Better Than Cash? Global Proliferation of Payment Cards and Consumer Protection Policy

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A global deluge of debit cards and prepaid cards—payment cards that do not require consumers to qualify for credit—is rapidly making electronic payment systems accessible to much of the world's population that previously paid in cash for goods and services. The global proliferation of payment cards is fraught with both risk and promise for consumers. The billions of people of low to moderate incomes who are being hurled from a cash economy into the era of electronic payments in emerging economies by the proliferation of debit and prepaid cards are particularly vulnerable to abuses by banks and merchants. Unregulated private lawmaking by payment card associations and card issuers will not ensure that consumers are treated fairly, due to their countervailing incentives to attract merchants into their payment networks. Technological solutions promote efficiency and limit abuse, but cannot ensure fair resolution of consumer-merchant disputes. Payment card associations such as Visa and MasterCard operate chargeback systems for resolving disputes, but chargeback systems cannot function in cash economies without merchants' consent, because cash transactions are usually anonymous, evidenced

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at most by a receipt, and do not involve an intermediary.

However, while the lack of anonymity inherent in the use of payment cards entails risk for consumer privacy, it also makes possible greater transparency in payment systems. As billions of vulnerable consumers become connected to electronic payment systems, chargeback systems become a possible means of protecting them from merchant misconduct. Moreover, this lack of anonymity makes possible new ways of protecting consumers, such as disclosure to consumers of outcomes of the Visa and MasterCard chargeback systems through merchant ratings such as those posted on eBay. There is a risk that nations with emerging economies will uncritically emulate regimes of consumer protection adopted in the United States and Europe. These regimes in many respects lack a consistent conceptual foundation and fail to address problems, such as bank fees, access to banking services, and payment system insolvency, that are poorly addressed in developed countries if they are addressed at all. For example, debit and prepaid card transactions are both a convenient means of obtaining cash and a substitute for cash, but this does not justify denying chargeback rights to consumers who use debit and prepaid cards as if they had paid in cash.

Prior scholarship on payment cards has suffered from the assumption that American use of credit cards is normative. This Article demonstrates that it is a global anomaly; most consumers worldwide use payment cards for convenience rather than a source of long-term credit, and that is why debit cards have become popular so quickly. Moreover, fees and charges imposed on consumers for payment card services are one of the most prolific sources of consumer complaints. Fee regulation should be regarded as a legitimate part of payments law in scholarship on the subject and should not be ignored in establishing a regulatory system to govern debit and prepaid cards.

I. INTRODUCTION

A global deluge of debit cards and prepaid cards—payment cards that do not require consumers to qualify for credit—is rapidly making electronic payment systems accessible to much of the world's population that previously paid in cash for goods and services. The global proliferation of payment cards is fraught with both risk and promise for consumers. Following an introduction to payment cards and card-based transactions in Part II, Parts III and IV of this Article explore the proliferation of payment cards in emerging and developed economies and the implications of debit cards overtaking credit cards as the world's dominant card-based payment system.

Prior scholarship on payment cards has suffered from the assumption that American use of credit cards is normative. The American credit card culture that gave rise to the rules in the Truth-In-Lending Act on loss allocation such as the $50 "deductible" is today a global anomaly. Most consumers worldwide use payment cards for convenience rather than as a source of long-term credit, and this is why debit cards have become popular so quickly. In Part IV.D, the Article explores how and why American use of credit cards became an anomaly.

Because of the global spread of payment cards, governments throughout the world need to adopt new laws protecting consumers who use them. The billions of people with low to moderate incomes who are being hurled from a cash economy into the era of electronic payments in emerging economies by the proliferation of debit and prepaid cards are particularly vulnerable to abuses by banks and merchants. Part V.A makes the case that private lawmaking by Visa, MasterCard et al. will not protect consumers because the payment card associations' economic incentive is to attract merchants to make the necessary investment in equipment to be able to accept payment cards.

There is a risk that nations with emerging economies will uncritically emulate regimes of consumer protection adopted in the United States and Europe. These regimes lack a consistent conceptual foundation and fail to address problems—such as bank fees, access to banking services, and payment system insolvency—that are poorly addressed in developed countries if they are addressed at all. In Parts V.B and C, the author argues for laws that take advantage of the traceability—the lack of anonymity—of electronic transactions to protect consumers. For example, debit and prepaid card transactions are both a convenient means of obtaining cash and a

substitute for cash, but this does not justify denying chargeback rights to consumers who use debit and prepaid cards as if they had paid in cash. Current rules on the allocation of loss in payment card transactions—the $50 "deductible" for unauthorized credit card transactions in the United States, the "bank statement rule" and deductibles applicable to debit cards, and the fault-based rules adopted in Europe—should be rejected in favor of a simple rule that unauthorized transactions be charged back to the merchant, regardless of the type of card used.

While the lack of anonymity inherent in the use of payment cards entails risks for consumer privacy, it also makes possible greater transparency in payment systems. As billions of vulnerable consumers become connected to electronic payment systems, the chargeback systems regulated and operated by Visa and other card networks become a possible means of protecting them from merchant misconduct. In Part V.B.1, the Article offers a new proposal to promote transparency in the payment card chargeback system: Legislation should be adopted requiring payment card associations such as Visa and MasterCard not only to make their rules public—rules that they currently refuse to disclose on the theory that they are "trade secrets"—but also to compile chargeback data regarding specific merchants and make it available to consumers, in the manner that eBay publicizes the complaint experience of its merchants.

Consumer problems associated with payment card use have changed in the twenty or thirty years since developing countries established their schemes of consumer protection law. For example, today, fees and charges imposed on consumers for payment card services are one of the most prolific sources of consumer complaints, yet they are not generally regulated by existing laws except through the imposition of disclosure requirements that are largely ineffective. Bank fees are not even included in scholarship on "payment systems" and "payments Law." In Part V.D, the Article makes the case that "payments law" should encompass not only regulation of the methods of payment but also regulation of the costs imposed on the use of those methods, just as regulation of the costs imposed on borrowers is an integral part of consumer credit law.

Developing countries newly inundated with payment cards confront problems of consumer protection that differ in some respects from the problems experienced in developed countries. Developing countries therefore should be wary of emulating these schemes, which in many respects are aimed at the kinds of abuses that predominated at another time and in another place. In Parts V.E and F, the Article further explores problems of access to banking

services and insolvency of payment service providers that are particularly relevant to consumers in developing countries but have been treated in the United States as problems of bank regulation rather than consumer protection.

II. PAYMENT CARDS

A. Debit, Credit, and Charge Cards

Debit cards, sometimes issued as "ATM cards," "check cards," "cash cards," or "Smart Cards"[1] are proliferating worldwide at a staggering rate.[2] Debit cards are distinguished from credit cards and charge cards in that the use of a debit card results in a direct debit to the user's bank account, while the use of a credit card or charge card results in an extension of credit to the cardholder.

Credit cards, in turn, are distinguished from charge cards such as the American Express and Diners Club cards in that a credit card balance can be rolled over at the cardholder's option, while charge card balances must be paid in full each billing period. Charge cards, in other words, are intended entirely as convenience cards, while credit cards give the cardholder the right to an extension of credit by rolling over his or her outstanding balance. The distinction has blurred somewhat, however, as American Express has adopted rules permitting the cardholder to roll over certain types of charges, such as travel-related charges.

Although the volume of credit card transactions has grown,[3] in 2003 debit cards overtook credit cards in aggregate dollar volume worldwide at Visa, by far the largest of the payment card networks, representing about half of the global payment card market.[4] Debit

1. "Smart Cards," also called "chip cards," are multifunction cards that include a microchip. They can function as debit cards or credit cards, and perform other data functions. *See infra* Part III.B. "Check cards," too, can have both a debit and credit feature. ATM is the acronym for "automated teller machine."

2. *See infra* Part III; *see also* Ronald J. Mann, *Making Sense of Payments Policy in the Information Age,* 93 GEO. L.J. 633, 653 (2005) (describing the rise to prominence of debit cards in the United States since the late 1990s).

3. COMM. ON PAYMENT AND SETTLEMENT SYS., BANK FOR INT'L SETTLEMENTS, RETAIL PAYMENTS IN SELECTED COUNTRIES: A COMPARATIVE STUDY, Charts 3–5 (1999), *available at* http://www.bis.org/publ/cpss33.pdf [hereinafter BIS RETAIL PAYMENTS STUDY]; *see also infra* notes 17, 168, tbl. 1.

4. News Release, Visa Int'l Service Ass'n, Visa Global Debit Card Volume Surpasses Credit (Apr. 20, 2004), http://www.corporate.visa.com/md/nr/press217.jsp ("[G]lobal Visa debit card volume reached U.S. $1.48 trillion at the end of 2003, an increase of 17 percent over the previous year. At the same time global Visa credit volume increased 5 percent from the previous year to U.S. $1.45 trillion.").

cards are now the dominant card-based payment system in most countries other than the United States, Canada, and Japan, and the most widely used non-cash consumer payment system in the world. Even in the United States, debit card transactions have risen precipitously, and now represent a higher percentage of Visa point-of-sale (POS) transactions than credit cards.[5]

In China alone, according to the People's Bank of China, over 663 million debit cards were active in 2004, the overwhelming majority of them issued by domestic banks.[6] As of 1995, the number stood at five million.[7]

The key parties to a debit, credit, or charge card transaction are the cardholder (usually a consumer),[8] the merchant, the card issuer (a bank where the cardholder maintains an account or has deposited funds), the "merchant acquirer" (the merchant's bank), the processor that usually processes the transaction for the merchant acquirer, and the payment card association (e.g., Star and Cirrus in the United States) that provides facilities for clearing and settling the transaction between banks.

Debit card transactions resemble credit card transactions in most respects, apart from the debit posted directly to the cardholder's bank account and the fee structure. Debit card transactions in America may be processed through payment card networks such as Visa and MasterCard, or they may be processed through interbank networks such as the Star and Cirrus systems. Other countries like China have their own domestic interbank networks which in many cases are not linked to international networks.

Debit and credit card transactions are governed by a series of contracts.[9] The underlying contract between merchant and consumer

5. Jonathan Zinman, *Why Use Debit Instead of Credit? Consumer Choice in a Trillion-Dollar Market*, FED. RES. BANK OF N.Y. STAFF REPORT 91, July 15, 2004, at 2, *available at* http://www.newyorkfed.org/banking/debit_or_credit.pdf.

6. *China Issues 762 Million Bank Cards by 2004*, XINHUA NEWS AGENCY, Feb. 14, 2005. In contrast, only one million of China's 1.3 billion people have credit cards. *Chinese, Foreign Banks Jointly Develop Credit Cards*, ASIA PULSE, Jan. 6, 2004, § Northern Territory Regional.

7. *See* Ted Griffith, *MBNA Sets Sights on China*, THE NEWS JOURNAL, May 23, 2004, *available at* http://www.delawareonline.com (search using "Archive" button for "MBNA Sets Sights on China") (pointing out that most people have to make bank deposits and withdrawals in person, apparently due to the lack of checking accounts).

8. *See infra* text accompanying note 15. Many countries do not draw a distinction between consumer and non-consumer debit cardholders. The United States and certain European Union countries do.

9. Charge card transactions such as American Express are structured somewhat differently, in that American Express performs both the card issuer and merchant acquirer functions. This is beginning to change recently, as American Express has begun to allow banks to issue American Express cards.

gives rise to the payment obligation and authorizes the merchant to draw funds from the consumer's bank account to satisfy it. The consumer-card issuer contract governs the obligation of the bank to honor an authorized order to pay funds from the consumer's account. The merchant-acquirer contract governs the rights of the merchant to be credited with funds by the merchant acquirer once the merchant presents the transaction to the merchant acquirer, and the right of the merchant acquirer to deduct a fee, called a "discount." The merchant transfers its rights against the consumer to the merchant acquirer, who then transfers these rights to the card issuer in exchange for payment in accordance with payment card association rules that contractually bind both banks as association members. The card issuer then debits the consumer's account for the authorized amount in accordance with the payment order and its contract with the consumer.

The costs of processing payment card transactions generally are borne by merchants through discount fees paid per transaction to their merchant acquirers. The merchant acquirers are the merchant's banks, members of Visa, MasterCard, or another card association, which either own—as in the case of Chase—or are part of a bank association affiliated with, a processing entity, the largest of which in the United States is First Data Corporation. These banks are called "merchant acquirers" because by contracting with the merchant to accept payment through Visa or MasterCard they are said to have "acquired" the merchant for the Visa or MasterCard association.[10]

Visa, the largest payment card network, is an association of banks governed by a common set of bylaws and operating regulations. It is organized as the Visa International association, comprised of six regional entities, the largest of which is Visa U.S.A., Inc.[11] Each regional entity is owned by member banks in the region. Worldwide, Visa has about 21,000 member banks. Banks may join as card issuers, merchant acquirers, or both. However, the merchant acquirer business, as a practical matter, is concentrated in a few large banks[12] while many smaller banks join so they can issue payment cards with the Visa logo. The regional entities provide member banks with clearing and settlement facilities for payment card transactions within their region and also with security

10. Wal-Mart Stores, Inc. v. Visa U.S.A., Inc., 396 F.3d 96, 101–02 (2d Cir. 2005).

11. Other regional organizations include Visa Latin America, Visa Asia Pacific, Visa Europe, and a region encompassing Africa and the Middle East. *See* Visa Cards, http://corporate.visa.com/pd/merchant.jsp (last visited Jan. 20, 2006).

12. In the United States, a group of large banks affiliated with First Data Corp., the largest processor, has almost half of the merchant acquirer market, while Chase, which has its own processor called Chase Merchant Services, has about 13% of the market.

technology and procedures. The MasterCard association has a structure similar to Visa's.

So-called "private label" credit cards are cards that can only be used at a particular retailer. These are common in the developing world at present, but have become a minor part of the American card market. Private label credit cards were common in the United States in the 1960s and 1970s, but today most credit cards offered by American retailers to their customers bear the Visa or MasterCard logo and therefore are usable anywhere that accepts Visa or MasterCard cards.

Debit cards are categorized as either personal identification number (PIN) debit, also called "online" debit, or signature debit, also called "offline."[13] PIN debit card transactions require entry of a PIN into a keypad and normally clear through interbank networks such as the Star and Cirrus systems. Signature debit cards are mainly issued in the United States by Visa and MasterCard member banks and bear the Visa or MasterCard logo. In most other countries, such as Canada, all debit cards are PIN-based. A signature is required, as with a credit card.

Although most consumers do not know it, there are significant differences between the two types of debit cards. PIN debit card transactions clear and are debited to the consumer's bank account almost instantaneously. They are real-time transactions. In the United States, the consumer often will be charged a fee by her bank for using another bank's or a merchant's facilities to consummate the PIN debit transaction. Such fees are uncommon in many other countries.

Signature debit transactions, like most checks, take two to three days to clear and to be posted to the consumer's bank account. They are riskier for the merchant, who could go unpaid if during those two to three days the consumer closes or depletes his bank account. However, signature debit is favored by American banks, which receive higher fees from merchants, paid in the form of discounts from what is credited to the merchant's account, than they do in PIN debit transactions. In contrast, merchants benefit from PIN debit in the form of lower discounts, but American consumers have resisted PIN debit due to the fees passed on to them by merchants and banks.

13. "Offline" is really a misnomer. Stored value cards and cash are true "offline" payment devices. Signature debit transactions may be posted and cleared electronically, but they are not posted and cleared in real time like PIN debit transactions.

Many newer debit cards are actually "Smart Cards." Rather than a magnetic strip, Smart Cards contain a microchip. This makes them capable of storing a greater volume of data and performing multiple functions. Smart Cards can have both debit and credit functions, of which the consumer can choose either at the point of sale. They can collect, utilize, and send data about purchases, benefit entitlements, and other information.

For the card issuer, Smart Cards represent an additional source of information about the consumer and a possible source of additional revenue through the use or sale of that information. For the consumer, there is a risk of loss of privacy in the collection of this information. This risk is not new; the ability to collect information about the consumer proved to be a selling point when Visa and MasterCard were building their bank networks in the United States in the 1970s. The inability to share customer information with other banks was one reason that, in the late 1960s, Bank of America ceded control of its BankAmericard franchise network, the predecessor of Visa, to what became the Visa International association.[14]

B. Payroll, Stored Value, and Other Prepaid Cards

In a massive change that has accelerated during the past few years, instead of cash, millions of employees from Russia to Mexico—and increasingly in the United States[15]—are now paid through prepaid cards called "payroll cards," which they can swipe at a store to make a purchase and have the price debited from an account funded by wages deposited by their employer.[16]

Prepaid cards are not limited to payroll cards, but include phone cards, gift cards, benefit cards, and travel cards, among others. Prepaid cards also are increasingly used to pay public benefits, especially in the many countries in which checks are rarely used as a method of payment.[17] Prepaid cards may be prepaid debit cards, the

14. *See* DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING 72–73 (2d ed. 2005) [hereinafter SECOND EDITION OF EVANS & SCHMALENSEE].

15. *See* Mark E. Budnitz, *Payment Systems Update 2005: Substitute Checks, Remotely-Created Items, Payroll Cards, and Other New-Fangled Products,* 59 CONSUMER FIN. L.Q. REP. 3, 6–7 (2005); Christopher B. Woods, *Stored Value Cards*, 59 CONSUMER FIN. L.Q. REP. 211 (2005); Christoslav E. Anguelov, Marianne A. Hilgert & Jeanne M. Hogarth, *U.S. Consumers and Electronic Banking, 1995–2003*, FED. RES. BULL., Winter 2004, at 5, *available at* http://www.federalreserve.gov/pubs/bulletin/2004/winter04_ca.pdf.

16. *See infra* Parts III.B, D.

17. In South Africa, for example, chip-based Smart Cards are now being used to pay government pension benefits. World Wide Worx: Smart Card market explodes in South Africa (Oct. 4, 2004), http://www.theworx.biz/smartcard04.htm; *see also infra* note 142.

use of which results in a debit to a bank account opened for the benefit of the cardholder (e.g., by an employer), or they may be "stored value cards" in which value is stored on the card itself.[18] While some prepaid cards—so-called "closed loop" cards, including most gift and phone cards—are usable only for purchases from a particular retailer or service provider, prepaid cards are increasingly network-branded "open loop" cards, transactions with which are processed through Visa, MasterCard, and other payment card networks.[19]

Because prepaid cards do not require either creditworthiness or bank accounts, they are proliferating especially in areas such as Africa and parts of Latin America where relatively few people have bank accounts.[20] Prepaid debit and stored value cards are a king of "poor man's credit card," allowing access to electronic payments networks for those who cannot qualify for credit or lack bank accounts. Even in the United States, prepaid phone cards have become popular and payroll cards are catching on as a way to pay wages to the many, usually low-income employees who lack a bank account, sometimes referred to as "the unbanked."[21]

C. Payment Card Transactions

The following is a description of the fee arrangements in a

18. *See generally,* Budnitz, *supra* note 15, at 6–7; *Prepaid Cards in Europe and the US 2004*, DATAMONITOR, Mar. 5, 2004, *available at* http://datamonitor.com/~ec641c4fc0a346018e7b491430411c27~/industries/research/?pid=BFFS0243&type=Brief; Julia S. Cheney, *Prepaid Card Models: A Study in Diversity*, (Payment Cards Ctr., Fed. Res. Bank of Phila., Discussion Paper, Mar. 2005), *available at* http://www.paymentsnews.com/2005/03/philadelphia_fe.html; Mark Furletti & Stephen Smith, *The Laws, Regulations, and Industry Practices That Protect Consumers Who Use Electronic Payment Systems: ACH E-checks and Prepaid Cards*, (Payment Cards Ctr., Fed. Res. Bank of Phila., Discussion Paper, Mar. 2005), *available at* http://www.paymentsnews.com/2005/03/philadelphia_fe.html; Beth S. DeSimone & Carrie A. O'Brien, *Payroll Cards: Would You Like Your Pay With Those Fries?*, 9 N.C. BANKING INST. 35 (2005).

19. Prepaid cards may also be divided into "online" and "offline" cards. The latter are stored value cards such as copy cards used in copy machines, which carry value stored internally on the card. The former are cards that electronically access value stored in an account maintained on a database at a bank, payroll processor, retailer, or other external location. In the United States, stored value cards are not currently covered by Federal Reserve Regulation E. The Federal Reserve Board (FRB) has proposed to extend Regulation E coverage to payroll cards, and the Federal Deposit Insurance Corporation has proposed extending deposit insurance to cover funds accessed with certain payroll cards. *See* Budnitz, *supra* note 15, at 6.

20. *See infra* Parts III.C, E.

21. Budnitz, *supra* note 15, at 6–7; *see also* Debra Wolfe, *Card Usage Climbs: New Survey Shows Prepaid Card Usage Doubled in the Last Two Years*, INTELE-CARD NEWS, Jan. 1 2002, *available at* http://www.intelecard.com/factsandfigures/03factsandfig.asp?A_ID=97.

typical credit card transaction, which differ only in limited respects from those of a debit card transaction:

> Bank A issues a Visa credit card to Consumer X, who purchases a garment for $100 at Store Y, which was "acquired" for Visa by Bank B. Visa rules mandate that Bank B must pay Bank A an interchange fee of 1.25% of the amount of the transaction, i.e., $1.25. Bank B will charge Store Y a "discount fee" higher than $1.25 in order to recover the mandated interchange fee and other fees that Visa rules mandate Bank B to pay Visa on each and every Visa credit card (and debit card) transaction and to earn a profit for itself. Thus, Bank B may charge a discount fee of 1.60% of the transaction amount (or $1.60) to Store Y. When Store Y presents Consumer X's $100 Visa transaction to Bank B, the bank will credit Store Y's account for $98.40, send the Visa mandated $1.25 interchange fee to Bank A and retain the $.35 balance of the "discount fee."[22]

Other than the fact that Consumer X's bank account at Bank A will be debited rather than having credit extended to it, there is little difference between the described credit card transaction and a debit card transaction except the revenue structure for the issuing bank. When a consumer pays by debit card, there is no revolving credit extended and no possibility of interest income for the card issuer as in a credit card transaction, so the issuer's principal revenue source is the interchange fee.

However, interchange fees on PIN debit transactions in the United States have been limited, for historical reasons. Debit cards were introduced in the United States in the 1970s as "ATM cards," used only for withdrawing cash from automatic teller machines. In 1986, when some banks belonging to interbank networks began to transform ATM cards into online PIN debit cards by persuading merchants, particularly gas stations and convenience stores, to install equipment to accept them,[23] consumers resisted having to pay a fee for online debit card transactions to use their own money. Merchants, too, objected to being charged interchange fees for POS debit card transactions when no such fees were paid on ATM card

22. Wal-Mart Stores, Inc. v. Visa U.S.A., Inc., 396 F.3d 96, 102 (2d Cir. 2005). Unless otherwise specified in this Article, all dollar amounts ($) refer to U.S. dollars.

23. The first use of ATM cards at the point of sale in North America appears to have been in Saskatchewan, Canada, in 1981, as an experiment conducted by a group of credit unions.

transactions, and many merchants instituted per-transaction fees.[24] Consequently, low bank fees became the rule for PIN debit.

As a result of the low interchange fee structure for PIN debit compared to credit cards, prior to around 1990, banks in the United States displayed little interest in issuing debit cards except as a convenience to their customers for use at ATMs. Due to the fees they were charged for using a debit card other than at their own bank's ATM, relatively few consumers used debit cards to make purchases and few merchants installed equipment to accept them.[25] Online debit cards did not become widespread in North America until the 1990s.[26]

Around 1990, Visa embarked on a campaign to promote the use of debit cards. To overcome the problem that interchange fees on online debit cards were too low to entice its member banks to issue more debit cards, Visa created a different form of debit card, the "offline" or signature debit card, which would work like Visa credit cards and involve an interchange fee set only slightly lower than the interchange fee issuers would receive on credit cards.[27] The new signature Visa debit cards were a better deal for issuers that would rake in more interchange fees than online debit cards. They were the same or a better deal for consumers, who in some cases still would have to pay transaction fees but in some cases would not. And they were a worse deal for merchants who saw more of their receipts disappear in the form of fees and chargebacks. MasterCard followed suit with a similar signature-based debit card strategy.[28]

This division of the debit card market is unique to the United States. In no other country are signature-based debit cards regularly issued by financial institutions.[29] In Canada, there is only one form of debit card transaction: online debit cards. And there is only one debit card network. There have never been interchange fees and the Canadian debit card network operates at par, like the American check collection system.[30] However, Canadian consumers even today pay

24. Richard Mitchell, *Bridging the Debit Gap; Signature and PIN Point-of-sale Debit Once Were Separate Worlds, But Now There are Signs of Convergence. Will One Form of Debit Gain Primacy in the U.S.?* CREDIT CARD MGMT., Feb. 2005, at 30.

25. DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING 311–12 (1st ed. 2000) [hereinafter FIRST EDITION OF EVANS & SCHMALENSEE]. Interbank networks independent of Visa and MasterCard started trying to market debit card use at the point of sale with PIN numbers ("online debit") in 1986. *Id.*

26. *Id.* at 312–13.

27. *Id.* at 313.

28. *Id.* at 314–15.

29. Mitchell, *supra* note 24, at 30.

30. Gordon Schnell & Jeffrey Shinder, *The Great Canadian Debit Debate*, CREDIT CARD MGMT., May 2004, at 12. The authors of this article were counsel for the plaintiffs in

higher transaction fees for the use of debit cards than Americans because banks charge the consumer instead of the merchant.[31]

The only flaw in the Visa and MasterCard strategy was the reluctance of merchants to accept signature-based cards when they could require consumers to use online debit cards and thereby pay a lower discount rate. To overcome this problem, Visa and MasterCard relied on a clause in the standard merchant-acquirer contract called the "Honor All Cards" (HAC) Clause, which required merchants to accept any card with the Visa or MasterCard logo. In effect, they required merchants that wanted to accept credit cards to accept signature debit cards as well.

Beginning in 1996, the HAC Clause was the subject of a class action antitrust lawsuit, *Wal-Mart Store, Inc. v. Visa U.S.A., Inc.*,[32] in which a class of over five million merchants, represented by Wal-Mart, The Limited, Sears, and several other large retailers as named plaintiffs, sued Visa, MasterCard, and other associations, challenging the HAC Clause as an illegal "tying" arrangement in violation of the Sherman Act. The retailers alleged that they wanted to accept Visa and MasterCard credit cards and online debits but not the offline signature debit cards. After almost nine years of litigation, a $3 billion settlement of the lawsuit was approved in January 2005, the largest ever in an antitrust case.[33]

As a result of the *Wal-Mart* settlement, the payment card industry in the United States is undergoing a reorganization in which control of the industry's future is in the balance. MBNA, the largest

Wal-Mart.

31. Oddly, however, Canadians are "swipe crazy"; they use their debit cards more frequently than anyone else in the world despite the higher fees. *See* Michael Kane, *Canadians Dishing Out $21.50 a Month on Bank Fees: "Swipe Crazy" Use of Debit Cards Inflates Figure*, CALGARY HERALD (Can.), Jan. 18, 2005, at E4; *see also* John Adams, *Cards: RBC Brings Canada's Debit Culture to the U.S.*, BANK TECH. NEWS, Dec. 1, 2004, at 24 ("Debit card volume in Canada matches U.S. volume despite the staggering difference in population."). One explanation is heavy marketing using travel miles and similar offers. *See* Kane, *supra.* Another possible explanation is that online debit cards got their start in Canada around 1981, a few years earlier than in the United States, and may have been more heavily marketed there in the 1980s, when Canadian consumers, like Americans, were forming their payment habits. This heavy use has a heavy price, in that Canada is also distinguished by markedly higher debit card fraud losses than the United States. A likely contributing factor is that Canadian debit cards are all linked to the same online network, the Interac Association, unlike the United States, which has twenty-five electronic funds transfer networks; Canadian fraudsters therefore have an easier task obtaining data and accessing accounts. *See Canada Appears to Have High PIN-Debit Losses*, ATM & DEBIT NEWS, Feb. 3, 2005, at 1.

32. 396 F.3d 96 (2d Cir. 2005).

33. The settlement reportedly came close to driving Visa U.S.A. into bankruptcy; allegedly it had to be rescued by JPMorgan. *See JPMorgan to Continue Issuing Both Visa and MasterCard*, CARDS INT'L, Mar. 9, 2005, at 8.

U.S. card issuer, is now issuing American Express cards, and Citibank plans to do the same.[34] Meanwhile, Wal-Mart, free of the HAC Clause since the District Court initially approved the settlement in 2003, negotiated a temporary 30% drop in the interchange fee as part of the settlement, and then temporarily stopped accepting MasterCard signature debit cards to keep fees down. Debit card interchange fees have been in flux since that time.[35]

Meanwhile, merchants, banks, and card networks jockey for leverage in the battle over the fee structure of payment cards. Wal-Mart teamed with GE Consumer Finance and Discover to issue its own "private label" debit card, and it is issuing prepaid debit and credit cards that can be used by people without a bank account.[36] Discover purchased Pulse, one of the largest online debit card networks.[37] Other retailers, such as Publix Super Markets of Florida, are offering free use of their proprietary ATMs only to the customers of banks that waive interchange fees.[38] The outcome and the effect on consumers remain uncertain. Efforts by consumers to piggyback on *Wal-Mart* by filing consumer class actions against Visa, MasterCard, and others have been unsuccessful.[39]

While debit cards have become more lucrative for issuers than they used to be, banks still earn more from credit cards, due to the interest and fees charged on unpaid balances. Therefore, banks compete with each other in offering benefits such as miles on airline loyalty programs for purchases charged on credit cards, but these benefits are not normally offered for debit card purchases. The objective of these benefit programs, of course, is to induce cardholders to use a particular credit card rather than another credit card or a debit card.

D. Reversal of Transactions

Major payment card networks, such as Visa and MasterCard, operate chargeback systems by which transactions can be reversed and the price charged back to the seller and credited to the

34. Jeffrey Green, *Change*, CREDIT CARD MGMT., Apr. 2005, at 4.

35. Lavonne Kuykendall, *Overview: Unexpected Outcomes*, AM. BANKER, Mar. 22, 2005, at 3A.

36. *Id.* (noting that about 9% of the U.S. population is "unbanked").

37. Eric Dash, *Doubts Center on Discover's Growth Potential*, INT'L HERALD TRIB., Apr. 6, 2005, at 13.

38. Kuykendall, *supra* note 35.

39. Such efforts have foundered on the U.S. Supreme Court's holding in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), denying standing to indirect purchasers to bring antitrust actions on the theory that inflated costs were passed through to them.

consumer's account through the network. The chargeback systems are governed by network association rules, such as the Visa Operating Regulations, which are contractually binding on both card issuers and merchant acquirers.[40] Chargeback rules differ by region.

Typically, chargeback rules provide that if a dispute is of a type that is subject to chargeback, the card issuer must investigate once the consumer has made a good faith attempt to resolve the dispute with the merchant. If it determines that the consumer's complaint is justified, the card issuer must reverse the charge to the consumer's account. Under association rules which are binding between banks under contract law, the issuer then may pass on the resulting claim for a refund to the merchant acquirer. The merchant acquirer then is entitled to debit the merchant's account to satisfy the claim.[41]

Chargeback may provide the consumer with recourse for certain common problems, such as: "I cancelled the transaction but didn't get credit on my statement"; "I lost my card [or it was stolen] and someone used it to buy something"; "someone stole my information and card number and used it to buy merchandise on my account or to withdraw money from my bank account" (a/k/a "identity theft"); "I never received the goods"; and "the amount on my statement is wrong." All of these common complaints can be grounds for a chargeback. Grounds for chargebacks are assigned separate "chargeback reason codes." Visa U.S.A. currently recognizes twenty-four reason codes, while MasterCard has eighteen and Discover has fourteen.[42]

However, the chargeback system is operated by Visa, MasterCard, and other associations to resolve disputes between banks and between banks and merchants, not between consumers and

40. For a description of how card networks operate, see Wal-Mart Stores, Inc. v. Visa U.S.A. Inc., 396 F.3d 96, 101–02 (2d Cir. 2005). On the chargeback system, see Organisation for Economic Cooperation and Development [OECD], *Consumer Redress in the Global Marketplace: Chargebacks*, OECD Doc. OCDE/GD(96)142 (Mar. 28, 1997) [hereinafter OECD, *Chargebacks Study*].

41. *See* OECD, *Chargebacks Study*, *supra* note 40, at 49–54. This study gives individual descriptions of chargeback regimes for twenty-one countries and the European Union as of 1996. The countries covered are Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Hungary, Japan, Korea, Mexico, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. It should be noted, however, that in most non-OECD countries, chargeback rights may be limited to billing errors and may not encompass unauthorized transactions or product-related disputes.

42. *See* Chargebacks & Dispute Resolution, http://usa.visa.com/business/accepting_visa/ops_risk_management/chargebacks_dispute_resolution/reengineering_disputes.html (last visited Jan. 5, 2006); *see also* Resolve Chargeback Tool, http://www.wellsfargosecure.com/customer/chargebacks/3.htm (last visited Jan. 5, 2006).

merchants. Consumer protection laws generally regulate the consumer-card issuer relationship and the consumer-merchant relationship, but not the multilateral relationship among consumers, banks and merchants that characterizes the credit and debit card systems. The issuer's right to pass on the claim to the merchant acquirer is a contractual right of the issuer, not a right of the consumer. Issuers have little incentive to pursue chargeback except to the extent the law or a contract compels them to recredit the consumer's account.

Laws enacted in the United States, the United Kingdom, and several other European Union (EU) countries that preserve against the card issuer claims and defenses the consumer may possess against the merchant have acted as a spur to card associations and issuers to adopt chargeback rules. In the United States, § 170 of the Truth-in-Lending Act (TILA)[43] permits credit cardholders to raise against the issuer any claims or defenses they may have against the merchant, under four conditions: (1) the cardholder made a "good faith attempt" to resolve the dispute with the merchant, (2) the transaction exceeded $50, (3) the initial transaction occurred in the same state or within 100 miles of the cardholder's billing address, and (4) the claims or defenses are limited to the balance remaining on the card when the cardholder first notifies the card issuer or merchant of the claim or defense.

However, laws on reversibility typically contain different protections for credit and debit card holders.[44] In the United States and the United Kingdom, for example, only consumers who pay by credit as opposed to debit cards retain product related claims and defenses against the card issuer such as breach of warranty and failure of the goods or services to conform to the contract between the consumer and the merchant or to reasonable standards.[45] In Denmark, protections are the same for different types of cards but do not include preservation of defenses against the card issuer in case of defective and non-conforming goods and services.[46] Without the impetus of a law entitling the consumer to withhold payment from

43. Truth-in-Lending Act § 170, 15 U.S.C. § 1666i (2005) [hereinafter TILA]. The TILA is officially part of the Consumer Credit Protection Act.

44. Israel and Denmark are two notable exceptions. Israeli law goes farther than Denmark's in preserving consumer defenses against issuers of both credit and debit cards in case of defective and non-conforming goods and services. *Compare* Debit Cards Law, 5746-1986, §§ 5, 9 (Isr.), *with* Act on Certain Payment Instruments, Act No. 414 of May 31, 2000, § 11 (Den.).

45. *See* TILA § 161, 15 U.S.C.A. § 1666 (2005); Consumer Credit Act, 1974, c. 39, § 84 (U.K.).

46. *See* Benjamin Geva, *Consumer Liability in Unauthorized Electronic Funds Transfers*, 38 CANADIAN BUS. L.J. 207, 252–53 (2003).

the card issuer in such cases, card issuers have little incentive to initiate chargeback procedures based on these types of claims and defenses. Consumers, therefore, have no effective remedy against merchants in many cases due to the high transaction costs of pursuing them.

Moreover, chargeback procedures were not designed to be an optimal solution for the resolution of disputes between consumers and merchants, but to resolve disputes between issuer banks that issue payment cards and merchant acquirer banks that "acquire" merchants for the payment system and handle their accounts. Consumers lack standing to pursue remedies through the chargeback process. Because chargeback systems are matters of private law between banks, they lack at least four features of an adequate consumer-merchant dispute resolution system including: (1) comprehensiveness, (2) transparency, (3) access to information, and (4) competence.

The Organisation for Economic Cooperation and Development (OECD) conducted a major study of chargebacks in 1996.[47] Its conclusion was that "[p]ayment card companies, as financial intermediaries, may be in the best position to address consumer concerns by performing a broad spectrum of 'chargeback' redress functions, as they do for example in the United States."[48] The OECD's 2002 *Report on Consumer Protections for Payment Cardholders* echoed this view.[49] A number of academic studies have also advocated expansion of chargeback procedures as a means of dispute resolution in cyberspace.[50] These studies have been primarily concerned with the use of chargeback procedures to resolve cross-border disputes arising out of electronic commerce.

Certain countries require card associations to enforce a chargeback regime for domestic transactions, "and some card associations have voluntarily extended their domestic regime to cover international transactions."[51] These regimes generally cover unauthorized transactions and billing errors, and some also cover

47. OECD, *Chargebacks Study*, *supra* note 40.

48. *Id.* at 47.

49. Concerns about theft of card numbers suggest that chargebacks "have an important role to play in developing the business-to-consumer electronic marketplace." OECD, Directorate for Sci., Tech. and Indus., Comm. on Consumer Policy, *Report on Consumer Protections for Payment Cardholders*, OECD Doc. DSTI/CP(2001)3/FINAL, at 4 (June 14, 2002) [hereinafter OECD, *Report on Consumer Protections for Payment Cardholders*].

50. *See, e.g.*, Henry H. Perritt, Jr., *Dispute Resolution in Cyberspace: Demand for New Forms of ADR*, 15 OHIO ST. J. ON DISP. RESOL. 675, 689–94 (2000); John Rothchild, *Protecting the Digital Consumer: The Limits of Cyberspace Utopianism*, 74 IND. L.J. 893, 977 (1999).

51. Rothchild, *supra* note 50, at 977.

product- and service-related disputes. They vary in the extent to which consumer fault affects the consumer's right to reverse the transaction.

The consumer is entitled to reversal of unauthorized transactions in several countries, including Belgium, Denmark, Finland, Greece, Hungary, Korea, Mexico, Norway, Sweden, the United Kingdom, and the United States.[52] However, several countries, including Belgium, Denmark, Korea, Norway, and Sweden, follow a fault standard, which allows liability to shift back to the consumer in certain cases.[53]

Fault standards are of two types. One standard shifts liability back to the consumer if the consumer was at fault in enabling the defrauder to use the card, e.g., by negligently losing the card or giving it to a third party. Such standards may include varying degrees of liability shifting depending on the degree of fault. "In Belgium, for instance, there are different ceilings of liability" for consumer negligence and for "extreme" negligence.[54] These standards also may require more than mere negligence, as in Korea where a "serious mistake" is required, and in the United Kingdom where only "gross negligence" will shift liability back to the consumer.

The other type of fault that can shift liability back to the consumer is delay in notifying the issuer of loss or theft of the card or other circumstances that give rise to a risk of misuse. Standards in some countries are more specific than others. They may state a particular number of days from notice of the loss or theft, or give a reasonable time. They also apply only upon receipt of a bank statement reflecting unauthorized transactions, shifting liability prospectively for any further unauthorized transactions. Similar "bank statement" rules in the United States contained in the Uniform Commercial Code (UCC) and the TILA stop consumers from having their accounts recredited if they delay in reporting errors or unauthorized transactions after receipt of a checking account or credit card statement reflecting the error or unauthorized transaction.[55]

Billing errors, such as duplicate charges, are another type of chargeback. In general, chargeback regimes require correction of

52. OECD, *Report on Consumer Protections for Payment Cardholders*, *supra* note 49, at 14.

53. *Id.*

54. *Id.*

55. Uniform Commercial Code (U.C.C.) § 4-406(c)–(d) (giving account holder thirty days after receipt of bank statement to dispute items reflected on it); TILA § 161, 15 U.S.C.A. § 1666 (2005) (allowing credit cardholder sixty days after transmission of credit card statement to report "billing errors").

billing errors. Some regimes, as in the United States, require that the consumer's account be recredited while the error is being investigated, unless the investigation is concluded within a fixed and brief timeframe.[56]

The other principal types of consumer disputes covered by some chargeback regimes are product- and service-related disputes, such as non-delivery or non-performance by the merchant and delivery of goods in defective condition or in non-conformity with the consumer's contract with the merchant.

Chargeback regimes tend to cover non-delivery, but consumer protection laws reflect the hesitance of issuers to intervene in disputes over product quality and conformity with the underlying contract. In the United States,[57] the United Kingdom, Finland, Greece, Japan, Korea, and Norway,[58] those who pay by credit card have the right of chargeback against the issuer when goods arrive in defective or non-conforming condition, or when they have any other claims or defenses against the merchant that would give them the legal right not to make the payment. Debit cardholders, however, do not have these rights.[59] Among OECD member countries, only Denmark's laws provide debit and credit cardholders equal chargeback rights, and Denmark does not provide for chargeback in product- and service-related disputes.[60]

E. The Global Trend Toward Debit and Prepaid Cards

Several factors have contributed to the rise of the debit card and the prepaid card. As further discussed below in this Article,[61] most developing countries never acquired the credit card habit. They lack the credit information and reporting systems necessary to support credit cards, and relatively few of their citizens have sufficient demonstrable income to qualify for credit. While computer use and e-commerce are growing in developing countries, they remain the domain of a small percentage of those populations. As a result, while the "Plastic Revolution" takes hold in developing

56. *See* TILA § 161, 15 U.S.C. § 1666 (2005).

57. TILA § 170, 15 U.S.C. § 1666i (2005).

58. *See* OECD, *Report on Consumer Protections for Payment Cardholders*, *supra* note 49, at 15.

59. *Id.* Professor Mann has argued that this distinction between debit and credit cards should be eliminated on functional grounds. Mann, *supra* note 2, at 665.

60. Geva, *supra* note 46, at 252–53. Denmark's Consumer Ombudsman Guidelines include protections in case of non-delivery. OECD, *Report on Consumer Protections for Payment Cardholders*, *supra* note 49, at 15.

61. *See infra* Part III.

countries like China, Brazil, and Mexico, it is not credit cards but debit and prepaid cards that are beginning to transform the cash economies of those countries.

The trend toward debit and prepaid card use is part of what some economists have erroneously called a trend toward "cashlessness."[62] In fact, debit cards and many prepaid cards are not only a substitute for cash, but also a convenient means of obtaining it at an ATM. ATMs, which are already ubiquitous in developed countries, are rapidly spreading through the developing world. Cash payments still amount to an estimated seventy to 90% of global retail payment volume,[63] though they are low in value compared to card transactions. In recent years, the growth in volume of debit card transactions has outpaced that of credit cards, indicating that payment cards—even credit cards—are primarily used as a cheap means of funds transfer rather than for credit purposes.[64] Rather than curtail the use of cash, the spread of debit cards has revitalized cash economies by making cash more readily available.[65]

Debit cards and "open loop" prepaid cards can be used either at ATMs or at the point-of-sale.[66] Other ways by which consumers access and transfer funds electronically include automated clearing house (ACH) payments, home banking, electronic *giros* (*e*-giro) in Europe and parts of Asia, and internet-based "electronic cash." However, none of these other methods has approached debit cards in the volume or share of transactions, nor in worldwide growth.[67]

Credit card use is not growing nearly as rapidly as debit card use.[68] Globally, the ability to finance a purchase and carry a balance on a credit card seems to hold limited appeal, because most consumers use payment cards—even credit cards—for convenience,

62. *See, e.g.*, Sheri M. Markose & Yiing Jia Loke, Can Cash Hold Its Own? International Comparisons: Theory and Evidence (Feb. 2002) (unpublished manuscript), *available at* http://privatewww.essex.ac.uk/~scher [hereinafter Markose & Loke, Cash]; Sheri M. Markose & Yiing Jia Loke, *Changing Trends in Payment Systems for Selected G10 and EU Countries 1990–1998*, INT'L CORRESPONDENT BANKING REV. Y.B. 2000/2001, Apr. 2000, *available at* http://privatewww.essex.ac.uk/~scher [hereinafter Markose & Loke, *Trends*].

63. Markose & Loke, Cash, *supra* note 62, at 4. However, Professor Mann cites data from a November 2003 Nilson Report indicating that in the United States as of 2002 only 42% of retail payment transactions were cash-financed. Mann, *supra* note 2, at 643 n.45.

64. Markose & Loke, Cash, *supra* note 62, at 4; *see also* Mann, *supra* note 2, at 656–58.

65. BIS RETAIL PAYMENTS STUDY, *supra* note 3, at 12.

66. For a description of various uses of payment cards by consumers and the structure of payment card networks with diagrams, see BENJAMIN GEVA, THE LAW OF ELECTRONIC FUNDS TRANSFERS ¶ 6.02 (2004).

67. *See* BIS RETAIL PAYMENTS STUDY, *supra* note 3, at 14, 22–23, charts 3–5.

68. *See infra* tbl. 1.

as a cash substitute or a way to obtain cash, not as a loan. Available data show that card use in retail payments has grown primarily at the expense of cash.[69] This is even true in the United States, where of the purchases of goods and services for personal consumption in 1996, 57% were made by checks, 21% with cash, and 22% with payment cards. In 1984, however, 58% of purchases of goods and services for personal consumption were made with checks, 36% with cash, and only 6% with cards.[70] While American consumers persist in the habit of maintaining large credit card balances and resist the use of debit cards for purchases, they remain an anomaly compared to consumers in most other countries.[71]

The stakes involved in the proliferation of debit and prepaid cards may be much greater than the fees generated by payment card transactions. Recent studies suggest that the rise in mobile telecommunications[72] and electronic payments each will generate an economic "growth dividend" in the developing world of about 0.6% of GDP.[73] Mobile telephone service providers may also emerge as

69. *See* Markose & Loke, Cash, *supra* note 62, at 3; Markose & Loke, *Trends*, *supra* note 62.

70. FIRST EDITION OF EVANS & SCHMALENSEE, *supra* note 25, at 91; s*ee also* SECOND EDITION OF EVANS & SCHMALENSEE, *supra* note 14, at 43–44 (reporting the distribution of U.S. purchases of goods and services for personal consumption in 1990 and 2001); Mann, *supra* note 2*,* at 656–58.

71. *See* BIS RETAIL PAYMENTS STUDY, *supra* note 3*,* at 25–27, chart 9; Ronald Mann, *Credit Cards and Debit Cards in the United States and Japan*, 55 VAND. L. REV. 1055, 1056–57 (May 2002); *see also infra* Part V.A.

72. While the deluge of debit and prepaid cards in emerging economies is linking much of the world's population and many of its retail businesses to payment card networks for the first time, mobile telephones are linking many of the same people to the telecommunications network. According to a study conducted by the Vodafone Group, mobile phone penetration of the consumer market already surpasses, in most countries, the percentage of consumers who have checking accounts. *See* THE VODAFONE GROUP, AFRICA: THE IMPACT OF MOBILE PHONES (2005), *available at* http://www.vodafone.com/assets/files/en/GPP%20SIM%20paper.pdf. In Africa, 6.1% of the population had a mobile phone as of the end of 2003, and they are often shared—a study in Tanzania revealed that as much as 97% of the population had "access" to a mobile phone—while consumer checking accounts are rare in many African countries. *Id.* at 3, 47. Mobile phone service in Africa and South America is overwhelmingly paid for with prepaid cards. In Europe overall, 55% of the population had a mobile phone, while the highest incidence of checking accounts in Europe was about 40% in France. *Id.* at 3. In Asia, 15% of the population had a mobile phone, and in most Asian countries checking accounts are not typically used by consumers. *Id.*

73. *See Electronic Payments Worth R7bn—Visa*, (Nov. 10, 2004), http://business.iafrica.com/news/389484.htm (citing studies conducted by Global Insight and Econometrix indicating "that a 10 percent increase in electronic payment share of private consumption expenditure would translate into a 0.6 percent increase in Gross Domestic Product"); Leonard Waverman, Meloria Meschi & Melvyn Fuss, *The Impact of Telecoms on Economic Growth in Developing Countries*, *in Africa: The Impact of Mobile Phones* 10, 10–11 (Vodafone Policy Paper Series, No. 3, Mar. 2005), *available at* http://www.vodafone.com/africa (reporting the results of a study by scholars from London Business School, John Cabot University (Rome), and University of Toronto, together with

serious competition for banks and money remitters, as prepaid phone cards make it possible for consumers to pay for goods and services, and to transfer funds, using short mobile phone messages rather than checks, credit cards, wire transfers, and other services offered by traditional financial institutions. Technology is emerging in the economically developed world for the use of mobile phones to make payments at checkout counters. Mobile payments may become a common method to circumvent the cash register.

The remainder of this Article explores the implications for consumer protection policy of the global proliferation of debit and prepaid cards and the regional differences in payment habits that affect the pace and distribution of that proliferation. Despite the explosive growth in debit and prepaid cards, and to a lesser extent, in credit cards, few jurisdictions outside the United States, Canada, and the European Union have enacted consumer protection laws regulating the rights of card users with respect to card issuers or merchants.[74] Within the United States, Canada, and the European Union, issues such as the reversibility of consumer transactions and the allocation of losses caused by unauthorized transactions are resolved in ways that are inconsistent and analytically unsatisfactory, unduly influenced by legal regimes designed to regulate the use of different payment technologies twenty or thirty years ago.[75]

While often cognizant of the inconsistencies in American payment law, scholarship in payment systems frequently has been premised on the assumption that American payment culture, and the American addiction to credit cards, is normative. With over one billion consumers in Asia, Latin America, Africa, and the former Soviet bloc gaining access to electronic payment networks with debit and prepaid cards, and few of them owning or using credit cards, this assumption is no longer accurate, if it ever was.

At the same time, the resolution of issues of consumer protection policy in those areas has become critical. Without legislation to regulate payment cards in developing countries, the governments of those countries effectively cede consumer protection to private lawmaking by card associations and banks.

LECG Consultants, suggesting that an increase of ten mobile phones per one hundred people in a typical developing country expands GDP by 0.6%); *see also Calling across the Divide*, THE ECONOMIST, Mar. 12, 2005, at 74.

74. For a summary of existing laws in OECD member countries, see OECD, *Report on Consumer Protections for Payment Cardholders*, *supra* note 49.

75. *See generally* Mann, *supra* note 2.

III. PAYMENT CARDS IN EMERGING ECONOMIES

A. China: Explosive Growth in Debit Cards as Government Policy

The People's Republic of China, apart from Hong Kong, was almost exclusively a cash economy until very recently, but much has changed. According to China UnionPay (CUP)—a Shanghai-based bank clearing house owned by more than eighty of the largest Chinese banks that, *inter alia,* provides clearing services for domestic card transactions—685 million debit cards had been issued in China as of June 2004,[76] almost all of them by Chinese banks, compared with about 300,000 as of 1990 and about eight million as of 1995.[77] The number of debit cards grew 64% in 2002 alone, and rose from 544 million to 663 million during 2003.[78] Estimates of the number of credit cards in circulation in 2004 have ranged from eight to ninety-eight million, but clearly debit cards vastly outnumber credit cards in China.[79]

The proliferation of debit cards is the result of a central bank policy called the "Golden Cards Project." The Chinese government initiated the Golden Cards Project in 1993 to prepare the country's infrastructure for a national electronic payments system that would move payments in China from cash to chip ("Smart") cards.[80] To build this infrastructure it was necessary to establish a national switching system, with sixteen regional centers that combined the several incompatible card payments systems already established by Chinese banks into a network.[81] Before the switching system, payment cards were difficult to use because transactions could not be routed from one Chinese card payments system to another.[82]

76. *Chinese State Banks to Charge Debit Card Fees*, CARDS INT'L, May 13, 2005, at 5, [hereinafter CUP Study]

77. *China Moves Up a Gear*, CARDS INT'L, May 22, 1997, at 12. While state-owned banks report that there are eight million credit cards in China, card associations suggest that the number stands at eighteen million. *Id.* The People's Bank of China, the central bank, puts the number of credit cards much higher—at ninety-eight million. *China Issues 762 Million Bank Cards by 2004*, *supra* note 6.

78. Andrew Ward, *Comment and Analysis*, FINANCIAL TIMES, Feb. 2, 2004, at 15.

79. *China Issues 762 Million Bank Cards by 2004*, *supra* note 6.

80. *China Set for Radical Payments Transformation*, CARDS INT'L, Aug. 21, 2000, at 11; *see also China Learns Western Ways*, CARDS INT'L, Nov. 28, 1997, at 9.

81. *China Set for Radical Payments Transformation*, *supra* note 80, at 11; *China Learns Western Ways*, *supra* note 80.

82. He Li-Ping, *Facing the WTO Accession: Problems and Challenges in China's Banking Industry*, 3 CHINA & WORLD ECON. (May–June 2001), *available at* http://www.iwep.org.cn/wec/english/articles/2001_03/heliping.htm.

The Chinese government wanted the Golden Card Project to encourage domestic consumption, but the lack of any national credit information system in China prior to 2004 in part compelled China's concentration on the issuance of debit cards rather than credit cards. Moreover, because 92% of personal consumption expenditure was in cash, the government logically focused on displacing cash with debit cards[83] rather than inducing Chinese consumers to adopt an American-style credit card culture. The Chinese government also intended the Golden Card Project as a measure to control the money supply and thereby control inflation, a function that ruled out card-based credit.[84] Accordingly, the cards are usable at ATMs and points-of-sale, but do not have a credit function.

However, issuance of cards does not mean that consumers use them. As of September 2004, only about 3% of China's merchants accepted payment cards.[85] As elsewhere in the developing world, merchants are slow to accept payment cards because of the investment in equipment that is necessary to join the card network. Yet, individuals commonly own six or seven debit cards. "Sleeping cards" are a problem. About two-thirds of the 685 million debit cards issued are unused;[86] recently, the four state-owned banks began to charge annual fees for debit cards,[87] which will likely cull dormant cards. Other banks, however, have not followed suit. Foreign banks, meanwhile, are forbidden from extending credit to persons other than foreigners until January 1, 2007.[88]

China remains predominantly a cash economy, but according to the Nilson Report, card spending grew to nearly 10% of all retail sales revenue in 2004 from 2.7% in 2001, mostly on debit cards.[89] The People's Bank of China gives a more conservative, but still telling, estimate that cards account for 5% of retail sales volume in 2004, up from 2% in 2001.[90] However, payment cards accounted for

83. *See Analysis: Visa Asia-Pacific—Staying on Track*, CARDS INT'L, June 30, 1997, at 11.

84. *China Moves Up a Gear*, *supra* note 77.

85. *China Gears Up for EMV Migration*, CARDS INT'L, Feb. 7, 2005, at 8 ("According to CUP [China UnionPay], the Chinese cards market had a merchant acceptance footprint of only 3 percent by the end of September 2004.").

86. *MasterCard Aims to Inform Chinese Card Market*, CARDS INT'L, Feb. 7, 2005, at 8 (reporting China UnionPay research).

87. *Chinese State Banks to Charge Debit Card Fees*, CARDS INT'L, May 13, 2005, at 5.

88. *Conference Reports: The Industry of the Decade*, CARDS INT'L, May 13, 2005, at 14.

89. Shazam Stocks, Profiles: Asia Payment Systems, Inc., http://www.shazamstocks.com/profiles/apym/strategy.php (last visited Jan. 21, 2006) (citing the Nilson Report, a payment card industry newsletter) [hereinafter Asia Payment Systems Profile].

90. *China Pacific Insurance to Issue Credit Cards*, CARDS INT'L, Mar. 31, 2005, at 7.

as much as 20% of retail sales revenue in the major cities of Beijing and Shanghai.[91]

Credit cards have not gained as much popularity as debit and prepaid cards, and consumers use them overwhelmingly for commercial purposes. According to one estimate, of about twenty-nine million credit cards extant in China as of June 2004, twenty-four million were secured by guarantee deposit accounts.[92] These secured credit card accounts carry extremely high interest rates for overdrafts. Those credit cardholders that do exist in China rarely carry balances from month to month. As in Japan, consumers in China primarily use credit cards as cash substitutes.[93] Prepaid cards are also becoming common in China,[94] and the unbanked population remains large. Personal bank accounts started in the late 1980s but became generally available only when regulatory changes in the banking system were implemented in China in April 2000, and checking accounts are generally limited to business and institutional users.[95] ATMs are scarce in many parts of China, and bank customers often have to wait in line to deposit and withdraw cash.

The Chinese government's incentive to encourage electronic payments as a means of encouraging consumption may have been bolstered by the Asian financial crisis of 1997–1998, for which weak domestic consumption was seen as one of the culprits. Elsewhere in East Asia, in 2000, South Korea took more extreme measures to encourage consumption in the hope of warding off a repetition of the crisis. In a debacle reminiscent of the October 1966 credit card giveaway in Chicago,[96] which created the momentum for the

Yet a third estimate, apparently by the central bank, placed bankcard payments at 10% of all retail sales as early as 1999. *See China Set for Radical Payments Transformation*, *supra* note 80.

91. *China Pacific Insurance to Issue Credit Cards*, *supra* note 90.

92. *See Singapore Bank Sets Up Representative Office in Dongguang*, SINOCAST CHINA FIN. WATCH, Dec. 9, 2004, at 1; *see also China Moves Up a Gear*, *supra* note 77. Figures for credit cards outstanding in China vary wildly; the People's Bank of China claims there are as many as ninety-eight million credit cards in circulation in China, while other reports give figures of twenty-nine million and one million, respectively. The twenty-nine million figure comes from the CUP study of December 2004 and is estimated as of June 2004. *See* CUP Study, *supra* note 76.

93. According to one report, only 5% of Chinese credit cardholders revolve credit, compared with 75% in the United States who revolve credit at least once a year. Asia Payment Systems Profile, *supra* note 89.

94. *See, e.g.*, *Debit and Prepay Aligned at MasterCard*, CARDS INT'L, June 7, 2005, at 20 (reporting an interview with Rick Lyons, global head of debit and prepaid card strategy at MasterCard, who observed, "Some of our largest prepaid programmes are in China").

95. He Li-Ping, *supra* note 82.

96. For an entertaining account of these events, see John C. Weistart, *Consumer Protection in the Credit Card Industry: Federal Legislative Controls*, 70 MICH. L. REV. 1475, 1478–83 (1972).

enactment of the TILA, more than fifty-seven million credit cards were issued within one year to South Koreans, with lax underwriting.

Recipients did not, for the most part, use the cards for purchases; rather, they went on a binge of drawing cash advances and spent the cash.[97] This credit card boom precipitated a bust in 2002 and a crisis of overindebtedness in South Korea, the effects of which are still reverberating in that country.[98] The nation's second-largest card issuer, LG Card, lost 5.59 trillion won (over $5 billion) in a single year.[99]

In Southeast Asia, credit card issuance is growing rapidly in Thailand, but stricter underwriting there has resulted in more modest growth in consumer debt than South Korea experienced in 2000 and 2001.[100] Credit card spending in Indonesia and the Philippines was estimated to grow 36% annually in 2004 and 2005.[101] Taiwan, too, has shown rapid growth in credit card debt, which now stands at 2.7% of GDP compared to 6.1% of GDP in the United States.[102]

It remains to be seen whether credit card debt will ever be as widespread in China as it is in the United States and whether credit cards will be as lucrative for Chinese banks as they are for U.S. banks. By 2009, it is estimated that China's credit card debt will represent only 0.65%of GDP.[103] Only 4–5% of Chinese credit card customers pay interest frequently, and "[s]ome 85 percent pay their account balance in full every month, compared with 40–50 percent in richer economies."[104] Banks in developing countries generally derive revenue on payment cards primarily from transaction fees of approximately 1%, rather than from the much higher rates of interest charged on unpaid balances.[105] However, China has recently established a central credit information database and propounded regulations governing the system, which should accelerate the

97. Focus on Korea—An Examination of Korea's Consumer Debt Bubble (2004), http://www.mastercard-masterindex.com/asiapac/insights/2Q2004/2Q2004Issue01.html (last visited Jan. 5, 2006) [hereinafter Focus on Korea].

98. Kim Jung-min, *Korea Exchange Profit Triples in Q1*, KOREA HERALD, May 12, 2005, § Business.

99. *Financial Industry Strives to Enhance Efficiency*, KOREA HERALD, Apr. 27, 2005, § Business.

100. *See* Focus on Korea, *supra* note 97. Credit card growth in Thailand of 45% in 2001—versus 8% the preceding year—was attributed to the Thai government's decision to cap credit card interest rates as well as a reduction in fees due to competition among commercial banks. *Id.*

101. Asia Payment Systems Profile, *supra* note 89.

102. *Id.*

103. *Id.*

104. *Making Advances*, THE ECONOMIST, Jan. 14, 2006, at 74, 75.

105. *Id.*

issuance of credit cards.[106]

B. Russia: Payroll Cards and Overdraft Credit

The American Chamber of Commerce in Russia describes the use of payment cards as "exploding throughout Russia."[107] About twenty-two million cards are in circulation and the number is expected to exceed thirty-two million by the end of 2006.[108] However, only 6% of card transactions are retail payments, as most cards are payroll cards used to withdraw cash from ATMs.[109] According to the Central Bank of Russia, 97% of the 10.6 million cards Visa and MasterCard issued in Russia are deferred debit cards linked to bank accounts.[110] Domestic banks such as Sberbank have issued 11.1 million "private label" cards, mostly debit cards. Of those private label cards, 4.7 million are "Smart Cards," utilizing chip technology that consumers can use for purposes other than payments.[111] Most non-payroll cards, possibly numbering nine million cards, are reportedly "overdraft" cards bearing high fees and only available for small overdrafts of bank accounts.[112] Only about 4% of payment cards in Russia are credit cards.

The principal impetus for payment cards in Russia was the adoption of a flat tax of 13% in 1998, which has substantially cut down on the past practice of "black" salary payments and resulted in direct deposit of salaries into bank accounts, linking many people to the banking system for the first time. However, a major Russian online merchant, Yandex, reports that credit cards "have yet to catch on in Russia," so paid services on the Internet are not a big moneymaker.[113] Bankers describe trying to "develop the payment culture of Russians" by "overcom[ing] a psychological barrier" and paying with credit cards, and do not expect credit cards to exceed

106. *See* The People's Bank of China, Provisional Rules on Management of Individual Credit Information Database, http://www.pbc.gov.cn/english/detail.asp?col=6800&ID=61 (last visited Jan. 21, 2006).

107. Plastic Cards—Coming of Age in Russia!, http://www.amcham.ru (last visited Apr. 12, 2005).

108. *Id.*

109. *Number of Credit Cards Issued in Russia Grew One-Third*, RUSSIAN BUS. MONITOR, Mar. 11, 2005. This headline is misleading: The term "credit card" appears to be used sometimes in Russian media as a generic term for payment cards.

110. Plastic Cards—Coming of Age in Russia!, *supra* note 107.

111. *Id.*

112. Alexander Yurov, *Foreign Banks Fight for Clients in Russia*, RIA NOVOSTI, Apr. 12, 2005.

113. Igor Korolev, *Yandex Founder Not Afraid of Bill Gates*, MOSCOW NEWS, Mar. 30, 2005.

30% of all bankcards issued in Russia in 2005.[114] An amendment to Article 212 of the Taxation Code, effective February 1, 2005, gave banks permission to offer an interest-free grace period requirement on credit and overdraft cards which may enhance their attractiveness; banks are otherwise forbidden from waiving interest on extensions of credit.[115]

C. Brazil: Debit Card Growth and the Cash Economy

According to one recent estimate, Brazil has 135 million debit cards and forty-five million credit cards in circulation.[116] About one-third of Brazil's population now has a bank account.[117] The figure is about 43% for urban residents.[118]

Like China, Brazil is predominantly a cash economy. Seventy-seven percent of urban Brazilians continue to use cash for all payments, even utility bills.[119] Of $70 billion in annual private consumption, 15% is paid electronically.[120] Checks never were a major way to make payments in Brazil. Only 61% of bank account holders, or about 20% of the population, even have access to checking facilities today, and this figure was far lower several years ago when banks were beginning to offer credit cards.[121]

Debit card transactions are growing in Brazil by 60% annually as opposed to 20% annual growth in credit card transactions.[122] Meanwhile, check volume is decreasing by 3.4% per year.[123] While debit cards help preserve the predominant cash economy, problems of over-indebtedness involving credit card use are growing in Brazil. About 25% of Brazilian consumer bankruptcy cases involve credit card debts.[124]

114. *Number of Credit Cards Issued in Russia Grew One-Third*, *supra* note 109.

115. *Major New Developments in Personal Income Tax Entered into Force on 1 January 2005*, PRICEWATERHOUSECOOPERS TAX FLASH REPORT, 10 Mar. 2005, *available at* http://www.pwcglobal.com/ru/eng/ins-sol/publ/TaxFR/2005/FR050310_eng.pdf.

116. *Credit Due*, LATIN TRADE, Jan. 2005, *available at* http://www.latintrade.com/dynamic/index.php?pg=site_en/pastissues/Jan05/currents.html.

117. World Bank, *Brazil: Access to Financial Services*, World Bank Rep. No. 27773-BR, at xxi (Feb. 19, 2004) [hereinafter *World Bank Brazil Report*].

118. *Id.* at xxiv.

119. *Id.*

120. *Credit Due*, *supra* note 116.

121. *World Bank Brazil Report*, supra note 117, at xxiv.

122. *Credit Due*, *supra* note 116.

123. *Id.*

124. Claudia Lima Marques, *Le surendettement des consommateurs au Brésil: propositions en vue d`une étude empirique sur l'endettement particulier dans un pays émergent*, unpublished paper given at the Tenth Annual Meeting of the International Association of Consumer Law, Lima, Peru, May 4–6, 2005.

Brazil, the world's ninth largest economy, represents by far the largest market for e-commerce in Latin America, exceeding $3.8 billion in e-commerce in 2003. It has the largest number of Internet users in the region (fourteen million as of the end of 2003).[125] However, as of 2001, only about two-thirds of Latin Americans who bought online were using any kind of payment card to make their purchase,[126] while over 90% of Americans and Western Europeans use credit cards to make online purchases. Also, the number of mobile telephone users, about 37.4 million as of the end of 2003, far exceeds the number of Internet users, and ten million Brazilian consumers are expected to be using mobile payment systems by the end of 2005.[127]

D. Mexico: Prepaid Cards for the Unbanked

Mexico, the second largest market in Latin America, displays Brazil's pattern of dominance by the cash economy and debit cards. Fewer Mexicans than Brazilians are "banked"; only 25% of urban Mexicans have a bank account, as compared with 43% of urban Brazilians.[128] However, 75% of economically active Mexicans carry a debit or prepaid card, compared with just 25% who carry a credit card.[129] Consumers in Mexico only make 12% of purchases with credit cards,[130] and only 160,000 businesses in the country of 106 million people accept credit cards.[131] To make it easier for lower-income people to use cards, MasterCard in 2004 began offering prepaid cards in Mexico.[132]

125. Global Information, Inc., *Financial Cards in Brazil*, EUROMONITOR, 2003, at 15.

126. Latin American Online Retailing to Reach $1.28 Billion, http://retailindustry.about.com/library/bl/q4/bl_bcg111301.htm (last visited Jan. 5, 2006).

127. *Financial Cards in Brazil*, *supra* note 125, at 16.

128. Stijn Claessens, World Bank, Access to Finance: A Review of the Obstacles in the Way of Access to Finance, Slide Presentation to World Bank Access to Finance Conference (Oct. 28–29, 2004). The 25% figure is for Mexico City and does not include compulsory "AFORES" savings accounts. If those accounts are included, the figure rises to 48.2%. It is significant that 70% of the Mexican "unbanked" say they do not have a bank account because the fees and minimum balance are too high, while only 45% of the "unbanked" in the United States gave this reason for not having a bank account. Fifty-three percent of "unbanked" Americans said they did not need an account because they had no savings, while only 7% of "unbanked" Mexicans gave that reason. *Id.*

129. *Credit Due*, *supra* note 116.

130. *Id.*

131. *Id.* (noting that only 160,000 Mexican businesses accept credit cards); http://www.infoplease.com/ipa/A0004379.html (estimating the mid-2005 population of Mexico at 106,202,903).

132. *Credit Due*, *supra* note 116. The author is informed by Visa that it is doing the same.

The spread of debit and prepaid cards has, to a great extent, coincided with the spread of mobile telephones, and the prepaid phone card is often the first exposure of consumers to electronic payments. As in Brazil, mobile telephones dominate the Mexican telephone market; there are over twenty-eight million of them, compared with fewer than half as many fixed lines. The dominant way to pay for telephone service in Mexico is with prepaid phone cards; over twenty-three million of the twenty-eight million mobile subscribers pay for service in this way.[133] The average denomination of phone card is $10, yet the average expenditure is about $12 per month.[134] This means that the average subscriber is buying a new phone card more than once a month. TelCel, the dominant cellular telephone service provider, maintains over 400,000 points of sale for phone cards, including mom-and-pop stores and street vendors, to satisfy demand.[135]

E. Southern Africa: Mobile Payments and Smart Cards

Nowhere has cell phone use grown more over the past five years than in Africa.[136] As many as 97% of people surveyed in Tanzania said they had access to a mobile phone, though only 28% had access to a landline.[137] Cell phones are revolutionizing African economies by overcoming barriers created by poor transportation networks, postal systems, and fixed telephone systems.

Cell phones are starting to be used to make mobile payments in southern Africa. In Zambia, for example, 300 small businesses that sell Coca-Cola have begun using cell phones to pay for their inventory.[138] In Zambia, too, gasoline stations, dry cleaners, restaurants, and scores of other retail shops let customers pay by funds transfers initiated by cell phone at the point of sale.[139]

Only about 40% of the population of the Republic of South

133. Carlos N. Lukac, *Three Corporate Giants Exploit Mexico's Fragmented Distribution Channels to Achieve Competitive Advance*, BUS. MEXICO, Mar. 1, 2004, *available at* http://www.bain.com/bainweb/publications/publications_detail.asp?id=15899&menu_url=publications_results.asp.

134. *Id.*

135. *Id.*

136. Telecompaper, *Mobile Subs in Africa Grow Faster Than Rest of the World* (Mar. 9, 2005), *available at* http://www.telecompaper.com/news/article.aspx?Id=70566&type=full&yr=&yr=2005 (reporting research by the Centre for Economic Policy Research, the Department for International Development, and Vodafone Group).

137. *Id.*

138. *Calling Across the Divide*, *supra* note 73, at 74.

139. *Id.*

Africa has a bank account,[140] but the SIM cards used in the GSM[141] cellular phones that are standard in South Africa are "Smart Cards" that contain microchips capable of performing payment functions.[142] As of January 1, 2005, all new debit and credit cards issued in South Africa are required to be "Smart Cards," and all pension payments handled by the South African Department of Social Welfare moved to a smart card system in 2005.[143] Visa cards are growing by about 43% per year in South Africa,[144] but debit cards are growing more than credit cards, as the lack of bank accounts and lack of creditworthiness of much of the population limits the issuance of credit cards.[145]

F. India: Debit Cards and Access to Bank Services

In India, debit cards have become immensely popular, while credit card penetration is low and credit cardholders tend to pay their balances in full each month.[146] One reason may be that Indians, despite their generally impoverished condition, have a relatively high rate of bank account ownership. A survey of residents of Uttar Pradesh and rural Andhra Pradesh revealed that 47.5% had bank accounts.[147] The high population density in India, even in rural areas, means that large numbers of people live close to a bank branch. Thus, as of 2004, while the average population per branch in Brazil was 9331 and the area per branch was 470 sq. km., the corresponding figures in India were 14,888 and 44 sq. km.,

140. *Banking the Unbanked in South Africa*, GLOBAL REGULATION (Deloitte Financial Services) Issue II, at 4 (2004).

141. GSM originally was the "Groupe Speciale Mobile," a French telecommunications organization, but the acronym now stands for "Global System for Mobile Communications," a set of international technological standards maintained by the European Telecommunications Standards Institute. There are more than one billion GSM mobile telephones worldwide, but GSM is not yet universally accepted in the United States. SIM cards are the "Subscriber Identity Modules" that enable GSM cellular phones to function. *See* Wikipedia, Global System for Mobile Communications (GSM), http://en.wikipedia.org/wiki/GSM (last visited Jan. 5, 2006).

142. Smart Card Market Explodes in South Africa, *supra* note 17.

143. *Id.*

144. ePaynews.com, Visa's Sub-Saharan Africa Issuance Grows Solidly (Mar. 23, 2004), http://www.epaynews.com (search "Archive Search" for "Visa's Sub-Saharan Africa") (last visited Feb. 5, 2006).

145. Euromonitor International, Financial Cards in South Africa, Executive Summary, *available at* http://www.euromonitor.com/financial_cards_in_south_africa (last visited Jan. 5, 2006).

146. Euromonitor International, Financial Cards in India, Executive Summary, http://www.euromonitor.com/financial_cards_in_India (last visited Jan. 5, 2006).

147. Claessens, *supra* note 128, n.19.

respectively.[148]

Mobile payments, however, have not yet become common in India as they have in southern Africa. Sumitomo Bank, together with a Chicago-based company, has recently introduced a "mobile electronic wallet" as a service to its customers, but it is a luxury item for the affluent.[149] Elsewhere in Asia, however, particularly in South Korea, mobile payments are rapidly increasing in use.[150]

However, globally mobile payments are hampered by the slow speeds at which most mobile telecommunications networks still operate, and by high per-minute charges for use of cell phones in developing countries, especially where mobile telephone service suffers from monopolistic or oligopolistic practices. As G3 packet switched data networks, the newest and fastest GSM mobile telephone systems, become more widespread and as calling charges go down, mobile payments are expected to gain popularity rapidly as a way to make small payments, particularly in high crime areas where carrying cash and payment cards presents a risk of theft.[151]

IV. PAYMENT CARDS IN DEVELOPED ECONOMIES

A. Overview

This Part examines payment card use in America, Canada, Japan, and Europe. Americans and Canadians continue to be addicted to credit cards, but as debit and prepaid cards proliferate globally, the American and Canadian addiction to credit cards is increasingly marginalized. In Japan, credit cards are used more than debit cards, but they are used principally for convenience, and few balances are rolled over. Meanwhile, Western and Central Europe and Scandinavia are divided into two payment cultures. Some countries like Germany rely heavily on *giros*, which are deferred debit transactions,[152] while in other countries such as France and the

148. *Id.*

149. N Vidyasagar & Prabhakar Sinha, *Pitroda Offers Bill Payments via Mobile*, TIMES OF INDIA, Mar. 14, 2005, § Indian Business, *available at* http://timesofindia.indiatimes.com/articleshow/ 1051551.cms.

150. Telephone Interview with Lyn Boxall, Executive Vice President and Regional Legal Counsel of Visa Int'l, Asia Pac. Region (Apr. 14, 2005) [hereinafter Boxall Interview].

151. *See* BANK FOR INT'L SETTLEMENTS COMM. ON PAYMENT & SETTLEMENT SYS., SURVEY OF DEVELOPMENTS IN ELECTRONIC MONEY AND INTERNET AND MOBILE PAYMENTS 4–5 (2004).

152. *Giros* are a means by which a consumer authorizes a merchant to draw funds from the consumer's deposits at a bank or other financial institution (e.g., funds deposited with the local post office) to make a payment.

United Kingdom, credit cards have a larger profile, though not nearly as large as in North America.

In 2005, credit cards still predominate among card-based payment systems only in the United States and, arguably, Canada.[153] Even in the United Kingdom, where payment habits before the advent of payment cards were more similar to those in the United States than in continental Europe, the debit card payment volume of £108 billion in 2003 exceeded credit card volume of about £100 billion.[154] Given the trend in favor of debit card use even in the United States and Canada, they might not continue to predominate there, either. However, if Americans cannot substantially change their payment habits, it is they who will remain out of step with the rest of the world in their use of credit cards.

B. Japan

In Japan, credit card use exceeds debit and prepaid card use. However, Japan maintains the institution of *ikkai barai,* loosely translated as "payment in one cycle." In about 85% of Japanese credit card transactions, consumers use the card to arrange a prescheduled debit transfer as in the case of the *giro* in Europe. At the cash register, the consumer decides to pay the issuer in full on the next monthly payment date, and authorizes a debit transfer out of his or her account to pay the transaction shortly after the last day of the billing cycle. The retailer then submits the authorization to its bank, which receives payment from the card issuer. At the end of the billing cycle, the card issuer then initiates the debit transfer and receives full payment, without any further action by the cardholder after he or she signs the authorization at the point of sale. "Because the cardholder at the point of purchase already has given the issuer access to a specified amount of funds in a specified account, the transaction resembles much more closely an American debit card transaction than an American credit card transaction."[155] Apart from Japan and the credit card giveaway in South Korea, nowhere in Asia or other developing regions are credit cards as widely used as debit and prepaid cards.

The failure to recognize the anomalous nature of American and Canadian payment culture is a flaw in the work of the leading

153. *See* Mann, *supra* note 2, at 653.

154. ASSOCIATION FOR PAYMENT CLEARING SERVICES, U.K. PAYMENT MARKETS TRENDS AND FORECASTS IN BRIEF 4–6 (2003), *available at* http://www.apacs.org.uk/downloads/APACSInBrief2003.pdf.

155. *See* Mann, *supra* note 71, at 1074–75.

American scholar on payment systems, Ronald Mann. In a 2002 article,[156] Professor Mann attempted to explain the Japanese use of credit cards as *ikkai barai*. Calling the credit card "the dominant card-based payment system in the world,"[157] Professor Mann concluded that the credit card is "likely to languish as a relatively minor system" in Japan, because "[f]inancial systems that develop in one country cannot be transplanted without change to other countries that have different institutional settings."[158] Yet, even in 2002, credit cards were not the dominant card-based payment system outside North America and a few countries in Western Europe. The immensity of the American economy obscures the status of Americans as outliers in relying on credit cards as a source of financing instead of convenience.

Moreover, payments by direct debit transfer in Japan dwarf the volume of payments by credit card. In Japan 53% of all non-cash payments in 1990—and 51% in 1997—were by direct debit transfer; in contrast, 9% and 10% of payments were made by credit card and 9% and 5% were made by check in those years, respectively.[159] Direct debit transfer, which authorizes a merchant to debit one's bank account, is also a dominant payment method in Germany, where it known as the *giro.* It is also common in the United Kingdom, France, and Italy.[160] The dominance of direct debit and *ikkai barai* is functionally consistent with payment methods common both in Japan and Europe, but differs from the use of credit cards in North America.

Japan's unique payment culture is not anomalous. Rather, there is a functional equivalence between Japanese use of credit cards as "convenience cards," payment by direct debit transfer, and the use of debit and prepaid cards for convenience in much of the world outside North America.[161] Japanese cardholders prefer to have the option of rolling over a balance on their cards, an option that debit cardholders in China, Russia, or India do not yet have due to both a lack of credit information systems and their relatively impoverished circumstances. Yet the Japanese exercise that option relatively infrequently. Moreover, Professor Mann himself has more recently noted the trend in the United States toward (or back to) the use of credit cards for payment convenience rather than as a source of

156. *Id*.
157. *Id.* at 1071.
158. *Id.* at 1108.
159. BIS RETAIL PAYMENTS STUDY, *supra* note 3, at 26.
160. SECOND EDITION OF EVANS & SCHMALENSEE, *supra* note 14, at 44.
161. *See supra* Part IV.B.

financing.[162]

In 1999 (a long time ago when discussing payment cards), the Bank for International Settlements study of the G10 countries and Australia recognized the trend toward debit card dominance: "[O]nly in Canada, Japan and the United States are credit card payments still a significantly greater percentage of non-cash payments than debit cards."[163] Professor Mann's study of the Japanese use of credit cards demonstrates that even in Japan, the dominance of the credit card as a non-cash payment method is illusory.[164]

C. Europe: Checks and Giros

One European scholar has summed up payment habits in Europe as follows:

> [Concerning] payment habits, traditionally there were two groups of countries in Europe. On one side, Germany and the Netherlands were characterized by large use of cash in retail payments and transfers for remote transactions, and France and the United Kingdom on the other side, where typically less [sic] retail payments were in cash, [and] cheques were also largely used.[165]

In Lisa Rinaldi's view, checks "actually constituted an intermediate step between cash and cards."[166]

Credit cards came into regular use in Europe in the 1960s, not long after they did in the United States, but did not receive the same degree of acceptance. The difference in acceptance has much to do with differences in preexisting payment traditions: The check in the

162. *See* Mann, *supra* note 2, at 653.

163. BIS RETAIL PAYMENTS STUDY, *supra* note 3, at 9*; see also infra* note 168 and accompanying text. Note that the BIS study was addressing the G10 countries and Australia, in most of which there are significant numbers of credit cardholders. It did not include developing countries such as China, in which there are very few credit card holders and massive numbers of debit cardholders.

164. BIS RETAIL PAYMENTS STUDY, *supra* note 3, at 9.

165. Laura Rinaldi, *Payment Cards and Money Demand in Belgium* (CES Discussion Paper DPS, at 4 (Jan. 16, 2001), *available at* http://www.econ.kuleuven.ac.be/eng/ew/discussionpapers/Dps01/Dps0116.PDF; *see also* INSTITUT FUR TECHNIKFOLGENABSCHATZUNG UND SYSTEMANALYSE FOR THE EUROPEAN SCIENCE AND TECHNOLOGY OBSERVATORY NETWORK (ESTO), ELECTRONIC PAYMENT SYSTEMS IN EUROPEAN COUNTRIES: COUNTRY SYNTHESIS REPORT 89 (Knud Bohle et al. eds., European Commission, Joint Research Centre, 1999) (referring to the United Kingdom, France, and Italy as "cheque countries," and most of the other European Union countries as "*giro* countries") [hereinafter ESTO EPS STUDY].

166. Rinaldi, *supra* note 165, at 2.

United States, the United Kingdom, Canada, France, and Italy; direct credit (account to account or "A2A") and direct debit elsewhere in Europe.

Unlike in the United States, in Germany, the Benelux countries, Switzerland, and Scandinavia, the most common consumer payment system is the *giro*, a form of payment instruction that traditionally was in hard copy like a check. In the *giro*, the consumer can authorize a merchant, such as a utility company, to withdraw payments from her bank account as a direct debit transfer. *Giros* are commonly used to pay utility bills, telephone bills, taxes, and other recurring obligations, and they are used in other countries such as Singapore as well as in Europe. *Giros* could also take the form of a credit transfer. For example, a common and early form of *giro* was the "postal *giro*" in which an amount was deposited by the consumer at the Post Office together with instructions to pay creditors. In the mid-1960s, while American consumers were opening checking accounts in record numbers and beginning to open credit card accounts, many European merchants were automating their systems so that consumers could actuate a *giro* electronically at the point of sale. In areas where the *giro* was well-established, neither checks nor credit cards became popular.

Two studies from 1999 and 2001 illustrate this point. Significantly, checks see greater use in Europe, for example, than they did fifty years ago. While in the United States, as of 2001, almost 60% of non-cash payment transactions in number were by check, only in France (among the other G7 countries) did the percentage exceed 30%.[167] While 74% of non-cash payment volume in the United States, as of 1997, was by check (and the figure had been as high as 82% six years earlier), in no other country among the G10 countries and Australia did it exceed France's 46%. Checks did not exceed 32% of non-cash payment volume in any of the G10 countries except in France, as well as Australia (a non-G10 country) at 41%. In many countries checks are almost unknown.[168]

Results of the Bank for International Settlements 1999 study, based on 1990 and 1997 data, are reproduced in the chart below:[169]

167. SECOND EDITION OF EVANS & SCHMALENSEE, *supra* note 14, at 44.
168. BIS RETAIL PAYMENTS STUDY, *supra* note 3, at 25–27.
169. *See id*. (reporting these data).

Table 1: Share of Non-Cash Payments, 1990/1997 (%)

Country	Credit	Debit	Check	Credit	Direct
Australia	11/14	4/20	56/41	21/20	8/5
Belgium	2/3	8/19	24/8	58/60	8/10
Canada	30/31	0/22	63/31	4/9	3/7
France	0/0	14/22	60/46	16/18	10/14
Germany	1/2	0/2	10/6	52/48	42/37
Italy	1/7	0/5	46/32	50/46	3/10
Japan	9/10	0/0	9/5	29/34	53/51
Netherlands	0/0	2/18	15/3	62/52	21/27
Sweden	0/1	5/17	15/2	73/76	4/7
Switzerland	4/4	3/9	6/1	85/72	2/4
U.K.	11/13	3/18	52/31	21/19	13/19
U.S.	16/19	0/4	82/74	1/2	1/1

Professor Laura Rinaldi calls checks an "intermediate step between cash and cards."[170] There is an intuitive logic to this theory. The credit card system depends on the cardholder's paying the card issuer by another means of payment. One cannot pay off a credit card with another credit card payment, except through a balance transfer, and at some point, there has to be a way of paying the bill.

However, in the case of a country like Germany where remote transactions traditionally were paid by *giro*, checks may be an unnecessary step, as *giro* would be more secure for the merchant and, in a jurisdiction with a non-par checking system, perhaps less costly. Nor would an evolution from *giro* to credit card make sense, unless the consumer intends to carry a balance as a loan. Using a credit card would then require a further payment transaction to pay the credit card invoice, either a check or a *giro*. In a cash-and-carry culture in which consumers normally pay either in cash or by a direct debit or credit transfer as in Japan and Germany, paying by credit card would serve no purpose other than, perhaps, reallocating some of the burden of processing from the merchant to the card issuer. In other words, while an evolutionary progression from cash to checks to credit cards makes sense, a progression from cash to *giro* to cards would not.

Moreover, if credit cards become part of payment culture more readily in countries in which consumers first become accustomed to paying bills by check, one would expect to see a pattern of usage of checks and credit cards. Yet, in France, for example, checks are the dominant method of payment, yet credit card

170. Rinaldi, *supra* note 165, at 1.

usage is extremely low, while debit card usage is increasing.[171]

It is sometimes assumed that the absence of checks in a national payment culture makes it easy for payment cards to make inroads in a consumer population. Bankers, including the FRB, often conceive of checks as a competing payment system. However, evidence from Spain does not bear this out. Consumer payments by check in Spain have never been as widespread as in Italy, the United Kingdom, and France.[172] "Partly because of that," said a leading European Commission-funded study, "Spain entered the stage of payment cards quickly."[173] Yet, when Visa España and Spanish banks installed "abundant" POS terminals and issued a large number of payment cards, they found that consumers were not using the cards—they continued to use cash.[174]

D. The American and Canadian Credit Card Habit

1. Explaining the Habit

If acquiring a check-writing habit pre-ordains acceptance of credit cards, the United States provides a good example. Americans acquired a check-writing habit with the assistance of the FRB, which subsidized the costs of the U.S. check clearing and collection system from 1918 to 1980. Beginning in 1915, the FRB personalized the nationwide check clearing and collection system. Obviously there were substantial costs of this system, totaling up to $500 million per year, but from 1918 to 1980 the FRB selected to have the American taxpayer absorb those costs by operating the system free of cost to member banks in order to maintain check collection at par.[175] Thus, a bank customer who deposited a check for $100 would, in fact, be credited with $100 in his or her account, not $100 minus a fee for the cost of clearing and collecting the check.

The use of checks grew enormously in the post-war United States, and checking account customers were among the first to receive credit cards. In 1966, when Bank of America decided to "go national" with the BankAmericard, the predecessor to Visa, competing banks in Chicago sent four million unsolicited credit cards to their existing checking account customers, as well as other consumers they could identify, in an effort to build their own credit

171. *See infra* tbl. 2 & Part IV.D.1.
172. ESTO EPS STUDY, *supra* note 165, at 85.
173. *Id.*
174. *Id.*
175. SECOND EDITION OF EVANS & SCHMALENSEE, *supra* note 14, at 42.

card businesses.[176] The massive fraud resulting from this incident provided the initial impetus for TILA provisions prohibiting the distribution of unsolicited credit cards.

Professor Mann, in his recent *Georgetown Law Journal* article,[177] has pointed to the increasing use of credit cards as convenience cards. This is not new, but a return to pre-1983 habits. Prior to about 1983, most American credit cardholders carried relatively low balances, and they were stable or declined over time.[178] However, average credit card balances surged in the United States after 1983.[179] As interest rates started to come down in 1983, consumers ran up credit card debt, as shown in Table 2. By 1983, the termination of FRB subsidization of the check clearing and settlement system in 1980 also resulted in the imposition of checking account fees. Meanwhile, interest-bearing money market accounts accessed by interest bearing check accounts, such as Negotiable Orders of Withdrawal (NOW), became available as a way of offsetting the fees and earning interest on deposits that were seen as rapidly losing value due to high inflation. However, those accounts

176. Weistart, *supra* note 96, at 1478–81. Weistart describes how, upon learning of Bank of America's plans shortly before they were to go into effect in the fall of 1966, a group of five Chicago banks, including Continental Illinois and Harris Bank, that had planned to issue a competing card called the Midwest Bank Card, hurriedly tried to beat Bank of America to the punch. Lacking time to screen recipients, in the first weeks of October 1966, the banks sent over four million unsolicited credit cards not only to their customers, but to virtually anyone whose name they could obtain in the Chicago area. One man received seven cards from a single bank in one day, and another received eighteen cards in a three-day period. Young children received cards; postal clerks stole unmailed cards and sold them on the black market. The result was chaos and massive fraud. *See also* SECOND EDITION OF EVANS & SCHMALENSEE, *supra* note 14, at 72–73.

177. Mann, *supra* note 2, at 656.

178. *See* BUS. WEEK (Indus. Edition), Oct. 18, 1982, at 30

> The US consumer debt load in relation to income has fallen to its lowest point in 20–30 years . . . . Although revolving credit, mostly credit cards, accounts for 40–45 percent of total consumer credit extensions and 66 percent of all new non-auto credit, it accounts for only 19 percent of total debt outstanding. C.B. Kenney [a Shearson/American Express economist] sees the reason being that consumers use a lot of credit as a convenient substitute for cash, as over half pay off credit-card balances at the end of every month [However,] consumer credit repayments as a percent of disposable income have been declining steadily.

Id.

To the same effect, see THE BOSTON GLOBE, Mar. 12, 1980, § Economy, *available at* 1980 WLNR 78934 (Westlaw) (reporting that a State Street Bank of Boston official testified that the bank would have to leave the credit card business if denied permission to charge $10 annual membership fee due to consistent losses: "Bankers have attributed the credit card squeeze to their rising cost of funds due to spiraling interest rates, increased operating costs, and the fact that many of their cardholders pay off their card balances month to month."); Roland E. Brandel & Carl A. Leonard, *Bank Charge Cards: New Cash or New Credit*, 69 MICH. L. REV. 1033, 1060 (1971) (noting a significant reduction in revolving credit card balances between 1969 and 1970).

179. SECOND EDITION OF EVANS & SCHMALENSEE, *supra* note 14, at 76–77.

were limited to two checks per month. Thus, there was an economic incentive for consumers to charge purchases, then pay for them with a check drawn on a money-market account.[180]

Table 2: Credit Card Balances and Interest Rates in the United States

Year	Average balance per card with an active balance	Percent carrying a balance[181]	Average most common interest rate on credit cards[182]
1969	$776[183]	n.a.	n.a.
1983	$751[184]	56.6	18.78
1989	$1362	57.9	18.02
1992	$1366	59.0	17.78
1995	$1852	61.9	15.79

While in the 1977–1983 period banks had cut back on issuing new credit cards,[185] as the economy improved in the 1980s, banks loosened underwriting criteria and consumers flocked in droves,[186] attracted by interest rates that were fairly nominal when adjusted for inflation, which peaked in 1981 at around 13%.[187] Accordingly,

180. *See* Jeanne Iida, *Fed's Revised Prices for Check Clearing, Electronic Payments Spark Cries of "Unfair,"* AM. BANKER, Nov. 15, 1993, at 17; *see also Lies, Damned Lies, and M1 Statistics*, FORBES, May 23, 1983, at 25 (attributing some of the rise of M1 to imposition of checking account fees by banks, resulting in consumers' avoiding fees by paying with cash or building credit card balances and then paying with large checks drawn on money-market accounts).

181. The source of this information is Edward J. Bird, Paul A. Hagstrom & Robert Wild, *Credit Cards and the Poor* 7, tbl. 1 (Inst. for Research on Poverty Discussion Paper No. 1148-97), *available at* http://www.irp.wisc.edu/publications/dps/pdfs/dp114897.pdf.

182. The source of this information is FED. RES. BD., THE PROFITABILITY OF CREDIT CARD OPERATIONS OF DEPOSITORY INSTITUTIONS tbl. 3 (1997), *available at* http://www.federalreserve.gov/boar docs/rptcongress/creditcard/1997/default.htm.

183. This number represents $187 adjusted to real 1995 dollars using information found on the Bureau of Labor Statistics website, http://www.bls.gov; *see also* N.Y. TIMES (Abstracts), Apr. 3, 1970, at 51. Data were for national banks only, issued by the Comptroller of the Currency. There were 10.5 million credit cards in circulation.

184. Average balances for 1983, 1989, 1992, and 1995 are taken from FED. RES. BD., SURVEY OF CONSUMER FINANCES. All are given in real 1995 dollars. *See* Bird, Hagstrom & Wild, *supra* note 181, at 7, tbl. 1.

185. SECOND EDITION OF EVANS & SCHMALENSEE, *supra* note 14, at 97.

186. *See id.* fig. 4.3. The only exception was the lowest income quintile of the population. *See generally* ROBERT D. MANNING, CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA'S ADDICTION TO CREDIT (2000).

187. J. Alfred Broaddus, Jr., Past President, Federal Reserve Bank of Richmond, Remarks before the 11th Annual Business Expo Luncheon (Oct. 21, 1997), *available at*

from 1980 to June 1985, the average outstanding balance on active Visa and MasterCard credit card accounts increased 28% in real (inflation-adjusted) dollars, while the number of accounts grew by 41%.[188]

After 1983, however, the cost of funds to banks dropped from 13.5% to 3% by the mid-1990s, yet credit card interest rates remained virtually unaffected. As credit card balances rose in the mid-1980s, banks showed an abrupt increase in the profitability of their credit card operations, and credit card interest rates displayed reduced sensitivity to changes in the cost of funds.[189] Various attempts have been made to explain why competition among the more than 4000 card-issuing banks did not lead credit card interest rates to follow these decreases in the cost of funds. David S. Evans and Richard Schmalensee argue that issuer profits in fact fell during the 1990s and that the high interest rates were therefore justified by higher costs other than the cost of funds, such as charge-offs due to consumer bankruptcies. Lawrence Ausubel posited that "many consumers systematically underestimate the extent of their current and future credit card borrowing and, using these underestimates, make suboptimal decisions regarding the choice and usage of credit cards."[190]

A consumer who thinks she can pay off her credit card balance whenever she wants to will be less inclined to worry about the interest rate. The American consumer was abetted in making her change of payment habits permanent by the escalation in home values of the late 1980s and 1990s. As long as refinancing home

http://www.rich.frb.org/news_and_speeches/past_presidents_speeches/index.cfm/1997/id=9. Indeed, the cost of funds to banks at one point reached 16%.

188. Christopher DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201, 210 n.39 (1986). Apparently either there was a dip in 1980, or in the years leading up to 1980, or most of the 28% increase was between 1983 and 1985, given the statistics shown in Table 2.

189. Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249, 260–61 (1997). It was an inopportune moment for the American consumer to begin to run up high credit card balances. In 1979, the U.S. Supreme Court had held in Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978), that under the National Bank Act, 12 U.S.C. § 85 (1864), the interest rate limit set by an issuer's resident state overrode usury limits imposed by other states in which the issuer did business. By 1982, credit card issuers had established residency for purposes of the National Bank Act in states such as Delaware and South Dakota in which usury laws were lenient or nonexistent. SECOND EDITION OF EVANS AND SCHMALENSEE, *supra* note 14, at 69–70. For example, Citicorp moved to South Dakota late in 1980 and 1981. *See* THE ECONOMIST, Nov. 29, 1980, at 73. South Dakota raised its usury ceiling to 19.8% in March 1979; New York's lifting of its ceiling altogether in November 1980 came too late to keep Citicorp's credit card operations in Manhattan.

190. Ausubel, *supra* note 189, at 261 (citing Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, AM. ECON. REV., Mar. 1991, at 50, 70–71).

mortgages and thereby paying off accumulated credit card balances was an option, consumers did not worry too much as their balances grew.[191]

2. Resistance to Debit Cards

While differences between American payment habits and payment habits elsewhere may have been shaped by historical factors such as the preexisting use of checks or *giros* and inflation and the costs of credit at a crucial stage in the development of consumer payment habits, the fee structure shaped early resistance to debit cards in the United States. Given the choice between being charged a $1.00 or $1.50 fee by their bank to use a debit card at a point of sale and no fee to use a credit card, consumers chose the credit card, even when they had a revolving balance and would be charged interest in excess of the fee they avoided. In contrast, debit card fees at the point of sale are relatively unusual in Europe, and only a small percentage of prepaid cards involve payment of a per-transaction fee.

This phenomenon of incurring interest-bearing debt in order to avoid imposition of an immediate fee is consistent with what behavioral economists call "hyperbolic discounting," the tendency for consumers to have higher discount rates for events perceived as likely to occur far in the future than they do for events likely to occur in the immediate future.[192] This is not irrational behavior. One may never have to pay interest if the credit card balance is paid currently, and in any event it is not incurred immediately and the amount is not known; in contrast, the $1.00 or $1.50 fee imposed by one's bank for use of a debit card at the point of sale or at another bank's ATM is charged immediately and is a known—or, at least, predictable—amount.

However, since 2000, debit card payment volumes and cards in circulation have grown rapidly in the United States. From 2000 to 2003, use of debit cards in the United States grew 23.5% per year

191. *See* Ben Weberman, *Second Thoughts on Second Mortgages*, FORBES, Oct. 5, 1987, at 42 (citing bankers' complaints that home equity lending was cannibalizing more profitable credit card lending).

192. *See, e.g.*, Mann, *supra* note 2, at 651–52; Stefano Dellavigna & Ulrike Malmendier, *Contract Design and Self-Control: Theory and Evidence*, 119 Q.J. ECON. 353 (2004); Shane Frederick et al., *Time Discounting and Time Preference: A Critical Review*, 40 J. ECON. LIT. 351, 360 (2002); Jonathan Gruber & Botond Koszegi, *Is Addiction "Rational"? Theory and Evidence*, 116 Q.J. ECON. 1261 (2001); George Lowenstein & Richard H. Thaler, *Anomalies: Intertemporal Choice*, J. ECON. PERSP. 181, 184–87 (Fall 1989) (discussing dynamic inconsistency in discount rates); Richard H. Thaler, *Some Empirical Evidence on Dynamic Inconsistency*, 8 ECON. LETTERS 201, 202 (1981).

compared with 6.7% for credit cards,[193] totaling 15.6 billion debit card transactions compared with 19 billion credit card transactions in 2003.[194] Debit cards today are used in about one third of all in-store transactions in the United States, compared with 20% four years ago.[195] Per household debit card spending, $5322 as of 2003, is expected to nearly double by 2008.[196] However, debit card payment volume remained less than half of credit card volume as of 2004.[197]

Debit cards have fared better still in Canada. In Canada, there were already more debit card transactions than credit card transactions by 2002, but credit card purchases still totaled CD $135.7 billion compared to debit card use of CD $104.9 billion.[198] However, debit card fraud is also higher in Canada than in the United States.[199]

V. CONSUMER PROTECTION POLICY ISSUES

A. Who Makes the Rules? Private Lawmaking and Public Policy in the Regulation of Debit and Prepaid Card Transactions

Professor Mann, in his recent *Georgetown Law Journal* article, asserts:

> At its heart, payments law must resolve four fundamental questions: who bears the risk of unauthorized payments; what must be done about claims of error; when are payments completed so that they discharge the underlying liability; and when can they be reversed? The first three questions are categorically different from the last because they often should be resolved based on the nature of the underlying technology.[200]

Professor Mann goes on to argue that reversibility of payment card transactions is different, due to the inequality of bargaining power

193. THE 2004 FEDERAL RESERVE PAYMENTS STUDY 8 (2004), *available at* http://www.frbservices.org/Retail/pdf/2004PaymentResearchReport.pdf.

194. *Id.*

195. Kuykendall, *supra* note 35.

196. THE 2004 FEDERAL RESERVE PAYMENTS STUDY, *supra* note 193, at 8.

197. *Id.*

198. *See* ePaynews.com, Debit Card Fraud is a Growing Problem in Canada (June 18, 2003), http://www.epaynews.com (search "Archive Search" for "Debit Fraud Canada Shawn Murray").

199. *See supra* notes 29–31 and accompanying text (discussing the debit card market in Canada).

200. *See* Mann, *supra* note 2, at 653.

between consumers and merchants, and that the TILA legal regime designed to protect consumers against making imprudent borrowing decisions, largely through disclosure requirements, should be reconsidered, as to payment cards, as a means of "redressing an imbalance of leverage."[201]

Professor Mann is not the first to call for reform of the reversibility rules in payment card transactions.[202] One European Commission (EC) study said, "In relation to debit cards, charge back rules are necessary, providing the consumer with the right to have the money transferred back on his demand, not only in case of fraud, but also where he avails himself of the right of withdrawal [from the contract with the merchant]."[203] The same study cited the need for an "open and flexible regime" of consumer protection that could adapt to new payment methods as they developed, and the consumer's lack of anonymity online as mandating privacy concerns.[204] Moreover, the study also emphasized the need for legislation rather than reliance on self-regulation.

The proliferation of debit and prepaid cards in developing countries has been met with regulatory inaction in most places. If the governments of developing countries such as China, Brazil, and India fail to establish regimes to regulate payment cards and, in Professor Mann's words, "redress an imbalance of leverage," then the question

201. *Id.* Professor Mann oddly omits any mention of regulation of fees and penalties charged by banks for the use of payment cards. In 2004, the highest percentage of all complaints to the FRB regarding state member banks concerned payment card fees and penalties. *Regulation Z (Truth in Lending Act): Hearing Before the Senate Comm. On Banking, Housing, and Urban Affairs*, 109th Cong. (2005) (statement of Edward M. Gramlich, Gov., Fed. Reserve), *available at* http://www.federalreserve.gov/boarddocs/testimony/2005/20050517/default.htm [hereinafter Gramlich Testimony]. The same is true of complaints about banks in the United Kingdom. *See* NAT'L CONSUMER COUNCIL, TRANSPARENCY OF CREDIT CARD CHARGES (Memorandum to the Treasury Select Comm., H.C. (U.K.)) June 20, 2003, *available at* http://www.ncc.org.uk/moneymatters/treasury20june.pdf. To exclude laws (or the lack thereof) regarding the cost of making a payment from "payments law" is analogous to excluding wage-hour laws, governing the cost of labor, from "employment law," or excluding rules regarding brokerage commissions and the pricing of securities offerings from "securities law."

202. *See, e.g.*, PRICEWATERHOUSECOOPERS, FINAL REPORT STUDY ON CONSUMER LAW AND THE INFORMATION SOCIETY 3, 5 (2000), *available at* http://europa.eu.int/comm/dgs/health_consumer/library/surveys/sur20_en.pdf (calling reform a "high priority" considering the "absence of binding EU rules," and citing chargebacks and reconsideration of the relationship between the cardholder and the card issuer as areas of special concern "in view of the prepay model that seems to join in with the Internet") [hereinafter EC STUDY ON CONSUMER LAW AND THE INFORMATION SOCIETY].

203. *Id.* at 75. The EC Distance Selling Directive gives a limited right of withdrawal for a period of days, but does not address the broader issues of preservation of claims and defenses and dispute resolution through the chargeback system. *See* Council Directive 97/7, 1997 O.J. (L 144) (EC).

204. EC STUDY ON CONSUMER LAW AND THE INFORMATION SOCIETY, *supra* note 202, at 75.

is whether the payment card industry can be expected to do so itself as a set of private lawmakers. Whether an imbalance of leverage with respect to reversibility will be redressed voluntarily depends to some degree on the relationship between the perceived difficulty of obtaining new merchants for the payment card association and the perceived difficulty of attracting consumers to apply for and use their cards.

There has been little difficulty in most countries in attracting consumers to obtain debit and prepaid cards, as discussed above. In China, the process has been hastened by government intervention. With respect to credit cards, a key limiting factor in most parts of the developing world, with the notable exception of the South Korean credit card debacle, has been banks' unwillingness to issue them, largely due to the lack of credit information systems. Moreover, as discussed above, consumers in most countries, and even the majority of consumers in the United States, tend to use credit cards for convenience rather than to run up unpaid balances.[205] Debit and prepaid cards do not present (at least, in the absence of an overdraft line of credit) an opportunity to indulge in over-indebtedness.

The primary limitation on the use of debit cards is the reluctance of merchants to make the investment in equipment necessary to accept payment cards. That is why there are so many "sleeping cards" in China, why South Koreans used their sudden credit card wealth to take cash advances and spent the cash, and why the proliferation of debit cards in Brazil has not reduced the use of cash to the same extent as the proliferation of credit cards did in the United States.

As long as private lawmakers in banks and card associations perceive that, on a global level, consumers are more anxious to obtain and use payment cards than merchants are to sign up and install the necessary equipment, their tendency will be to make private laws that are favorable to merchants rather than consumers.

Another major factor is that banks and merchants, not consumers, comprise the membership of card associations, and the private lawmakers are these bankers and their attorneys. Association rules unsurprisingly favor members of the association over consumers, who are outsiders to the network.

The status of consumers as outsiders to the card association damages both the transparency and legitimacy of self-regulation. Because the Visa and MasterCard associations regard chargeback procedures as ways of allocating losses between banks, and not

205. *See* Mann, *supra* note 2, at 656–57.

between consumers and merchants, they decline to disclose the rules that govern chargeback procedures to anyone not affiliated with a member financial institution or regulatory agency. The rationale given by Visa U.S.A. is that the rules are "proprietary and confidential information" in the nature of trade secrets, valuable to someone who might want to start a competing system.[206]

This rationale is both implausible and insufficient. It is implausible because there are not likely to be any major new credit and debit card networks coming on the scene that would significantly benefit from copying Visa's and MasterCard's chargeback procedures. Other network associations such as the National Automated Clearing House Association (NACHA) publish their rules and procedures and freely sell copies to non-members. It is insufficient because consumers have an interest in the rules that govern chargebacks, since they affect the willingness of card issuers to recredit consumers' accounts. Issuers frequently recredit accounts even when not obligated to do so by consumer protection laws, but it is important that such recrediting be done in a fair and non-discriminatory fashion in accordance with rules and following adequate investigation of the consumer's complaint.

Besides lack of transparency, unfairness to consumers is another defect in current chargeback procedures. Again, because the network associations regard chargeback procedures as a private matter between their member banks rather than as a consumer protection system, the procedures are not designed to ensure that the consumer's voice is heard or that her interests are adequately represented.

The primary unfairness of the chargeback system to consumers lies in the fact that in the case of a dispute, nothing requires the issuer to do more than take the merchant's word for what happened. As a practical matter, this means that if the facts are in material dispute, the issuer is likely to restore the charge to the consumer's bill, on the theory that the consumer has no defense against liability to the merchant, and leave it to the consumer to pursue other remedies against the merchant. This is not an effective means of redress in many cases.

Although American consumers have the right, under TILA § 170, subject to certain limitations, to withhold payment from the issuing bank if they have paid with a credit card and have a defense against the merchant, only an unusual consumer would risk losing as

206. E-mail from Russell W. Schrader, Senior Vice President and Assistant General Counsel of Visa U.S.A., Inc., to the author (Apr. 12, 2005, 19:33:00 EST) (on file with author) [hereinafter Schrader E-mail]; *see also* Boxall Interview, *supra* note 150.

much as a hundred points in his or her credit score, as well as loss of credit card charging privileges, by doing so. For these reasons, the volume of chargebacks in the United States, which Professor Mann characterizes as "quite small," cannot be considered evidence that consumers are overwhelmingly satisfied with the goods and services they purchase, or that unauthorized transactions or other grounds for reversal of transactions are *de minimis*.[207] The high volume of complaints to the U.S. Federal Trade Commission (FTC) about identity theft in credit card transactions[208] and the stagnant indices of consumer satisfaction in market research studies[209] are evidence to the contrary.

Moreover, although chargeback rules generally provide for arbitration of disputes between issuing banks and merchant acquirers (e.g., if the merchant is insolvent, one of the banks will bear the loss), this procedure only applies if the issuing bank initiates a chargeback, and it has no incentive to do so unless compelled by public law to recredit the consumer's account. The consumer lacks any right to initiate or participate in the arbitration process. The consumer has no right to invoke a hearing, to be present or ask questions, or even to know what the rules are.

That is not to say that the bodies of private law created by banks to govern payment card networks are entirely one-sided. For instance, the NACHA, which govern automated clearing house ACH payments in the United States and Canada, provide consumers the right to be "promptly credited" with the amount of an unauthorized debit entry upon submitting an affidavit demanding the money.[210] In contrast, the federal Electronic Funds Transfer Act (EFTA) gives banks ten business days to complete an investigation and recredit the consumer's account in case of an unauthorized electronic funds transfer.[211]

207. Mann, *supra* note 2, at 665. It should be noted, however, that many chargebacks likely are handled informally between the consumer and merchant, outside the credit card dispute resolution system.

208. More complaints to the FTC concern identity theft than any other matter. The FTC received 650,000 complaints of fraud and identity theft in 2004. A large percentage involved new accounts opened in the names of senior citizens. *See* Press Release, Fed. Trade Comm'n, FTC Testimony: Identifying and Fighting Consumer Fraud Against Older Americans (July 17, 2005), *available at* http://www.ftc.gov/opa/2005/07/seniortest.htm.

209. See American Consumer Satisfaction Index National Scores, http://www.theacsi.org/national_scores.htm (last visited Jan. 5, 2006). The American Customer Satisfaction Index National Quarterly Score is significantly lower as of second quarter 2005 than it was in 1994. *Id.*

210. NACHA Op. Rules § 7.6.1.

211. Electronic Funds Transfer Act § 908(c), 15 U.S.C. § 1693f (2005).

Banks and bank networks that operate payment card systems have a number of reasons to promulgate private rules that are not one-sided. First, the banks and bank networks generally have an interest in avoiding or minimizing the extent of government regulation of new payment systems. When consumers regard industries as greedy and unfair towards consumers, they have prodded legislatures into enacting prophylactic legislation to remedy the perceived abuses. A good example is the Expedited Funds Availability Act (EFAA),[212] enacted by the U.S. Congress in 1987 in response to an outcry over banks' placing extended and unwarranted holds on deposits into customer checking accounts.

Second, banks and bank networks have an interest in uniformity. As networks become global in scope, the risk of attracting adverse regulatory action by overreaching is compounded. A network that spans five countries must keep five governments happy. If any one is aroused to act, the whole network will have to change its rules accordingly, not just in that single country. The widespread consequences of a misstep in self-regulation that makes the system appear too unfair toward consumers mean that banks and bank networks have an interest in maintaining a margin of safety. Banks not only have an interest in being perceived as staying off the toes of consumers, but also in appearing to remain at least a few inches away from them.

At the same time, however, banks and bank networks have less need to be concerned about governmental regulation in countries with small domestic markets. For example, Visa International and its regional cooperatives, in designing its policies for Africa, are likely to be guided more by a desire to satisfy merchants in South Africa, the largest African market, than by concern about adverse regulation in Burundi. Visa might credibly threaten to curtail operations in a small, impoverished country, but not in a larger market.

At least one scholar has argued that private lawmaking may be more likely to yield rules that promote efficiency where there is "regulatory competition."[213] However, Visa and MasterCard as

212. Expedited Funds Availability Act, 12 U.S.C. §§ 4001–4010 (2005).

213. David Snyder, *Private Lawmaking*, 64 OHIO ST. L.J. 371, 441 (2003).

> More choices, at least initially, are better: assuming the parties behave as the economists would have them do, a competitive rulemaking environment will allow not only the most efficient rules but also an efficient degree of uniformity or diversity. In other words, molecular federalism, in the presence of competition and an efficient market, should lead not only to relatively efficient rules but also to an appropriate number of regulatory choices.

Id.

In fairness, the author acknowledges that "the assumptions may not hold. Realists must temper their optimism with knowledge of potential market failure and the occasional

private lawmakers are more likely to compete to attract merchants than consumers. Indeed, Visa has cited competition as its reason for keeping its chargeback rules secret from the public.[214]

Overall, it is unlikely under present conditions that banks and card associations will voluntarily adopt a reversibility regime that grants global consumers effective chargeback rights. The fact is, for example, that their interest in uniformity has not been strong enough to result in the universal extension of chargeback rights to product- and service-related disputes, as TILA § 170 did for many American consumers who purchase with credit cards. The economic power of the U.S. market makes it worthwhile for banks and card associations to comply with § 170, but the rights granted by that section are treated as idiosyncratic rights of consumers in the United States and those few other countries with parallel legislation, not as a model to be followed globally.

This evidence raises troubling inferences for consumers in emerging economies where debit and prepaid cards are proliferating. In many places, these consumers may face greater risk of merchant misconduct than consumers in the developed world, due to the lack of effective law enforcement and unfamiliarity with modern payment systems. Yet, overwhelmingly payment card issuers and card associations are self-regulating in emerging economies, more so than in the United States and Western Europe where consumer protection has a longer history. Nowhere is there a greater need for legislation to redress the imbalance of leverage between consumers and merchants than in emerging economies.

B. Reversibility of Debit and Prepaid Card Transactions

In this section, I propose three changes in the law as it currently exists in the United States and Western Europe, with the hope that governments in developing countries will consider them as they devise consumer protection laws to govern payment card transactions. These changes are made possible by the reversibility and lack of anonymity of payment card transactions. They are: (1) transparency of chargeback rules, (2) transparency of merchant chargeback experience and experience ratings, and (3) consumer standing to assert against the card issuer product-related defenses against the merchant, regardless of whether the consumer used a debit or credit card in the transaction.

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emergence of markets for lemons." *Id.*

214. *See* Schrader E-mail, *supra* note 206.

1. Transparency and Reversibility: A Proposal

Transparency in the chargeback system could play an important role in redressing the existing imbalance of leverage between consumer and merchant. Private lawmaking by card associations has rejected transparency, yet policy makers seem to have given little thought to legislation that would mandate a degree of transparency for the benefit of consumers.

Private lawmaking by payment card associations has eschewed transparency for at least two reasons. First, as discussed above, competition for merchants is more keen than competition for consumers, especially in global markets in which payment cards are proliferating faster than merchants equipped to accept them. Second, as behavioral economists have observed, consumers tend not to consider the possibility of something going wrong at the time when they enter into a transaction, let alone when they apply for a payment card that will facilitate future transactions. Therefore, a transparent system for resolving disputes would not confer any significant advantage on card issuers in competing for consumer accounts.

The chargeback system lacks transparency in two particularly important respects. First, the rules of the system, and the right to participate in chargeback arbitrations, are open only to card association members.[215] Second, and perhaps more importantly, card associations, merchant acquirers, and card issuers keep data about the chargeback experience of individual merchants confidential.

The card associations' claim that chargeback rules are a trade secret has been discussed above. However, the unavailability of information about the chargeback experience of individual merchants is more important. If a specific merchant has engaged in misrepresentation of its merchandise or sold poor quality merchandise, resulting in a high number of chargebacks, this information should be available to consumers when they are shopping.

Card associations compete, through merchant acquirers, for merchant memberships. Merchants presumably prefer to keep negative information about themselves confidential. Card associations therefore have an interest in promising merchants that they will keep chargeback information secret from the public.

Compare the card associations' incentives with those of eBay, the online auction service. eBay posts data about online merchants, including consumer ratings and complaints, that is available to

215. *Id.*

consumers when they make a purchase. Online merchants have to overcome the remoteness of the transaction in gaining consumers' trust because consumers often must rely on a merchant's representations about merchandise they cannot hold in their hands even though they are unfamiliar with the merchant. eBay, anticipating this problem, chose to require merchants to consent to release of data about them.

Visa and MasterCard could compile the same data as eBay, but they do not, or, at least, they do not make such data accessible to the public. It is in consumers' interests to have access to such information. Most merchants would ultimately benefit from ratings based on chargeback experiences, even if they do not perceive the release of the information positively, because most have relatively few complaints.

Trade names and trademarks perform the same function as eBay's ratings in consumer transactions with most retailers. Overloaded with information from advertising and confronted with choices frequently too complex for rational decision-making within their limited time available, consumers rely on the reputation of the retailer to select where to shop and on brand loyalty to choose products. As available time for consumer decision-making becomes more limited, assuming a similar volume of input of relevant information, reliance on brand loyalty increases.[216]

Regulatory intervention to mandate compilation and release of relevant chargeback statistics for merchants that accept payment cards would be in the interests of consumers and would not present an insurmountable cost to issuers, merchant acquirers, or the card associations. Chargebacks are already coded according to the reason for reversal of each transaction.[217] Codes that simply reflect

216. *Cf.* J. Edward Russo, *More Information is Better: A Reevaluation of Jacoby, Speller and Kohn*, 1 J. CONSUMER RES. 68, 71–72 (1974). Russo took issue with the theory of information overload, but his research, showing that confusion decreased with increased data, was predicated on the assumption that the subjects took enough time to process the information. Information is not overload if consumers have enough time to process it, but the accelerated pace of life in the twenty-first century gives consumers less processing time.

217. Chase Merchant Services lists the ten most common reasons for chargebacks as follows, with the first being the most frequent:

> 1: Business fails to respond to a retrieval request [i.e., a request for documentation of a disputed charge] (reason codes 01/26/79). . . .
> 2: Customer was billed more than once for a single transaction (reason codes 25/34/82). . . .
> 3: Customer denies making or authorizing a transaction (reason codes 23/43/61). . . .
> 4: Failure of business to follow correct procedures or complete the sales slip at the point-of-sale (reason codes 37/39/81/84). . . .
> 5: Account numbers don't match (reason codes 12/25/77). . . .
> 6: A credit/refund was not processed properly (reason codes 24/60/85). . . .

voluntary exchange or return of merchandise, for example, would not be held against a merchant. A merchant that behaved properly in making an exchange would not incur negative consequences. Card associations would compile data only for those codes reflecting culpable conduct by the merchant. To do so, the associations might have to revise their chargeback reason codes to clearly distinguish chargebacks that should affect a merchant's rating and chargebacks that are irrelevant to it.

For example, Visa U.S.A. currently has twenty-four chargeback reason codes, down from forty-four codes with fifty-nine subcodes that were in use prior to October 2004.[218] The Wells Fargo Online Merchant Services website defines Visa Reason Code 53, "Merchandise/Service Not As Described or Defective Merchandise," as:

> Either the customer claims the goods or services received did not match the description/picture on your [the merchant's] Web site or other documentation/information they received from you, or the merchandise arrived damaged, defective or otherwise unsuitable for the purpose sold. Additionally, the customer claims the merchandise was returned, the service was cancelled, or they attempted to resolve the dispute with you.[219]

MasterCard Reason Code 53 and Discover Reason Code RM are similar.[220] All chargeback systems give the merchant an opportunity to credit the customer's account or to explain why a credit is inappropriate.

This Article proposes that if the issuer rejects the merchant's explanation or receives no explanation, or alternatively, if the merchant does not credit the customer's account until the customer has had to complain to the issuer, the card association would count a chargeback coded as Visa Reason Code 53 or its equivalent

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> 7: Failure to obtain proper authorization (reason codes 08/20/72). . . .
> 8: The card was used either before or after the valid dates (reason codes: 22/23/32/35/58/73). . . .
> 9: Merchandise or service not received by cardholder (reason codes 24/55/90). . . .
> 10: Cardholder disputes quality of merchandise/service (reason codes: 53/54/56).

Resolve Chargebacks: Ten Most Common Reasons for Chargebacks, http://www.chase.com/cm/cs?pagename=Chase/Href&urlname=chase/sb/merchantservices/custservice/resolve (last visited Jan. 9, 2006).

218. Chargebacks & Dispute Resolution, *supra* note 42.

219. *See* Resolve Chargeback Tool, *supra* note 42.

220. *Id.*

MasterCard or Discover in statistics it discloses to the public regarding that merchant.

Other chargeback reason codes can readily be classified as countable or not countable in the statistics, depending on whether they may reflect culpable conduct by the merchant. Thus, for example, codes reflecting that items were illegible, that presentment was late, or that a card was declined obviously do not reflect on the merchant's conduct, while codes for "altered amount" or "non-receipt of goods" may well reflect misconduct by the merchant or its employees.[221]

If compilation of, and public access to, chargeback data were mandated by law, a consumer interested in buying a washer-dryer could identify merchants carrying the desired products and then research the merchants' respective chargeback records, perhaps by visiting a website where the card association would post the data. If one merchant has a poor record and the other has a good record, consumers could benefit from being able to take those data into account in choosing where to shop. However, it is highly unlikely private lawmaking would effectuate this proposal.

Oddly, Visa and MasterCard have not chosen to pursue this idea in the United States. Competition to acquire merchants for the network is considerably lessened by the ubiquity of payment cards in this country. A merchant that does not accept cards is likely to be very small, and most businesses that accept Visa also accept MasterCard and, for the most part, American Express.[222] As debit and prepaid cards gain market share in the United States, there is a proportionately greater need for card associations and card issuers to compete for consumers and to try to steer them to more lucrative credit card use, while there is less need to compete for merchants. The provision of chargeback data could be restricted to consumers who own or use payment cards, increasing consumer goodwill. Indeed, the data could be offered for a fee, with the fee waived for consumers who use their cards regularly.

One function that greater transparency in the chargeback system would perform is to deter merchant misconduct. Transparency seems to have had a beneficial effect in deterring misconduct by merchants that do regular business on eBay. eBay

221. The Wells Fargo Online Merchant Services website includes a convenient list of eighteen Visa reason codes, eighteen MasterCard codes and fourteen Discover codes, with links to the definition of each. *See id.*

222. American Express cards technically are "charge cards" rather than "credit cards," since the balance due, apart from the "Blue" or "Optima" card, must be paid in full each month.

maintains ratings of online merchants by consumers and displays the frequency of complaints.[223] eBay gives merchants the opportunity to respond to particular complaints and posts their responses.

Another means of deterring merchant misconduct would be experience rating of the discounts that are deducted from what merchants collect from credit and debit card issuers. Currently, industry practice is to standardize discount rates depending on whether the merchant engages in remote transactions, in which the card is not presented by the customer. Mail order-telephone order (MOTO) and Internet merchants, now collectively called "card-not-present" or "MO/TO/ECI" merchants,[224] are at high risk for unauthorized charges and, hence, incur a higher discount rate than the roughly 1.6% discount that is deducted from what "card-present" merchants receive from card issuers for transactions with customers using credit and debit cards.

Differentiating discount rates according to card acceptance procedure will not deter merchants from engaging in fraudulent practices or selling shoddy merchandise. Currently the only sanction against merchant misconduct is to threaten to terminate a merchant's membership in the card association and access to the card network. This is rarely used and is not a nuanced approach to the problem.

An alternative would be to set discount rates according to a chargeback experience rating system. Issuers and merchant acquirers would charge a higher discount rate to merchants that have a relatively high incidence of certain types of chargebacks that may indicate misconduct. The chargeback reason code would determine the types of chargebacks that would count in setting discount rates.

Regulators, legislators, and legislative proposals in many other contexts have relied on experience ratings, including: workers' compensation systems for determining employer premiums for insurance against employee injuries,[225] medical malpractice insurance,[226] disability insurance in the Netherlands,[227]

223. *See* Henry H. Perritt, *Dispute Resolution in Cyberspace: Demand for New Forms of ADR*, 15 OHIO ST. J. ON DISP. RESOL. 675, 694 (2000); Victoria C. Crawford, *A Proposal to Use Alternative Dispute Resolution as a Foundation to Build an Independent Global Cyberlaw Jurisdiction Using Business to Consumer Transactions as a Model*, 25 HASTINGS INT'L & COMP. L. REV. 383, 396 (2001). By citing these sources, I do not mean to endorse the notion of an "independent global cyberlaw jurisdiction," whatever that may be.

224. VISA U.S.A. INC., RULES FOR VISA MERCHANTS 94–95 (2005), *available at* http://usa.visa.com/download/business/accepting_visa/ops_risk_management/rules_for_visa_merchants.pdf

225. *See* Edwin R. Teple & Charles G. Nowacek, *Experience Rating: Its Objectives, Problems and Economic Implications*, 8 VAND. L. REV. 376 (1954); Almon R. Arnold, *Experience Rating*, 55 YALE L.J. 218 (1945).

226. *See* Lori L. Darling, Note, *The Applicability of Experience Rating to Medical*

unemployment insurance; and even ticket raffles.[228] Bank regulators, too, employ experience rating in the United States. The "CAMELS"[229] rating is used by the FRB, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation to determine the extent of supervisory activity and the levels of premiums they charge to banks for federal deposit insurance.

Using experience rating in setting discount rates for individual merchants is problematic after *Wal-Mart* because discount rates may be subject to negotiation based on considerations that may have little to do with chargeback experience. Even if Wal-Mart had a higher percentage of chargebacks than other merchants, its high volume of payment card business strengthens its hand in negotiating a lower discount rate. In contrast, small merchants are likely to be charged a higher discount rate despite favorable chargeback experience. Public disclosure of merchants with adverse chargeback experience would be more effective, and would not necessitate a retreat from negotiated discount rates.

2. Grounds for Reversal of Transactions

Most countries that have adopted regulatory regimes for payment cards have made provisions correcting billing errors. Card association chargeback rules permit chargebacks in cases of billing error. However, only in the United States, Canada, Israel, and a few European countries do laws permit consumers to initiate chargebacks based on contract disputes between the consumer and merchant, such as non-conformity of the goods with the contract, non-delivery or delayed delivery of goods, and defective goods. In addition, bank statement rules—rules regarding the time and procedure for giving notice of billing errors and the effect of failure to do so—differ from country to country.

One key issue regarding reversibility of debit and prepaid card transactions is whether consumers should be entitled to reversal of transactions based on claims and defenses arising out of the underlying contract between consumer and merchant. Prior to 1974,

Malpractice Insurance, 38 CASE W. RES. L. REV. 255 (1987).

227. *See* Pierre Koning, *Estimating the Impact of Experience Rating on the Inflow into Disability Insurance in the Netherlands* (CPB Discussion Paper No. 37, Aug. 2004).

228. *See* Vandenberg Systems, Inc., Applying traditional fund-raising techniques to Ticket Raffles: Experience Rating, http://www.vansys.com/research/experience_rating_1.html (last visited Jan. 5, 2006).

229. CAMELS is an acronym for capital, asset quality, management, earnings, liquidity, and sensitivity to interest-rate risk.

when the U.S. Congress enacted TILA § 170,[230] it was a subject of considerable debate in the United States about whether a credit card issuer should be accorded the status of a holder in due course (HDCs), like finance companies that financed consumer purchases of automobiles, washing machines, or other consumer goods based on a negotiable promissory note or chattel paper. If card issuers were HDCs, they would have the right to recover from the cardholders regardless of most types of defenses or claims in recoupment, such as breach of warranty or fraud.[231]

Under UCC § 3–305, prior to various consumer protection laws and rules that now cover many consumer transactions, a consumer who purchased a car or a washing machine that was a "lemon" normally might have been required to pay the company that financed the purchase due to its HDC status, and would have been left with a claim against the merchant that sold him or her the machine. Exceptions existed for lenders that purchased the note or chattel paper with notice of a defense or claim—so-called "real" defenses such as illegality, incapacity, bankruptcy discharge, and fraud *in factum*—and cases in which the lender was so related to the merchant as to have constructive notice of consumer claims or defenses. Beginning in the 1960s, additional consumer defenses gained recognition, further constraining the HDC doctrine. In American law journals, scholars debated whether charge slips on a credit card account should be regarded as the equivalent of negotiable chattel paper or promissory notes, or whether, instead, consumer claims and defenses should be preserved.[232]

The debate of the early 1970s over preservation of consumer claims and defenses in payment card transactions was resolved in favor of the consumer with the enactment of TILA § 170.[233] That

230. 15 U.S.C.A. § 1666i (2005).

231. *See* U.C.C. § 3–305 (2002).

232. *See, e.g.*, Brandel & Leonard, *supra* note 178, at 1064 (suggesting a geographic limit within which defenses would be preserved); Neil O. Littlefield, *Preservation of Consumer Defenses in Interlocking Loans and Credit Card Transactions—Recent Statutes, Policies, and a Proposal*, 1973 WIS. L. REV. 471 (1973); Note, *Preserving Consumer Defenses in Credit Card Transactions*, 81 YALE L.J. 287 (1971); Note, *Direct Loan Financing of Consumer Purchases*, 85 HARV. L. REV. 1409 (1972); Robert J. Banta, *Negotiability in Consumer Sales: The Need for Further Study*, 53 NEB. L. REV. 195, 196 (1974) ("Preservation of consumer defenses has been and continues to be one of the most hotly debated issues in the consumer credit industry."); Alan Schwartz, *Optimality and the Cutoff of Defenses Against Financers of Consumer Sales*, 15 B.C. INDUS. & COM. L. REV. 499 (1974); Benjamin Geva, *Optimality and Preservation of Consumer Defenses—A Model for Reform*, 31 CASE W. RES. L. REV. 51, 70–73 (1980).

233. 15 U.S.C.A. § 1666i (2005). The debate went on for two more years regarding whether a holder of a consumer credit contract for the purchase of goods or services should be subject to the same claims and defenses as the merchant, until, in 1976, the FTC promulgated a rule requiring consumer credit contracts to contain a legend requiring any

section, in the nature of an anti-holder-in-due-course rule, preserves against the issuer any claims a consumer has against the merchant such as breach of warranty, or defenses against the merchant's right to payment for goods and services, if (1) the consumer first made a good faith attempt to resolve the dispute, (2) the transaction occurred within the same state as, or within one hundred miles of, the consumer's mailing address, and (3) the chargeback did not exceed the consumer's bank account balance when the consumer first notified the card issuer of the claim or defense. Whether a remote transaction over the Internet or telephone occurred within the geographic limit is a question that has received inconsistent answers from the American courts.[234]

No equivalent provision regarding preservation of claims and defenses exists in the EFTA with respect to debit card transactions or regarding purchases with prepaid cards. Thus, authorized debit and prepaid card transactions are final, as if they were cash transactions.[235]

Several non-U.S. jurisdictions have also enacted laws enabling consumers to assert against certain card issuers defenses or claims they have against merchants, other than duplicate or erroneous entries and unauthorized transactions. These countries include Finland, Greece, Israel, Japan, Korea, Norway, and the United Kingdom.[236] However, with the exception of Israel,[237] like the United States these countries' laws universally draw a distinction between credit and debit cardholders, affording credit cardholders the right to assert defenses and claims against the issuer but not debit cardholders.

In the 1970s debate over preservation of claims and defenses, the banking industry asserted that it was unfair to place liability on

holder to be subject to the same claims and defenses as the merchant. *See* 16 C.F.R. § 433.2 (2005).

234. *Compare* Plutchok v. European American Bank, 540 N.Y.S.2d 135, 137 (N.Y. Sup. Ct. 1989) (holding that plaintiff's long-distance phone call to out-of-state defendant in response to the latter's solicitation mailing constituted an offer; thus, the defendant's acceptance during the phone conversation resulted in the contract being consummated in the defendant's state), *with In re* Standard Financial Management, 94 B.R. 231, 239 (Bankr. D. Mass. 1988) (holding that where the seller made a solicitation by phone, "[s]ocial policy favors finding that the transaction took place in the customer's home").

235. EFTA § 908(f), 15 U.S.C.A. § 1693f (2005), lists types of "errors" that are subject to required error resolution procedures. These include unauthorized and incorrect entries on bank statements and the receipt of an incorrect sum of money from an ATM but do not include authorized transactions. *Id.*

236. *See* OECD, *Report on Consumer Protections for Payment Cardholders*, *supra* note 49, at 14–15 (discussing Finland, Greece, Japan, South Korea, Norway, the United Kingdom, and the United States).

237. Debit Cards Law, 5746–1986, 40 LSI 193–99, §§ 5, 9 (Isr.).

the issuer for merchant misconduct and that, because the issuer was not able to limit its risk on debit cards by placing a ceiling on the amount that could be withdrawn, the issuer's risk was potentially unlimited. On the other hand, consumer groups and a number of legal scholars raised two counterarguments: (1) banks are in a position to "police" merchants that engage in frequent misconduct and prevent them from having access to the card network,[238] and (2) banks are in a better position to allocate risks through chargebacks and pass on losses through the discount rates imposed on merchants and in the case of credit cards, through the interest rates charged to consumers.[239]

With the exception of Professor Mann's recent article,[240] commentators have written little on the subject of preservation of consumer claims and defenses against card issuers since the early 1980s. In countries that have yet to adopt consumer protection regimes, however, this is an issue that policy makers must decide. Also, since the early 1980s, changes in conditions have strengthened some of the policy arguments on the subject of preservation of claims and defenses and weakened others. When Congress enacted EFTA in 1978, bankers were concerned that consumer protection laws might restrain the growth of the debit card networks or deter consumers from using the system.[241] However, consumer protection laws—or at least, the consumer's perception that he or she was protected when using debit cards—increased consumer confidence in using them, and the card networks grew.[242]

Instead, it is now the odd merchant in the United States that refuses to accept any kind of payment cards in face-to-face transactions.[243] The same is true in Japan, parts of Continental Europe, and the United Kingdom. Moreover, the merchant acquirer business—the banks that acquire merchants for the network and handle their accounts—has developed into a highly concentrated specialty in banking in which a small number of large banks and card data processors handle vast numbers of merchant accounts, all of which are linked to and contractually bound by the chargeback

238. *See* Littlefield, *supra* note 232, at 493–94.

239. Geva, *supra* note 232, at 55.

240. *See* Mann, *supra* note 2.

241. Lewis M. Taffer, *The Making of the Electronic Fund Transfer Act: A Look at Consumer Liability and Error Resolution*, 13 U.S.F. L. REV. 231, 235 (1979).

242. *Id.* at 234 (citing the example of Wisconsin, which adopted an EFT statute in 1976).

243. Gramlich Testimony, *supra* note 201 ("Technology has significantly changed consumers' payment options, with the credit card becoming an accepted payment medium for virtually any consumer good or service.").

system.[244] Additionally, in the United States at least, many bank debit card networks are linked to one another, further linking merchants and banks regardless of which network they are on.

At the same time, due to the massively greater number of merchants that are part of the payment card networks, "policing" merchants is no small job. The idea that card issuers should be responsible for policing merchants within a limited geographic area, an idea which was incorporated into the TILA provisions on preservation of claims and defenses, now seems quaintly archaic, as the Internet has made geography almost irrelevant.[245]

The banking industry's argument that a bank's liability on a debit card transaction should be limited only by the amount in the card holder's bank account also is dated; in fact, it made little sense to begin with. Credit card limits are commonly higher than the cardholder's bank account balance. Also, with merchants' overwhelmingly being linked to the chargeback system in the United States, it is unusual—though certainly not unheard of[246]—for a bank to be left without recourse to the merchant's account when it finds that a chargeback is justified. In any event, the bank's exposure is dependent on the merchant's solvency, not the solvency of the consumer, and merchant acquirers are capable of screening out those merchants whose solvency is questionable.

In countries in which networks are just being established and in which merchants may be reluctant to participate in the system and may be at greater risk of insolvency than typical merchants in the United States, the arguments against preservation of consumer claims and defenses have greater force. However, at the same time, the vast growth in debit cards suggests that merchants even in those countries will prefer to participate in payment card networks to remain competitive. Consumers, meanwhile, will use debit cards more frequently if they have recourse to the chargeback system in case of

244. *See* Bob Carr, *Knowledge is Power: Tectonic Events to Rearrange Payments Landscape—Part III*, THE GREEN SHEET, July 14, 2003, at 26–30, *available at* http://www.greensheet.com/PriorIssues-/030701-/6.htm (noting that, according to the Nilson Report, the five largest merchant acquirers represented 68.7% of the total market as of the end of 2002. The largest, First Data Corporation, controlled 31.4% of the market) (citing NILSON REP. No. 783 (Mar. 2003)).

245. *See* TILA § 170, 15 U.S.C.A. § 1666i (2005) (preserving consumer defenses if the "transaction occurred . . . in the same State . . . or . . . within 100 miles" of the consumer's billing address). Perhaps a distinction should be drawn between the card association that authorizes the merchant and the bank that issues the card, because the bank cannot control the consumer's choice of merchant.

246. Airline failures, such as that of ANZAC in Australia, are good examples of situations in which banks have wound up with significant liability and without recourse to the merchant. Boxall Interview, *supra* note 150.

problems with merchants. As remote transactions grow with improvements in telecommunications, consumer confidence is at a premium.

C. Problems of Loss Allocation

In this section, I argue for changes in loss allocation rules that are made workable and desirable by the global proliferation of payment cards and technological changes in card transactions. First, deductibles such as the $50 ceiling on consumer liability for unauthorized credit card transactions in the United States, and fault-based loss allocations for unauthorized card transactions such as those in effect in the United Kingdom and many European Union countries, should be discarded in favor of allocating all such losses to the card issuer. Second, disparities in loss allocation between users of credit and debit cards should be eliminated.

1. Fraudulent and Unauthorized Transactions

In the United States, fraudulent transactions are the consumer problem of greatest concern in payment systems and the greatest concern overall. Identity theft is particularly concerning. Thirty-nine percent of consumer complaints to the FTC in 2003 were for identity theft, and U.S. consumers rate it as their highest priority among consumer issues, although the incidence of identity theft through credit cards actually has begun to level off.[247] On the other hand, debit card fraud in the United States is growing rapidly.[248] Debit card fraud is already at high levels in Canada.[249]

247. *Fraud Increasing, Americans Believe*, THE GLOBE AND MAIL, Feb. 18, 2005, *available at* http://www.globeandmail.com (search "Search Site" for "Fraud Increasing, Americans Believe") (citing a survey conducted by Ipsos Financial Services). However, an estimated 5.7 million Americans were victims of credit card fraud in 2004. *See* Kim Clark, *Charged Up*, U.S. NEWS & WORLD REP. (Feb. 28, 2005), *available at* http://www.usnews.com/usnews/biztech/articles/050228/28eesuite.lunch.htm. Identity theft and hacker attacks against U.S. targets are often perpetrated by non-U.S. nationals. It makes sense that the targets of identity theft would be users of payment systems in the world's wealthiest nation, and that the perpetrators would be located in countries such as China, Russia, and the Philippines, where law enforcement may be more lax and less equipped to find and prosecute high-tech offenders.

248. Clark, *supra* note 247. However, according to Visa U.S.A., payment fraud in the United States is at an all-time low of five cents per $100 spent. *Id.*; *see also Canada Appears to Have High PIN-Debit Losses*, *supra* note 31 ("U.S. financial institutions in 2003 lost a total of $145.3 million in 522,327 cases of debit card fraud [of which s]ignature debit card losses [constituted] $102.2 million in 452,958 cases.").

249. *Canada Appears to Have High PIN-Debit Losses*, *supra* note 31 ("Canadian banks on average are losing much more per card with a PIN-debit function than their U.S.

The high level of fraud in Canada occurs despite the fact that Canadian debit cards are entirely PIN (online) debit. The linkage of all ATMs to a single network, Interac, in Canada and more frequent use of debit cards there are related causes. By comparison, in the United States there are twenty-five different networks.[250] On the other hand, signature debit, unique to the United States, has two- to three-day delay in clearance and settlement and entails greater risk of loss due to non-payment in cases of insufficient funds and closed bank accounts.

The problems of debit card users are similar to those of users of credit cards and checks, particularly with respect to the allocation of loss due to unauthorized use, identity theft, and fraud. However, laws in many countries establish divergent rules and standards for debit card users and the users of credit cards, checks, and cash.

If a consumer in the United States loses a blank check on the bus, and a thief forges the consumer's signature, the loss normally falls on the payor bank absent fault on the part of the consumer, but if the loss of the check was caused by the consumer's negligence, the consumer bears at least part of the loss on comparative fault principles.[251]

However, if the same consumer lost a credit card along with the check, and the same thief used the credit card to make a purchase, the consumer's liability would be limited by law to a maximum of $50, regardless of the amount of the purchase, the consumer's negligence in losing the card, and the consumer's further negligence in failing to review credit card statements.[252] In the case of a credit card, the loss ultimately would fall on the merchant, barring the merchant's insolvency and assuming that the card issuer pursued its right of chargeback under association (Visa or MasterCard) rules.

Legal scholars have rationalized the $50 "small-dollar exclusion" as an attempt to achieve optimal efficiency of the system by placing the obligation on the party who can avoid the loss at the lowest cost.[253] Professor Mann continues to argue for the small-dollar exclusion on the ground that in small transactions "claims to reverse payment would more commonly be abusive than in the context of more significant purchases, if only because it is difficult to

counterparts."). Canadians use debit cards seventy-six times per year, on average, compared with fifty-four times per year for Americans. *Id.* This is so despite higher fees for debit card use in Canada. *Id.*

250. *Id.*

251. *See, e.g.*, U.C.C. §§ 3–401–20, 4–401–07 (2002).

252. TILA § 133(a), 15 U.S.C. § 1643(a) (2000).

253. *See* Robert D. Cooter & Edward L. Rubin, *A Theory of Loss Allocation for Consumer Payments*, 66 TEX. L. REV. 63, 97 (1987).

imagine a legitimate basis for reversing payment in that context."[254] This argument is incoherent. There is no logical reason why small-dollar transactions would be more prone to abusive claims by consumers than large-dollar transactions. In fact, the cost in terms of time and effort necessary to make a claim for reversal of payment and the risk of being found out if the claim is abusive would likely deter scoundrels from making fraudulent claims unless the dollar amount made it worthwhile to do so.

The $50 ceiling was originally put forth in a seminal article by Roland Brandel and Carl Leonard in 1971 as an "arbitrary" figure that they selected as a boundary between small purchases in which credit cards normally would be used for convenience as a cash substitute, and larger purchases which a consumer normally might expect to carry as a revolving credit balance.[255] The United Kingdom adopted a £50 ceiling, in Section 84 of the Consumer Credit Act adopted in 1974.[256] Again, however, transfers from deposit accounts were excluded. Section 84 was said to be an exception to the general rule of Section 83 of the Consumer Credit Act that a debtor under a regulated consumer credit agreement is not liable for loss "arising from use of the credit facility by another person."

In the case of debit cards, American law attempts to have it both ways. The consumer's liability for unauthorized debit card transactions is limited to $50, but only if he or she reports the loss to the issuer within two business days after discovery.[257] For the consumer who fails to report promptly, the ceiling is raised to $500 for charges beyond the two business days, and to unlimited liability for charges on the lost card once a consumer has had sixty days to review a credit card statement reflecting unauthorized charges and still has failed to report the loss.[258] The consumer's duty is to be a prompt reporter and careful reader of statements from her bank, but not to prevent the loss or theft of the card (apart from the now-minor risk of a $50 liability, which may be waived by the issuer). The law leaves the merchant's duty entirely up to its contract with the merchant's bank and to association rules.

Other countries have taken a variety of approaches to the consumer's liability for unauthorized debit card transactions. In some, a negligence standard applies, and in others, a combination of

254. Mann, *supra* note 2, at 667.
255. Brandel & Leonard, *supra* note 178, at 1062.
256. Consumer Credit Act, 1974, c. 39, § 84; *see also id.* § 83.
257. EFTA § 909(a), 15 U.S.C. § 1693g (2005).
258. *Id.*

rules and standards is applied. For example, in Australia, under codes of practice adopted by the banking industry and enforced through the Australian Banking Ombudsman, a cardholder is absolved of liability beyond fifty Australian dollars (AUD) for unauthorized transactions occurring before notification of the issuer that a card has been lost or stolen, provided that the cardholder was neither negligent nor contributory to the loss of the card.[259]

The EC issued a recommendation in 1997 on the subject of electronic payment instruments, which applies to debit cards.[260] The EC recommended that Member States adopt a liability ceiling of one hundred and fifty European Currency Unit (ECU) for the holder in case of loss or theft of the card for unauthorized transactions prior to the holder's reporting the loss or theft to the issuer, "except where he acted with extreme negligence or fraudulently."[261] It included a recommendation that in case of a dispute, the issuer should have the burden of proving that a transaction was accurately recorded and entered into accounts.[262] However, only two Member States of the European Union had adopted laws following that recommendation as of 2002.[263]

In 1968, when the U.S. Congress originally enacted TILA, credit cards were seen as an instrument not of access to cash, but access to credit.[264] Therefore, legislators drafted TILA on the assumption that credit cardholders must be treated as borrowers. A purported borrower is not ordinarily liable to repay a loan that he or she did not authorize and from which he or she did not benefit. Something more serious than presenting a plastic card to the merchant is necessary to commit the borrower to a loan, and even failure to report the loss of the card is insufficient to ratify the unauthorized loan transaction.

Debit cards, on the other hand, confer access to cash. The liability ceiling for unauthorized use of a debit card in the EFTA was

259. OECD, *Chargebacks Study*, *supra* note 40, at 59.

260. Commission Recommendation of 30 July 1997 Concerning Transactions by Electronic Payment Instruments and in Particular the Relationship Between Issuer and Holder, 1997 O.J. (L 208) 52, *available at* http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:31997H0489:EN:HTML.

261. *Id.* art. 6:1.

262. *Id.* art. 7:2(e).

263. *A Possible Legal Framework for the Single Payment Area in the Internal Market* 30 (European Commission Working Document, 2002).

264. *See* Brandel & Leonard, *supra* note 178, at 1059 ("Consultants predicted to the banking industry 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.").

a compromise, the outcome of a battle between advocates of a negligence standard, including the banking industry, and consumer advocates who advocated the same $50 ceiling that applied to credit cards.[265] Consumer advocates argued that the $50 ceiling was adequate incentive to consumers to exercise sufficient care with respect to their cards, and that making the issuer liable for losses over $50 would incentivize consumers to implement security measures to minimize their losses.[266] Banks, on the other hand, argued that unlike credit cards, which have a fixed credit limit, debit card losses depended entirely on the amount of money the consumer had in his bank account.[267] However, at that time debit cards were only usable to access ATMs, which have dollar limits for cash withdrawals.

Compare these rules to the rules pertaining to cash. Because cash is both negotiable and anonymous, containing no internal means of identifying the person entitled to it, a consumer has no recourse with respect to stolen cash, except to sue for conversion if he or she can identify the perpetrator. A merchant who receives payment in lost or stolen cash has no duty to restore it to the consumer who owned the cash.[268] The reason for this misallocation of loss is primarily the anonymity of cash, and secondarily the cost of time. If cash was identified by owner—e.g., if a dollar bill had an electronic tag stating in bright neon letters who owned it at any given moment—then would the merchant, receiving tagged cash from the thief, still be held to no duty with respect to the identified owner of the cash? Possibly not, but only if the legislature considered the transaction costs in terms of time that would be incurred by the merchant in examining the bills and asking for identification to be too significant.

For purposes deemed sufficiently important and amounts sufficiently significant, the legislature has restricted the anonymity of cash by imposing reporting requirements on its recipient. For example, money laundering rules adopted pursuant to the Bank Secrecy Act[269] require banks to file Currency Transaction Reports for cash transactions of $10,000 or more.[270] Cash transactions of $5000 or more under suspicious circumstances require the filing of Suspicious Activity Reports.[271]

265. Taffer, *supra* note 241, at 237–38.
266. *Id.* at 238.
267. *Id.* at 238–39.
268. *See* RESTATEMENT OF RESTITUTION §§ 172, 215(1) (1937).
269. Bank Secrecy Act, Pub. L. No. 91-508, 84 Stat. 1114 (codified as amended in scattered sections of 12 U.S.C.).
270. 31 C.F.R. § 103.22 (2005).
271. 31 C.F.R. § 103.18 (2005).

American consumer law thus incorporates divergent rules and standards of loss allocation for four instrumentalities of payment, all of which are usually used by consumers as cash or cash equivalents. This divergence has drawn the attention of legal scholars. In 1996, Professor Clayton P. Gillette criticized Robert Cooter and Edward Rubin on the theory that an attempt to achieve optimal efficiency could not adequately explain the choices of legislatures to treat loss allocation rules for checks and payment cards differently. "It is curious," he wrote, "that the [American] law concerning fraud in payment systems varies among payment devices."[272] He assumed that "in designing payment rules, the legislature was seeking to allocate risks optimally,"[273] but concluded that the "difficult issues of classification" posed by regulated activities, for example, that are "susceptible to significant variance in precautions or losses" and externalities such as politics and historical accident can result in sub-optimal levels of precision in legislation and motivate courts to intervene by creating exceptions or treating rules as guidelines.[274] He further pointed out that in payment systems regulation, the identification of superior risk-bearers may be incapable of being done cost-effectively except through generalizations or the use of surrogates.[275]

The Visa and MasterCard associations ultimately decided to waive the $50 in all cases.[276] Presumably the transaction costs and loss of goodwill incurred by card issuers in collecting the $50 from card holders who had been the victims of loss or theft proved to be more costly than the amounts collected.

This action by Visa and MasterCard speaks eloquently to the folly of attempting to read precise legislative judgments about optimal loss allocation into rules and standards adopted at different times under different political conditions. Fifty dollars was picked as an "arbitrary figure" to establish a boundary between transactions intended by the credit cardholder as convenience transactions and transactions intended as credit transactions, not as an attempt to optimize anything.[277] This "arbitrary figure" was established on the

272. Clayton P. Gillette, *Rules, Standards, and Precautions in Payment Systems*, 82 VA. L. REV. 181, 184 (1996) (criticizing Cooter & Rubin, *supra* note 253).

273. *Id.* at 188.

274. *Id.* at 251.

275. *Id.*

276. *See* OECD WORKSHOP ON CONSUMER DISPUTE RESOLUTION AND REDRESS IN THE GLOBAL MARKETPLACE, BACKGROUND REPORT 14 (Apr. 19–20, 2005) (noting that Visa advertises a "zero liability" policy for U.S. cardholders).

277. In their seminal article on the subject, Roland Brandel and Carl Leonard, addressing the use of cards for convenience transactions as if they were cash rather than an extension of credit, advocated picking "an arbitrary dollar figure" as a liability ceiling:

theory that up to that amount the lost or stolen card would have been used as a "convenience card" in place of cash, so that the loss should be treated as if cash had been lost. The differences in the liability ceilings for debit and credit cards reflected a political compromise between those who wanted to treat credit cards and debit cards the same, and those dissatisfied with the low credit card liability ceiling who wanted to import a fault concept into the rule.[278] The rationale for the small-dollar exclusion is further weakening as consumers increasingly use credit cards as convenience cards even in the United States,[279] and as the functional differences between debit and credit cards correspondingly diminish.

Once the consumer charges back an unauthorized debit card transaction to the issuer, as between the issuer and the merchant, which party bears the loss? In this regard, the loss allocation in debit card transactions is different from credit cards. Card association rules generally allocate the loss to the issuer, on the theory that the issuer is better situated to adopt security measures than the merchant.[280] Unlike credit card transactions, the consumer using a PIN debit card may remain anonymous to the merchant as long as the consumer possesses the correct PIN.

Imposing liability on the consumer for unauthorized debit card transactions in most cases makes no sense. In general, the loss of cash is final only because cash can be spent anonymously, which is not the case with cards that are used at the point of sale.[281] In 1972, in a Note in the *Harvard Law Review* written when credit cards were the only payment cards in the marketplace, the author wrote:

> It is contended that bankcards are predominantly used as convenience cards and that consumers tend to pay for their purchases as they are billed for them rather than on an installment basis. But for the purposes of furthering the two goals, which were posited in

> 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.

Brandel & Leonard, *supra* note 178, at 1062.

278. The EFTA, the statute containing the liability ceilings for debit cards, was passed by Congress in the wee hours of the night during a marathon legislative session. *See* Roland E. Brandel & Eustace A. Olliff III, *The Electronic Fund Transfer Act: A Primer*, 40 OHIO ST. L.J. 531, 531 (1979).

279. *See* Mann, *supra* note 2, at 656.

280. LYNN M. LOPUCKI ET AL., COMMERCIAL TRANSACTIONS: A SYSTEMS APPROACH 445 (2d ed. 2003).

281. *Id.*

> section II [reducing seller misconduct and internalizing seller misconduct costs], any similarity between credit card purchases and cash sales is irrelevant. The costs of seller misconduct in cash sales fall on the buyer by necessity rather than by design. Indeed, if a convenient device were available in cash sales to shift these costs to a third party who was in a better position to minimize the cost of seller misconduct and to reflect the remaining costs in the explicit price of goods, it would be desirable to do so. The fact that such a mechanism is infeasible in actual cash sales, therefore, does not support its exclusion in other transactions, no matter how similar.[282]

In other words, the physical limitations of cash itself result in a misallocation of the costs of merchant misconduct and encourage such misconduct. Currency and coin, once received by a merchant, cannot be charged back to that merchant by a consumer if the merchant is engaged in fraud or does not agree to the return of defective merchandise, for example, while electronic payments can. It is strange yet true to regard even the simplest face-to-face cash transaction as containing the seed of market failure.

The use of payment cards makes it feasible in most cases to correct this misallocation through the intervention of the financial institutions that operate the payment system. Those institutions are capable of protecting themselves through security procedures. Since most debit cards do, or should, require use of a PIN, allocation of loss to the consumer should be limited to cases in which the consumer negligently or culpably divulged the PIN to the wrongdoer or in which the consumer's negligent or culpable conduct otherwise compromises a security system implemented by the issuer to protect against unauthorized use of the card.[283] If American banks want to promote signature debit because the interchange fees are higher, and thereby forego password protection of card transactions, they, and not the consumer or merchant, should bear the losses that could have been prevented by the use of a PIN.

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282. Note, *Direct Loan Financing of Consumer Purchases*, *supra* note 232, at 1421 (citation omitted).

283. Imposing the risk of loss on the debit card issuer would be consistent with the policy of Article 4A of the U.C.C. concerning unauthorized wire transfers. Section 4A-202 generally allocates losses to the originator's bank if the bank and the originator, its customer, agree on a commercially reasonable security procedure for preventing unauthorized transfers and the bank fails to comply with that procedure, while the originator bears the loss if it gives an unauthorized person access to its transmitting facilities or information facilitating a breach of the security procedure (e.g., passwords). *See* U.C.C. §§ 4A-202, -203(a)(2) (2002).

2. Inconsistency in Loss Allocation Rules

Several countries, including the United States, Canada, the United Kingdom, Denmark, and Israel, have statutes on the protection of debit and credit cardholders.[284] In many respects they treat credit and debit cardholders the same. However, there are two principal differences.

First, the rules regarding liability of the cardholder for unauthorized use of the card are different in most countries, with debit cardholders bearing greater risk than credit cardholders.[285] Second, the claims and defenses the cardholder has based on breach of the contract by the merchant, e.g., by supplying defective or non-conforming goods, may be asserted against the bank that issued the card (the "issuer") by a credit cardholder but not by a debit cardholder.

Prepaid cards are generally treated as equivalent to cash with respect to loss allocation. Thus, if an employee paid on a payroll card loses the card, the employee may have no recourse, and chargeback rules applicable to credit cards do not apply.[286] However, the U.S. Federal Reserve has recently issued a proposed rule that would extend Regulation E coverage to certain payroll card accounts. The proposed rule would extend to the holders of payroll cards the same disclosure and error resolution procedures and limitations of liability for unauthorized use that currently cover the holders of debit cards.[287]

284. Australia has done so in the form of a voluntary banking industry code of conduct. For a more detailed description and analysis, see Geva, *supra* note 46, at 256–67.

285. The only exceptions are Denmark and Israel. In Denmark, under Section 11 of the Act on Certain Payment Instruments, *supra* note 44, the holder of any "payment instrument," broadly defined to include both credit and debit cards as well as other electronic means of payment and access to cash, is not liable for unauthorized use after notice to the issuer that the card has been lost, an access code has been obtained by an unauthorized person, or the holder requests a stop on the card. The holder also is relieved of liability if the payee knew or should have known of the unauthorized use or if a payment card was used fraudulently in a distance transaction. However, the holder is subject to unlimited liability if a PIN is used by someone to whom the holder disclosed it and if the holder realized or should have realized the circumstances created a risk of abuse. *See* Geva, *supra* note 46, at 252. In Israel, Sections 5 and 9 of the Debit Cards Law, *supra* note 44, accord both debit and credit cardholders equal rights to redress.

286. *See* MARK FURLETTI, FED. RES. BANK OF PHILA., PREPAID CARD MARKETS AND REGULATION 6 (2004), *available at* http://www.phil.frb.org/pcc/discussion/feb_04_prepaid.pdf.

287. Electronic Funds Transfers, 69 Fed. Reg. 55996 (proposed Sept. 17, 2004) (to be codified at 12 C.F.R. pt. 205), *available at* http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040913/attachment.pdf. Payroll cards would be covered by Regulation E if the employer, directly or indirectly, established a payroll card account on behalf of a consumer into which wages, salary or other employee compensation are deposited by electronic funds transfer on a recurring basis. *Id*.

Outside North America, the United Kingdom, the European Union, Australia, and Israel, laws specifically addressing consumer protection with respect to payment cards generally do not yet exist. Thus, in Russia, Brazil, and other emerging economies in which debit cards are spreading rapidly, general standards and rules of contracts law determine the consumer's liability.

In November 2005, the People's Bank of China, China's central bank, issued a set of rules that it termed "guidance" on electronic payments, and it made them effective immediately.[288] The rules do not distinguish between debit and credit cards.[289] They apply to "net payment, phone payment, mobile payment and POS payment, ATM payment and other payments."[290] Under the rules, bank-customer agreements must contain several types of information, including privacy rules and provisions governing "[d]isputes, errors handling and indemnity liability."[291] Customers have a duty to "promptly submit electronic or written application" to the bank (presumably for recredit to their account) in case of "[t]heft or loss of . . . tools of depositing and withdrawing," "[a]lteration of the customers [sic] basic data," and other similar circumstances.[292] However, while they say that banks have a duty to "ensure . . . the truthfulness of customers' identity,"[293] the rules are silent on the allocation of losses due to unauthorized transactions, except that if "tools of depositing and withdrawing" are stolen, banks have a duty to "actively assist" their customers in avoiding losses.[294] With respect to the allocation of losses due to errors in the initiation or execution of payment instructions, losses are to be allocated between the bank and its customer according to fault.[295]

In the United States, where credit cards continue to predominate over debit cards and most consumers own both kinds of cards, discrimination against debit cardholders in favor of credit

288. The People's Bank of China, Announcement of PBC No. 23 (2005), http://www.pbc.gov.cn/english//detail.asp?col=6400&ID=610&keyword=cards (last visited Jan. 21, 2006).

289. *Id.*

290. *Id*. art 2.

291. *Id*. art. 13(6).

292. *Id.* art. 14. Article 44 contains a similar reporting requirement and also imposes a duty on bank customers to "properly keep [and] use e-payment business tools of depositing and withdrawing . . . ." *Id.* art. 44.

293. *Id*. art. 26.

294. *Id.* art. 45.

295. *Id.* arts. 42–43, 46. Article 46 requires a bank to investigate the cause of an error and, if the customer was at fault, the bank is instructed to "inform customers to make rectification and assist customers in making remedies." *Id*. art. 46. However, it is apparently left to the bank to decide who is at fault. *Id.*

cardholders has not, to date, been controversial, Professor Mann's recent article notwithstanding.[296] However, in countries such as China and Russia, where relatively few people own credit cards while many millions own and use debit cards, drawing distinctions between them adverse to debit cardholders would have a number of public policy disadvantages.

First, as Professor Mann has argued,[297] there is not a clear rationale for distinguishing between credit and debit cards on functional grounds:

> These payment devices serve similar functions. Checks and ATM cards are equivalents for the purpose of gaining access to the customer's account at the bank, and checks and credit cards are equivalents for the purpose of incurring obligations to pay third-party providers of goods and services. Efforts to allocate the risk of loss for use of these payment devices also would appear to share the same objectives . . . to allocate losses in a manner that induces each party involved in a payment transaction to take cost-effective precautions against loss.[298]

The functions of credit and debit cards are even more similar in societies like Japan where credit cards are used primarily for convenience rather than revolving credit, and as convenience use increases as a proportion of total credit card charges in the United States,[299] arguments for treating American debit cardholders like users of cash rather than like credit cardholders become weaker.

Second, issues of equity would be raised by laws or policies that discriminate against debit cardholders in societies in which credit cards are limited to a small economic elite capable of qualifying for them. While in the United States the differences between consumers' rights under TILA and EFTA can be attributed to perceived functional differences between credit and debit cards, in countries where a few businessmen and politicians who are able to purchase with credit cards can return shoddy merchandise and obtain a refund while ordinary customers who use debit cards or cash cannot, the public is likely to perceive this difference as an assertion of class privilege.

296. *See* Mann, *supra* note 2.

297. *Id.* at 656.

298. Gillette, *supra* note 272, at 183–84 (citation omitted). In a footnote, Gillette added, "The similarity of function between the three payment devices is increasing as ATM cards are increasingly usable to pay for goods at the point of sale." *Id.* at 183 n.8.

299. Mann, *supra* note 2, at 656–58.

Third, because of the presumable socioeconomic differences between credit and debit cardholders, it is likely that debit and prepaid card users in most countries will be less sophisticated consumers than credit cardholders and therefore more in need of access to means of recourse in cases of fraud, seller misconduct, and breach of contract. Indeed, it could also be asserted that consumers using stored value cards should be accorded such rights, as they are often likely to be the "unbanked" and least sophisticated among payment card users. However, some stored value cards share with cash the problem of anonymity and the risk of fraudulent claims.

Fourth, there may be economic justifications for disparate treatment of debit and credit cards. On this point, Professor Mann observed that:

> One obvious concern is that the extension of the reversibility rule to the debit card context will increase the costs of debit cards to those that use them. If so, the reform might alter the relative desirability of the products in significant ways. From one perspective, that is not a reason for concern. The only reason that it might alter the costs significantly is if there is a significant volume of chargeback activity, which suggests that there are a significant number of transactions in which consumers currently lack effective recourse. On the other hand, as discussed above, there is the empirical possibility that a significant level of chargebacks might reflect abusive consumer conduct rather than dishonest merchant conduct. For the reasons discussed above, however, I think it unlikely that there will be a sufficiently large volume of chargebacks to affect pricing significantly, largely because the volume of payment-reversing charge-backs in the credit-card system now is quite small.[300]

D. Layered Disclosure of Payment Card Fees and Other Terms

Most countries that regulate payment cards impose a disclosure regime on credit card issuers, requiring disclosure of various terms and conditions of the accounts. In the United States, TILA and Federal Reserve Regulation Z require elaborate and

300. *Id.* at 665.

lengthy disclosures of the terms and conditions of credit card accounts to which consumers typically pay little attention, apart from a few key terms such as the annual percentage rate.[301] Separate disclosures must be furnished to the cardholder in credit card applications and solicitations, at the time of establishing the account, in the cardholder's periodic statements, and on an annual basis.[302] Model forms for applications and solicitations included in an appendix to FRB Regulation Z contain key credit terms in tabular form, followed by more voluminous detailed disclosures.[303] However, the disclosures required for debit cards in the United States under the EFTA and FRB Regulation E[304] are somewhat less voluminous,[305] and model forms are limited to the text of clauses and notices.[306]

Disclosure requirements as consumer protection policy must be evaluated in light of behavioral studies suggesting that disclosure, without more, is ineffective at impacting consumer choice.[307] The

301. *See* 15 U.S.C. §§ 1604, 1631, 1632, 1637, 1637a, 1638, 1639, 1662–1665b (2005); *see also* 12 C.F.R. §§ 226.5, .5a, .6–.7, .9 (2005).

302. *See* Truth in Lending (Regulation Z), 12 C.F.R. §§ 226.5–.9 (2005). For a useful summary of TILA and Regulation Z disclosure requirements for credit cards and current proposals to amend Regulation Z, see Gramlich Testimony, *supra* note 201.

303. Truth in Lending (Regulation Z), 12 C.F.R. pt. 226, app. G (2005).

304. Election Fund Transfers (Regulation E), 12 C.F.R. pt. 205 (2005).

305. *See id.* §§ 205.4, .7–.10, .16.

306. *Id.* at app. A.

307. *Compare* Jacob Jacoby, Margaret C. Nelson & Wayne D. Hoyer, *Corrective Advertising and Affirmative Disclosure Statements: Their Potential for Confusing and Misleading the Consumer*, 46 J. MARKETING 61, 68 (1982) ("The difficulty involved in accurately communicating meaning is often underestimated, and regulators would seem to be no exception in this regard."), *and* Jacob Jacoby, *Perspectives on Information Overload*, 10 J. CONSUMER RES. 432, 435 (1984) ("Can consumers be overloaded? Yes, they can. Will consumers be overloaded? Generally speaking, no, they will not. This is because they are highly selective in how much and just what information they access, and tend to stop well short of overloading themselves."), *and* Kevin Lane Keller & Richard Staelin, *Effects of Quality and Quantity of Information on Decision Effectiveness*, 14 J. CONSUMER RES. 200, 212 (1987) ("[B]oth the presence of too much available information and too much high-quality information appears to have caused consumers to exhibit a decrease in decision effectiveness."), *with* David M. Grether, Alan Schwartz & Louis L. Wilde, *The Irrelevance of Information Overload: An Analysis of Search and Disclosure*, 59 S. CAL. L. REV. 277 (1986) (arguing that information overload is not a significant issue in consumer law), *and* Roberta Romano, *A Comment on Information Overload, Cognitive Illusions, and Their Implications for Public Policy*, 59 S. CAL. L. REV. 313 (1986) (same), *and* Robert E. Scott, *Error and Rationality in Individual Decisionmaking: An Essay on the Relationship Between Cognitive Illusions and the Management of Choices*, 59 S. CAL. L. REV. 329, 329–37, 361 (1986) (arguing that information overload and cognitive error are less relevant to legal analysis of consumer behavior than is choice management theory, in which consumers follow a rational pre-set strategy of self control; also arguing that the psychological literature on human error and decision-making leads legal analysts to the incorrect conclusion that inherently fallible behavior is correctable through legal regulation), *and* Naresh K. Malhotra, *Information Load and Consumer Decision Making*, 8 J. CONSUMER RES. 419 (1982) (arguing that consumers can handle large amounts of information without being overloaded), *and* J.

1970s debate over simplification of TILA requirements that resulted in the Truth-in-Lending Simplification Act of 1980 was centered on cognitive psychology and the theory of information overload. The theory of information overload posits that if too much information is disclosed to consumers, they are easily confused, cannot use the information, and do not make better decisions as a result.[308]

One solution—adopted in some of the TILA model forms published by the FRB, advocated by consumer groups in the United States and the United Kingdom,[309] and sometimes called the "Honesty Box" or the "Schumer Box" after Senator Charles Schumer (D-NY)—is "layered" disclosure that highlights a few key terms, e.g., in boldface type in a box, while more voluminous disclosures are set forth in fine print elsewhere on the document. There is no reason why layered disclosure should be used only in certain forms under the TILA and not in debit card disclosures that are subject instead to the EFTA.

If debit card issuers are required to give layered disclosures, what terms should be "in the box"? The annual percentage rate and other terms disclosed "in the box" for credit cards are inapplicable to debit cards. However, exorbitant and undisclosed fees for debit and prepaid card transactions remain a problem for consumers, and affect access for consumers who typically remit small amounts of money. In the United States, a significant percentage of prepaid cards include per-transaction POS fees.[310] Moreover, although payroll cards may be usable at ATMs, fees for such use are unregulated and are commonly imposed,[311] apparently on the theory that payroll cardholders are not considered bank customers because the employer, not the cardholder, funds the account. Not only may banks impose debit card fees, but often merchants that accept PIN-based debit cards

Edward Russo, *supra* note 216, at 71–72 (arguing that confusion decreased with increased data, as long as subjects took enough time to process the information), *and* John O. Summers, *Less Information Is Better?*, 11 J. MARKETING RES. 467, 467–68 (1974) (questioning whether the data from Jacoby, Nelson, and Hoyer's research truly supported the conclusions they reached).

308. For recent discussions of information overload theory and its application to disclosure, see Marie C. Pollio, *The Inadequacy of HIPAA's Privacy Rule: The Plain Language Notice of Privacy Practices and Patient Understanding*, 60 N.Y.U. ANN. SURV. AM. L. 579, 613–16 (2004); Jacob Jacoby, *Is It Rational to Assume Consumer Rationality? Some Consumer Psychological Perspectives on Rational Choice Theory*, 6 ROGER WILLIAMS U. L. REV. 81 (2000); Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417 (2003); Howard Latin, *"Good" Warnings, Bad Products, and Cognitive Limitations*, 41 UCLA L. REV. 1193 (1994).

309. *See, e.g.*, NAT'L CONSUMER COUNCIL, *supra* note 201.

310. Budnitz, *supra* note 15, at 6–7.

311. *Id.*

do, too. Consumers who use debit cards at a POS in the United States often cannot be sure whether they will be charged no fees, one fee by their bank, or two fees, one by their bank and one by the merchant.

Moreover, the recent global proliferation of debit cards has made it easier for consumers to overdraw their bank accounts. In some countries, such as Russia, banks have been quick to grant small, fee-laden overdraft credit lines along with debit cards, so that consumers who use their new debit cards to overdraw their bank accounts pay heavy charges and interest. Elsewhere, as in China, banks have also issued secured credit cards to their customers, and established stiff penalties and interest for overdrafts.

Fees imposed on consumers for debit card use are often arbitrary. For example, ATM users are typically charged a fee for withdrawing cash from ATMs in Germany but not in France, where ATM use is free.[312] An EC study in 1999 found that card issuers in Belgium, Ireland, Spain, Luxembourg, and Finland charged no fee to Member State debit card users who made purchases in other Member States, while issuing banks in other Member States did charge fees for the same transactions, with German banks charging the most.[313]

However, EU Regulation 2560/2001 has required banks to charge the same fee for small euro cross-border payments as for domestic payments since July 2003. The effect is that, at least in theory, a French bank's customer armed with a French debit card could withdraw cash from a German ATM without paying a fee while the same person using a German debit card would have to pay a fee for withdrawing the same amount from the same ATM.[314] If the German ATM operator charges a fee, the French bank is supposed to bear it, not the customer.

In the United States, attempts by local governments to regulate abusive ATM surcharges by federally chartered banks have been frustrated by federal preemption.[315] The same has been true of judicial attempts to use "Little FTC Acts" and other state laws on

312. *Id.* at 16.

313. EUROPEAN INTERREGIONAL INST. FOR CONSUMER AFFAIRS (IEIC), BANK CHARGES IN EUROPE 28 (Apr. 2000) (a report prepared for the European Comm'n), *available at* http://europa.eu.int/comm/consumers/cons_int/fina_serv/pay_systems/sur14_en.pdf.

314. Internal Market and Services Dir. Gen. (EC), *Note on Practical Implementation of Article 3 of the Regulation No. 2560/2001 on Cross-Border Payments in Euro*, No. Markt/2902/2002 (2002), *available at* http://europe.eu.int/comm/internal_market/payments/docs/reg-2001-2560-article3_en.pdf.

315. For a discussion of ATM surcharges in the United States and attempts by local governments to regulate them, see Anita Famili, Note, *The Legality of Local ATM Surcharge Bans: The Case for the Cities of Santa Monica and San Francisco*, 74 S. CAL. L. REV. 1353 (2001).

unfair trade practices to strike down other bank fees, such as overdraft fees.[316] A recent ruling of the Office of the Comptroller of the Currency held that the application of most state regulatory statutes to national banks is preempted by federal law.[317] In contrast, the European Union has taken an approach more favorable to substantive regulation of fees and charges, under the authority of its Unfair Contract Terms Directive.[318]

Issuers should require layered disclosure of debit and prepaid card fees, so that consumers will be likely to pay attention to the disclosures. Merchants that charge fees for use of debit and prepaid cards should be required to disclose these fees in a meaningful fashion. Disclosure when one's goods have already been rung up at the cash register is not meaningful. Consumers are already psychologically committed to the transaction by that time. Rather, merchants should make disclosures upon entry to the store, or on approaching the cash register, and in a manner calculated to catch one's attention.

Even layered disclosure, however, is likely to be insufficient protection for consumers against behavioral manipulation. For example, consumers display behavioral biases that result in the

316. *See* Perdue v. Crocker Bank, 38 Cal. 3d 913, 702 P.2d 503, 216 Cal. Rptr. 345 (1985) (holding that a bank customer's complaint, brought as a class action, stated a cause of action where it was alleged that a checking account overdraft fee was unconscionable due to an alleged gross disparity between the amount of the fee and the actual cost of overdrafts to the bank). For other cases applying state laws to invalidate bank charges and terms, see Best v. U.S. Nat'l Bank, 303 Or. 557, 739 P.2d 554 (1987) (overdraft fees); Mazaika v. Bank One, 439 Pa. Super. 95, 653 A.2d 640 (1994), *rev'd sub nom*. Bank One v. Mazaika, 545 Pa. 115, 680 A.2d 845 (1994) (late payment charges and annual fees charged on credit card constitute excessive "interest"; reversed in light of Smiley v. Citibank (S.D.), N.A., 517 U.S. 735 (1996)); Copeland v. MBNA America, 820 F. Supp. 537 (D. Colo. 1993) (late payment charges on credit card); Heastie v. Cmty. Bank of Greater Peoria, 727 F. Supp. 1133 (N.D. Ill. 1989) (violation of Illinois Consumer Fraud Act in terms of consumer loan); Ashlock v. Sunwest Bank, 753 P.2d 346 (N.M. 1988) (failure to pay interest despite representation that bank would provide "interest-bearing" account); Vogt v. Seattle-First Nat'l Bank, 117 Wash. 2d 541, 817 P.2d 1364 (1991) (excessive fees for trust administration).

317. Bank Activities and Operations, 69 Fed. Reg. 1895 (Jan. 13, 2004) (to be codified at 12 C.F.R. pt. 7); *see also* Julie R. Caggiano, *2004 Update on Residential Mortgage Lending (Including Preemption, RESPA, ECOA and TILA) and Texas HELOCs*, 58 CONSUMER FIN. L.Q. REP. 308, 309 n.21 (2004); Bank of America v. San Francisco, 309 F.3d 551 (9th Cir. 2002) (holding that the National Bank Act and OCC regulations together preempted conflicting state limitations on the authority of national banks to collect fees for the provision of electronic services through ATMs; municipal ordinances prohibiting such fees were invalid under the Supremacy Clause), *cert. denied*, 598 U.S. 1069 (2003); Wells Fargo Bank of Texas v. James, 321 F.3d 488 (5th Cir. 2003) (holding that a Texas statute prohibiting certain check-cashing fees was preempted by the National Bank Act); Metrobank v. Foster, 193 F. Supp. 2d 1156 (S.D. Iowa 2002) (holding that national bank authority to charge fees for ATM use preempted the Iowa prohibition on such fees); Bank One, Utah v. Guttau, 190 F.3d 844 (8th Cir. 1999) (holding that federal law preempted an Iowa restriction on ATM operation, location, and advertising), *cert. denied* 529 U.S. 1087 (2000).

318. Council Directive 93/13, 1993 O.J. (L 95) 29 (EC).

underestimation of future borrowing, and an undue optimism that they can pay credit card balances currently, making interest rates seem unimportant.[319] No amount of disclosure is likely to curb that optimism. Moreover, the subject-matter of disclosures lends itself to manipulation, that is, the meaninglessness of disclosure of annual percentage rates of variable loans that are based on initial promotional rates.

Payment card fees charged by issuers are a good example of manipulable subject-matter, because they are a morass of cross-subsidization. Issuers set late fees and over-limit fees and interest rates for credit cards well above marginal cost while setting annual and per-transaction fees below marginal cost and usually, in the United States, charging no annual or per-transaction fees at all.[320] Bank issuers of credit cards effectively defray transaction processing costs by increased spreads between interest rates and their cost of funds, and by imposing late fees and over-limit fees. In the United States, POS fees and fees for use of other banks' ATMs have historically been common for PIN debit, though POS fees have been cut back post-*Wal-Mart*.[321]

In parts of Europe, however, such as Finland and Belgium, POS fees are uncommon. Do Finnish and Belgian banks subsidize processing costs, and if so, what charges do they impose on other services to offset this subsidy? Are banks in the United States charging above marginal cost and making a profit on POS fees that goes to subsidize credit card use, on which issuers earn high rates of interest? Most importantly, how can a consumer know the true cost of using a payment card when certain fees subsidize other fees? These questions require further study, but they illustrate the difficulty of formulating disclosure requirements that will be meaningful to consumers.

E. Problems of Access to Banking Services

Debit cards, unlike prepaid cards, require a bank account. This fact places a premium on the right to open a bank account. Banks may turn away customers they deem undesirable due to adverse credit history, immigration status, or other reasons. It appears to be uncommon in the United States for customers to be denied the right to open a bank account, but not so in Europe. During

319. Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1375 (2004).
320. *Id.*
321. Wal-Mart Stores, Inc. v. Visa U.S.A. Inc., 396 F.3d 96 (2d Cir. 2005).

2004, Belgium enacted legislation guaranteeing all consumers the right to access bank services, and other EU countries have enacted or considered enacting similar legislation.

Outside Western Europe and Scandinavia, however, laws of this kind are virtually non-existent. Although American law prohibits credit and employment discrimination on the basis of certain invidious categories such as race and gender, there is no general right to a bank account in the United States, and nothing prevents banks from turning away customers who want to open a deposit account on grounds related to poverty. For example, they may have a past bankruptcy or foreclosure on their credit record, have been evicted from their residence, or lack a permanent address.

In several countries, lack of physical access to banking services has been a prominent consumer issue, particularly the lack of branch banks in rural areas. In addition to promising technological solutions like m-banking, one creative attempt to provide geographic access is Banco Postal in Brazil. Banco Postal is a joint venture between a major bank, Bradesco, and the Brazilian Postal and Telegraph Co. (Correios) to place branches in post offices in areas that previously lacked financial services.[322] The post office banks have brought over 1.5 million previously "unbanked" people in Brazil into the banking system.

As discussed above, password-protected prepaid cards are another solution to the problem of the "unbanked." Stored value cards present money-laundering issues that are beyond the scope of this Article but might limit the enthusiasm of law enforcement authorities for them as a solution. As the amount of value stored on cards grows, they also could pose economic issues regarding regulation of the money supply. The trend in the developed economies is toward stored value cards, particularly phone cards, being used for mobile micropayments to vendors of goods and services apart from their use to pay for telephone calls.[323] Stored-value cards also are usable at ATMs to obtain cash.

However, in emerging economies such as Russia, and to some extent in the United States, stored-value payroll cards, such as those now offered by Visa U.S.A., are becoming common. If a consumer's entire salary is paid by loading value onto a stored value card, it is likely that consumer will use the card for more than just

322. *Brazil Revamps Payments Infrastructure*, ELEC. PAYMENTS INT'L, July 28, 2004, at 13, *available at* http://www.ncrc.org/global/americas/Brazil/Brazilart3.pdf.

323. *See* BIS COMM. ON PAYMENT AND SETTLEMENT SYS., BANK FOR INT'L SETTLEMENTS, SURVEY OF DEVELOPMENTS IN ELECTRONIC MONEY AND INTERNET AND MOBILE PAYMENTS ¶ 3.3 (Mar. 2004).

micropayments or ATM transactions.

As payroll cards solve problems of access to banking services, and as merchants in the developing world acquire the necessary equipment to accept them in payment, the number of large-amount stored-value card payment transactions can be expected to increase significantly. Also, storing such great values on cards magnifies problems of security and the risk of unauthorized transactions. Though payroll cards are usually password-protected, such protection has not always prevented fraudulent transactions; in Canada, for example, sophisticated schemes have resulted in a high rate of theft and misuse of passwords for PIN debit cards.

F. Discharge of Obligations in Debit and Prepaid Card Transactions: The Insolvency Problem

Because most debit and prepaid card transactions clear in real time, discharge of obligations in debit and prepaid card consumer transactions is usually not an issue, except in the case of "signature" debit transactions where there is a delay before the merchant receives payment. Misdirected payments are not usually a problem because magnetic strip and chip technology on cards and the technology of card-reading equipment have made them unusual. In contrast, UCC Article 4A, applicable to "wholesale" wire transfers through commercial wire transfer systems such as the FRB's FedWire system, devotes several sections to problems of discharge and misdirected payments.[324] Wire transfers are more susceptible to error due to manual entry of payment instructions such as the beneficiary/payee's account number.

Discharge rules can become an issue in case of insolvency, either the insolvency of financial institutions, payment service companies such as PayPal that maintain consumer accounts, or transaction processors, such as First Data Corp., that process card transactions on behalf of financial institutions. Discharge also can be problematic in the case of the insolvency of the payor or the merchant.

Financial institution insolvency continues to be a problem for consumers in Africa and elsewhere in the developing world. In the mid-1990s, nine banks in Zambia, representing over 23% of total commercial bank assets, failed.[325] At roughly the same time, Nigeria

324. *See, e.g.*, U.C.C. §§ 4A-302, 4A-303, 4A-406 (1998).

325. Martin Brownbridge, *The Causes of Financial Distress in Local Banks in Africa and Implications for Prudential Policy*, UNCTAD DISCUSSION PAPER NO. 132, at 13,

witnessed the failure of seventeen local banks, while Kenya and Uganda also experienced the failure of several local banks that represented significant percentages of commercial bank assets in those countries.[326] A large number of these banks, particularly in Kenya and Nigeria, failed due to defaults on insider loans made to politicians to whom credit had apparently been extended in exchange for arranging to have the funds of governmental or parastatal organizations deposited in the bank.[327] Bank failure was not confined to Africa; for example, another six banks failed in Turkey at about the same time.

As mobile telephone service providers and other intermediaries enter the market for payment services, insolvency of payment service providers and money remitters has become a consumer issue in the developed world as well. Numerous payment services have been dissolved or have initiated bankruptcy cases in the United States, and the legal system has had to address issues regarding the entitlement of consumers and payees to funds deposited with the payment service. If mobile telephone service providers become major providers of payment services, the legal system may confront the same issues with respect to telephone service providers that become insolvent.

One solution is to extend governmental deposit insurance programs to cover funds deposited to add value to prepaid cards. For example, the Federal Deposit Insurance Corporation in the United States recently initiated a proposed rulemaking to extend deposit insurance to bank accounts established by employers to pay workers who are issued payroll cards linked to those accounts.[328]

VI. CONCLUSION

Debit and prepaid cards are proliferating in countries that lack an adequate regulatory regime for protecting the consumers who use them. Billions of vulnerable consumers newly initiated into the use of payment cards will not be adequately protected by unregulated private lawmaking by payment card associations, due to their countervailing incentives to attract merchants to make the necessary investment in equipment so they can accept cards and join payment associations. Technological solutions promote efficiency and limit

UNCTAD/OSG/DP/132 (Mar. 1998).

326. *Id.*

327. *Id.* at 16–17.

328. *See* DeSimone & O'Brien, *supra* note 18.

abuse, but they cannot ensure fair resolution of consumer disputes.

Because of the global spread of payment cards, governments throughout the world need to adopt new laws protecting consumers who use them. However, nations with emerging economies should not uncritically emulate regimes of consumer protection adopted in the United States and Europe. These regimes lack a consistent conceptual foundation and fail to address problems such as bank fees that have worsened since the regulatory regimes were adopted. Moreover, they fail to address problems such as access to banking services and payment service insolvency which, though not unknown elsewhere, are more pressing in the developing world.

Without a global focus, scholarship in payment systems law is flawed. American use of credit cards has been treated as mainstream. It is not. The American addiction to credit cards is an anomaly—perhaps one that is gradually disappearing, but an anomaly nonetheless.

Current rules on allocation of loss in payment card transactions—the $50 "deductible" for unauthorized credit card transactions in the United States, the "bank statement rule" and deductibles applicable to debit cards, and the fault-based rules adopted in Europe—should be rejected in favor of a simple rule that unauthorized transactions be charged back to the merchant, regardless of the type of card used. Debit and prepaid card transactions are both a convenient means of obtaining cash and a substitute for cash, but this does not justify treating consumers who use debit and prepaid cards as if they had paid in cash.

The lack of anonymity inherent in the use of payment cards entails risk for consumer privacy, but also makes possible greater transparency in the chargeback system. Consumer protection laws should require payment card associations such as Visa and MasterCard not only to make their rules public—rules that they currently refuse to disclose on the theory that they are "trade secrets"—but also to compile chargeback data regarding specific merchants, selected according to chargeback reason code, and make those data available to consumers in the form of merchant experience ratings.

Fees and charges imposed on consumers for payment card services are one of the most prolific sources of consumer complaints. Fee regulation should be regarded as a legitimate part of payments law in scholarship on the subject, and should not be ignored in establishing a regulatory system to govern debit and prepaid cards. Moreover, problems that disparately impact consumers in the developing world such as lack of access to financial services and

bank insolvency are legal problems that deserve attention from legal scholars and should not be left solely to economists and international financial institutions.