has provided the cardholder with a self-addressed, prestamped notification to be mailed by the cardholder in the event of the loss or theft of the credit card, and the unauthorized use occurs before the cardholder has notified the card issuer . . . . Notwithstanding the foregoing, no cardholder shall be liable for the unauthorized use of any credit card which was issued on or after the effective date of this section, and, after the expiration of twelve months following such effective date, no cardholder shall be liable . . . regardless of the date of its issuance, unless (1) the conditions of liability specified in the preceding sentence are met, and (2) the card issuer has provided a method whereby the user of such card can be identified as the person authorized to use it.[109]

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the technical details are not insurmountable." Id. See also Truth-in-Lending—Special Releases —Correspondence, 4 CCH Consumer Credit Guide ¶ 30,652, at 66,288 (excerpts from a Federal Reserve Board Letter of Mar. 11, 1971, No. 454, by Griffith L. Garwood). The letter reads, in part, as follows: "[W]ith respect to new cards issued after January 25, 1971, any credit card issuer wishing to hold cardholders liable for up to $50 for unauthorized use may do so only if, among other things, a method has been provided by which the user of the card can be identified as the person authorized to use it. . . . * * *'s patent consists of a card which is incomplete without the insertion of a key with matching indeces [sic]. A portion of the raised name and number on the card is completed by insertion of the key. The key would be carried separately with other house, office or car keys so that the possibility of both the key and the card being lost or stolen would be remote. Theft through the mails would also be minimized by sending the key and card separately . . . .

In our view this key-card system is 'a method whereby the user of such card can be identified as the person authorized to use it' under the provisions . . . of Regulation Z." Id. (citation omitted). See also note 107 supra and accompanying text.

109. 15 U.S.C. § 1643(a) (1970). In addition to the standards established by Congress, there are the requirements of Regulation Z, promulgated by the Federal Reserve Board to implement the Truth-in-Lending legislation. Regulation Z demands, for instance, that the card issuer provide the cardholder with "an addressed notification requiring no postage to be paid by the cardholder which may be mailed by the cardholder in the event of the loss, theft, or possible unauthorized use of the credit card." 12 C.F.R. § 226.13(c)(4) (1972); that irrespective of this requirement, the cardholder may give sufficient notice either "to the cardissuer or his designee in person or by telephone or by letter, telegram, radiogram, cablegram," id. at § 226.13(f), or by taking any steps "as may be reasonably required in the ordinary course of business," id., and that any written notice "shall be considered given at the time of receipt or, whether or not received, at the expiration of the time ordinarily required for transmission, whichever is earlier," id.; and that the card issuer provide a method of identification "such as by signature, photograph, or fingerprint on the credit card or by electronic or mechanical confirmation." id. at § 226.13(d). Moreover, the Federal Reserve Board has served notice in the form of "letter rulings" that notice to the cardholder of his potential liability for the first $50 lost must be plainly visible on the card, Truth-in-Lending—Special Releases—Correspondence, 4 CCH Consumer Credit Guide ¶ 30,772 at

Furthermore, the *Union Oil Co.* rule as to burden of proof was adopted by placing that burden on the issuer to show either that "the use was authorized or . . . that the conditions of liability for the unauthorized use of a credit card, as set forth in subsection (a) of this section, have been met."[110]

This legislation goes a long way toward providing the uniformity necessary for the effective administration of preventative measures. Although the cardholder might still be held responsible for the first $50 of loss, this can be done *only* if he is adequately notified of that possibility; presented with the opportunity of giving notice of loss as quickly as possible; and a system of identification capable of preventing unauthorized use is instituted, all at the issuer's expense.

V. CONCLUSION

If growth in the use of bank and other tripartite credit cards is to lead to a "cashless and checkless society" they must be made to function more efficiently and their benefits more equitably distributed. The courts have not been up to this task. The judicial process is too slow and limited, more often than not, to distinguishable sets of facts. In the areas of usury and consumer defenses, presently existing statutes are also inadequate. They were not drafted with the bank credit card in mind, and would have to be stretched beyond reason to meet the problems presented. Either amendment or a new code is called for.

This Comment has dealt with only three of the problems which have arisen. As to credit charges which should be allowed, it is suggested that the old judicially created time-price doctrine be codified and limited by the currently accepted rate of 1½ percent per month. As far as can presently be determined, the system can function to the benefit of both banks and the majority of consumers at this rate. In dealing with the problem of defenses, it is proposed that consumers be allowed to assert them as against issuing banks. The original costs this will impose upon

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66,338-39 (1972), and that in restricting cardholder liability to $50, Congress intended the limitation to apply irrespective of the number of times the card is used in an unauthorized manner. Id at ¶ 30,641, at 66,284. It should be noted that neither Congress in the Truth-in Lending Act, 15 U.S.C. § 1643(c) (1970), nor the Federal Reserve Board through Regulation Z, 12 C.F.R. § 226.13(h) (1972), impose liability upon a cardholder for the unauthorized use of a credit card in excess of his liability for such use under other applicable law or under any agreement with the issuer.

110. 15 U.S.C. § 1643(b) (1970). Addition of Section 1643 to the Truth-in-Lending Act has given rise to a dispute as to whether it was intended to protect only the individual cardholder, and therefore not the corporate holder. The original purpose of the Act was to protect only the consumer. As such, it is inapplicable to "credit transactions involving extensions of credit for business or commercial purposes." 15 U.S.C. § 1603(1) (1970). The Federal Reserve Board therefore originally construed the fraud provisions of Section 1643 so as not to apply to company credit cards (issued to corporate executives and employees, either bearing the company name or the company and employee names jointly). 4 CCH Consumer Credit Guide ¶ 30,708, at 66,309. The Board has, however, recently reversed itself on this position, proposing an amendment to Regulation Z expressly applying the limitation of liability to all credit cards. Federal Reserve Board Order of Aug. 3, 1972, 37 Fed. Reg. 16408 (1972). The trend is clearly toward imposing upon the issuer as heavy a burden as a reasonable interpretation of Truth-in-Lending will allow.

banks are necessary. These, and the restrictions in the number of participating merchants which must result from the quality requirements banks would establish, will eventually be phased out as consumers become more and more dependent on the card and merchants clamor to carry it. As for the problem of unauthorized use, one can only hope that the limited burden imposed on the issuer by Congress will spur the desired action; otherwise more specific guidelines will have to be enacted, particularly in the area of cardholder identification. Regardless of the need for future action, the steps taken thus far should make even more evident the need for such legislation in the area of usury and consumer defenses.