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Making Sense of Payments Policy in the Information Age

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INTRODUCTION

Although I had been mulling over the ideas in this Essay for quite some time, I finally was driven to put the ideas on paper by a call from a colleague one Friday afternoon. He recently had purchased something on the Internet. Regrettably, the Internet merchant had never shipped the goods; apparently the merchant had failed. My colleague had given the merchant the number from his Visa card to pay for the transaction. Being well educated, my colleague assumed that he could have the charge removed from his credit card statement.

When he called the toll-free service line for the bank that issued his card, however, he was surprised to hear that he could not rescind the charge because it had been processed as a debit card transaction, rather than a credit card transaction. He called me, hoping that I would tell him his bank was incorrect. Unfortunately, because the Visa card was a debit card rather than a credit card, I was forced to tell him no, that his bank was acting within its rights.

That anecdote crystallizes something that is deeply wrong with the current framework of our payments policy. The portion of that policy reflected in the Truth in Lending Act (TILA) grants consumers a variety of generous rights in credit card transactions.¹ By contrast, the Electronic Fund Transfer Act (EFTA), which governs debit card transactions, is relatively chary in its protections.² Today, however, with the debit card market increasingly dominated by the PIN-less debit cards marketed by Visa and MasterCard,³ the distinction between the credit card and the debit card is almost invisible to all but the most sophisticated consumers.

This Essay explores that problem. The cause of the problem is easy to see: technology has altered the landscape of private payment institutions, and Congress has not updated the statutes that regulate those transactions. The solution, however, seems sufficiently difficult to warrant detailed consideration. The first part of the Essay starts at a high level of generality, analyzing the general question of what types of considerations should inform a sophisticated payments policy. There has been some substantial prior thinking on the subject, most obviously in the Uniform New Payments Code (UNPC)⁴ and by writers

1. For a general summary of those rights, see RONALD J. MANN, PAYMENT SYSTEMS AND OTHER FINANCIAL TRANSACTIONS 114–18, 121–38 (2d ed. 2003). For a more detailed analysis, see *infra* Part II.

2. For a general summary of those rights, see MANN, *supra* note 1, at 146–54. For a more detailed analysis, see *infra* Part II.

3. For an introduction to the PIN-based and PIN-less debit cards, see MANN, *supra* note 1, at 144–46. For a more detailed analysis, see *infra* Part II.

4. Because the UNPC was not adopted in any jurisdiction or finally approved by the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL), there is no official final version. For this project, I have relied on copies kindly loaned to me by the

like Peter Alces who criticized that project.⁵ The central point of Part I is that previous analysis has failed to recognize the importance of the underlying transactions in which payments are made to issues ordinarily treated in the legal rules that regulate payment systems. Generally, I argue that issues of payments policy need to be separated into two categories: those for which determination of the appropriate rule is heavily influenced by the technology of the payments system; and those for which determination of the appropriate rule depends for the most part on the nature of the underlying transaction. Among other things, my argument suggests that issues like the one raised above—the ability of a purchaser to reverse a completed payment—should be driven more by transactional considerations. For example, I argue here that the differences in relative leverage between merchants and consumers support a broader role for reversibility of payment in consumer transactions, while issues about unauthorized transactions should be driven more by the nature of the technology.

To illustrate that framework in application, the remainder of the Essay considers the two most rapidly growing payment systems in our economy, credit and debit cards. Part II starts with a summary of the existing positive law on the subject and a description of the normative policy that law seems to reflect: a concern about cognitive limitations that afflict consumers in debt transactions. Part III challenges the value of that framework by arguing that the normative underpinnings of the current rules have become outmoded in several ways. Most importantly, it seems likely that many if not most credit card transactions no longer reflect the kinds of long-term borrowing transactions that justify the cognitive concerns underlying the existing policy. Similarly, the practical distinctions between credit and debit cards have eroded to the point where it is difficult to rely on that distinction as conveying anything of apparent import to the typical consumer.⁶ That is not to say, of course, that the use of credit cards for borrowing is not an important policy issue.⁷ It is to say, however, that it is not sufficiently dominant in the decision to use a credit card to exclude other relevant concerns.

That argument leads to at least two possible responses. The simplest course

Harvard Law Library. References that do not identify a particular draft are to the final draft that was formally circulated. UNIFORM NEW PAYMENTS CODE (Permanent Editorial Bd. for the Uniform Commercial Code, Draft No. 3, June 2, 1983) (available at Harvard Law Library). For a detailed explanation of the project, see HAL S. SCOTT, NEW PAYMENT SYSTEMS: A REPORT TO THE 3-4-8 COMMITTEE OF THE PERMANENT EDITORIAL BOARD OF THE UNIFORM COMMERCIAL CODE (1978) (available at Harvard Law Library).

5. See Peter A. Alces, A Jurisprudential Perspective for the True Codification of Payments Law, 53 *FORDHAM L. REV.* 83 (1984).

6. Although I do discuss in Part IV some of the difficulties of relying on disclosures in this context, it is not the project of this Essay to consider in any general way how to construct and implement legal distinctions in a way that will be comprehensible to consumers. I have argued elsewhere that some of the cognitive problems related to credit cards can be remedied by real-time disclosures to consumers. See Ronald J. Mann, *Global Credit Card Use and Debt: Policy Issues and Regulatory Responses* (2005) (unpublished manuscript). As I explain below, that approach seems less effective in this context.

7. I discuss that topic comprehensively in Mann, *supra* note 6.

would be to repeal the TILA protections as outdated. Part III, however, builds on the framework articulated in the first part of the Essay to argue that those rules have come fortuitously to serve other important policies,⁸ specifically the transaction-related sales policies that are important in issues of reversibility. The most obvious one is to redress the imbalance in enforcement capabilities between the typical merchant seller and the typical consumer buyer. If the existing rules shift the burden of instituting and pursuing litigation from the consumer to the merchant, they might enhance the likelihood that disputes in retail transactions are resolved appropriately. If so, then that burden-shifting justifies the TILA rules.

The problem with such a justification, at least as an explanation of existing law, is that the enforcement-imbalance concern applies to any payment system that the consumer uses. The major point cutting against broad application of that rule is the need to maintain payment options with different characteristics, so that merchants and their customers can choose between payment systems that are final and those that are not final. Part IV of the Essay considers the implications of that point in two contexts, conventional face-to-face retail payments and Internet payments. In both contexts, I conclude that credit and debit cards should have similar limitations on reversibility, leaving open the possibility that developing formats like prepaid cards ultimately might be left on the cash-equivalent side of the line. To be sure, that does limit the availability under current technology of any payment option in the Internet context that is both practical and wholly final. In the end, however, the distinctions between credit and debit cards do not seem sufficient or sufficiently clear to the user to justify a major distinction in how they are treated legally.

I. PAYMENTS POLICY IN GENERAL

Two events at the close of the twentieth century have underscored the need to think more clearly about payments policy. The first is the proliferation of markets in which credit and debit cards are used. What once was a niche product designed for the payment of expenses by business travelers has now come into widespread use in a variety of contexts that raise differing policy concerns. The second, related to the first, is the substantial shift in the locus of retail payment transactions from retail, face-to-face payments in brick-and-mortar stores to remote payments for Internet purchases. Collectively, those changes have destabilized the system for which existing payments rules were designed.

As the introduction suggests, I would be remiss to discuss harmonization of rules for payment cards without some general consideration of the propriety of

8. The pattern is a familiar one, especially in the context of common-law rules. *See, e.g.*, OLIVER W. HOLMES, *THE COMMON LAW* 31-32 (Mark D. Howe ed., Harv. Univ. Press 1963) (1881).

uniformity in the law of payment systems.⁹ I am of course not the first to come upon that problem. The UNPC, for example, rested on the basic premise that the law governing issues common to multiple payments should be as uniform as possible. As the Reporter explained in his memorandum justifying the project, the goal was "to arrive at a set of comprehensive rules applicable in some respects to all payment systems."¹⁰ Conversely, Peter Alces's perceptive analysis of that project argues that the UNPC went too far by ignoring important differences between payment systems that justify differing rules for devices, primarily credit cards, that provide for the extension of credit.¹¹ More recently, Clay Gillette has presented a particularizing argument about rules for unauthorized transactions, contending that those rules should turn on the relative ability of courts and legislatures to identify optimal risk-bearers.¹²

Looking back from the vantage point of the twenty-first century, it seems clear that the basic problem with the earlier proposals is not that they are excessively uniform or excessively particularizing, but that they have not undertaken to consider why it might be useful to have uniform or particularized rules on particular subjects. I attribute that blind spot in the existing literature to the historical accident of the structure of the modern commercial-law curriculum.¹³

Even with the law of payments itself, work that attempts to address broader policy concerns is hampered by the balkanized nature of the existing regulatory apparatus. The UCC itself is promulgated by the ALI and NCCUSL for adoption by the various state legislatures. The Federal Reserve—which is motivated

9. The division between the law of sales and the law of payments is a foundational element of our framework for teaching and writing about commercial law. Uniform Commercial Code (UCC) Article 2 governs sales. It is a subset of contract law, traditionally taught either in the first-year contracts course, as a free-standing upper-division course, or as the first segment in a commercial transactions course. Payments are governed by a number of separate UCC articles (3, 4, 4A, and 5), as well as a variety of federal statutes (the EFAA, *see* Expedited Funds Availability Act, 12 U.S.C. §§ 4001–4010 (2000); the Check 21 Act, *see* Check Clearing for the 21st Century Act, Pub. L. No. 108-100, 117 Stat. 1177 (2003), to be codified at 12 U.S.C. §§ 5001–18; TILA, *see* Truth in Lending Act, 15 U.S.C. §§ 1601–67(f) (2000); and the EFTA, *see* Electronic Fund Transfers Act, 15 U.S.C. §§ 1693–93r (2000), being the most important). As a course, it is a separate and freestanding division of commercial transactions, which can be taught on its own or taught as a separate part of a commercial transactions course. Aside from notable polymaths like Jim White, leading academics do not often make substantial contributions to both subjects. I am not sure of another example, but Jim White certainly is a good one. He served as the reporter for the recent revisions to UCC Article 5 (on letters of credit) and (aside from his work on his hornbook with Bob Summers) also has written a number of noteworthy articles on UCC Article 2. *See, e.g.*, James J. White, *Autistic Contracts*, 45 WAYNE L. REV. 1693 (2000); James J. White, *Default Rules in Sales and the Myth of Contracting Out*, 48 LOY. L. REV. 53 (2002); James J. White, *Good Faith and the Cooperative Antagonist*, 54 SMU L. REV. 679 (2001).

10. SCOTT, *supra* note 4, at 252.

11. Alces, *supra* note 5, at 112–15.

12. Clayton P. Gillette, *Rules, Standards, and Precautions in Payment Systems*, 82 VA. L. REV. 181 (1996).

13. I do not attribute the inconsistencies in payment law itself to the law school curriculum. My point here is only that the gap in the scholarly literature reflects the way in which the curriculum is organized.

primarily by concerns about stability and to a lesser degree by concerns about cost-effectiveness—implements most of the relevant provisions of the EFAA, TILA, and the EFTA. Even the Federal Trade Commission has a minor role, with some frankly protective regulations related to holder-in-due-course status.¹⁴

The basic problem is that payments policy needs to attend more consciously to the contexts of the transactions in which payments are made. Existing law articulates rules that are bounded almost entirely by the nature of the technology with which the payment is made. Thus, we have separate rules for wire transfers, letters of credit, checks, electronic transfers, and the like. That type of boundary makes sense only for issues driven by the nature of the technology. It makes no sense for issues that should be resolved by reference to the nature of the underlying transaction in which the payment is made.

At its heart, payments law must resolve four fundamental questions:¹⁵ who bears the risk of unauthorized payments; what must be done about claims of error; when payments are completed so that they discharge the underlying liability; and when they can 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. Thus, for example, with respect to the risk of unauthorized payments, the fundamental question is how to design a system that gives adequate incentive to the user to avoid and mitigate losses from unauthorized transactions, while giving adequate incentive to the system operator to make advances in technology and system design that can avoid and mitigate those losses. In our legal system, we have taken the view for most high-technology payments that an almost complete allocation of the risk of those losses to the system operator is appropriate.¹⁶

The premise of those rules is that even a complete allocation of loss to the network operator will leave the consumer a sufficient incentive to attend to contract provisions that resolve the legal questions summarized above. That could be true because of the hassle of reversing unauthorized charges, because of doubts that financial institutions readily will fulfill their obligations in such a situation, or even because of ignorance of the legal protections for unauthorized transactions. At the same time, the rules reflect the implicit premise that losses in technology-driven systems are most effectively reduced by technological and

14. See *infra* note 35 and accompanying text. The minor role of the FTC and the greater role of the Federal Reserve at least in part reflect a congressional compromise designed to ensure that TILA would not be enforced with excessive vigor. See Edward L. Rubin, *Legislative Methodology: Some Lessons from the Truth-in-Lending Act*, 80 GEO. L.J. 233 (1991).

15. There is some necessary arbitrariness in providing any list of fundamental issues, because any of these issues could be divided into multiple parts and because other issues that I omit might be regarded as fundamental. I think, however, that this list is sufficiently general and inclusive to serve the point that I wish to make here.

16. See Electronic Fund Transfer Act § 909, 15 U.S.C. § 1693q (2000); see also UNIF. NEW PAYMENTS CODE § 200 (Permanent Editorial Bd. for the Uniform Commercial Code, Draft No. 3, (1983) (general exoneration for unauthorized orders).

system-design initiatives that are exclusively within the control of the system operator. Thus, we are not surprised to see major investments in fraud-prevention technology in the credit-card and debit-card sectors. Because the justifications for those rules relate to the nature of the technology, it is plausible for federal law to prescribe such a rule for all electronic transfers from consumer accounts. It is less plausible to include a similar rule for credit card transactions based on the availability of credit in the transaction.¹⁷ It would be more sensible for that rule to be justified by the fact that the transactions are processed and cleared in an electronic way,¹⁸ which justifies rules like those discussed above.

Rules related to error are similar. The types of events that are likely to lead to an error, as well as the mechanisms for detecting, confirming, and responding to an error, usually depend on the technology that is used to clear and process payments. Thus, it makes some sense that the rule for transactions processed electronically, which are covered by the EFTA,¹⁹ would differ from the rule for transactions processed entirely by paper/conventional check transactions, which are governed by Article 4.²⁰ At the same time, the continuing shift of check transactions from paper to electronic processing, perhaps to be accelerated by the Check 21 Act, might undermine that distinction.

Rules that determine when a payment is made²¹ are similar, in that they are for the most part made based on the practicalities of a particular system. Thus, in the wire-transfer system, we say that the payment is complete when the beneficiary's bank becomes obligated to pay the beneficiary.²² In the checking system, we say that the payment is not complete with respect to an ordinary check until the check is paid,²³ but that it occurs with respect to a cashier's check when the payee accepts the instrument.²⁴

Rules related to reversibility, however, are completely different in that they should depend on the dynamics of the underlying transaction in which the payment is made. In the simplest cases, payment systems are specialized for use in particular situations. Thus, for example, in business transactions, parties often choose to make payments with letters of credit or wire transfers. Those systems include particular rules designed for the particular transactions in which they are

17. See Truth In Lending Act § 133, 15 U.S.C. § 1643 (2000).

18. See MANN, *supra* note 1, at 113-14.

19. Electronic Fund Transfer Act § 908, 15 U.S.C. § 1693f (2000). The UNPC adopted a process similar to the EFTA process. UNI. NEW PAYMENTS CODE §§ 300-06 (Permanent Editorial Bd. for the Uniform Commercial Code, Draft No. 3 (1983)).

20. There is no specific provision for errors in the checking system. For a general discussion, see MANN, *supra* note 1, at 85-96.

21. As suggested above, I mean by this concept the moment when the payment discharges the obligation for which the payment is made. This is distinct, of course, from the concept of finality in Articles 3 and 4, which occurs when the payor bank finally becomes obligated to pay. See U.C.C. § 4-215(a).

22. See U.C.C. § 4A-506.

23. See U.C.C. § 3-310(b)(1).

24. See U.C.C. § 3-310(a).

used, which determine the timing and circumstances in which payments can be recovered or stopped once the process has been initiated.²⁵ Because those systems are quite specialized, the system-specific rules work well for them.

It is important to see that the rules make sense because of the underlying transaction and not because of anything about the payment instrument itself. For example, there is nothing inherent in the use of a bank's written commitment to pay that calls for the formalistic emphasis on both an absolute obligation of payment upon presentation of conforming documents²⁶ and at the same time an utterly unconstrained right to refuse payment upon presentation of nonconforming documents.²⁷ On the contrary, that structure has grown up solely as an adjunct to the particular sales transaction for which the instrument is commonly used. If the law of letters of credit makes sense—and for the most part I think it does—it makes sense only in light of a practical assessment of the realities of the sales transactions in which that law is brought to bear.²⁸

The law of wire transfers is animated by an even more conclusive rejection of reversibility.²⁹ From the perspective articulated here, that emphasis reflects a desire to create an entirely "pure" payment system, divorced from any transaction; the wire transfer is suitable for cases in which the party making the payment is willing to forgo any payment-related right of recovery at all. Once the payment is made by wire transfer, there is no substantial recourse inside the system. That makes sense in context, because wire transfers are used typically by reasonably informed businesses that select such a pure system in contexts in which the most important aspect of the transaction is to provide reliably final payment as promptly as possible.³⁰

When we turn to less specialized payment systems, however, the issues become considerably more difficult. Historically, if not in current practice, the most prominent is the negotiable instrument. The most distinctive feature of the negotiable instrument is the ability of those that acquire the instrument to obtain holder-in-due-course status.³¹ As a practical matter, that status involves an ability to separate the instrument from the transaction as much as possible and thus make the obligation to pay irreversible at an early point, at least as regards claims related to the underlying transaction.³²

The complicating features of negotiable instruments law, however, largely operate to render that separation irrevocably permeable. For present purposes,

25. The rules for letters of credit appear in U.C.C. art. 5 and in the UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (ICC Publication 500). The rules for wire transfers appear in U.C.C. art. 4A. For secondary discussion, see MANN, *supra* note 1, at 227–28, 292–98.

26. See U.C.C. § 5-108(a); UNIF. CUSTOMS & PRACTICE FOR DOCUMENTARY CREDITS art. 9.

27. See U.C.C. § 5-108(a); UNIF. CUSTOMS & PRACTICE FOR DOCUMENTARY CREDITS art. 13.

28. See Ronald J. Mann, *The Role of Letters of Credit in Payment Transactions*, 98 MICH. L. REV. 2494 (2000).

29. See MANN, *supra* note 1, at 227–28.

30. See U.C.C. Article 4A prefatory note.

31. See U.C.C. § 3-302.

32. See U.C.C. §§ 3-305, 3-306.

what is most important is that the policy justifications for those complicating features uniformly relate to concerns about the balance of power in the underlying transaction for which the instrument was issued. For example, several arbitrary formalities limit the use of the negotiable instrument to cases in which the parties are sufficiently sophisticated and focused to ensure that the payment instrument is drafted in a stripped-down form that includes the requisite formal language and omits any substantial discussion of the underlying transaction.³³ Similarly, even if the instrument is issued in a proper form and transferred in the appropriate way, certain defenses will remain valid against the purchaser. These defenses, the so-called real defenses, address such matters as contracts with minors or contracts procured by fraud; they plainly are designed to protect fundamental concerns about fairness in the underlying transaction.³⁴ Finally, in nonmortgage credit transactions that involve consumers, holder-in-due-course status is generally prohibited as a matter of supervening federal law.³⁵

The negotiable instrument, of course, has been superseded for the most part by its main surviving descendant, the check, an instrument for which the classic rules of negotiability have little continuing significance.³⁶ Because the check is less specialized than the letter of credit or the wire transfer or the negotiable instrument in its heyday, its rules do not reflect the close accommodation to the balance of the underlying transaction that typifies the law of those earlier, primarily business-related payment systems. Many of the most important rules in the checking system allocate losses from unauthorized transactions and risks of errors related to the payment device that have little or nothing to do with problems in any underlying transaction.³⁷ Of course, the focus of modern check law on such questions, to the exclusion of any substantial concern for the consumers that use them, is the basis of many of the most forceful criticisms of Articles 3 and 4 as they now appear in the UCC.³⁸ But even the checking system includes rules that address the basic problem at the intersection of every payment system and the transactions for which it is used: the consequences of

33. See U.C.C. § 3-104; see also MANN, *supra* note 1, at 400-12.

34. See U.C.C. § 3-305(a)(1).

35. See 16 C.F.R. § 433 (2004); MANN, *supra* note 1, at 441-42; Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 967-68 (1997)

36. See Mann, *Searching for Negotiability in Payment and Credit Systems*, *supra* note 35, at 985-1004.

37. See MANN, *supra* note 1, at 69-83, 85-104.

38. See, e.g., Robert K. Rasmussen, *The Uneasy Case for the Uniform Commercial Code*, 62 LA. L. REV. 1097 (2002). As this Essay suggests, I am not persuaded by much of the criticism. I recognize that it is difficult to draw a coherent line between commercial and consumer instruments. See, e.g., William J. Woodward, Jr., "Sale" of Law and Forum and the Widening Gulf Between "Consumer" and "Nonconsumer" Contracts in the UCC, 75 WASH. U. L.Q. 243 (1997). And I think the law does more harm by watering down rules for transactions between businesses to protect consumers, largely because of my sense that the statutes end up including bad rules for businesses that do not in any event provide adequate protection for consumers. Thus, although this is not the place to defend that view, I think it is better as a matter of design to articulate separate rules for a describable class of consumer transactions, as federal regulatory legislation traditionally has done in this context.

the payee's failure to perform. On that point, the UCC grants the check-writer a right to stop payment without any assessment of the validity of the claim.³⁹

The check, however, is now outdated. As we now know, it has been declining in use for some time.⁴⁰ The pressure to revise rules related to the check thus will continue to decrease. At the same time, consumer use of credit and debit cards is increasing rapidly.⁴¹ Moreover, of importance for our purposes, credit and debit cards over the last decade have come into dominance in areas in which they were not frequently used in the past. In particular, credit cards have come to dominate payments in remote-purchase transactions, especially on the Internet.⁴² Debit cards, reaching broad use in this country only in the last decade, are now commonly used in face-to-face transactions and perhaps soon will be a major option for remote transactions as well.⁴³

Thus, if there is an area of payments law that is both important and currently contestable, it is the law that addresses card-based payment transactions. The remainder of this Essay examines that law in some detail, comparing and contrasting it to the law of checks, always with a view to discerning the policies that motivate the existing structure and explaining how it could be reconstructed in accordance with the framework discussed above.

II. THE EXISTING FRAMEWORK

A. REVERSIBILITY IN EXISTING PAYMENT SYSTEMS

As suggested above, the most contested policy question for card-based payment systems is the question of reversibility: when does the consumer lose the right to retract the payment from the merchant? Reversibility also is the issue for which my analytical approach of tying the payments question to underlying sales policy has the most pronounced application. The rules related to errors and unauthorized transactions may differ in minor details for credit cards and debit cards, but for the most part they are quite similar.⁴⁴ Furthermore, as suggested above, I believe those rules generally yield plausibly correct answers for reasons that do not warrant extended discussion.

For reversibility, however, the situation is quite different. On that topic, the

39. U.C.C. § 4-403. For an argument that this right is unduly narrow, see Alces, *supra* note 5, at 95.

40. *The Use of Checks and Other Noncash Payment Instruments in the United States*, FED. RESERVE BULL., Aug. 2002.

41. See MANN, *supra* note 6.

42. PAYMENT INSTRUMENTS AS A PERCENTAGE OF TOTAL eCOMMERCE, at <http://www.epaynews.com/statistics/transactions.html#39> (last visited Mar. 11, 2004) (reporting 81.3% for 2002).

43. See *infra* note 98.

44. See Truth in Lending Act § 133, 15 U.S.C. § 1643 (2000) (limiting liability of credit card holder for unauthorized transactions to fifty dollars); Electronic Fund Transfer Act § 909, 15 U.S.C. § 1693(g) (2000) (limiting liability of debit card holder for unauthorized transactions to fifty dollars, unless the cardholder fails to report either the theft of the card or unauthorized transactions that appear on the cardholder's statement); see also Ronald J. Mann, *Regulating Internet Payment Intermediaries*, 82 TEX. L. REV. 681 (2004).

paradigm starts from the simple rule for cash payments: if a consumer pays with cash, the "payment" is final at that moment, in the sense that the consumer cannot recover the cash. Of course, the consumer might obtain a separate right to payment from the merchant by establishing some separate claim under the contract in question. That is, however, quite a different thing from a right to retract the payment itself. For cash payments, such a right of retraction obviously is impractical.

For non-cash payment systems, however, the situation is considerably more complicated: the different non-cash payment systems afford consumers differing rights to retract a payment made to a merchant without first proving a failure of the merchant's entitlement to payment under the contract in question. That right of retraction and the system-to-system differences in its application is the focus of the remainder of this Essay.

Although the landscape is changing rapidly, three systems now dominate non-cash consumer payments in the United States. As of 2002 (the last year for which complete statistics are available), checks still were delivered in 23% of all retail payment transactions, credit cards were used in about 17% of those transactions, and debit cards were used for 11% of transactions.⁴⁵ The following sections discuss the reversibility rules that apply in each of those three systems.

1. Reversibility with Checks

The checking system offers the customer what seems at first to be the broadest right to retract payment, a right to stop payment set out in U.C.C. § 4-403(a).⁴⁶ The customer's right to stop payment is absolute: the customer can act for any reason it wishes or even, it seems, for no reason at all. The general concept, as the comment to that provision explains, is that the right to stop payment is a basic right that should be incident to a bank account, even if the bank occasionally incurs some loss through the customer's exercise of that right.⁴⁷

However salutary that policy might sound in the abstract, technological

45. See *Consumer Payment Systems*, NILSON REP., Nov. 2003, at 1, 6. Cash was used in 42% of the transactions. All other systems (including money orders, prepaid cards, travelers cheques, food stamps, and others) collectively amount to about 7%.

46. That provision states: "A customer . . . may stop payment of any item drawn on the customer's account . . . by an order to the bank describing the item . . . with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it . . ." A few states (including New York) have not yet adopted the current version of Article 4. See Table of Jurisdictions Wherein Code Has Been Adopted, 2B U.L.A. 1 (Supp. 1999-2000) (table indicating that the only U.S. jurisdictions that have not adopted the revised Article 4 are New York, South Carolina, Delaware, and the Virgin Islands). The older version still in effect in those states grants a substantially identical right to stop payment in U.C.C. § 4-403(1) (pre-1990 version).

47. U.C.C. § 4-403 cmt.1; see Robert D. Cooter & Edward L. Rubin, *A Theory of Loss Allocation for Consumer Payments*, 66 TEX. L. REV. 63, 118-19 (1987). The nature of the losses that the comment expects the bank to bear is obscure, because the UCC plainly contemplates that banks will be permitted to charge customers that choose to exercise the privilege of stopping payment on their checks. See MANN, *supra* note 1, at 14 (discussing UCC provisions indicating a hands-off attitude to regulation of

developments have so overtaken it that in the contexts most important to consumers it has become almost a dead letter. The difficulty is in the last clause of the relevant sentence of Section 4-403(a), which limits the time within which the customer can send a stop-payment order. Specifically, the notice must be sent at a time that gives the bank a reasonable opportunity to act "before any action by the bank . . . described in Section 4-303." That section, in turn, describes the points in the life of a check after which a third party cannot prevent a bank from paying a check; the key point for this discussion is the moment when "the bank settles for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement."⁴⁸ Thus, the customer's right under Section 4-403 to force its bank to stop payment on a check that the customer has written terminates when the bank's obligation to pay the check, normally to a depository bank or some intermediary that has transmitted the check to the customer's bank, becomes final under Section 4-303.⁴⁹ Interestingly enough, the UNPC adopted that rule as the test for all of the payment systems that it covered,⁵⁰ rather than the more generous rules from TILA and the EFTA discussed below.⁵¹

The problem for the customer is that modern settlement mechanisms are likely to get the check to the customer's bank, the "payor" bank in the UCC's terminology,⁵² quite swiftly. For example, if the customer writes the check locally, that is, in the metropolitan area in which the customer's bank is located, the payor bank often will receive the check on the very day that the customer writes it. Because the federal Expedited Funds Availability Act (EFAA) generally requires depository banks⁵³ to allow their customers second-business-day availability for funds deposited by local check,⁵⁴ banks into which such checks

checking-account fees); *see also* Alces, *supra* note 5, at 95 (discussing how bank's right of subrogation under UCC § 4-407 undermines the practical value of the right to stop payment).

48. U.C.C. § 4-303(a)(3).

49. The UCC permits an even shorter deadline at "a cutoff hour no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check." U.C.C. § 4-303(a)(5). It appears, however, that banks do not generally rely on that provision. *See, e.g.*, Telephone Interview with Joe DeKunder, Vice President, Bank of America, N.A., at 1 (Aug. 23, 1999) (transcript on file with author) (explaining that Bank of America's policy generally permits customers to stop payment until the bank has become obligated to pay the check under applicable rules of the clearinghouse or other arrangement under which the bank receives the check).

50. The definition of "order" in the UNPC is quite broad, and generally would cover what we now would regard as checks, ACH transfers, wire transfers, credit card, and debit card transactions, with the odd exception of store cards. UNIF. NEW PAYMENTS CODE § 10 & cmt. 10 (Permanent Editorial Bd. for the Uniform Commercial Code, Draft No. 3 (1983)).

51. *See id.* § 420. The UNPC did afford a right to reverse orders for three business days, but the right to do so could and presumably normally would have been waived in the customer's account agreement. *Id.* § 425(2).

52. *See* U.C.C. § 4-105(3) (defining "[p]ayor bank").

53. The depository bank is the bank into which the merchant deposits the check. *See* U.C.C. § 4-105(2) (defining "[d]epository bank").

54. *See* 12 C.F.R. § 229.12(b) (2004); MANN, *supra* note 1, at 24-25.

are deposited have powerful incentives to process those checks rapidly. Responding to that incentive, large banks in major metropolitan areas have developed efficient local clearinghouses that typically get local checks into the hands of the payor bank by the middle of the night on the date on which those checks are deposited.⁵⁵ To protect depository banks against the risk that their depositors will withdraw funds purportedly deposited by check before the depository banks can learn which checks will be dishonored,⁵⁶ the clearinghouses include draconian rules requiring payor banks to provide swift notice of dishonor, normally no later than early in the afternoon of the next business day, usually, the day after the check is written.⁵⁷

This acceleration of check processing is an improvement to the checking system, because it reduces the inefficiency of the time lag between the moment the check is tendered and the moment that the payee reliably has access to the funds. But the statutory rule that ties the customer's right to retract/stop payment to the processing system has important consequences for the consumer. To understand those consequences, consider a typical check, written at ten in the morning to purchase a lawnmower at a store in the consumer's hometown, in which the consumer's bank is located. The merchant might deposit the check late that afternoon, in which case it probably would reach a clearinghouse that evening and the payor bank sometime in the middle of the night. The payor bank, in turn, would become finally obligated to pay the check if it did not dishonor the check by early the following afternoon. Thus, the consumer's right to stop payment on the check would last little more than twenty-four hours.⁵⁸

To be sure, many consumers purchase things in locations far from their homes, in locations from which depository banks would not have access to those speedy local clearinghouses. However, even for remote purchases, the big picture for the consumer is not particularly sanguine. For one thing, merchants are much less likely to accept a check from a customer whose bank is in a remote location than they are to accept such a check from a local customer with a local bank. Moreover, when the merchants do take such checks,⁵⁹ their banks

55. See MANN, *supra* note 1, at 43-48 (discussing those clearinghouses).

56. Depository banks are at risk for two distinct reasons. First, they are obligated to release the first \$100 of funds deposited by check on the first business day after the check is deposited, even though it is most unlikely that they would have received a notice of dishonor by the beginning of that business day. See 12 C.F.R. § 229.10(c)(1)(vii) (2004). Second, they might and often do have funds availability policies more generous than those required by the statute. Indeed, recent surveys suggest that a substantial minority of banks, especially large metropolitan banks, have such policies. See Bd. of Governors of the Fed. Reserve System, Report to the Congress on Funds Availability Schedules and Check Fraud at Depository Institutions 39 tbl.10.1 (Oct. 1996) (on file with author) (reporting Federal Reserve data indicating that about 36% of banks offer same-day availability for local checks).

57. See MANN, *supra* note 1, at 52-59.

58. See *id.* (explaining clearinghouse processing and showing how the payment becomes final when the clearinghouse deadline passes without objection by the payor bank).

59. Industry statistics indicate that about one-third of checks deposited at large metropolitan banks are cleared through local clearinghouses, with two-thirds of those checks to be cleared through other, typically slower mechanisms. See MANN, *supra* note 1, at 52-53, 59-61. Those statistics do not

have every incentive to move rapidly to clear the checks; funds deposited in the form of nonlocal checks ordinarily must be made available to depositors within five business days.⁶⁰ Thus, both the Federal Reserve and the banking industry have devoted considerable resources over the last few decades to speed the processes by which they clear those checks.⁶¹

The result is that a substantial majority of nonlocal checks are received by the payor banks within two or three business days from the day on which they are written.⁶² Thus, even for nonlocal checks, the customer probably has only three or four business days within which to stop payment.⁶³ Moreover, for remote purchases it is important to recognize the heightened likelihood of a deferred discovery of dissatisfaction with the purchase. The consumer that purchases something while away from home often will not discover a problem with the purchase until returning home; if the return home is just a few business days after the date of the purchase, then, as surely as if the check had been written locally, the consumer's right to stop payment will lapse before the problem is discovered.

In sum, however generous the promise of the UCC's right to stop payment in checking transactions seems at first glance, the reality is that American consumers have no generally effective practical right to retract payments made by check. Once the check is handed to the merchant, the recourse of the consumer as a practical matter is limited to the cumbersome device of a legal action claiming some defect in the purchased goods or services.⁶⁴

2. Reversibility with Credit Cards

The above summary might strike the casual reader as unexceptional. After all,

distinguish between retail consumer transactions and other checking transactions. A wholly anecdotal review of my recently written checks suggests that those statistics, which aggregate *all* checks, understate the role of local clearinghouses in retail consumer transactions: it appears that none of the last 100 checks that I have written were payable to a party located outside my local metropolitan area.

60. See 12 C.F.R. § 229.12(c)(1) (2004); MANN, *supra* note 1, at 25-26.

61. For a brief description of the current industry practices, see MANN, *supra* note 1, at 51-66.

62. The most recent published data indicate that in 1997, 59.9% of nonlocal checks were returned to the depository bank within four business days, and 82.8% within five business days. There is every reason to think that processing is significantly faster now than it was then. But even using those figures, if it takes two business days from the date of receipt at the payor bank to the date the check is returned back to the depository bank, then the 82.8% figure represents the number of checks received by the payor bank within three business days of deposit. Availability of Funds and Collection of Checks, 63 Fed. Reg. 69,027, 69,028 (Dec. 15, 1998). Even if the payor bank is getting the check back to the depository bank on the first business day after it receives the check (which seems most unlikely), 59.9% of the checks are hitting the payor bank by the third day.

63. The right to stop payment normally will end no later than the first banking day after the banking day on which the payor bank receives the check because the payor bank's obligation to pay the check normally will become final on midnight at the end of that first subsequent banking day. See U.C.C. §§ 4-104(a)(10), 4-215(a)(3), 4-301(a); MANN, *supra* note 1, at 50-54 (discussing the steps that a payor bank must take to dishonor a check in a timely manner).

64. For a brief discussion of some of the most obvious reasons why such a remedy is not likely to be adequate, see Ronald J. Mann, *Verification Institutions in Financing Transactions*, 87 GEO. L.J. 2225, 2248-49 (1998).

when a consumer purchases something with cash, a bout of next-day dissatisfaction will not give the consumer the right to go back to the merchant and force the merchant to return the cash. If the consumer wants to retract the cash from the merchant, the consumer will have to convince the merchant of the validity of the complaint or, at least, of sufficient sincerity in the complaint that the merchant will disgorge the cash even if it doubts the validity of the complaint. From that perspective, the limited practical effectiveness of the check-using consumer's right to stop payment is not likely to be upsetting.

For the second major non-cash payment system, however, the situation is quite different. If the hypothetical lawnmower purchaser had used a credit card, it would retain, for a period likely to extend several weeks, two overlapping rights to retract payment from the merchant. Those rights both arise not under the state-promulgated Uniform Commercial Code, which has little or no application to credit card transactions, but rather under the Truth in Lending Act (TILA), Title I of the federal Consumer Credit Protection Act.⁶⁵

The first appears in TILA § 170(a),⁶⁶ which grants cardholders that make purchases with a credit card the right to assert against their issuing banks any defense that they could have asserted against the merchants from whom the purchases were made.⁶⁷ In legal substance, Section 170(a) articulates a general anti-holder-in-due-course rule⁶⁸ for credit card transactions. Thus, the section protects the cardholder's defenses even when the claim for payment is transferred from the merchant, from which the purchase was made, to the bank that issued the credit card.

But the practical effect of the rule is somewhat broader, allowing consumers to retract payment from merchants essentially at will. The key is the internal network rules of the major credit card systems. Under those rules, a card-issuing bank can and typically does unwind, or charge back, any credit card transaction for which a customer disputes its obligation under TILA. Thus, as soon as the cardholder interposes a claim under Section 170(a), the issuing bank charges the

65. TILA is codified at 15 U.S.C. §§ 1601–1667e (2000). The Consumer Credit Protection Act is codified at 15 U.S.C. §§ 1601–1693r (2000). For clarity, I adhere in the text of this article to the customary practice of referring to specific provisions of TILA by the section number of the Consumer Credit Protection Act itself rather than by the section number in the codification in Title 15 of the United States Code.

66. 15 U.S.C. § 1666i(a) (2000); see Regulation Z, 12 C.F.R. § 226.12(c) (2004) (regulatory explication of Section 170(a)).

67. For a general discussion of Section 170(a), see MANN, *supra* note 1, at 114–18.

68. The standard holder-in-due-course doctrine is a rule applicable to negotiable instruments, which grants certain favored transferees immunity from most defenses to the obligation reflected in the instrument. See U.C.C. § 3-302 (statutory grant of rights of a holder in due course); MANN, *supra* note 1, at 432–43 (secondary discussion of holder-in-due-course doctrine); JAMES WHITE & ROBERT SUMMERS, UNIFORM COMMERCIAL CODE ch. 14 (5th ed. 2000). The legislative history of TILA indicates that the analogy to that rule drove Congress in articulating the rule in this area. S. REP. NO. 93-278, at 9–11 (1973). For a thorough and contemporaneous presentation of the argument that holder-in-due-course protections for traditional negotiable instruments supported the TILA rule on reversibility, see Roland E. Brandel & Carl A. Leonard, *Bank Charge Cards: New Cash or New Credit*, 69 MICH. L. REV. 1033 (1971).

transaction back to the bank that processed the transaction for the merchant. That bank, in turn, recovers the funds that it advanced to the merchant for the transaction in question.⁶⁹ Thus, if the merchant wants to receive payment for the challenged transaction, the onus is on the merchant to take some action to substantiate its right to payment.⁷⁰

To be sure, Section 170(a) itself is subject to various limitations. For one thing, it does not apply to transactions that occur both outside the state of the cardholder's residence and more than 100 miles from that residence.⁷¹ For another, the right expires when the cardholder pays the charge in question.⁷² Nevertheless, even with those limitations, the right seems much more likely to have significance to the consumer than the stop-payment right for checks described above. Assuming a four-week credit card billing cycle, the average bill will not come for at least two weeks after the date of the transaction, and the date on which payment is due will be at least several days after that. Thus, even for cardholders that ordinarily pay their entire bills promptly each month, Section 170(a) affords an effective remedy, at least for local transactions, that extends for a period of weeks after the transaction.

Moreover, the statute also provides a broader remedy for cases in which the merchant fails to perform entirely, as in the transaction that inspired this Essay.

69. The charge-backs ordinarily are effected by netting out the funds to be recovered by the issuing bank from the merchant against funds for new sales transactions, which flow in the opposite direction (from the issuer to the acquiring bank and from the acquiring bank to the merchant). For a brief summary of the process, see MANN, *supra* note 1, at 115-16. For industry explanations, see Telephone Interview with Michael Butts, Creditcards.com, at 2-3 (Oct. 15, 1999) [hereinafter Butts Interview] (transcript on file with the author); Telephone Interview with Steven Klebe, Vice President for Payment Industry Alliances, CyberSource Corporation, at 3 (Oct. 19, 1999) [hereinafter Klebe Interview] (transcript on file with author).

70. See MANN, *supra* note 1, at 116; Klebe Interview, *supra* note 69, at 3.

71. I have not been able to locate statistics regarding the share of credit card transactions to which that limitation applies. The question is complicated by the uncertainty in locating mail-order transactions submitted by telephone or Internet. Compare *Plutchok v. European Amer. Bank*, 540 N.Y.S.2d 135, 137 (Dist. Ct. 1989) (transaction occurs at the merchant's location), with *In re Standard Fin. Mgmt. Corp.*, 94 B.R. 231, 238 (Bankr. D. Mass. 1988) (transaction occurs at the consumer's location). Furthermore, it is not clear how often banks rely on that limitation or how receptive courts would be if the banks did rely on it frequently. See *Hyland v. First USA Bank*, 1995 WL 595861 (E.D. Pa. Sept. 28, 1995) (accepting a cardholder's contention that a bank's response to a complaint related to an overseas credit card transaction amounted to a waiver of the bank's right to avoid responsibility based on the location of the transaction).

The industry sources to whom I have spoken claim that the Visa and MasterCard networks do not rely upon the Section 170(a) limitation. See Telephone Interview with Paul Confrey, Vice President, Electronic Commerce Planning and Communications, MasterCard, at 7-8 (Nov. 10, 1999) [hereinafter Confrey Interview] (transcript on file with author) (responding "No way José" to the suggestion that a MasterCard issuer would reject a claim on that basis); Klebe Interview, *supra* note 69, at 4-5. One executive explained: "[T]he cardholders wouldn't do business with anyone who came up with that. *Consumer Reports* would write them up within a week." Confrey Interview, *supra*, at 8.

72. See Truth in Lending Act § 170(b), 15 U.S.C. § 1666i(b) (2000); Regulation Z, 12 C.F.R. § 226.12(c)(1) & n.25 (2004). TILA applies a first-in, first-out rule to allocate payments for the purpose of determining the time at which any particular charge has been paid for purposes of Section 170(a). See Truth in Lending Act § 170(b) (2000); Regulation Z, 12 CFR § 226.12(c)(1) n.25 (2005).

If the case is one in which the goods or services were not delivered at all, the cardholder's complaint falls within the broad definition of billing errors in TILA § 161.⁷³ That section is not covered by the geographic limitation in Section 170; thus, it can be applied to transactions of any location. More importantly, billing-error claims need not be presented to the issuing bank for months; the statute requires only that the cardholder provide written notice to the issuer within 60 days after the date on which the creditor sent the relevant statement to the cardholder.⁷⁴ Also, the billing-error claim continues even if the charge in question already has been paid.⁷⁵ As with the right to withhold payment under Section 170(a), the ordinary effect of a claim of billing error by a cardholder is a prompt retraction by the issuing bank of the payment that it previously made to the merchant.⁷⁶

In sum, the consumer that reaches for the credit card instead of the check-book has a much more effective device for pressing subsequent disputes with the merchants from whom the consumer buys retail goods and services.

3. Reversibility with Debit Cards

The final consumer payment device of current significance is the debit card. Although the debit card looks much like an ordinary credit card, the cards are distinct in ways that are quite significant legally, largely because the debit card authorizes the merchant and the issuing bank to obtain payment directly from a designated bank account of the cardholder. Thus, the payment comes from the cardholder's bank account at the time of the transaction or, at most, a few days later; unlike the credit card, there is no delay for the transmittal of a statement and payment of the monthly bill by the cardholder.⁷⁷

Like the credit card, the consumer protections for debit cards come from federal law, in this case the Electronic Fund Transfer Act (EFTA).⁷⁸ The rules under the EFTA, however, differ starkly from the rules under TILA. Specifically, the EFTA contains no analogue either to TILA Section 170(a)'s right to

73. Truth in Lending Act 15 U.S.C. § 1666 (2000); see Regulation Z, 12 CFR § 226.13(a) (2004) (regulatory explication of TILA's billing-error rules); MANN, *supra* note 1, at 121–31 (general discussion of TILA's billing-error rules).

74. See Truth in Lending Act § 161(a), 15 U.S.C. § 1666(a) (2000); Regulation Z, 12 CFR § 226.13(b) (2004).

75. Neither Section 161 nor the regulatory explication of that provision at Regulation Z, 12 CFR § 226.13, states expressly that the right to complain of billing errors continues after payment is made. But given the express limitation of the Section 170(a) right to claims for which payment has not been made, the absence of any such limitation from Section 161 and Regulation Z strongly suggests the conclusion stated in the text.

76. See MANN, *supra* note 1, at 131.

77. For a general description of the mechanics of the system, see MANN, *supra* note 1, at 141–46.

78. The EFTA is Title IX, §§ 902–920, of the Consumer Credit Protection Act, 15 U.S.C. §§ 1693–1693r (2000). As with TILA, the text of this article adheres to the common practice of citing the section numbers of the Consumer Credit Protection Act itself rather than the section numbers of that act as codified in the United States Code.

withhold payment or to the billing-error rules in TILA Section 161.⁷⁹ Thus, payments made with a debit card are just as final as if they had been made with cash.⁸⁰

B. THE EXISTING POLICY JUSTIFICATION: LIMITING IMPRUDENT BORROWING

Stepping back from the details of the legal rules discussed above, it is easy to discern an overarching policy justification for the existing framework, rooted in the long-standing concerns of the Anglo-American legal system about the rationality with which borrowers evaluate credit transactions.⁸¹

From that perspective, the existing rules divide consumer payments into two classes. The first class includes transactions in which the consumer makes contemporaneous payment: cash, checks, and debit cards. Because the consumer at the time of the transaction understands that the payment is being made more or less immediately, the consumer is treated as having adequately assessed the wisdom of the payment in question.

Credit cards, however, are quite different from that perspective, because the consumer that purchases with a credit card does not make immediate payment. Rather, although the merchant receives contemporaneous payment,⁸² the payment by the consumer is deferred automatically until a statement is received and, at the consumer's option, more or less indefinitely, as permitted by the strikingly lenient repayment options typical of the modern American credit card.⁸³

79. The EFTA and Regulation E, 12 CFR § 205, do include procedures for resolving errors, but the definition is limited to unauthorized transactions or other errors in posting the transaction to the account. Unlike the analogous provisions in TILA and Regulation Z, the debit card rules do not extend to a failure of the merchant to perform its obligations in the transaction. *See* Electronic Fund Transfer Act, 15 U.S.C. § 908(f) (2000); Regulation E, 12 CFR § 205.11(a)(1) (2004).

80. The distinction is not an accident. As Jim Rogers has pointed out to me, consumer advocates pressed this point vigorously in the debates about adoption of the EFTA. Congress simply refused to include it. *See* NAT'L COMM'N ON ELEC. FUND TRANSFERS, EFT IN THE UNITED STATES: POLICY RECOMMENDATIONS AND THE PUBLIC INTEREST 49-53 (1977) [hereinafter EFT IN THE US REPORT] (recommending against a rule of reversibility for electronic fund transfers). Still, it is difficult to explain the differing rules as a positive matter. *Cf.* Gillette, *supra* note 12, at 207-09 (noting the oddity of similar rules for credit cards and debit cards in an area where they seem to be functionally dissimilar). The principal arguments advanced by the National Commission on Electronic Fund Transfers to support its rejection of the rule were that too many merchants would refuse an electronic payment system with reversibility and that consumers who wanted reversibility could use checks or credit cards. EFT IN THE US REPORT, *supra*, at 52-53. On the first point, the success of credit cards is a strong counterexample. I have never seen an American merchant that accepts debit cards but not credit cards. On the second point, the discussion above explains that checks no longer provide a substantial reversibility option. Finally, as I discuss in Part IV, credit cards provide such an option only for those wealthy enough to have them.

81. Peter Alces argues that credit and debit transactions should be treated differently, but he does not clearly make the link to behavioral concerns that I use here to justify that distinction in existing law. *See* Alces, *supra* note 5.

82. *See* MANN, *supra* note 1, at 115-16.

83. The perception that those options are too lenient has motivated congressional efforts to require specific disclosures regarding the length of time repayment would take at the minimum payment rates. *See* Dean Anason, *LaFalce Sees Compromise as Reform's Best Hope*, AM. BANKER, Apr. 29, 1999, at 3

The Anglo-American legal system has a long tradition of protecting borrowers from the folly of imprudent borrowing. The most famous example surely⁸⁴ is the centuries-long effort of English courts to invalidate a series of creditor devices that had the effect of granting mortgage creditors a broad right to take real-estate collateral from borrowers that failed to perform precisely as they had promised at the time of the loan.⁸⁵ That instinct continues to have broad application today, as courts steadily broaden the range of devices to which that invalidation rule extends.⁸⁶

Although it is a bit much to superimpose the insights of modern academic literature onto the policy instincts of the medieval English judiciary, that policy finds broad support in the specific concerns of the nascent behavioral economics movement. Scholars in that field often point to an overlapping set of tendencies that generally lead a normal individual to underestimate the likelihood of negative future events that have not previously been salient in the experience of the individual's circle of personal acquaintances.⁸⁷ A similar, related phenomenon leads to systematic underestimation of the likelihood that a negative event will happen to the estimating individual, even if the individual accurately understands the overall likelihood of the event.⁸⁸ Both of those phenomena are exacerbated by the likelihood that consumers 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.⁸⁹ Thus it is reasonable to worry that borrowers entering into credit transactions do not adequately weigh harms likely to befall them from the difficulties that might come at the time that

(discussing possible disclosure requirements); Dean Anason, *Bankruptcy Bill Is Getting Last-Minute Tweaks*, AM. BANKER, Sept. 10, 1999, at 2.

84. At least from the perspective of an academic who began his career teaching in the area of real-estate finance.

85. See RESTATEMENT OF MORTGAGES § 3.1 cmt. a (1997); Ann M. Burkhart, *Lenders and Land*, 64 MO. L. REV. 249, 250–67 (1999). For citations to more detailed treatments, see 1 G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 3.1, at 32 n.1 (1993) (Practitioner Treatise Series).

86. See, e.g., RESTATEMENT OF MORTGAGES, *supra* note 85, §§ 3.1–3.4 (articulating rules for modern real-property applications); WHITE & SUMMERS, *supra* note 68, § 21.3 (discussing the application of similar rules to transactions that purport to involve leases of personal property).

87. See, e.g., Amos Tversky & Daniel Kahnemann, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1127–28 (1974) (discussing availability biases).

88. See, e.g., Laurie Larwood & William Whittaker, *Managerial Myopia: Self-Serving Biases in Organizational Planning*, 62 J. APPLIED PSYCHOL. 194 (1977); Ola Svenson, *Are We All Less Risky and More Skillful Than Our Fellow Drivers?*, 1981 ACTA PSYCHOLOGICA 143; Neil D. Weinstein, *Unrealistic Optimism About Future Life Events*, 39 J. PERSONALITY & SOC. PSYCHOL. 806 (1980) (discussing the optimism bias).

89. The phenomenon generally is known as hyperbolic discounting. For a discussion in this context, see Stefano Dellavigna & Ulrike Malmendier, *Contract Design and Self-Control: Theory and Evidence*, 119 Q.J. ECON. 353 (2004). See generally 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., Fall 1989, at 181, 184–87 (discussing dynamic inconsistency in discount rates); Richard H. Thaler, *Some Empirical Evidence on Dynamic Inconsistency*, 8 ECON. LETTERS 201, 202 (1981).

repayment is due.⁹⁰ Also, with a little more subtlety, those that pay in advance might underestimate the likelihood that they will harm their strategic relations with the merchant by agreeing to pay now and receive the subject merchandise or services later.

Finally, that concern works well as a lens for understanding TILA. TILA does little or nothing to regulate anything about credit card transactions divorced from their credit-related features.⁹¹ The bulk of its regulations appear to rest on the concern that crafty credit card issuers will trick consumers into using credit cards without understanding the costs of repayment.⁹² Thus, the statute relies heavily on a variety of disclosure rules reflecting the well-intentioned notion that mandatory disclosures will resolve the cognitive problems that afflict the potential credit card user.⁹³

III. A BETTER FRAMEWORK: REDRESSING AN IMBALANCE OF LEVERAGE

Although the concern about consumers' general failure to appreciate the risk of borrowing transactions seems to provide a relatively coherent normative explanation of the current system, a comparison of that explanation to the framework discussed in Part I suggests that the existing framework is deeply flawed. Three general points illustrate my concerns. First, developments in payment systems render the distinction between credit and debit payments illusory. Second, although the point necessarily is subjective, and not to be pressed absolutely, I believe that the concern about cognitive problems in credit

90. In addition to the academic studies that generally relate to discounting problems (several of which are cited *supra* note 89), there is some limited empirical evidence to support the existence of the problem in consumer credit markets. See Joshua Brockman, *Survey by Fannie Says People Underestimate Effects of Poor Credit*, AM. BANKER, July 30, 1999, at 14 (reporting study by Federal National Mortgage Association indicating that consumers systematically underestimate the adverse effects of poor payment behavior on future lending transactions). Oren Bar-Gill argues vigorously that much of the credit card system is driven by issuer exploitation of behavioral problems of consumers. Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2004). Because his argument focuses on overall interest-rate pricing and efforts to cause consumers to accept cards rather than the actual purchasing transactions it is not directly relevant to the issues that I address here. As I explain in Ronald J. Mann, *Credit Cards, Consumer Credit, and Bankruptcy* (2005) (unpublished manuscript), I am impressed with his argument that behavioral concerns have a significant impact on the design of credit card products. I am less sure, however, of his empirical conclusion that this aspect of the design contributes significantly to the policy problems related to credit card use.

91. For a detailed description of the rules imposed by TILA, see 2 BARKLEY CLARK & BARBARA CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* ¶15.04 (1999).

92. A particularly telling example is the odd provision that bars the mailing of unsolicited activated credit cards. See Truth in Lending Act § 132, 15 U.S.C. § 1642 (2000); Regulation Z, 12 C.F.R. § 226.12(a) (2004). The legislative history shows that concern about this practice was common at the time. See *Unsolicited Credit Cards: Hearings on S. 721 Before the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency*, 91st Cong., 2d Sess. (1970).

93. For a detailed description of various ways in which TILA fails at that purpose, see Mann, *supra* note 6.

card transactions is in practice largely irrelevant.⁹⁴ Third, and most importantly, I think that concerns about an imbalance of leverage in dispute resolution are much more significant, and call for an even broader consumer-protection policy than the credit-cognition policy justifies or the existing legal rules provide.

A. THE ILLUSORY CREDIT/DEBIT DISTINCTION

The first point looks to the reality of current market use of payment systems, in which the distinction between debit and credit payment devices has eroded almost completely from the consumer's standpoint. The key point here has been the recent rise of the debit card from a highly specialized and limited retail payment instrument to an instrument of widespread use and soon-to-be universal acceptance.

Although the debit card was invented more than thirty years ago,⁹⁵ it did not rise to prominence until the last days of the millennium. Many factors doubtless play a role in that rise, including the steadily decreasing costs and increasing reliability of the dialup telephone connections on which retail debit card usage depends.⁹⁶ But one factor is crucial: the development of the PIN-less Visa and MasterCard debit card products (VisaCheck and MasterMoney, respectively).⁹⁷

Although neither of those products existed until the mid-1990s, they already have surpassed in market share the traditional PIN-based regional debit card networks that have been operating for much longer. Starting from less than 400 million transactions worth only \$5 billion in all of 1994, by 2002 the PIN-less systems were used in more than 8 billion transactions for \$318 billion, compared to only 5.2 billion transactions worth \$162 billion for the conventional PIN-based products.⁹⁸

The cynic might attribute the rapid growth of the PIN-less systems to an unrelenting advertising campaign (especially for the VisaCheck card).⁹⁹ However, a more fundamental reason for the success is the advantage that the Visa and MasterCard products have over the traditional regional cards at the point of sale: an installed user base that includes an overwhelming majority of retail merchants in the United States. Now that credit card transactions are cleared

94. That is not to say that there are no relevant cognitive concerns. On the contrary, I think cognitive concerns are a major problem in the credit card industry. See Mann, *supra* note 6, at 90. It is only to say that they are not related to the issue of reversibility in any plausible way.

95. See D. BAKER ET AL., *THE LAW OF ELECTRONIC FUND TRANSFER SYSTEMS: LEGAL AND STRATEGIC PLANNING* ¶ 7.02 (rev. ed. 1999) (discussing the early history of the use of the debit card at retail locations).

96. For discussion of that point, see Ronald J. Mann, *Information Technology and Non-Legal Sanctions in Financing Transactions*, 54 *VAND. L. REV.* 1627, 1630–36 (2001).

97. The following discussion draws heavily on MANN, *supra* note 1, at 144–46.

98. See *U.S. General Purpose Cards*, NILSON REP., Aug. 1999, at 1, 9–10; *U.S. Debit Cards*, NILSON REP., Apr. 2003, at 1, 6–7.

99. Early advertisements featuring Bob Dole were particularly notable. See Gary Tuchman, *Bob Dole: Taking Madison Avenue By Storm*, CNN, Aug. 7, 1997, at <http://www.cnn.com/allpolitics/1997/08/07/dole> (describing the success of those advertisements).

almost exclusively by telephone connections,¹⁰⁰ the basic infrastructure for the debit card is in place at almost all Visa and MasterCard merchants. Those merchants can take debit card transactions using the same terminals with which they take Visa and MasterCard credit card transactions.

The difference in the nature of the authorization transactions—an examination of a particular bank account rather than a particular line of credit—seems insignificant to the merchant in the current, telephone-based clearing environment. In either case, the merchant's terminal dials up the designated telephone number and transmits the card number and related information about the card and the transaction. The issuer's computer simply checks a different database for transactions that use debit card numbers than it does for transactions that use credit card numbers. The same analysis applies to the collection arrangements, which require deduction from a checking account instead of posting to a credit card account. That difference is irrelevant to the merchant, which receives funds in its account promptly after it forwards the appropriate transaction information. Thus the merchant that clears MasterCard and Visa credit card transactions electronically needs nothing new to accept the VisaCheck and MasterMoney debit card products.

A regional debit card network attempting to persuade a merchant to accept its cards for point-of-sale transactions has a much more difficult time because the merchant necessarily will have to invest in some additional technology. In some cases, the debit card network may require the use of a different terminal—one that can accept entry of a PIN—which necessarily will increase costs for the merchant. At a minimum, the merchant will have to alter its existing procedures to cause its terminal to recognize the situations in which it must dial the telephone number for the regional debit card network instead of its regular acquiring credit card bank.¹⁰¹ That might sound like a simple task, but it will seem complicated to *some* merchants, and no alterations will be necessary for merchants that choose to accept only VisaCheck and MasterMoney.

Furthermore, the merchant is quite unlikely to suffer a significant loss of business because of a failure to accept PIN-based debit cards. Currently, few of us will enter a store planning to buy, but depart when we discover that the store takes a Visa or MasterCard product but not our ATM card. The converse, of course, is even more telling. Quite a number of consumers would depart without buying or choose not to return if a store did not accept Visa and MasterCard products, even if the store did accept an ATM card from a large local bank.¹⁰²

100. See Jeremy Quittner, *Processing Paper on Wane, but Still Lucrative*, AM. BANKER, Nov. 1, 1996, at 10.

101. The acquiring bank in a credit card transaction is the bank that processes the transactions on the merchant's behalf, forwarding them through the Visa and MasterCard network to the various issuers, and providing payment to the merchant after deduction of the appropriate fees. For brief discussion, see MANN, *supra* note 1, at 111-14.

102. The ATM card faces an additional disadvantage in those metropolitan areas where major banks are not members of the same network, because a retailer that makes an arrangement with one network

Finally, and perhaps a bit less justifiably, Visa and MasterCard adopted the forceful tactic of insisting that their merchants accept all of their products, debit and credit. Thus, any merchant that already accepts the Visa and MasterCard credit card products was obligated to accept the Visa and MasterCard debit card products. A number of large merchants were unhappy about that, largely because the Visa and MasterCard debit card products exact discount fees substantially higher than those charged by the traditional regional debit card networks. Retailers responded by instituting antitrust litigation that eradicated the practice.¹⁰³ By the time the tying practice was eradicated, however, the debit card system already had become widespread.

The result is that the leading credit card products and the leading debit card products in our country now use precisely the same technology. The cards have the same appearance, they use the same anti-fraud technology, they are cleared through the same network, their transactions are verified in the same way—by signature—and they are issued by the same entities. This fosters a world in which the consumer often cannot even tell whether the card pulled from the wallet is a credit card or a debit card.¹⁰⁴ Indeed, because many banks issue cards that have both debit and credit features, the answer often is that the card is both. In that case, the choice depends on nothing more than which button the clerk presses on the telephone terminal. Moreover, in some cases, under current technology, a consumer can use a card only by pushing a button at the checkout counter that inaccurately identifies the card!¹⁰⁵

would gain access only to the customers whose banks use that network. The deep market penetration of Visa and MasterCard products in terms of both merchant acceptance and consumer usage obviates that problem for their products.

103. For discussion of the retailers' success, see Robert A. Bennett, *The Retailers' Home Run*, CREDIT CARD MANAGEMENT, July 2003, at 24.

104. That is not an accident. See Jennifer Kingson Bloom, *Visa Stands by Updated Debit Card, Though Banks' Response Is Cool*, AM. BANKER, July 28, 1999, at 1, 13 (emphasizing the effort by Visa to obscure the difference between the credit and debit products at the consumer level: "Few consumers know those details – and this is by design. Consumers 'won't know the difference, so there is no point confusing them.") (quoting Visa's vice president for debit products); see also *Your Debit Card Is the Key To Protecting Your Money*, USA TODAY, Oct. 5, 1999, at 14A (full-page advertisement for Visa debit cards, which neglects to mention the disadvantageous EFTA rules discussed in the text). Almost every year in my Payment Systems course I have the experience of students insisting that they have a strange kind of credit card in which the bank automatically deducts the amounts from their bank account every month. The card, of course, is not a strange kind of credit card—it is a debit card—and the deductions are made daily, not monthly; the confusion on that score arises because the cardholders receive statements showing the deductions only on a monthly basis.

More recently, a few American banks (such as Citibank)—adopting the typical practices of banks in Japan and some European countries—have started to offer a product in which the credit card bill is paid automatically each month by a deduction from the customer's bank account. Finally, falling in between those products is a delayed debit product in a pilot program from MasterCard, in which all debit charges are aggregated and posted to an account once or twice a month. See Charles Davis, *Delayed Debit Card Differentiates Offering*, CARDS INTERNATIONAL, January 2005, at 11.

105. I speak from experience with the Verifone terminal at a prominent Austin merchant. I have a VisaCheck card from my local bank, which can be used either as a PIN-based debit card through a local EFT network or as a PIN-less Visa debit card. Because the merchant in question does not accept

In sum, the practical distinction in modern commerce between a credit card and a debit card is one that would be obscure to even sophisticated consumers. Given the limited likelihood that the typical consumer understands the distinction, it is at best dubious for the law to place as great a weight on that distinction as it currently does.

B. THE LIMITED USE OF CREDIT WITH CREDIT CARDS

The confusing similarity of the leading debit and credit card products would not matter so much if the credit aspect of the transaction were central to the consumer's mind. A consumer buying with a credit card would regard the transaction as substantially less serious and immediate than a transaction with a debit card.

In the modern era, however, the credit aspect of the purchase transaction is increasingly obscure. For many of us, the credit card is used much more for convenience than for any purpose related to borrowing. To put it another way, we often pull a credit card from our wallet not because we lack the present wealth to pay the purchase price for the item in question, but for some other reason unrelated to a credit decision.

If there is anything that proves that point, it is the rise of the "convenience" credit card user, who charges purchases on the card but pays off the bill in full each month.¹⁰⁶ Once a relatively small sector of the market, convenience users now constitute about 40% of the market.¹⁰⁷ For those users that consciously limit their spending to what they can repay out of resources available that month, it is almost deceitful to treat the transaction as one involving a significant extension of credit.

Many people use the credit card for reasons completely unrelated to credit. The most economically rational is a desire to get the "float"—the use of the funds during the time that elapses between the date of the transaction and the date that the credit card bill must be paid to avoid a finance charge. But the

PIN-based debit cards, the card will not be accepted if I select "ATM" on the terminal. It will work, however, if I select "credit," although the transactions are processed as debit transactions, being withdrawn from my bank account in a few days. It seems at best ironic that I should be denied TILA protections for a transaction in which I am forced to present my card as a credit card.

106. Because many American credit card issuers no longer charge annual fees, the profits from issuing credit cards largely come from interest charges and late fees. Thus, the convenience users, even if relatively creditworthy, are relatively unprofitable customers for the credit card issuer. See Lisa Fickensher, *New Discover Cards Aimed at People Who Run Balances*, AM. BANKER, Apr. 17, 1995, at 1 (attributing the limited profitability of the Discover card to its unusually large share of convenience users); Lisa Fickensher, *Citi's Card Unit Says It Will Stick to Basics*, AM. BANKER, July 27, 1999, at 14 (reporting estimates that 80% of industry profits come from those who are not convenience users).

107. It rose steadily from 28.6% in 1990 to 44.4% in 2000, but has fallen each of the last two years to 39.9% in 2002. See CARDDATA, BANK CREDIT CARD CONVENIENCE USAGE—CURRENT, available at http://www.cardweb.com/carddata/charts/convenience_usage.amp (last visited Jan. 13, 2004) (subscription required). In my work on credit cards, I argue that a more useful metric of the extent of borrowing tracks the ratio of outstanding balances at any given time against the annual credit purchase volume; that figure has fluctuated for the last decade between 55 and 65%. See Mann, *supra* note 6.

rapid rise of the debit card, which has no such float, suggests that the float is not the dominating market factor in the choice of a credit card over cash or a check.

More likely reasons probably include the desire not to have to carry enough cash to cover all of the purchase transactions of our daily life. That is not just a desire to limit the risk of a loss from theft, but also has to do with the relative ease with which credit cards can be used as compared to the ease with which we can get cash from our banks. Many of us stand at retail counters thinking something like, "If I use a credit card here it means I won't have to stop at the ATM to get money before I go to work tomorrow."

Another consideration for some relates to the ease of recordkeeping. If most transactions can be pushed onto a single credit card, which provides a single consolidated monthly statement, the task of monitoring expenses to review compliance with a budget (or, perhaps more commonly, to understand the failure to comply with a budget) is rendered much easier.¹⁰⁸

Still another reason, at least by comparison to the check, is the desire to close the transaction rapidly. Although this has not always been true, it now plainly is the case that the check is the slowest of retail payment mechanisms. When a grocery store customer pulls out a checkbook to pay for groceries, the hurried customers in the line behind inevitably sigh, knowing that their wait will be protracted by the additional time for the consumer to write the check and for the clerk to decide whether to accept it.

Finally, a recent factor is the affinity program. A credit card often carries with it "perks" of some kind that have value to the cardholder. I am motivated to obtain frequent flyer credits on my favorite airline; a colleague is motivated to obtain credits toward purchase of an automobile from a particular manufacturer. Those perks give all of us who have such cards an incentive to place charges on a credit card—especially large charges—even if we could just as easily write a check, because passing the transaction through the credit card issuer earns us something of value that amounts to a discount on the transaction price.¹⁰⁹

Those points speak to my thesis with some ambiguity. One could say that the reasons for using a credit card are likely to induce many to purchase things on credit without realizing that they are borrowing, thus pushing credit card users into an imprudent cycle of borrowing. And I recognize, of course, that credit cards are still used to borrow money. Americans as a class now carry a staggering amount of credit card debt, in the range of 750 billion dollars.¹¹⁰

108. American Express was a leader at pushing this feature of the credit card, with its user-friendly subject-oriented statements.

109. That motivation, of course, can be unprofitable for the credit card company, which earns no income on such convenience-use transactions. It should surprise nobody that credit card issuers have noticed that practice and are beginning to respond to it. See, e.g., Antoinette Coulton, *Banc One Clips Wings of Convenience Users*, AM. BANKER, Aug. 1, 1997, at 12 (reporting program under which Banc One gives lower affinity credits to convenience users than other users). For a thorough discussion of affinity programs and their problems, see Mann, *supra* note 6.

110. See *Credit and Debit Cards U.S. Projected Thru 2010*, NILSON REP., Sept. 2002, at 7 (\$723.66 billion outstanding on U.S. credit cards at the end of 2001).

Indeed, I argue in related work that the rise of credit card debt has contributed in part to a disturbing rise in consumer bankruptcy in this country.¹¹¹

The extent of credit card borrowing does not undermine my point that the decision to use a credit card is not necessarily the same as the decision to borrow.¹¹² In practical import, two different decisions must be distinguished: the decision to use a credit card to make a purchase and the decision to borrow from a credit card issuer. Obviously there are cases in which people purchase things on credit cards planning to pay for them at the end of the month, but then find themselves unable to pay. For those cases, the credit cognition concern has some weight. However, the existence of some range for the credit cognition concern does not respond to my basic view that the credit card transactions raise major policy considerations as a payment method, entirely apart from their borrowing aspects.¹¹³

The cognition concern need not be discarded, but just the same, it should not be pushed to the exclusion of other concerns that have more practical significance in the broad range of daily transactions. The fact is, for many of us the credit card involves no credit at all. A sound payments policy must take account of the dynamics of those transactions as well as the more traditional credit transactions. The next section suggests that the reversibility rule in TILA responds well to a policy concern common to all of those transactions, and to debit card transactions as well.

C. LEVERAGE AND DISPUTE RESOLUTION

The preceding pages suggest a considerable tension in the existing legal framework. Part II discusses a variety of legal rules that provide protections for consumers limited for the most part by the time when they pay their credit card bills. The preceding sections of this Part, in contrast, discuss the likelihood that many consumers arrange their affairs so that they take care to pay those bills promptly after receipt, to make sure that they do not incur any charges to the credit card issuer.¹¹⁴ But the cardholder that diligently pays bills at the same

111. Mann, *supra* note 90.

112. It may be that the situation will change as the debit card grows in popularity and as credit card issuers increase efforts to repel confirmed convenience users, *see, e.g., supra* note 109. Those two changes together suggest the possibility of a market in which different groups of consumers use credit cards and debit cards: those who borrow use credit cards and those who do not use debit cards. For example, in a world in which credit card companies charge annual fees and deny affinity benefits to convenience users, why would those users choose a credit card instead of a debit card that their bank might provide to them for free (on the premise that it is cheaper for the bank to process debit card transactions than it is to process checks). The existing situation is in such flux, however, that it is difficult to predict the ultimate outcome. For this Essay, however, it is enough to note that such a scenario would not undermine my point: that the debit/credit distinction should be irrelevant to the reversibility question *whether or not* it is important in practice.

113. For a comprehensive discussion of the policy issues related to borrowing on credit cards, *see* Mann, *supra* note 6.

114. The fee-free time is shortening rapidly, as credit card issuers struggle to limit the costs of servicing convenience users, and shift to a model that relies more heavily on those fees. *See* Noreen

time blindly gives away many of the valuable rights that TILA grants to the cardholder.

Of course, if you accept the policy premise of TILA then those protections make no sense once the bill has been paid. On the other hand, if you sense a windfall for the merchant that has sold to a convenience user as compared to a merchant that has sold to a credit user, then some broader normative justification underlies your instincts—a justification that survives the cardholder's payment to the issuing bank. That justification, I submit, is supplied from the framework articulated in Part I of this essay, by reference to the underlying sales transaction. In this context, the concern is the imbalance of leverage between the typical consumer and the typical merchant.¹¹⁵

1. What Policies Does TILA Serve?

As summarized in Part II, the practical impact of the relevant provisions of TILA is to alter the burden of going forward in a dispute about a retail purchase transaction. Without TILA—that is, in a cash or debit card transaction—the merchant has the funds and the consumer can obtain satisfaction only through the exercise of some legal remedy or threatened non-legal sanction such as public outcry designed to harm the merchant's reputation. Conversely, if TILA intervenes, then the charge will be removed from the cardholder's account and the funds retracted from the merchant, at least temporarily.¹¹⁶ Thus, the merchant will have to take action to obtain the disputed funds. With zero transaction costs and perfectly balanced positions that change would not matter. But the general imbalance in litigating capabilities between merchants and consumers at least suggests the possibility that the shift of the burden of going forward could improve the effectiveness of the system considerably.¹¹⁷

At bottom, the consumer with TILA as a weapon is much better positioned in the dispute than the consumer without TILA. Moreover, if the improvement of

Seebacher, *Consumer Issues: Keep Credit Card Penalties from Imprisoning You*, DETROIT NEWS, Sept. 13, 1999, available at 1999 WL 3938007 (reporting programs by card issuers to shorten grace periods and, in some cases, cancel the accounts of convenience users). Credit card issuers have had less success in efforts to enforce late fees more rigorously. See Miriam Kreinin Souccar, *Late Fees Seen Backfiring on Card Issuers*, AM. BANKER, Oct. 19, 1999, at 1, 18 (reporting three 1999 lawsuits against large card issuers alleging improper assessment of late charges and other fees). For discussion of some policies responsive to that problem, see Mann, *supra* note 6.

115. Cooter & Ruben allude to that imbalance briefly, but suggest that it has little interest for them because it is "better examined as [an] aspect of sales law, not payment law." Cooter & Ruben, *supra* note 47, at 121. As this Essay suggests, I think it has much more to do with payment law than they do.

116. The statute requires the issuing bank to cease any efforts to collect the charge from the consumer until it has conducted a reasonable investigation of the consumer's allegations and determined that they are unfounded. Truth In Lending Act, 5 U.S.C. § 161(a)(B) (2000); see Regulation Z, 12 C.F.R. §§ 226.13(d)(1), (f) n. 31 & (g) (2004).

117. See Cooter & Ruben, *supra* note 47, at 80–81; 116–17 (discussing reasons why consumers are likely to underenforce their legal rights); see also Gillian Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953 (2000) (arguing that the market for lawyers systematically limits the relative availability of lawyers to individuals and expands the relative availability of lawyers to commercial enterprises).

the consumer's position seems appropriate then the lesson of the earlier sections of this part is obvious: the improvement in the consumer's position should not depend on whether the consumer uses a debit card or a credit card. To put it bluntly, the distinction in consumer protections between credit cards and debit cards rests on a circumstance—the possibility that the consumer will fail to pay the bill at the end of the month—that is irrelevant to the basic transaction between the consumer and the merchant. Thus, it should be irrelevant to the procedures that facilitate the consumer's ability to obtain satisfaction in that transaction.

2. Is TILA Beneficial?

It is, of course, difficult to be sure that the protections offered by TILA provide a net benefit to all consumers.¹¹⁸ If those protections impose costs on merchants and issuing banks, as they almost certainly do, then it is natural to expect the charges that merchants and credit card issuers charge to customers and cardholders will rise to compensate for those additional costs. If those additional charges exceed the benefits cardholders obtain from TILA, then the TILA protections impose a net loss on the cardholders for whose benefit they seem to exist.

The greatest problem in assessing those provisions is the difficulty of obtaining the relevant empirical information. In particular, it would be most useful to know the frequency of cardholder claims under TILA and the frequency with which those claims ultimately prevail. If we knew, for example, that such claims are raised relatively rarely but succeed quite commonly when they are raised, we might conclude that the provisions impose nugatory costs on issuers and merchants and substantial benefits to the cardholders that use them.

Conversely, if we knew that cardholders frequently interpose frivolous claims solely to avoid payment of just obligations, we might conclude that the costs that the provisions impose on the system outweigh any benefits they might bring to worthy cardholders. The difficulty of evaluating that question is aggravated by the impossibility of drawing firm conclusions from a finding that a large fraction of cardholder claims are rejected. The problem is that it is entirely possible that cardholder TILA claims are rejected not because they are meritless, but because the same litigation imbalance that could lead merchants to reject informal inquiries by customers—thus leading the customers to invoke their TILA rights—would lead the same merchants to reject the claims when presented through the issuing bank under TILA.

To the extent any light can be shed on those empirical questions, my impression based on a few interviews with industry sources is that the former picture is closer to the truth in two important ways. First, consumers interpose

118. See Cooter & Rubin, *supra* note 47, at 117 (suggesting that it “can be only a matter of speculation” whether an enhancement in the consumer's ability to shift losses is worth higher charges for consumers in general).

chargeback claims quite rarely. All of the sources to whom I spoke agreed that the general rate of complaint-based chargebacks is quite small, significantly below one percent.¹¹⁹ That should not be surprising given the obvious likelihood that the noncash transaction costs—the hassle of successfully shepherding such claims through the complex TILA process—will exceed the expected recovery on any but the largest and most plainly meritorious consumer complaints.

Second, the general perception in the industry is that merchants accede quickly to quality-related complaints by their customers.¹²⁰ As one executive explained, “the merchant if they are smart would just immediately issue a credit and not argue at all.”¹²¹ To be sure, the willingness to accommodate is likely to vary from merchant to merchant and also differ with the size of the claim. Furthermore, it is not clear that merchants are motivated by a perception of their own fault. The apparent motivations are much broader and induce concession by the merchant without regard to the merits of the consumer’s claim. Among other things, the system charges merchants a fee for each transaction that consumers charge back.¹²² Also, more tellingly, banks charge higher discount rates—higher charges on *all* transactions, not just disputed ones—to merchants for whom an unusually high rate of transactions are charged back.¹²³ Indeed, if chargebacks rates are unusually high, a bank might refuse to provide service to the merchant entirely, effectively denying the merchant access to the Visa and MasterCard system.¹²⁴ To the extent that merchants do contest claims, the clear impression in the industry is that the dispute resolution system is weighted heavily in favor of the consumer.¹²⁵ For example, one executive explained:

[B]ecause this is a consumer-driven society and Visa and MasterCard are primarily driven by the cardholder’s side—all the issuing banks are the ones who sit on the board with Visa and MasterCard—I would say [it’s] just [the] law of averages[; I] would say that most of those would rule on behalf of the cardholder.¹²⁶

119. See Butts Interview, *supra* note 69, at 1 (reporting an overall chargeback rate of 0.4% on all transactions); Confrey Interview, *supra* note 71, at 8–9 (explaining that fraud claims and consumer-complaint claims each are about one half of all chargebacks); Klebe Interview, *supra* note 69, at 6 (reporting an overall rate of 0.005%).

120. See Confrey Interview, *supra* note 71, at 9 (“[T]he merchant is usually better off in business practice. Going to the customer and trying to satisfy the customer rather than trying to deal through the acquirer and the issuer.”).

121. Klebe Interview, *supra* note 69, at 3.

122. See Confrey Interview, *supra* note 71, at 9; Klebe Interview, *supra* note 69, at 3–4 (reporting a fee that ranges from ten to fifteen dollars at the low end up to forty to fifty dollars on the high end).

123. See Klebe Interview, *supra* note 69, at 3.

124. See *id.*

125. See Confrey Interview, *supra* note 71, at 10 (“The acquirers usually lose. Statistically, remember, that’s not a judgment as to whether their case is valid or not.”).

126. Butts Interview, *supra* note 69 (transcript at 7). He reports that in the entire MasterCard system there are only about ten such arbitration hearings each month. Butts Interview, *supra* note 69, at 7.

My information on that point is purely anecdotal and thus cannot resolve the empirical questions raised above. Moreover, it is somewhat ambiguous on the question of the merits of claims that consumers interpose.¹²⁷ Furthermore, whatever the current level of frivolous claims might be, it is difficult to be sure that the level would not rise were TILA more broadly applicable.

Fortunately, a definitive analysis of that question is not necessary for the relatively limited thesis of this Essay. As explained above, my principal thesis is that the existing framework draws an unjustified distinction between debit cards and credit cards. Thus, the main point is that if the TILA provisions are justifiable for credit cards, then they are also justifiable for debit cards. It would be reasonable for the reader to conclude that the collapse of the debit/credit distinction justifies a repeal of the TILA provisions in question without regard to the discussion in this section about the potential benefits of TILA.

It is important to point out some reasons why the TILA provisions may be an appropriate exercise of regulatory authority. The first point, and doubtless the most important, is that this is not an area in which consumer choice can be expected to result in a set of perfectly efficient contract terms. As Cooter and Rubin have explained in some detail, several related factors make market failure relatively likely in the development of provisions in a contract with a financial institution for payment services. Among other things, the cost of negotiation is likely to exceed the potential benefits to the individual consumer; the consumer is unlikely to have complete information about the relevant differences between potential card issuers; and even if the consumer does have such information, it is quite difficult for it to evaluate the tradeoff such differences should have by comparison to the more salient features of the transactions: the fees that the issuer charges for its services.¹²⁸

Furthermore, for the reasons explained above, a standard analysis from behavioral economics justifies considerable skepticism about the likelihood that the consumer selecting a payment card from a menu of potential issuers will give adequate weight in its selection to the issuer's rules for dealing with cardholder-merchant disputes.¹²⁹ The typical consumer is likely to focus much more closely on the interest rate and affinity benefits than it is on any informa-

127. That is not true not only because of the point noted above—that merchants give in to consumers for reasons not directly related to the merits of the claims—but also because of the clear prevalence of a significant number of dubious fraud claims. See Butts Interview, *supra* note 69, at 4 (describing “friendly fraud” claims as cases “that are claimed as fraudulent transactions but the cardholder really knows that they or a family member did in fact participate. They just because of the ease of disputing the transaction, go ahead and dispute it.”). Those claims are particularly prevalent in the area of “adult” information sold in the Internet. See *id.*, at 8–9; Klebe Interview, *supra* note 69, at 1–2.

128. See Cooter & Rubin, *supra* note 47, at 68–69 (discussing those difficulties and the limited likelihood that consumer choice will turn on the issuer's policies for dealing with problem transactions); Norman I. Silber, *Observing Reasonable Consumers: Cognitive Psychology, Consumer Behavior, and Consumer Law*, 2 LOYOLA CONSUMER L. REP. 69, 72–73 (1990) (discussing cognitive problems in consumer transactions).

129. See *supra* Part I.B.

tion it might be able to glean about the issuing bank's practices in resolving cardholder-merchant disputes.¹³⁰

A natural regulatory response to that analysis is that a more effective disclosure regime could produce sufficient information to ensure that consumers make an informed choice between credit and debit cards. That could be done in any of several ways: through consumer-awareness advertising by government agencies, by warnings included in monthly bank statements or even on the debit card itself, or perhaps by information at the point of sale. It is of course not possible to be sure that such a scheme could not work, but any proponent of such a plan must recognize the general difficulty of using disclosure of information to overcome behavioral biases.¹³¹ This is particularly true here, where the information is relatively complex (the distinction between the different kinds of cards and the legal import of that distinction) and when the people most in need of the information are not highly educated and sophisticated but rather ordinary consumers.¹³² Proponents of disclosure in this context need to recognize that regulatory systems that might be effective when sophisticated intermediaries can use the information to drive market-clearing prices, as in the securities industry, are not likely to be effective in altering the atomistic behavior of individual consumers. The best example from existing experience probably is the home mortgage market, in which the federal government has waged a concerted effort to disclose relevant information to consumers, but by all informed accounts has had little positive effect.¹³³ Thus, although I cannot be sure that a disclosure regime could not foster informed choice, the situation does justify skepticism.

More broadly, giving consumers more detailed information about the incoherent distinctions that characterize the existing system does not address the concerns discussed above. To be sure, a perfect and costless disclosure system addressed to perfectly rational consumers might result in perfect choices with respect to reversibility, but in any real-world scenario there will be considerable costs and imperfections. Thus, even if we can preserve a menu that allows consumers and merchants to select from different reversibility rules, the system would be better than it is now if that menu was coupled with default rules that came closer to reaching the optimal results than the rules currently in place

130. See William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consistent with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1117-18 (1984) (making a similar point about home-mortgage loan transactions); Bar-Gill, *supra* note 90, at 1395-1411 (discussing the relation between cognitive problems and the structure of credit card transactions); Cooter & Ruben, *supra* note 47, at 122 (discussing cognitive problems in transactions between consumers and financial institutions).

131. For a general discussion, see William M. Sage, *Regulating Through Information: Disclosure Laws and American Health Care*, 99 COLUM. L. REV. 1701, 1729-30 (1999).

132. See Sage, *supra* note 131, at 1728-29 (making a similar point about health-care disclosures).

133. See Eskridge, *supra* note 130, at 1128-54.

do.¹³⁴ That ideal menu, in turn, would be supplemented with policies designed to ensure that consumers understood the relevant rules, so that they could select the appropriate payment system for their situation. A coherent system should both lower the costs of disclosure—because it would be easier to explain—and lower the costs of selection among systems—because the default rules would be closer to optimal.

Another important concern is the differing classes of consumers that will hold debit and credit cards. Although credit cards have now penetrated quite thoroughly into our society, a significant portion of the population, 24% of families by one recent estimate, do not have a credit card even now.¹³⁵ That 24%, however, is disproportionately composed of poor and minority families. Thus, for example, only 35% of families with an income below \$10,000 have a credit card, but 98% of families with an income over \$100,000 have one.¹³⁶ Consumers that do not have a credit card do not choose a payment system without the reversibility option because they are imprudent; they choose it because they are poor. That is not a problem to be solved by enhancements in the information available to cardholders.

The information effects of the rule also are relevant. As suggested above, the financial system currently relies on chargeback information in part to identify merchants that engage in unfair practices and consequently to exclude them from the credit-card system. Thus, the information generated by a consumer's chargeback decision itself provides a positive externality to the system. That is true whether the individual chargeback claim has merit or not because chargeback claims as a whole are likely to correlate inversely with merchant quality. That positive externality should have some weight in analysis of the overall effect of the system.

Finally, even the most optimistic believer in the effectiveness of reputational sanctions on merchant actors¹³⁷ must acknowledge the existence of a large class of consumer retail purchases in which reputational sanctions will give the merchant little or no incentive to provide fair redress to the consumer. Most obviously, the merchant might be insolvent or close to insolvency and thus have no concern for future transactions.¹³⁸ More generally, merchants remote from the cardholder's residence—engaged in sales to tourists and the like—rationally might doubt the possibility that a disappointed customer would be able to

134. This point is analogous to the common problem of "sticky" default rules. See, e.g., Ronald J. Mann, *Contracts—Only with Consent*, 152 U. PA. L. REV. 1873 (2004).

135. See Dēmos, *Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the '90s*, at 10 (2003), available at http://www.demos-usa.org/pubs/borrowing_to_make_ends_meet.pdf (last visited May 19, 2004).

136. See Dēmos, *supra* note 135, at 10.

137. As it happens, I am quite optimistic about the effectiveness of reputational sanctions as a general matter. See Mann, *supra* note 64, at 2252–57 (discussing factors that make reputational sanctioning effective).

138. Recall the transaction from which this article began, in which the retailer failed without performing the obligations for which my colleague had paid.

impose any significant reputational harm on the merchant, however intransigent the merchant might be.¹³⁹

IV. APPLICATIONS

A. FACE-TO-FACE TRANSACTIONS

Collectively, the preceding points are enough to persuade me in the absence of any countervailing empirical evidence that the TILA protections reflect an appropriate intervention to redress a significant imbalance in litigation capacity. The question, then, is what policies that conclusion implies. Albeit with some trepidation, I propose an extension of those protections to all face-to-face retail transactions that use cards that access either a deposit account or a line of credit.¹⁴⁰ My proposal would differ from existing law both in extending the existing TILA rule to debit cards, and also in removing the limitation on that rule to local transactions that currently appears in TILA Section 170(b).¹⁴¹

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 chargebacks in the credit-card system now is quite small.¹⁴²

It would be easy to push that rationale farther to transactions that use cash or checks, but for several reasons that seems to me unwise. First, the most determined consumer advocate could not credibly claim that the TILA policies should be extended to all transactions and all payment instruments. There is

139. That line of reasoning, of course, suggests the perversity of the provision in TILA Section 170(b), which excludes such transactions from the consumer's right to withhold payment under TILA Section 170(a). See *supra* notes 71-72 and accompanying text (discussing that exclusion); see also MANN, *supra* note 1, at 120 (Problem 6.6) (presenting that point).

140. The purpose of that somewhat convoluted formulation is to leave open the possibility that some of the newly developing card systems such as prepaid cards and gift cards properly might be treated as providing a cash-equivalent payment option. Because the systems for issuing and using those cards are developing so rapidly, I leave the details of any such exception for another day. My main point, however, is that I do not intend to exclude the possibility of a cash-equivalent electronic payment option from face-to-face transactions. I simply think that the debit card as it has developed should not be viewed as such a thing.

141. See *supra* note 71 (discussing that rule).

142. See *supra* note 119 (discussing current chargeback rates in credit card system).

some category of transactions for which reversibility would be completely incompatible with the expectations of the parties, if only because the purchased object is one for which the likelihood of a dispute is too low to justify such a remedy. I think, for example, of the New York City street vendor from whom I might buy a newspaper or beverage.

To accommodate those transactions, it seems crucial that the system provide a menu of payment options with different reversibility attributes. To be sure, one could argue that the law should redress problems of leverage imbalance through the imposition of a single set of rules on all consumer payment systems. That seems, however, to go too far. For one thing, as long as there is a menu of payment systems that includes reasonably practical options with reversibility and without reversibility, the system imposes relatively small costs on merchants and customers because merchants can insist on irrevocable payment, if they wish, simply by insisting on cash or cash equivalents. Consumers concerned about reversibility, conversely, can shift patronage to merchants that accept reversible payment systems or choose to use those systems when merchants accept both types.

The discussion above, however, convinces me that the need for a menu of options justifies a distinction between credit and debit cards primarily because that distinction is not likely to present a realistic option in the current milieu. There certainly is a tradeoff between a system in which consumers choose among the various payment systems based on their reversibility attributes and a system in which legal rules establish a single reversibility rule that governs all transactions of a particular type without regard to the payment mechanism that the consumer selects. The first system reflects the difficulty any government would face in defining the proper universe of transactions to be covered by any particular rule of reversibility and relies on market forces to produce the appropriate coverage. The second system reflects the likelihood that market forces, even when supported by government disclosure and information efforts, cannot produce an appropriate result. The discussion above suggests to me that, in this context at least, it is plausible to follow the second route—having the government articulate mandatory rules of reversibility based on the type of transaction.

The next question is how to define the boundaries of the covered transaction. The logic of the framework of this essay is that distinctions among reversibility attributes should depend at least in part on the nature of the transaction. Thus, in an ideal world, perhaps the legal rule that described transactions in which payment was reversible would define the relevant class by reference to various features of the transaction such as the type of goods and the purchase price.

Notwithstanding the existing provisions in TILA Section 170(b), it does not make sense to exclude remote transactions.¹⁴³ The premise of that exclusion in existing law is that credit card issuers will have arrangements with local

143. By "remote transactions" I mean transactions that are conducted more than 100 miles from the cardholder's residence and outside the cardholder's state.

merchants that will make it easy for them to verify the quality of those merchants and to recover from those merchants in the event of a dispute.¹⁴⁴ In modern commerce, however, that argument has no empirical support. For one thing, the modern chargeback system allows the issuer to recover the funds promptly without regard to the merchant's location.¹⁴⁵ If anything, the imbalance in litigation capabilities discussed in the previous section is likely to be exacerbated in remote transactions where consumers are likely to be incapable of effective recourse. That is not to say that consumers would not abuse such a rule when they deal with remote merchants. It is simply to recognize that there are dishonest merchants as well as dishonest consumers; that reputational constraints are unlikely to constrain either of them; and that as a class the honest merchants will be better situated to deal with the dishonest consumers than the honest consumers will be situated to deal with the dishonest merchants. As with much of this discussion, empirical information about the nature of chargeback claims would influence my views, but it is difficult to see how that information could be generated in a reliable and cost effective way.

At the same time, I also think there is much to be said for a small-dollar exclusion from the reversibility right, with a floor in the range of \$50.¹⁴⁶ The idea is that there are certain sales transactions in which the optimal rule certainly is to deny reversibility—the transaction to purchase a newspaper or piece of fruit from a street vendor providing an obvious benchmark. In that context, it might be that claims to reverse payment would more commonly be abusive than in the context of more significant purchases, if only because it is difficult to imagine a legitimate basis for reversing payment in that context.¹⁴⁷ At the same time, the relative burdens of costs and benefits are different in that context because the administrative costs of reversing payment and dealing with the chargeback are likely to be relatively fixed, while the benefits to the consumer—the loss that the consumer otherwise would have borne if it could

144. See Brandel & Leonard, *supra* note 68, at 1064–68. Brandel & Leonard (who wrote recommended rules that ultimately became the statute now codified in TILA) justified the basic reversibility rule by analogy to negotiability doctrine, which bars holder-in-due-course status for lenders that are closely connected with merchants. See *id.*, at 1042–44. It would follow naturally from that justification that issuers should be free from merchant-based claims of their cardholders when the merchants are remote from the issuer. As the text suggests, however, I do not think the analogy to negotiability should drive the rules at this late date. See generally Mann, *supra* note 35 (discussing the declining importance of negotiability doctrine).

145. See *supra* notes 69–70 and accompanying text.

146. Brandel & Leonard argued for a \$50 floor in their pre-TILA work advocating reversibility, Brandel & Leonard, *supra* note 68, at 1059–64, but it was not included in the statute as enacted. I use that number for discussion here because it is the figure that TILA uses as the floor for claims of unauthorized transactions, but I recognize that it is a much smaller exclusion than the \$50 exclusion in 1971 dollars that Brandel & Leonard contemplated.

147. Remember, I am not discussing claims that transactions are unauthorized; see *supra* text accompanying notes 17–18.

not reverse the payment—are diminished.¹⁴⁸ Thus, I am inclined to support a \$50 floor for the reversibility right, parallel to the \$50 floor in existing law for claims that transactions are not authorized.

One seeming inconsistency in my analysis is that I would define the universe of transactions also by reference to the particular payment system, including the major existing card-based systems but excluding cash and checks. I rest that aspect of the analysis on practical concerns, motivated in part by the desire to preserve some menu of reversibility options. At least in the United States,¹⁴⁹ where non-cash payment systems have so penetrated the economy, a rule providing substantially lower protections for the consumer in a cash transaction is unlikely to lead to a shift toward cash-only merchants. For the reasons summarized above, street merchants and casual restaurants aside, merchants in our economy rarely find it profitable to insist on cash as a payment medium.¹⁵⁰ Also, and perhaps more importantly, it is difficult to imagine a practical system for involuntarily retracting cash payments: cash transactions obviously lack the network of relationships that leaves a payment path over which the consumer can retract the payment. To restate what should be obvious by now, that problem does not apply to debit cards because of the increasing parallelism of the systems for clearing debit and credit card transactions.

Checks are a harder problem, and thus a closer call. On the one hand, consumers that use checks to make purchases often use them in transactions of a size and type quite similar to the transactions in which they use credit cards, with the choice depending more on personal predilection than anything else.¹⁵¹ Thus, there is every reason to expect that consumers that purchase with checks would benefit as much from a right to retract payment as consumers that purchase with credit cards.

On the other hand, a rule permitting check purchasers to retract payments would be almost as complicated as a rule that benefited cash purchasers because it would require substantial revisions to Article 4 of the Uniform Commercial Code and Regulation CC.¹⁵² Perhaps more importantly, checks resemble cash in the sense that the path of a cleared check is not nearly so easily retraced as the path of a completed credit card transaction. The issuing bank in a credit card

148. If the burdens of such a rule exceed its benefits, then a statute imposing a \$50 floor on reversibility claims might make it easier for low-price merchants to accept payment cards. To the extent that the rule lowered their transaction costs, it would provide a net social benefit.

149. As I write this passage in a Tokyo hotel—in a country where cash payment seems to be much more common, for much larger transactions, than it is in the United States—I am conscious of the cultural contingency of the analysis that follows.

150. More importantly, those merchants that do refuse credit cards rarely accept debit cards, so an alteration of the legal rules related to debit cards would be unlikely to affect their transactions.

151. In 2002, the average consumer retail purchase with a check was \$77, with a credit card \$64, with a debit card \$36, and with cash \$22. See *Consumer Payment Systems*, *supra* note 45, at 6.

152. Regulation CC, 12 C.F.R. Part 229 (2004), sets out regulations promulgated under the Expedited Funds Availability Act that regulate the check-collection process. See generally MANN, *supra* note 1, at 60–66 (discussing briefly the provisions of Regulation CC relevant to the check-collection process).

transaction has an all but immediate, almost cost-free, and usually certain mechanism to retract funds when it unwinds a credit card transaction. In contrast, whatever rights the law might grant, the bank on which a check is drawn often would have significant doubts about its ability to retract the funds through the system. Most obviously, it could recover the money only if the depositor's account contained sufficient funds to cover the retracted check. Because merchants generally leave the credit card system only upon insolvency, that is not likely to be a problem of similar significance in unwinding credit card transactions.

Moreover, even if it were practical to extend retraction rights into the checking system, it is not clear that such a rule would produce benefits to consumers that plausibly could justify the complexity of the necessary reforms. For one thing, the steadily diminishing level of retail check usage suggests that improvement of the system in this respect hardly justifies the complicating features that would be required. That is particularly true in light of the ready availability of the card-based payment system as an option for the "savvy" purchaser to whom this issue is important. Credit and debit cards have sufficiently penetrated the marketplace that almost any consumer can choose to use a card-based payment system.¹⁵³ Again, my instinct is that, at least in our country, merchants would not respond to the increase of consumer protections for debit cards by refusing to take credit *and* debit cards.¹⁵⁴ If those protections were a concern, the merchants already would be refusing to take credit cards. More specifically, if TILA protections were a significant concern for merchants, they would not be objecting to Visa and MasterCard policies that require them to accept debit cards.¹⁵⁵

In sum, I tentatively propose a mandatory rule of reversibility for both debit and credit cards. Checks and cash would be excluded, but transactions that used debit cards would include rights to interpose defenses to payment for a period of time in the range of 60 days, analogous to the period practically available under current TILA-based credit card practices.¹⁵⁶ The rule would apply to local and

153. Although almost a quarter of families do not have credit cards, *see supra* notes 135–136 and accompanying text, many of those families have debit cards, particularly among families who have checks. The rise of prepaid cards, which are available over the counter at local convenience stores, and thus do not require a checking account, may make the cardless consumer even rarer. *See Consumer Payment Systems, supra* note 45, at 6 (reporting that prepaid cards were used for 1.99 billion transactions in the United States in 2002 (1.65% of all retail payments), with an average amount of \$27).

154. It might be that it would cause fewer consumers to use checks. Given the relatively high costs of check-processing, however, that effect in itself might provide a significant benefit to society.

155. *See* Bennett, *supra* note 103 (discussing such a complaint interposed by, among others, Wal-Mart and Sears); Bennett, *Wal-Mart's Bull Eyes Master Card*, CREDIT CARD MANAGEMENT, Jan. 2004, at 6 (reporting decision of Wal-Mart to refuse MasterCard's PIN-less debit product, although it will continue to accept MasterCard's credit card product).

156. I recognize that academic calls for payment systems reform based on large-framed structural similarities have not always been well received, as evidenced by the dismal reception of the Uniform New Payments Code. *See, e.g.,* Gillette, *supra* note 12, at 219–20 (discussing the failure of the Uniform

nonlocal transactions, but not to small transactions below an arbitrary threshold in the vicinity of \$50.

B. INTERNET TRANSACTIONS

The most prominent change in payments over the next decade surely will be the continuing shift of the market from face-to-face retail transactions to Internet transactions. From a market of truly insignificant proportions five years ago to a trillion-dollar market in the next few years, the growth is nothing short of exponential.¹⁵⁷

Almost buried in the bustle of news stories about e-commerce is the question of how consumers will pay for their e-purchases. Presently, those transactions are paid for almost exclusively with credit cards.¹⁵⁸ Thus, absent some change of infrastructure, those transactions might be thought to raise no questions of interest for the subject of this Essay.

That conclusion, however, would be too facile. As it happens, the credit card in its current form is not well suited for the broad run of transactions that are expected to populate the Internet in the years to come. Three concerns are salient. One is the privacy issue: credit card transactions result in the collection of a considerable body of valuable information by the issuing bank. Many observers worry that a shift of purchasing to the Internet will lead to a shift away from cash purchases toward credit card purchases and to a consequent increase in the ability of banks to collect and, more to the point, disseminate information about consumer purchasing power.¹⁵⁹

Second, because of its relatively high per-unit charges, the credit card transaction is not well suited to small "micro-transactions." Many observers believe that a significant market in the electronic commerce of the future will consist of the purchase and sale of individual pieces of information ranging from weather reports, to sports information, to music.¹⁶⁰ If those transactions are priced on a per-unit basis and paid for contemporaneously, the credit card would not provide a workable payment device.¹⁶¹

Third, the credit card as used on the Internet seems to be particularly

New Payments Code and its implication for reform proposals in the area). I hope that my effort to rely on contextual detail and functional consistency distinguishes my work from that project, but recognize the possibility that it does not. I note that the rule on which I focus in this Essay is one that the Uniform New Payments Code left entirely to private contract. *See supra* note 51.

157. *See, e.g.*, Keith Regan, *Holiday E-Tail Sales Set Records Despite Performance Woes*, E-Commerce Times, Dec. 30, 2003, at <http://www.ecommercetimes.com/perl/story/32491.html> (reporting Internet retail sales of \$16 billion during the 2003 holiday season from Nov. 1 to Dec. 19).

158. *See Mann, supra* note 44.

159. *See* RONALD J. MANN & JANE KAUFMAN WINN, *ELECTRONIC COMMERCE* 584-85 (2d ed. 2005) (discussing that problem).

160. *See Klebe Interview, supra* note 69, at 17 (discussing music transactions that occur already).

161. *See* MANN & WINN, *supra* note 159, at 585-86 (discussing that problem); *see Klebe Interview, supra* note 69, at 15 ("Visa and MasterCard are actually geared towards transactions that are in like the \$65-\$80 range. They are not even really geared toward transactions down in the \$10-\$50 range. But they handle it reasonably well. Anything below that they just can't do.").

susceptible to fraud, which increases the cost of those transactions significantly.¹⁶² The difficulty is that those transactions, like mail-order transactions, offer the merchant no credible mechanism for verifying the identity of the purported cardholder. Recognizing that problem, the card issuer in those transactions, unlike face-to-face transactions in which the card is "swiped," leaves the risk of unauthorized transactions on the merchant.¹⁶³

Because of the potential size of the Internet market, it should come as no surprise that considerable effort is being devoted to a response to those problems. The simplest response would be deployment of technology permitting the general acceptance of debit cards on the Internet.¹⁶⁴ More ambitious are the projects attempting to develop a new electronic currency—generally referred to as electronic money. Using technology closely related to stored-value cards—and, ideally, compatible with them¹⁶⁵—electronic money would allow consumers to pay merchants by transferring to them packages of electronic impulses (ecoins) that reflect value previously deposited with a reputable financial institution. Because the ecoins would not be traceable to a particular consumer, the bank would not be able to develop records of the consumer's transactions. Similarly, because the system would be entirely electronic, its per-transaction charges would be sufficiently low to accommodate microtransactions.¹⁶⁶ Less technologically ambitious but more practical responses depend on aggregation of large numbers of transactions into a single billing event.¹⁶⁷

The credit card industry, of course, could overcome those problems as well. It could upgrade its processing system to lower its transaction charges so as to make credit cards practical for smaller transactions. Issuers also could refrain from collecting and disseminating purchasing information about their customers to third parties. At least to date, however, I am aware of nothing that suggests the industry is moving in either of those directions. Furthermore, and perhaps most seriously in the long run, it is less clear what the industry could do to prevent the use of stolen credit card numbers in Internet transactions. Absent some definitive mechanism for tying the individual transmitting information to

162. See MANN & WINN, *supra* note 159, at 581–84 (discussing concerns about fraud in Internet transactions and possible responses).

163. See *id.*; Confrey Interview, *supra* note 71, at 6–7 (discussing the historical development of that distinction in the credit card industry); Klebe Interview, *supra* note 69, at 8–9 (same).

164. See, e.g., Peter Lucas, *How the Rest of the World Does Web Payments*, CREDIT CARD MANAGEMENT, Apr. 2003, at 24.

165. Although it seems an obvious advantage, it appears that the system being tested in Japan is one of only a few systems yet put into operation that offers both stored-value and Internet capabilities for an electronic payment device. See Yasushi Nakayama et al., *An Electronic Money Scheme: A Proposal for a New Electronic Money Scheme Which Is Both Secure and Convenient* 7–11 (Institute for Monetary and Economic Studies, Bank of Japan, Discussion Paper No. 97-E-4) (describing that system).

166. For a general description of the mechanics of electronic-money systems, see MANN & WINN, *supra* note 159, at 614–20. For a more technical description, see David Chaum, *Achieving Electronic Privacy*, SCI. AM., Aug. 1992, at 96.

167. MANN & WINN, *supra* note 159, at 460–61.

the merchant to a particular card account,¹⁶⁸ that problem seems likely to remain.¹⁶⁹ Thus, the likelihood of a large-scale electronic-money system seems greater here than in the face-to-face context discussed above.

Although the stated purposes for developing such a system strike me as entirely salutary, one obvious side effect under the existing legal regime would be to remove a large class of payment transactions from the protections granted by TILA to current Internet transactions. But that result is just as much a windfall to the payment operator here as it is to the debit card issuer discussed in the preceding sections. Accordingly, it might be appropriate to extend the charge-back rights described above to any Internet electronic payment system as well, even if that system diverges from current practice sufficiently to abandon the use of a card-based account.

There are no obvious technological difficulties in that approach. Although a payor-anonymous system might not provide the bank with records of the particular transactions of its customer, the customer that wishes to charge back a transaction need only forward to the bank the customer's record of the transaction from the customer's own computer. That record should include enough information to allow the bank to match the transaction to the transaction it cleared from the merchant. At that point, the electronic-money system would resemble the credit card system, with the issuer in possession of information that would enable it to retract funds previously forwarded in payment of the transaction. In sum, I doubt that it would be technologically difficult to include a charge-back option in an electronic-money system.¹⁷⁰

The biggest problem with that approach is that it would make it quite difficult in the electronic milieu for a merchant to insist on a practical payment option that is irreversible. As discussed above, I see considerable value in permitting merchants some flexibility in the type of payments that they are willing to accept. In my view, however, that problem is less serious in the Internet context. For one thing, it is clear that the absence of such an option is not a major problem at present. Internet commerce grows rapidly now with no signs of hindrance from the chargeback rights currently available to Internet purchas-

168. The most obvious solution to that problem would be a biometric device that would ensure that a person present at the computer terminal had some characteristic that matched information residing on the card. Even with the rise of biometric passports as a response to the September 11 attacks, such a solution remains some years away. See, e.g., *Smart Travel*, *ECONOMIST*, Mar. 12, 2005.

169. The credit card industry has initiated programs that would have consumers use PINs with credit cards on the Internet. See, e.g., https://usa.visa.com/personal/secure_with_visa/verified_by_visa.html (last visited May 18, 2004) (discussing the "Verified by Visa" program); <http://www.mastercardmerchant.com/securecode/> (last visited May 18, 2004) (discussing MasterCard's "SecureCode" program). If those programs succeed, it is likely that fraud rates would fall significantly.

170. Informal conversations with officials at the Bank of Japan responsible for their system convince me that this would be possible. The problem could be solved more directly, of course, by abandoning the payor-anonymous features described above (as the Japanese system does), in which case the clearing banks could simply forward complete transaction records to the issuing bank when they process payments. See Nakayama et al., *supra* note 165, at 10-11 (describing that process for handling unauthorized transactions).

ers.¹⁷¹

I also am influenced here by the typical nature of Internet transactions, which at least at the present time are likely to involve relatively large purchases shipped remotely, a context in which the problem of leverage imbalance is likely to be particularly serious. A rule that does not, as a practical matter, permit irreversible payments is not in practice any different from the rule discussed above which permits merchants to insist on irreversible payments only if the merchants are willing to insist on cash for large purchases.

Finally, if a context appears in which a payment option of irreversibility would be important—micropurchases of information, for example—the existence of the transactions will afford an opportunity for designing a rule that would accommodate such an option. It would be easy at that time, for example, for the appropriate regulatory authority, presumably the Federal Reserve, to adopt a transaction-bounded rule permitting merchants to make cash-like irreversible payments in appropriate circumstances.¹⁷²

It is difficult to fashion a payments policy for transactions that are only beginning to occur.¹⁷³ Thus, my recommendations with respect to electronic payments in this section must be taken much more tentatively than my analogous recommendations in the previous part. Still, the discussion itself has value if only to pose the basic choice of whether payments in electronic transactions should be analyzed under rules that depend solely on the type of technology or under rules that also depend on the type of transaction. I hope my discussion illustrates the virtue of the latter course.

V. CONCLUSION

I have argued that payments policy should be reexamined in a fundamental way. Once we see the source of those policies in the nature of the underlying transactions, it becomes clear that the rules should be determined not only by the nature of the payment systems that are used, but also by the nature of the transactions. Many might disagree with my explication of that framework in the later parts of this Essay, but I hope that most will agree that the framework itself can do much to illuminate the issues that should concern us in articulating payments policy.

171. That point can be overstated. There is, for example, a persistent problem with relatively high levels of chargebacks in the adult-entertainment area, as customers disavow transactions in which they in fact engaged. See Lauri Giesen, *The Chargeback Squeeze*, CREDIT CARD MANAGEMENT, Nov. 2003, at 26 (general discussion of that problem). In my view, however, that problem is unique to an industry that sells things customers do not wish to acknowledge buying. The problems of that industry should not drive rules for more conventional commerce.

172. Such a rule, for example, might bar chargebacks for purchases of contemporaneously delivered information with a cost per item below some threshold selected by regulation (such as a dollar or twenty-five cents). I think such a rule would be appropriate even if there were not a general floor for reversibility claims. If there were such a floor, there would be no need for a special rule for micropurchases.

173. See Jane Kaufman Winn, *Clash of the Titans: Regulating the Competition Between Established and Emerging Payment Systems*, 14 BERKELEY TECH. L.J. 675, 708-09 (1999).