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Credit or Debit? Unauthorized Use and Consumer Liability Under Federal Consumer Protection Legislation

The payment system had a certain romance when its standard instrument could be stolen by pirates, placed in a wooden chest, and buried, but our contemporary commercial culture has made the subject much more mundane.¹

INTRODUCTION

Debit cards are the fastest growing method of payment in America.² As an alternative to carrying cash and bulky checkbooks, consumers are electing to use debit cards as a preferred way to pay for many goods and services.³ In 1995, Visa brand debit cards alone initiated nearly 100 transactions every second of every day.⁴ By 1997, sixty million debit cards were in circulation, a 40% increase from 1995.⁵ Consumer confidence in using debit cards is increasing because many debit cards now carry the familiar Visa or MasterCard logo.⁶ If the current trend continues, banking experts predict that by the year 2000 more than two-thirds of American households will possess a debit card.⁷

Although debit cards may closely resemble credit cards in appearance, consumer liability for unauthorized use is not similar and the payment transaction initiated through use is very different.⁸ In response to the increasing use of debit card products, consumer protection issues concerning liability for unauthorized use have been raised, new legislation has been

1. Robert D. Cooter & Edward L. Rubin, *A Theory of Loss Allocation for Consumer Payments*, 66 TEX. L. REV. 63, 123 (1987).

2. *Visa Expands Debit Card Consumer Education With National Consumers League*, PR NEWswire, July 27, 1998.

3. See Michelle Clayton, *The Case for Debit Cards*, AMERICA'S COMMUNITY BANKER, Mar. 1998, at 22.

4. VISA-U.S. DEBIT & CASH PRODUCTS (visited Dec. 29, 1998) <<http://www.visa.com/cgi-bin/vee/pd/debit/main.html?2+0>>.

5. BETTER BUSINESS BUREAU, *Debit Cards Could Be Costly, Warns Better Business Bureau* (visited Dec. 28, 1998) <http://www.sddt.com/reports/97reports/bank97_09_08/DN97_09_08_tf.html>.

6. See *id.* (stating that some debit cards carry the Visa or MasterCard logo).

7. A bill to amend the Electronic Fund Transfer Act to safeguard consumers in connection with the utilization of certain debit cards. H.R. 445, 106th Cong. (1999).

8. *Visa Expands Debit Card Consumer Education With National Consumers League*, PR NEWswire, July 27, 1998.

introduced to Congress and an extremely lucrative debit card market has prospered.⁹

Sections I through IV of this comment provide an overview of the federal Truth in Lending Act¹⁰ and of the federal Electronic Fund Transfer Act¹¹ in relation to consumer liability issues concerning the use of credit and debit cards. Section V briefly discusses self-regulatory industry efforts that are pertinent to unauthorized use. Section VI outlines proposed federal legislation, which, if enacted, may make a consumer's liability for the unauthorized use of a debit card similar to a consumer's liability for the unauthorized use of a credit card.

Section VII contains a broad discussion of whether existing debit card law should be amended by Congress to provide consumers with liability protection similar to existing credit card law. The discussion offers three general reasons to support the conclusion that the framework under existing federal debit card law, concerning consumer liability for unauthorized use, should not be changed to resemble the federal credit card law. First, existing federal law governing the unauthorized use of a credit card may provide an unreasonable amount of time in which consumers can enjoy protection against liability from unauthorized use; amending debit card law to resemble such is unwarranted. Second, even if liability protection under federal credit card law is justified, it should not be the same under federal debit card law because the nature of and mentality toward the debit card transaction is not the same. Put simply, paying with a debit card is more similar to using a check as a method of payment. Third, to the extent that existing federal debit card law is amended to resemble the unauthorized use liability framework under federal credit card law, the effect of the additional consumer protection legislation will be extremely minimal. The discussion ends with a focus on additional industry considerations, reemphasizing that major industry participants have already implemented policies that extend liability protection beyond that offered under existing federal debit card law. In short, industry regulations afford consumers more than adequate additional protection against liability resulting from unauthorized use.

This comment briefly concludes that the enactment of federal legislation further limiting a consumer's liability for unauthorized debit card transactions is unnecessary. Amending the liability framework applicable to debit cards will likely provide no additional protection to responsible consumers, and

9. David A. Balto, *Can the Promise of Debit Cards be Fulfilled?*, 53 BUS. LAW. 1093, 1098, 1102, 1105 (May 1998).

10. 15 U.S.C. §§ 1601-1665b (1994 & Supp. II 1996).

11. 15 U.S.C. §§ 1693-1693r (1994).

ultimately, it may encourage irresponsible account maintenance. Finally, adequate industry-initiated safeguards are in place. Therefore, consumers are already provided with sufficient protection against liability that may result from an unauthorized debit card transaction.

I. HISTORY OF THE TRUTH IN LENDING ACT & REGULATION Z

On May 22, 1967, the Consumer Credit Protection Act (CCPA) was passed by Congress.¹² The CCPA contained five titles when it was originally enacted.¹³ Title I of the CCPA was named Consumer Credit Cost Disclosure.¹⁴ This title is officially known as the Truth in Lending Act (TILA).¹⁵

Primary purposes behind enacting the Truth in Lending Act were "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uniformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices."¹⁶ To implement the TILA, the Board of Governors of the Federal Reserve System ("Board") is authorized to promulgate regulations in accordance with the TILA.¹⁷ These

12. Act of May 29, 1968, Pub. L. No. 90-321, 82 Stat. 146, 15 U.S.C. § 1601 (1994). See also 7 KENNETH M. LAPINE, *BANKING LAW*, Ch. 150-156, § 152-4 (1998).

13. LAPINE, *supra* note 12, § 152-4.

14. *Id.*

15. Act of May 29, 1968, Pub. L. No. 90-321, Title I, § 101, 82 Stat. 146, TILA § 101, 15 U.S.C. § 1601 *et seq.* (1994). The TILA was not fully effective until July 1, 1969. *Id.* Since the TILA became effective, it has been amended on eight occasions. See LAPINE, *supra* note 12, § 152-6-10.

16. TILA § 102, 15 U.S.C. § 1601 (1994).

Truth in Lending Act was enacted to provide consumers meaningful information about their credit transactions; act requires uniform disclosure of credit terms, including annual percentage rates, imposes restrictions on credit advertising, provides right of rescission where personal residence used as collateral, prohibits mailing of unsolicited credit cards, and establishes procedures for handling billing disputes.

LAPINE, *supra* note 12, § 152-4. In 1967, Lyndon B. Johnson endorsed the TILA when stating, "The Truth-in-Lending Act of 1967 would strengthen the efficiency of our credit markets, without restraining them. It would allow the cost of credit to be fully determined by informed borrowers and responsible lenders. It would permit the volume of consumer credit to be fully responsive to the growing needs, ability to pay, and aspirations of the American Consumer." H.R. Doc. No. 57 (1967), *cited in* LAPINE, *supra* note 12, § 152-5, 6.

17. TILA § 105, 15 U.S.C. § 1604 (1994).

The Board shall prescribe regulations to carry out the purposes of this subchapter. [T]hese regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and expectations for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to

regulations have been compiled and designated as Regulation Z ("Reg. Z").¹⁸

In promulgating Reg. Z, the Board has "adopted many provisions of the act without change, further amplified some provisions, and not dealt at all with other provisions."¹⁹ To help creditors understand the requirements set forth under Reg. Z, the Board issues an Official Staff Interpretation.²⁰

The Board's interpretation of Reg. Z can be extremely useful to creditors, especially since it provides many examples of how the various regulations apply.²¹ However, creditors should not solely rely on the Board's interpretation. The interpretation should be used only as a compliance guide because liability extends to those who fail to comply with the TILA.²² To avoid liability under the TILA, a creditor should always examine the Board's interpretations as compared to the most recently amended version of the TILA. The TILA, however, does provide a safe harbor for creditors who rely in good faith on the Board's interpretation.²³ If the requirements of this safe harbor provision are satisfied, a creditor will not be subjected to civil or criminal liability for noncompliance with the TILA.²⁴

II. CARDHOLDER LIABILITY UNDER THE TILA & REG. Z

A. UNAUTHORIZED USE

A primary objective of the TILA is "to protect the consumer against inaccurate and unfair credit billing and credit card practices."²⁵ To further this objective, the TILA provides liability safeguards to consumers²⁶ who maintain

facilitate compliance therewith.

Id. See also LAPINE, *supra* note 12, § 152-11.

18. 12 C.F.R. pt. 226 (1998).

19. LAPINE, *supra* note 12, § 152-12.

20. Official Staff Commentary to Reg. Z, 12 C.F.R. pt. 226, Supp. I (1998).

21. See, e.g., 12 C.F.R. § 226, Supp. I, 12(b)-3 (1998) (listing steps a card issuer may take to conduct a reasonable investigation upon a cardholder providing notice of an unauthorized credit card use or billing error).

22. TILA § 130(a), 15 U.S.C. § 1640(a) (1994).

23. TILA § 130(f), 15 U.S.C. § 1640(f) (1994), *added by* Act of Oct. 28, 1974, Pub. L. No. 93-495, § 406, 88 Stat. 1518. This section also applies when a creditor, in good faith, erroneously relies on Reg. Z because the TILA has been amended and this change has yet to be consistently reflected by the Board through issuing an amended Reg. Z. *Id.* See also, LAPINE, *supra* note 12, § 152-15.

24. TILA § 130(f), 15 U.S.C. § 1640(f) (1994).

25. TILA § 102(a), 15 U.S.C. § 1601(a) (1994). The Truth in Lending Act is to be liberally construed in favor of the consumer. *Davis v. Werne*, 673 F.2d 866, 869 (5th Cir. 1982).

26. Under the TILA, a "consumer" is a natural person to whom credit is extended "primarily for personal, family, or household purposes." TILA § 103(h), 15 U.S.C. § 1602(h)

open end credit plans²⁷ or charge accounts with creditors.²⁸ The common means used to initiate an extension of credit is the "credit card", which is defined under the TILA as "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit."²⁹ The TILA refers to the person to whom the credit card is issued as the "cardholder"³⁰ and the person sending or providing the card as the "card issuer".³¹

Section 133 of the TILA governs the liability of a cardholder with respect to the unauthorized use of a credit card.³² The term "unauthorized

(1994). *See also* Reg. Z, 12 C.F.R. § 226.2(a)(11) (1998) (defining "consumer" as including a "cardholder").

27. An "open end credit plan" is defined under the TILA as a:

plan under which the creditor reasonably contemplates repeated transactions, which prescribes the terms of such transactions, and which provides for a finance charge that may be computed from time to time on the outstanding unpaid balance. A credit plan which is an open end credit plan within the meaning of the preceding sentence is an open end credit plan even if information is verified from time to time.

TILA § 103(i), 15 U.S.C. § 1602(i) (1994). *See also* Reg. Z, 12 C.F.R. § 226.2(a)(20) (1998).

28. The TILA defines "creditor", in part, as a person who:

both (1) regularly extends . . . consumer credit which is payable in four installments or for which the payment of a finance charge is or may be required; and (2) is the person to whom the debt from the credit transaction is initially payable on the face of the evidence of indebtedness or, if there is no such evidence of indebtedness, by agreement.

TILA § 103(f), 15 U.S.C. § 1602(f) (1994). *See also* Reg. Z, 12 C.F.R. § 226.2(a)(17)(i) (1998).

29. TILA § 103(k), 15 U.S.C. § 1602(k) (1994); *see also* Reg. Z, 12 C.F.R. § 226.2(a)(15) (1998).

30. TILA § 103(m), 15 U.S.C. § 1602(m) (1994); *see also* Reg. Z, 12 C.F.R. § 226.2(a)(8) (1998).

31. TILA § 103(n), 15 U.S.C. § 1602(n) (1994); *see also* Reg. Z, 12 C.F.R. § 226.2(a)(7) (1998).

32. TILA § 133, 15 U.S.C. § 1643 (1994). This section specifically applies to the unauthorized use of a "credit card". It is common, however, for creditors to send cardholders convenience checks. A convenience check is not processed through Visa or MasterCard, rather, it functions as a negotiable instrument and is sent by a depository bank for collection. *See generally infra* notes 204-207. A convenience check will eventually be presented for settlement to the bank on which it was drawn, which will be a bank where the creditor holds an account. *Id.* If a presented convenience check is not timely returned for exceeding a cardholder's credit line, the amount of the draft will be paid, and this amount will be debited to drawer-cardholder's account. *Id.* Assume, however, that the convenience check was stolen from mail belonging to the cardholder and it was subsequently cashed containing a forged signature. Since it is impractical for large credit card companies to timely review the signature on every convenience check that is presented for settlement, a convenience check with a forged signature will usually be paid. In this scenario, the creditor will not become aware of the forgery until the cardholder provides notice. This would generally occur when the cardholder receives a periodic statement that reflects an extension of credit in the amount paid on the forged convenience check. Since

use" is defined under the TILA as "use of a credit card by a person other than the cardholder who does not have actual, implied, or apparent authority."³³ A typical unauthorized charge occurs when a cardholder loses a credit card or becomes victim to credit card theft and a third party possessor uses the card to make a purchase. If a card's use is unauthorized, the TILA affords the cardholder extensive protection.³⁴

§ 133 of the TILA specifically limits the liability of a cardholder for the unauthorized use of a credit card, the question becomes: Is a convenience check a credit card? Under § 103(k) of the TILA, a *credit card* means "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit." Although a convenience check is not generally perceived as a credit card, it seemingly falls under the § 103(k) definition because it is an "other credit device existing for the purpose of obtaining money, property, labor, or services on credit." Thus, the liability limitations under § 133 of the TILA apply. However, there is a discrepancy between § 133 of the TILA and its implementing counterpart found under Reg. Z at 12 C.F.R. § 226.12. Similar to § 133 of the TILA, § 226.12 of Reg. Z limits a cardholder's liability for an unauthorized use of a credit card. However, § 226.2(15) of Reg. Z defines a credit card as meaning "any card plate, coupon book, or other single credit device *that may be used from time to time to obtain credit.*" (emphasis added). Since a convenience check does not fit the physical description of a credit card under § 226.2(15) and because a convenience check can only be used once, not from time to time, it fails to fall under this definition of a credit card.

33. TILA § 103(o), 15 U.S.C. § 1602(o) (1994). For an insightful discussion of when a charge is authorized because the charge was made with apparent authority, see *Towers World Airways Inc. v. PHH Aviation System Inc.*, 933 F.2d 174 (2nd Cir. 1991). In defining apparent authority, the court in *Towers* states: "the cardholder, as principal, creates apparent authority through words or conduct that, reasonably interpreted by a third party from whom the card bearer makes purchases, indicate that the card user acts with the cardholder's consent." *Id.* at 177. Voluntarily giving another access to a credit card or account number has rendered the cardholder liable for all subsequent charges in some states. *Draiman v. American Express Travel*, 892 F.Supp 1096, 1099 (N.D. Ill. 1995). See also *Stieger v. Chevy Chase Savings Bank*, 666 A.2d 479, 484 (D.C. 1995) (stating that "[t]o a merchant, voluntary relinquishment combined with the matching of a signature is generally a reasonable indication of apparent authority to utilize the credit card."). In contrast, other states have viewed this conduct as an important factor, yet in the context "of other conduct and circumstances, especially industry custom, prior course of dealing and the presence or absence of characteristics that tend to distinguish authorized from unauthorized uses." *Draiman*, 895 F. Supp. at 1099. For an in-depth analysis of the unauthorized use of a credit card, see Mary Elizabeth Matthews, *Credit Cards—Authorized and Unauthorized Use*, 13 ANN. REV. BANKING L. 233 (1994).

34. See TILA § 133, 15 U.S.C. § 1643 (1994) (imposing numerous requirements upon a card issuer prior to holding a cardholder liable for any amount incurred for an unauthorized use). Although most sections of the TILA apply exclusively to situations involving "consumer" credit, it should be noted that for the limited purposes of the rules on issuance of credit cards and liability for unauthorized use, "a *cardholder* includes any person, (including organizations) to whom a card is issued for any purpose, including a business." Official Staff Interpretations to Reg. Z, 12 C.F.R. pt. 226, Supp. I, 12(b)(1) (1998) (emphasis added). However, if a card issuer has issued 10 or more cards for the use of employees of an organization and an agreement to liability exists between the card issuer and the organization, then liability is governed under the agreement and § 133 of the TILA is not applicable. 12 C.F.R. § 226.12(b)(5) (1998).

A cardholder is not liable for *any* amount resulting from an unauthorized use unless the following conditions have been met:³⁵ (1) the card used in the transaction was an accepted credit card,³⁶ (2) the card issuer disclosed adequate notice to the cardholder of potential liability,³⁷ (3) the card issuer has disclosed and provided the cardholder with a means by which the cardholder can notify the card issuer if a card is lost or stolen,³⁸ and (4) the card issuer has provided the cardholder with a method whereby the cardholder can be identified as an authorized user.³⁹ Furthermore, a cardholder is not liable for any unauthorized use occurring after the card issuer has received notice that an unauthorized use of the credit card has occurred or may occur as the result of loss, theft, or otherwise.⁴⁰ If all of the conditions are met and an unauthorized use occurs prior to the card issuer receiving notice, a cardholder is liable for no more than \$50 of the unauthorized use.⁴¹ As added protection, if a card issuer chooses to judicially challenge a cardholder's claim of unauthorized use, the burden of proof falls on the issuer to establish that the charge was in fact authorized.⁴²

Aside from limiting a cardholder's liability, the scope of the liability protection offered under the TILA broadly extends to the unauthorized use of a "credit card", and thus, the type of consumer credit plan is irrelevant.⁴³ For instance, by applying generally to a credit card, the liability protection offered under the act exists regardless of whether or not the credit plan is revolving or otherwise. In short, "consumers need not discern what form of credit card may have been issued to understand quickly the card's level of risk and ultimate liability."⁴⁴

Moreover, the TILA's \$50 liability limit to cardholders who incur an unauthorized use is not contingent upon the cardholder reporting a credit card lost or stolen, upon promptly reporting suspected unauthorized use, or upon

35. TILA § 133(a)(1), 15 U.S.C. § 1643(a)(1) (1994).

36. TILA § 133(a)(1)(A), 15 U.S.C. § 1643(a)(1)(A) (1994). An accepted credit card is "any credit card which the cardholder has requested and received or has signed or has used, or authorized another to use, for the purpose of obtaining money, property, labor, or services on credit." TILA § 103(l), 15 U.S.C. § 1602(l) (1994).

37. TILA § 133(a)(1)(C), 15 U.S.C. § 1643(a)(1)(C) (1994).

38. TILA § 133(a)(1)(D), 15 U.S.C. § 1643(a)(1)(D) (1994).

39. TILA § 133(a)(1)(F), 15 U.S.C. § 1643(a)(1)(F) (1994).

40. TILA § 133(a)(1)(E), 15 U.S.C. § 1643(a)(1)(E) (1994).

41. TILA § 133(a)(1)(B), 15 U.S.C. § 1643(a)(1)(B) (1994).

42. TILA § 133(b), 15 U.S.C. § 1643(b) (1994).

43. TILA § 133, 15 U.S.C. § 1643 (1994).

44. Balto, *supra* note 9, at 1103.

time in general.⁴⁵ In fact, the cardholder who negligently fails to realize that their credit card is missing or to review an inflated monthly statement will still be entitled to the \$50 liability limitation under the TILA. Since the TILA fails to impose a time limit in which consumers must act in order to receive protection under § 133, the burden of preventing fraud falls heavily upon the creditor. This does not mean every alleged unauthorized charge will be waived to the extent that it exceeds \$50. Rather, the card issuer must conduct a reasonable investigation upon notice of an alleged unauthorized charge and must comply with § 133 liability limitations only when procured evidence reasonably favors the cardholder's claim.⁴⁶

B. BILLING ERRORS

In addition to providing cardholders with protection against unauthorized use, cardholders are also protected, if certain conditions are satisfied, from liability that results from a billing error.⁴⁷ Under Reg. Z⁴⁸, a billing error may

45. Section 133 under the TILA fails to limit a cardholder's time to claim an unauthorized use. 15 U.S.C. § 1643 (1994). Moreover, Reg. Z, 12 C.F.R. § 226.12(b), (*Liability of cardholder for unauthorized use*), the Board's implementation of § 133, does not limit a cardholder's time to make an unauthorized claim.

46. 15 U.S.C. § 1643 (1994). Although neither § 133 under the TILA nor § 226.12(b) under Reg. Z expressly requires the card issuer to conduct a reasonable investigation, § 226.13(f) (*Procedures if different billing error or no billing error occurred*), does require a reasonable investigation in that it states: "If, after conducting a *reasonable investigation* . . ." (emphasis added). In direct support, the Official Staff Commentary to Reg. Z, 12 C.F.R. § 226.12(b)-3 (1998), states: "If a card issuer seeks to impose liability when a claim of *unauthorized use* is made by a cardholder, the card issuer must conduct a reasonable investigation of the claim." (emphasis added). A reasonable investigation may include:

- i. Reviewing the types or amounts of purchases made in relation to the cardholder's previous purchasing pattern.
- ii. Reviewing where the purchases were delivered in relation to the cardholder's residence or place of business.
- iii. Reviewing where the purchases were made in relation to where the cardholder resides or has normally shopped.
- iv. Comparing any signature on credit slips for the purchases to the signature of the cardholder or an authorized user in the card issuer's records, including credit slips.
- v. Requesting documentation to assist in the verification of a claim.
- vi. Requesting a written, signed statement from the cardholder or authorized user.
- vii. Requesting a copy of a police report, if one was filed.
- viii. Requesting information regarding the cardholder's knowledge of the person who allegedly used the card or of that person's authority to do so.

Id.

47. 12 C.F.R. § 226.13 (1998).

48. 12 C.F.R. § 226 (1998).

constitute any of the following circumstances: (1) a reflection on a billing statement of an unauthorized charge,⁴⁹ (2) a reflection of an extension of credit that fails to adequately identify transactions,⁵⁰ (3) a reflection of a charge for property or services that were never accepted by a cardholder, or were not delivered to the cardholder in accordance with an agreement made in relation to the transaction,⁵¹ (4) failure by the card issuer to correctly reflect a payment made by the cardholder or other credit owed to the cardholder's account,⁵² (5) a reflection of a computational error,⁵³ (6) a reflection of an extension of credit in which the cardholder requests additional clarification or explanation,⁵⁴ and (7) failure to send a cardholder's periodic statement to a last known address as long as the card issuer has received written notice of the cardholder's last known address no sooner than twenty days prior to the end of the billing cycle.⁵⁵

49. 12 C.F.R. § 226.13(a)(1) (1998). Due to overlapping language, confusion can arise when § 226.13(a)(1) is compared to § 226.12(b), *Liability of cardholder for unauthorized use*. Depending on *the time* a consumer makes a claim, both sections apply to situations involving the unauthorized use of a credit card. Section 226.13(a)(1) applies when the cardholder notifies the creditor of an unauthorized use, reflected on their periodic statement, as long as the cardholder provides this notice in writing and within sixty days of when the statement containing the possible billing error was transmitted by the creditor. If a cardholder fails to report the suspected unauthorized charge within sixty days of when the statement was transmitted, § 226.13 is inapplicable because timely notification by the cardholder is a condition precedent to claiming a "billing error." *Id.* § 226.13(b)(1). However, under § 226.12(b), which speaks directly to a cardholder's liability for the unauthorized use of a credit card, there is no time limit in which notification must be provided. Thus this section is applicable when a cardholder's claim of unauthorized use fails to constitute a billing error. In support, the Official Staff Commentary to Reg. Z, 12 C.F.R. § 226.12(b)(3)-3, states: "The liability protections afforded to cardholders in § 226.12 do not depend upon the cardholder's following the error resolution procedures in § 226.13. For example, the written notification and time limit requirements of § 226.13 do not affect the section 226.12 protections." Consider, for instance, a situation where a cardholder finds out his bookkeeper has embezzled money by using the cardholder's credit card to make unauthorized purchases and has successfully covered-up the scam for over 2 years. In this scenario, the cardholder is still liable for no more than \$50 under Reg. Z, § 226.12(b). Lastly, if a cardholder disputes a charge as unauthorized and the creditor thereafter keeps the alleged unauthorized charge(s) on the cardholder's account, irrespective of a legitimate justification (e.g. creditor conducts reasonable investigation and concludes that charges were authorized), at this time an alleged violation of the TILA occurs and the statute of limitations to bring suit within one year of the alleged violation would begin to run pursuant to § 133(e) of the TILA.

50. 12 C.F.R. § 226.13(a)(2) (1998).

51. 12 C.F.R. § 226.13(a)(3) (1998).

52. 12 C.F.R. § 226.13(a)(4) (1998).

53. 12 C.F.R. § 226.13(a)(5) (1998).

54. 12 C.F.R. § 226.13(a)(6) (1998).

55. 12 C.F.R. § 226.13(a)(7) (1998).

A creditor is obligated to conduct a reasonable investigation upon being notified in writing⁵⁶ from a cardholder that a billing error has occurred.⁵⁷ Reg. Z excuses the creditor from this obligation if the cardholder fails to report the billing error within sixty days of when the statement reflecting the alleged error was transmitted.⁵⁸ If the cardholder provides the creditor with timely notice, then the creditor must issue a provisional credit equal to the amount of the disputed charge,⁵⁹ investigate the cardholder's claim⁶⁰ and resolve the dispute by the sooner of two full billing cycles or ninety days.⁶¹ Upon

56. Written notification of a billing error should enable the creditor to identify the consumer's name and account number. 12 C.F.R. § 226.13(b)(2) (1998). Such notification should also indicate reasons why the consumer believes a billing error exists. 12 C.F.R. § 226.13(b)(3) (1998). Upon receiving written notice of a billing error, a creditor must provide the consumer with written acknowledgment or resolution within 30 days of receiving a billing-error notice. *Id.* § 226.13(c) (1998).

57. 12 C.F.R. § 226.13(b) (1998). For actions that may be included in conducting a reasonable investigation, see Official Staff Commentary to Reg. Z, *supra* note 46, § 226.12(b)-3 (1998).

58. 12 C.F.R. § 226.13(b)(1) (1998).

59. See 12 C.F.R. § 226.13(d)(1) (1998) (a cardholder's right to withhold the disputed amount and collection actions by the creditor are prohibited).

60. 12 C.F.R. § 226.13(f) (1998); see also Official Staff Commentary to Reg. Z, *supra* note 46, § 226.12(b)-3.

61. 12 C.F.R. § 226.13(c)(2) (1998). When a cardholder claims that an unauthorized use occurred, yet fails to put notice of such in writing or notice is received after the sixty day time frame, *billing error* procedures do not apply. See 12 C.F.R. § 226.13(b) (1998). In this case, the cardholder is claiming a non-billing-error unauthorized use (because notice was either not in writing or not timely) and, if liability is to be imposed on the cardholder, the card issuer must still conduct a reasonable investigation to establish whether the charge was in fact authorized. See Official Staff Commentary to Reg. Z, *supra* note 46, § 226.12(b)-3. Thus, the cardholder's claim of unauthorized use would be governed under Reg. Z, § 226.12 (Special Credit Card Provisions). The Official Staff Commentary to Reg. Z, § 226.12(b)-3, expressly states that a reasonable investigation is necessary before a card issuer imposes any liability when a claim of *unauthorized use* is made, but neither the Official Staff Commentary nor 12 C.F.R. § 226.12 require a card issuer to complete the investigation within any time period, as does 12 C.F.R. § 226.13(c)(2), which would apply if the claim of unauthorized use was timely or in writing (i.e., if the claim was a *billing error* unauthorized use). The Official Staff Commentary to Reg. Z provides steps that a card issuer may take to conduct a reasonable investigation, regardless of whether the investigation is pursuant to a billing-error or non-billing-error unauthorized use. See Official Staff Commentary to Reg. Z, § 226.12(b)-3 (1998). It is therefore assumed that the nature of a "reasonable investigation" is essentially the same regardless of whether the claim is a billing-error unauthorized use or non-billing-error unauthorized use. But can it be assumed that the omission of requiring a reasonable investigation and time frame in 12 C.F.R. § 226.12, the section applicable to non-billing-error unauthorized use, was intended to allow card issuers more time to complete a "reasonable investigation"? At least two arguments can be made, both opposite in effect. First, the lack of an expressed time frame regarding non-billing-error unauthorized use claims may mean that a creditor who takes longer than the sooner of two full billing cycles or ninety days to complete a "reasonable investigation" is technically not in violation under Reg. Z. Since a cardholder is

concluding its investigation,⁶² a creditor must either issue a permanent credit equal to the amount erroneously reflected⁶³ or remove the provisional credit in accordance with its findings.⁶⁴ A creditor who removes the provisional credit because it concludes that a billing error did not occur may appropriately charge the cardholder's account interest on an amount equal to the provisional credit.⁶⁵ Further, a creditor need not respond to a claim if the cardholder is reasserting a claim that has already been resolved.⁶⁶ If the cardholder

not under a time restraint to report a non-billing-error unauthorized use, but is subject to a time limit to report a billing-error unauthorized use, Congress may have intended to not impose a time limit on card issuers regarding an investigation into non-billing-error unauthorized use because it may take longer to conduct a "reasonable" investigation when a cardholder has an unlimited amount of time in which to claim an unauthorized use. For instance, if a cardholder timely reports a billing-error unauthorized use, it is possible for a card issuer to conduct a "reasonable investigation" as articulated under § 226.12(b)-3 of the Official Staff Commentary to Reg. Z because the transaction is not older than three months and pertinent information is usually available. On the other hand, if a cardholder is responding to a claim made two years after the alleged non-billing-error unauthorized use, then a "reasonable" investigation may take more than two full billing cycles because pertinent information will be more difficult to obtain. Therefore, the lack of a time frame to complete a non-billing-error unauthorized use may have been intended, and as long as a card issuer posts a provisional credit to the cardholder's account, equal to the amount alleged to be unauthorized, taking more than two full billing cycles to complete a "reasonable" investigation is necessary. Second, in the alternative, the argument can be made that in spite of the fact that 12 C.F.R. § 226.12 and the Official Staff Commentary omit a time limit in which a card issuer must conduct a "reasonable investigation", if liability is to be imposed for non-billing-error unauthorized use claims, the two full billing cycle time limit under 12 C.F.R. § 226.13(c)(2) was intended to apply. The Board's interpretation, in respect to the reasonable investigation requirement, clearly fails to distinguish between billing-error and non-billing-error unauthorized use, thus the billing-error time limit to conduct the investigation may be applicable irrespective of whether the unauthorized use constitutes a billing error. Thus, arguably, a reasonable investigation should never take longer than the sooner of two full billing cycles or ninety days.

62. If a creditor concludes that the billing error asserted did not occur, then: 1) the creditor must provide the consumer with an explanation of its findings, 2) if requested, provide the consumer with documentary evidence of the consumer's indebtedness, 3) if a billing error other than the one asserted occurred, the creditor must correct the error and credit the consumer's account accordingly. 12 C.F.R. § 226.13(f) (1998).

63. See 12 C.F.R. § 226.13(e)(1) (1998) (stating that a creditor must "[c]orrect the billing error and credit the consumer's account with any disputed amount and related finance or other charges, as applicable").

64. See 12 C.F.R. § 226.13(g)(1) (1998) (stating that a creditor must promptly notify the consumer "in writing of the time when payment is due and the portion of the disputed amount and related finance or other charges that the consumer still owes").

65. *Id.*

66. 12 C.F.R. § 226.13(h) (1998). However, if a consumer reasserts the same claim before the expiration of 10 days from the date of resolution or the expiration of the contractual grace period, whichever is longer, the creditor must: promptly report to relevant credit reporting agencies that the amount is still in dispute, provide the consumer with notice of each credit reporting agency that the creditor reports to, and promptly report subsequent resolution to each person or agency to which the account has been reported. 12 C.F.R. § 226.13(g)(4) (1998).

disagrees with a creditor's conclusion, or believes that the creditor failed to conduct a reasonable investigation, the cardholder's recourse against the creditor is confined to judicially pleading, pursuant to § 130 of the TILA, that a violation has occurred.⁶⁷

C. CLAIMS AND DEFENSES

A final protection granted to cardholders under Reg. Z is the right to assert claims or defenses against the card issuer.⁶⁸ This right is not contingent upon an unauthorized use or billing error, but rather it exists when "a person who honors a credit card fails to resolve satisfactorily a dispute as to property or services purchased with the credit card in a consumer credit transaction."⁶⁹ A dispute may generally arise if a merchant fails to provide the cardholder with property or services in accordance with the related sales contract. However, before a cardholder can assert a claim or defense against the card issuer the following conditions must be satisfied: 1) a good faith attempt has been made by the cardholder to resolve the dispute with the merchant,⁷⁰ 2) the amount in dispute exceeds \$50, and 3) the disputed transaction occurred in the state in which the cardholder resides or within 100 miles of the cardholder's current address.⁷¹ If these conditions are met, and the cardholder could not resolve the dispute with the merchant, then a cardholder may assert a claim against the card issuer. Once a claim has been asserted, a card issuer cannot require payment or impose a finance or any other fee on the amount in dispute.⁷²

III. HISTORY OF THE ELECTRONIC FUND TRANSFER ACT & REGULATION E

Resulting from the "rapidly increasing volume of transactions involving electronic fund transfers",⁷³ Congress ultimately passed Title XX of the Fin-

67. See 12 C.F.R. § 226.1(e) (1998) (stating that liability and enforcement under Reg. Z exists pursuant to the TILA). See also, TILA § 112(3), 15 U.S.C. § 1611(3) (1994) (stating that criminal liability exists for creditors who "willfully" and "knowingly" fail to comply with the TILA).

68. 12 C.F.R. § 226.12(c) (1998).

69. 12 C.F.R. § 226.12(c)(1) (1998).

70. 12 C.F.R. § 226.12(c)(3)(i) (1998).

71. 12 C.F.R. § 226.12(c)(3)(ii) (1998).

72. 12 C.F.R. § 226.12(c)(1) (1998). "Section 226.12(c) merely preserves the consumer's right to assert against the card issuer any claims or defenses that can be asserted against the merchant. It does not determine what claims or defenses are valid as to the merchant; this determination must be made under state or other applicable law." Official Staff Commentary to Reg. Z, *supra* note 46, § 226.12(c)-2.

73. See S. Rep. No. 915, 95th Cong. (1978), cited in 8 KENNETH M. LAPINE, BANKING

ancial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRA).⁷⁴ This legislation has been designated as Title IX of the Consumer Protection Credit Act⁷⁵ and is officially known as the Electronic Fund Transfer Act (EFTA).⁷⁶ To implement the EFTA, the Board of Governors of the Federal Reserve System is authorized to prescribe regulations in accordance with the EFTA.⁷⁷ These regulations are designated as Regulation E ("Reg. E").⁷⁸

The Electronic Fund Transfer Act establishes the "rights, liabilities, and responsibilities of participants in electronic fund transfer. The primary objective of this title, however, is the provision of individual consumer rights."⁷⁹ An electronic fund transfer (EFT) is "any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a *financial institution* to debit or credit an account."⁸⁰ (emphasis added). The EFTA applies only to EFTs between accounts belonging to natural persons since the term "financial institution" is defined as an institution that maintains "an account belonging to a consumer"⁸¹ and the term "consumer" means "a natural person."⁸² However, the EFTA does not apply to business accounts held by consumers because the term "account" relates to those accounts "established primarily for personal, family, or household purposes."⁸³

An EFT does not include transactions that originate by "check, draft, or similar paper instrument."⁸⁴ EFTs may include, however, point-of-sale (POS) transfers,⁸⁵ automated teller machine (ATM) transactions, direct deposit or

LAW, Ch. 157-169, § 164-4.

74. Pub. L. No. 95-630, 92 Stat. 3741, 3728 (1978). See also, LAPINE, *supra* note 73, § 164-5.

75. 15 U.S.C. §§ 1693-1693r (1994).

76. 15 U.S.C. § 1693 et seq. (1994).

77. EFTA § 904(a), 15 U.S.C. § 1693b(a) (1994).

78. 12 C.F.R. pt. 205 (1998).

79. EFTA § 902(b), 15 U.S.C. § 1693(b) (1994).

80. EFTA § 903(6), 15 U.S.C. § 1693a(6) (1994).

81. EFTA § 903(8), 15 U.S.C. § 1693a(8) (1994).

82. EFTA § 903(5), 15 U.S.C. § 1693a(5) (1994). The EFTA would not be applicable regarding an EFT between corporations. *Id.* See also LAPINE, *supra* note 73, § 164-7.

83. EFTA at § 903(2), 15 U.S.C. § 1693a(2) (1994). The consumer's account must be a demand deposit (checking account), a savings account or other asset account. *Id.*

84. EFTA § 903(6), 15 U.S.C. § 1693a(6) (1994).

85. "P.O.S. debit card transactions generally take place at merchant locations, but also include mail and telephone orders to purchase goods and services involving the use of a debit card. Transactions at A.T.M.s, however, are not P.O.S. even though the A.T.M. may be in a merchant location." Official Staff Commentary to Reg. E, Q. 11-11.5, *cited in* LAPINE, *supra* note 73, § 164-4, n. 2.

other automated clearing house (ACH) transfers, and transfers initiated by telephone.⁸⁶

An increasingly popular way to initiate an EFT is through using a debit card.⁸⁷ A debit card is used as an access device to initiate an EFT.⁸⁸ Debit cards may function as initiating either online or offline transactions.⁸⁹ With ATM machines entering the national market in the late 1960s and early 1970s, the ATM card became the first commonly used access device that allowed consumers to initiate online EFTs.⁹⁰ Upon entering a personal identification number, a consumer using an ATM card can instantly and electronically transfer funds.⁹¹ Online debit cards also include "cards that can be used at online POS terminals [and] require the use of a personal identification number (PIN) to initiate the transaction."⁹²

On the other hand, offline debit cards are used to initiate offline transactions.⁹³ Offline debit cards resemble credit cards in many ways and the initiated transaction does not result in an immediate transfer of funds.⁹⁴ Offline debit cards may contain the Visa or MasterCard logo and may not require the use of a PIN.⁹⁵ Similar to initiating a credit card transaction, the

86. EFTA § 903(6), 15 U.S.C. § 1693a(6) (1994). However, any transfer of funds initiated by way of a telephone conversation between a consumer and an employee of a financial institution is not an EFT if it is not pursuant to a prearranged agreement that contemplates recurring transfers. EFTA § 903(6)(E), 15 U.S.C. § 1693a(6)(E) (1994).

87. "By the year 2000, two-thirds of American households will have a debit card. Debit cards are expected to rival cash and checks as a form of payment. With the debit card, you are using your own money, not the issuer's money." NATIONAL CONSUMERS LEAGUE, *Debit Cards: Beyond Cash and Checks* (visited Nov. 27, 1998) <<http://www.natlconsumersleague.org/debitbro.htm>>.

88. As defined under the EFTA, the term "accepted card or other means of access" means "a card, code, or other means of access to a consumer's account for the purpose of initiating electronic fund transfers." EFTA § 903(1), 15 U.S.C. § 1693a(1) (1994).

89. Balto, *supra* note 9, at 1093.

90. See Jane Kaufman Winn, *Open Systems, Free Markets, and Regulation of Internet Commerce*, 72 TUL. L. REV. 1177, 1233 (1998). In 1978 fewer than 14,000 ATMs were installed in the U.S., whereas in 1998, over 110,000 ATMs will operate nationally. Roland E. Brandel & Lee S. Adams, *The Modernization of Regulation E*, ABA BANK COMPLIANCE, Jan./Feb. 1997, at 13.

91. THE BETTER BUSINESS BUREAU, *Tips On . . . Using Debit Cards* (visited Dec. 28, 1998) <<http://www.bbb.org/library/debitcard.html>>.

92. Balto, *supra* note 9, at 1093-94.

93. THE BETTER BUSINESS BUREAU, *Tips On . . . Using Debit Cards* (visited Dec. 28, 1998) <<http://www.bbb.org/library/debitcard.html>>.

94. *Id.*

95. BETTER BUSINESS BUREAU, *Debit Cards Could Be Costly, Warns Better Business Bureau* (visited Dec. 28, 1998) <http://www.sddt.com/reports/97reports/bank97_09_08/DN97_09_08_tf.html>.

customer is required to sign a sales slip instead of using a PIN.⁹⁶ Similar to using a check as a means of payment, the transaction does not immediately result in debiting the consumer's checking account. The initiated transaction is generally processed through a Visa or MasterCard network and the funds may take a few days to clear or settle.⁹⁷ Ultimately, the method of payment initiated with an offline debit card functions more like the method of payment initiated with a paper check.⁹⁸

Offline debit cards have raised consumer protection issues regarding unauthorized use.⁹⁹ Since a debit card serves as a means to directly access a consumer's account, an unauthorized user could easily convert all of the funds held in the account.¹⁰⁰ Since many consumers do not realize their debit card can be used without a PIN, the risks associated with losing the card could be substantial.¹⁰¹ Though debit cards may resemble credit cards in appearance, the protection afforded under federal legislation, to consumers who use a debit card as a method of payment, is much less than when a consumer uses a credit card as a method of payment.¹⁰²

IV. CARDHOLDER LIABILITY UNDER THE EFTA AND REG. E

A. UNAUTHORIZED USE

Section 909 of the EFTA governs a consumer's liability for unauthorized transfers.¹⁰³ A consumer will not be liable for any amount resulting from an

96. THE BETTER BUSINESS BUREAU, *Tips On . . . Using Debit Cards* (visited Dec. 28, 1998) <<http://www.bbb.org/library/debitcard.html>>.

97. Balto, *supra* note 9, at 1094, 1102-03.

98. BETTER BUSINESS BUREAU, *Debit Cards Could Be Costly, Warns Better Business Bureau* (visited Dec. 28, 1998) <http://www.sddt.com/reports/97reports/bank97_09_08/DN97_09_08_tf.html>.

99. Balto, *supra* note 9, at 1102. An unauthorized electronic fund transfer is defined under the EFTA as "an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate such transfer and from which the consumer receives no benefit." EFTA § 903(11), 15 U.S.C. § 1693a(11) (1994). The definition expressly states that if the person initiating the transfer was given the access device by the consumer, unless the consumer gave the financial institution actual notice that transfers by such person are no longer authorized, transfers are deemed authorized. *Id.*

100. Balto, *supra* note 9, at 1103.

101. *Id.* at 1102-03.

102. *Id.* at 1107-08. Reg. Z, under certain circumstances, grants the holder of a credit card the right to assert claims or defenses against the card issuer. 12 C.F.R. § 226.12(c) (1998). Reg. E does not allow such a right against a financial institution.

103. An "unauthorized electronic fund transfer" means:

an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate such

unauthorized EFT unless the access device was an accepted card (or other means of access) and the card issuer has provided the consumer with a means whereby the consumer or user can be identified as the person authorized to use the access device.¹⁰⁴ Examples of ways the card issuer can provide the card user with identification as an authorized user include "by signature, photograph, or fingerprint or by electronic or mechanical confirmation."¹⁰⁵

Even when the above conditions are satisfied, a consumer's liability is limited to the lesser of \$50 or the amount of the unauthorized transfer(s) if the consumer reports the loss or theft of their card within two business days of learning of the loss or theft.¹⁰⁶ If a consumer reports the loss after two business days from the time of discovery, the consumer is liable for the lesser of \$500 or the sum of \$50 (or the amount of the unauthorized transfer(s) occurring prior to the end of the second business day if less than \$50) and the amount of unauthorized transfer(s) that could have been prevented had the consumer given timely notice.¹⁰⁷ A consumer is completely liable for all unauthorized transfers that occur more than sixty days after the transmittal of

transfer and from which the consumer receives no benefit, but the term does not include any electronic fund transfer (A) initiated by a person other than the consumer who was furnished with the card, code, or other means of access to such consumer's account by such consumer, unless the consumer has notified the financial institution involved that transfers by such other person are no longer authorized, (B) initiated with fraudulent intent by the consumer or any other person acting in concert with the consumer, or (C) which constitutes an error committed by a financial institution.

EFTA § 903(11), 15 U.S.C. § 1693a(11) (1994).

104. EFTA § 909(a), 15 U.S.C. § 1693g(a) (1994). An "accepted card or other means of access" means:

a card, code, or other means of access to a consumer's account for the purpose of initiating electronic fund transfers when the person to whom such card or other means of access was issued has requested or received or has signed or has used, or authorized another to use, such card or other means of access for the purpose of transferring money between accounts or obtaining money, property, labor or services

EFTA § 903(1), 15 U.S.C. § 1693a(1) (1994).

105. *Id.*

106. EFTA § 909(a), 15 U.S.C. § 1693g(a) (1994). Although not conclusive, receiving a periodic statement that reflects an unauthorized EFT may be evidence of the consumer's knowledge that the card was lost or stolen. Official Staff Commentary on Reg. E, 12 C.F.R. pt. 205, Supp. I, § 205.6, A6-6.

107. EFTA § 909(a), 15 U.S.C. § 1693g(a) (1994).

a periodic statement that reflects an unauthorized transfer.¹⁰⁸ Thus, a duty is imposed upon consumers to review their periodic statements.

There is an exception, however, to the above time limits in which a consumer must provide notice to avoid the respective liability.¹⁰⁹ If the consumer fails to notify the financial institution within one of the time limits as a result of extenuating circumstances,¹¹⁰ Reg. E provides the consumer with a reasonable extension in which notice may be provided.¹¹¹

B. ERROR RESOLUTION

Reg. E also sets forth procedures a financial institution must follow in the event of error resolution.¹¹² Under Reg. E, an "error" may constitute any of the following: an unauthorized EFT,¹¹³ an incorrect EFT to or from an

108. EFTA § 909(a)(2), 15 U.S.C. § 1693g(a)(2) (1994). In *Kruser v. Bank of America NT & SA*, a husband and wife were found liable for all unauthorized electronic transfers concerning their joint checking account. 230 Cal. App. 3d 741 (1991). The Krusers, believing that Mr. Kruser's ATM card was destroyed, received a statement reflecting a \$20 unauthorized withdrawal in December of 1986. *Id.* at 744. The Krusers failed to notify the bank because, during this time period, Mrs. Kruser underwent surgery, remained in the hospital for 11 days, and spent the next six months recuperating at home. *Id.* In September of 1987, the Krusers received statements for July and August, which reflected 47 unauthorized transfers totaling \$9020. *Id.* The bank was notified within a few days, however, the bank would not credit the Kruser's account. *Id.* The court held that under § 1693g of the EFTA the Kruser's failure to notify the bank within 60 days of receiving the statement that reflected the \$20 unauthorized transfer, the bank was relieved of liability for the unauthorized transfers that took place seven months later. *Id.* at 750. The rationale relied on by the court is that the subsequent transfers would not have occurred but for the Kruser's failure to timely report the \$20 unauthorized transfer. *Id.*

109. 12 C.F.R. § 205.6(b)(4) (1998).

110. Extenuating circumstances may include "extended travel or hospitalization." *Id.* The Kruser court held an illness is not an extenuating circumstance under § 205.6(b)(4) of Reg. E when the illness does not prevent a consumer from reviewing a bank statement. *Kruser*, 230 Cal. App.3d at 748. In *Kruser*, evidence established that Mrs. Kruser reviewed bank statements while she was at home recuperating from her illness. *Id.*

111. 12 C.F.R. § 205.6(b)(4) (1998).

112. *Id.* § 205.11.

113. Under the definition of an "unauthorized electronic fund transfer", as defined in the EFTA, *supra* note 103, an "error committed by a financial institution" is expressly excluded from the definition. *Id.* § 903(11)(C) (emphasis added). However, under § 908(f)(1) of the EFTA, an "error" means an unauthorized EFT. This apparent statutory discrepancy is clarified in Reg. E where the definition of an "[u]nauthorized electronic fund transfer" does not qualify the exclusion by using the term "error", but rather, it excludes any EFT that is "initiated by the financial institution or its employee." 12 C.F.R. § 205.2(m)(3) (1998). When "error" requirements are satisfied, a financial institution must follow the procedures set forth under Reg. E, § 205.11, if notified of an unauthorized EFT. Generally, these procedures may apply when the financial institution receives oral or written notice of an alleged unauthorized EFT within 60 days after the institution has transmitted a periodic statement on which the error is first reflected. 12 C.F.R. § 205.11(b)(1)(i) (1998). Therefore, since notification within 60 days is

account,¹¹⁴ a periodic statement that fails to reflect an EFT that should be reflected,¹¹⁵ a computational or bookkeeping error made by the financial institution,¹¹⁶ an incorrect amount of money received by a consumer from an electronic terminal,¹¹⁷ or a request by a consumer for clarification or documentation relating to an EFT.¹¹⁸

Any of the above circumstances constitutes an error if a financial institution receives notice of such within sixty days of when the institution sent the periodic statement that first reflects the alleged error.¹¹⁹ Even when the consumer reports a suspected error in a timely manner, a financial institution is not obligated to immediately credit the consumer's account for an amount equal to the alleged error.¹²⁰ Prior to issuing a credit, the financial institution is allowed an opportunity to conduct a good faith investigation.¹²¹ If the investigation is not complete within ten business days a provisional credit must be issued.¹²² Once a provisional credit is issued, the financial

required for error resolution procedures to take effect, *id.*, and since a consumer who fails to report an unauthorized EFT within 60 of the transmittal of a statement reflecting an EFT is liable for unauthorized transfers occurring after 60 days of transmittal, § 205.6(b)(3), when a consumer fails to timely report an unauthorized EFT under § 205.11(b)(1)(i), a financial institution need not follow the error resolution procedures with respect to unauthorized EFTs that were not timely reported and the consumer is completely liable for those unauthorized EFTs that occur after 60 days, even though these EFTs may have been timely reported in respect to activating "error" resolution requirements. *See* 12 C.F.R. § 205.11(b)(1)(i) (1998).

114. 12 C.F.R. § 205.11(a)(1)(ii) (1998).

115. 12 C.F.R. § 205.11(a)(1)(iii) (1998).

116. 12 C.F.R. § 205.11(a)(1)(iv) (1998).

117. 12 C.F.R. § 205.11(a)(1)(v) (1998).

118. 12 C.F.R. § 205.11(a)(1)(vii) (1998). An error also includes an EFT not properly identified in accordance with § 205.9 or § 205.10(a). *Id.* § 205.11(a)(1)(vi).

119. 12 C.F.R. § 205.11(b)(1)(i) (1998). Notice may be received by a financial institution, from the consumer, in writing or through oral communication. *Id.* § 205.11(b)(1). If notice is provided orally the financial institution may require the consumer to provide written notice within 10 days of receiving oral notice. *Id.* § 205.11(b)(2).

120. 12 C.F.R. § 205.11(c)(1) (1998). At the time a consumer reports a possible error, a financial institution is only obligated to credit a consumer's account immediately, or not later than one business day, if enough facts were available at the time of the notification to determine that an error had in fact occurred. *See id.* (stating that the institution shall correct the error within one business day upon determining that an error occurred).

121. *Id.* If a consumer brings action against a financial institution for failing to comply with liability provisions concerning an error and the court finds the financial institution did not conduct a good faith investigation into the matter, the consumer is entitled to treble damages under § 908(e)(1) of the EFTA.

122. 12 C.F.R. § 205.11(c)(2)(i) (1998). Allowing ten business days to credit a consumer's account could turn into a serious problem for a consumer who loses a large amount of money as the result of an error. Consider the following hypothetical. On December 23, 1998 a consumer loses their offline debit card while Christmas shopping. On Thursday, December 24, the consumer realizes the loss, learns that all \$5,000 in their checking account has been depleted and then notifies their financial institution. Assuming the financial institution is open

institution may generally take up to forty-five calendar days, if needed, to conclude its investigation.¹²³ A financial institution that determines that an error did occur must correct the error within one business day of its finding¹²⁴ and report notice to the consumer of its finding within three business days.¹²⁵

If the financial institution determines that no error occurred, this also must be disclosed to the consumer within three business days of the determination.¹²⁶ This disclosure must contain a written explanation of the financial institution's findings and a statement explaining the consumer's right to request the documentation that the financial institution relied on to reach its conclusion.¹²⁷ Furthermore, a financial institution can debit the consumer's account for an amount equal to the provisional credit.¹²⁸ Upon debiting this amount, a financial institution must notify the consumer of the date and amount of the debit and of the fact that the financial institution "will honor checks, drafts, or similar paper instruments payable to third parties and preauthorized transfers from the consumer's account (without charge to the consumer as a result of an overdraft) for five business days after the notification."¹²⁹

If a consumer reasserts the same error after a financial institution has complied with the error requirements under Reg. E, the financial institution has no further responsibilities unless the reasserted error is based upon an original request for documentation.¹³⁰ Therefore, a consumer's recourse for suspected noncompliance would be limited to judicial action by filing a claim

on Christmas Eve, but only for limited purposes, the first full business day is Monday, December 28, because a "business day" is defined in Reg. E as a day on which "the offices of the consumer's financial institution are open to the public for carrying on substantially all business function." 12 C.F.R. § 205.2(d) (1998). Further, considering that the financial institution may be open for limited purposes on New Year's Eve and considering that it will be closed completely for the New Year holiday and on weekends, the tenth business day arrives on January 11, 1999. If the financial institution did not issue a temporary credit or resolve the issue until the tenth business day, the consumer has no access to an amount equal to the amount of the alleged error for 18 full calendar days. In this case, the consumer would be fortunate to have a credit card.

123. 12 C.F.R. § 205.11(c)(2) (1998); *see also* 12 C.F.R. § 205.11(c)(3) (1998) (stating that when a provisional credit is granted by the tenth business day a financial institution is allowed 90 calendar days to investigate so long as the unauthorized transfer(s) resulted from a point-of-sale debit card transaction).

124. 12 C.F.R. § 205.11(c)(1) (1998).

125. *Id.*

126. *Id.* *See also* 12 C.F.R. § 205.11(d) (1998) (setting forth procedures a financial institution must follow if it determines no error occurred).

127. 12 C.F.R. § 205.11(d)(1) (1998).

128. 12 C.F.R. § 205.11(d)(2) (1998).

129. *Id.*

130. 12 C.F.R. § 205.11(e) (1998).

that the financial institution has failed to comply with, and thus violated, the EFTA.¹³¹

V. LIABILITY ALLOCATION AND INDUSTRY REGULATORY MEASURES

A. CARD ISSUER PROTECTION

Under certain circumstances, Visa and MasterCard regulations provide credit card issuers with extensive protection against liability when a card issuer is obligated to waive a cardholder's liability that resulted from an unauthorized use or billing error.¹³² Most of the protection works in the form of chargebacks.¹³³ A "chargeback" is a procedure where a card issuer charges an interchange transaction back to the merchant's bank¹³⁴ in accordance with bankcard regulations. When certain criteria are met, a chargeback is the means by which a card issuer electronically debits an amount from a merchant's account and credits an equal amount into their own account.¹³⁵

131. EFTA § 915(a), 15 U.S.C. § 1693m(a) (1994).

132. Visa and MasterCard information relating to certain governing regulations, not disclosed to the public, is confidential and cannot be publically divulged.

133. See generally *Secrets about chargebacks when you deal with CardPro!* (visited Dec. 28, 1998) <<http://www.card-pro.com/chbks.htm>> (on file with author). In general, a card issuer, whose product(s) is processed through a bankcard's network may utilize such network to electronically charge-back an amount to a merchant's account if the merchant failed to comply with its contractual obligations under bankcard by-laws. To merchants who honor Visa or MasterCard brand credit cards, chargebacks initiated by card issuers are not highly anticipated transactions. *Id.* According to CardPro:

A merchant who gets even a few charge-backs has not been trained well by their credit card provider or processor. They should get zero chargebacks. The unpleasant critters known to most merchants who accept credit cards are probably the worst part of doing business and processing credit transactions either in-store or out of a home office. Why? Chargebacks are what happens when a consumer decides that the product or service provided by a merchant was not acceptable or didn't meet his/her expectations . . . The credit card companies' [sic] policy is that the customer is always right . . . We teach our merchants to give refunds whenever a customer asks for one, otherwise, they will unwillingly give the refund and be charged fees for chargebacks as well.

Id.

134. This bank is referred to as an "acquirer". BUSINESS RESOURCES: FOR MERCHANTS (visited Apr. 6, 1999) <<http://www.mastercard.com/business/merchant/bankglos.html>>. An acquirer is a "licensed [bankcard] member that maintains the merchant relationship and acquires the data relating to a transaction from the merchant or card acceptor and submits this data into interchange, either directly or indirectly." *Id.*

135. A bankcard merchant means a "retailer, or any other person, firm, or corporation that (pursuant to a merchant agreement) agrees to accept credit cards, debit cards, or both, when properly presented." *Id.*

For example, a cardholder may dispute a charge as unauthorized. Assume that the charge reflects a transaction with a merchant who accepted the cardholder's credit card number over the Internet or telephone.¹³⁶ As long as the card issuer has evidence to support the cardholder's claim that the charge was unauthorized (usually a signed affidavit is sufficient) and the merchant has failed to present the card issuer with concrete evidence that proves the cardholder actually made the charge (such as a signature), the card issuer has a contractual right to recover its loss through a chargeback.¹³⁷ The rationale behind this loss allocation is that a merchant who accepts credit cards over the Internet or telephone assumes the risk of loss because the cardholder may not be who he or she purports to be. Therefore, unless the merchant can provide the card issuer with evidence that demonstrates the person using the card was in fact the cardholder, a card issuer is permitted to initiate a chargeback.¹³⁸ Generally, chargebacks serve as an equitable means to allocate liability among industry participants; liability that often results from a card issuer's inability under the TILA and Reg. Z to hold the consumer liable for legitimate unauthorized uses, billing errors and/or claims and defenses.¹³⁹

B. CARDHOLDER PROTECTION

Visa and MasterCard have also initiated self-regulatory measures to allocate liability resulting from the unauthorized use of an offline debit card.¹⁴⁰ The respective measures, however, have not been initiated entirely in response

136. If the unauthorized use was not over the Internet or telephone and the merchant followed appropriate procedure in processing the credit transaction, then the card issuer absorbs the amount resulting from the unauthorized use because no chargeback right against the merchant is available.

137. Randy Gainer, *Allocating the Risk of Loss for Bank Card Fraud on the Internet*, 15 J. MARSHALL J. COMPUTER & INFO. L. 39 (1996).

138. Other chargebacks may be initiated by card issuers against merchants when the sales draft reflects an error in addition or an incorrect transaction amount, when merchandise received is defective, when material transaction information on the sales draft appears illegible, when a counterfeit transaction occurs, when a merchant fails to verify an account number, when authorization was declined or an expired card was accepted, and when the merchant failed to obtain a signature. If a merchant accepts a credit card, not over the Internet or telephone, and obtains any form of writing that could constitute a signature on the sales draft, not even legible writing or the cardholder's writing, there is no chargeback for failing to obtain a signature that matches the signature on the back of a credit card. Thus, with respect to chargeback rights only, verifying the signature written on the sales draft with the signature on the back of a credit card is unnecessary in a practical sense since merchants need only obtain some form of scribble on the sales draft.

139. Chargebacks may be an option when a cardholder initiates a dispute with a card issuer and when the card issuer can demonstrate that the respective merchant failed to comply with bankcard regulations.

140. Balto, *supra* note 9, at 1104.

to federal legislation.¹⁴¹ Instead, these measures recognize the reality that an offline debit card may be accepted and used without a PIN, just as a credit card is used. These measures appear to reflect the failure of the EFTA to provide the consumer with protection, similar to the liability limit provided under the TILA, against the unauthorized use of an offline debit card.¹⁴²

When a MasterCard brand debit card is used to initiate an unauthorized EFT a consumer is liable for \$0 if the card is reported lost, stolen or used in an unauthorized manner within twenty-four hours of discovery.¹⁴³ After this time period a consumer is generally liable for a maximum of \$50.¹⁴⁴ According to MasterCard, this policy change was completely consumer-oriented.¹⁴⁵ Demonstrating this purpose, Alan Heuer, president of U.S. Region, MasterCard International, stated that "[t]he Board realized that consumers had come to expect a certain level of protection from MasterCard brand."¹⁴⁶ Furthermore, support from industry members also reflects an interest in protecting consumers who use offline debit cards.¹⁴⁷ Robert Hedges, senior vice president at Fleet Financial Group, has commented: "Given the critical role of credit and debit cards in the payment system, the pro-active adoption of policies that ensure the programs' future success – by protecting the consumers' interest – is an important move."¹⁴⁸

Visa requires member institutions who issue Visa brand debit cards to impose zero liability for unauthorized EFTs as long as the card is reported lost or stolen within two business days of discovery.¹⁴⁹ If the consumer fails to provide notice within two days of the loss or theft, Visa regulations set the consumer's maximum liability at \$50.¹⁵⁰ However, under Visa's policy, an

141. MasterCard advertises to have capped liability for unauthorized use of its debit card products to protect consumers. See CARDTRAK ONLINE, *MasterMoney Liability Reduced*, July 31, 1997 (on file with author).

142. See 12 C.F.R. § 226.12(b)(1) (1998) (limiting cardholder liability for the unauthorized use of a credit card to \$50).

143. *Understanding Credit and Debit*, CARDHOLDER SERVICES: MASTERCARD UNIVERSITY (visited Apr. 6, 1999) <http://www.mastercard.com/consumer/mcu/credit_b5pg6.html>.

144. *Id.*

145. See CARDTRAK ONLINE, *MasterMoney Liability Reduced*, July 31, 1997 (on file with author).

146. *Id.*

147. The senior vice president of Chase Manhattan Bank claims that preventing fraud and protecting debit card customer's funds is a key objective. *Id.*

148. *Id.*

149. Balto, *supra* note 9, at 1104-05; see also *Statement of PIRG Responding to VISA Announcement Limiting ATM Debit Card Liability*, PUBLIC INTEREST RESEARCH GROUPS (visited Dec. 28, 1998) <http://www.pirg.org/consumer/banks/debit/pr_visa.htm>.

150. *Id.*

institution that determines a cardholder was grossly negligent while handling their debit card, and that this negligence resulted in unauthorized use, may hold the cardholder liable to the extent allowed under the EFTA.¹⁵¹

VI. LEGISLATIVE ATTEMPTS TO AMEND THE EFTA

As a legislative attempt to further limit a consumer's liability for unauthorized EFTs initiated with a debit card, on September 9, 1997, Senator Jack Reed¹⁵² introduced Senate Bill 1154, the Dual-Use Debit Cardholder Protection Act of 1997.¹⁵³ Senate Bill 1154 would have limited a consumer's liability to \$50 for unauthorized EFTs that were initiated with an offline debit card.¹⁵⁴ The maximum liability of \$50 would have applied only to unauthorized transactions that occurred prior to the consumer notifying the financial institution of card loss or theft and would be contingent upon the consumer receiving mandatory, and timely, disclosures.¹⁵⁵ This bill, however, died with the 105th Congress.

Also during the 105th Congressional term, on September 23, 1998, the Senate passed an amended version of the Consumer Bankruptcy Reform Act of 1998.¹⁵⁶ Under this Act, § 208 would have implemented the Dual-Use Debit Cardholder Protection Act of 1997.¹⁵⁷ Section 208 drew a distinction between offline and online debit cards and created a separate liability provision for each.¹⁵⁸ Debit cards requiring a unique identifier prior to initiating an EFT would have remained subject to traditional liability provisions under the EFTA.¹⁵⁹ As defined in this bill, the unique identifier needed to initiate an EFT may be by photograph, retina scan, fingerprint, or by electronic or other mechanical confirmation.¹⁶⁰ This category of debit cards is commonly categorized as online, such as ATM cards that require a PIN prior to initiating an EFT.¹⁶¹

151. *Id.* Visa also requires member institutions to give provisional credits within five days of notice that an unauthorized transfer has occurred. *Id.*

152. Senator Reed is a member of the Committee on Banking, Housing, and Urban Affairs.

153. S. 1154, 105th Cong. (1997).

154. *Id.*

155. *Id.*

156. H.R. 3150, 105th Cong. (1998).

157. *See id.* § 208.

158. *See id.* § 208(a)(1).

159. *See id.* (failing to strike § 909(a)(2) liability framework under the EFTA as applied to cards necessitating a unique identifier).

160. *Id.* § 208(a)(1)(B)(iii).

161. *See House, Senate Banking Members Raise Concerns About Debit Cards*, 16 NO. 17 BANKING POL'Y REP. 8, (Sept. 1, 1997).

Section 208 would have created a new liability provision with regard to offline debit cards.¹⁶² This provision applied primarily to debit cards that can be used without a unique identifier.¹⁶³ A consumer's signature did not constitute a unique identifier under § 208.¹⁶⁴ When the debit card is capable of initiating an EFT without a unique identifier, the maximum amount of liability a consumer can be held to for an unauthorized EFT would have been limited to \$50.¹⁶⁵ Even this amount was contingent upon (1) the financial institution properly issuing the debit card,¹⁶⁶ (2) the unauthorized EFT occurring prior to the financial institution receiving notice that an unauthorized EFT has or may occur as the result of theft or loss, and (3) the consumer receiving timely notice requirements under § 905(a)(1) and § 905 (b) of the EFTA.¹⁶⁷

The 106th Congress responded quickly to the 105th's inability to pass the above-mentioned legislation. On February 24, 1999, House Representative George W. Gekas introduced the Bankruptcy Reform Act of 1999.¹⁶⁸ Different from the September 23rd version of the Bankruptcy Reform Act of 1998, the 1999 bill has eliminated the former bill's § 208 provisions – provisions which were designed to amend the EFTA's liability framework.¹⁶⁹ However, § 113 of the Bankruptcy Reform Act of 1999 is titled "Dual Use Debit Card", and it simply requires the Board of Governors of the Federal Reserve System to "conduct a study of existing protections provided to consumers to limit their liability for unauthorized use of a debit card or similar access devices."¹⁷⁰ More specifically, § 113 requires an examination of: (1) unauthorized use liability protection granted under the EFTA and Reg. E,¹⁷¹ (2) voluntary industry rules that may enhance a consumer's protection against

162. See H.R. 3150, 105th Cong. § 208(a)(2) (1998) (inserting new liability provision applicable to debit cards that can be used without a unique identifier).

163. *Id.*

164. See H.R. 3150 § 208(1)(B)(iii) (striking signature from category of unique identifier for purposes of new liability provision).

165. *Id.* § 208(a)(1)(B)(iv).

166. *Id.* Section 911 under the EFTA addresses the issuance of debit cards. The Consumer Bankruptcy Reform Act of 1998 would have amended this section by inserting that a financial institution that provides a debit card that does not require a unique identifier other than a signature must be accompanied by "a clear and conspicuous disclosure that use of the card may not require the use of such code or other unique identifier." *Id.* § 208(b)(1)(B).

167. *Id.* § 208(a)(1)(B)(iv).

168. H.R. 833, 106th Cong. (1999). The Bankruptcy Reform Act of 1999 had 106 cosponsors by the end of August, 1999.

169. See generally *id.* (failing to incorporate a formally proposed amendment to the EFTA's liability framework concerning unauthorized use).

170. *Id.* § 113(a).

171. *Id.* § 113(b)(1).

unauthorized use,¹⁷² and (3) whether amending federal legislation is "necessary to provide adequate protection for consumers in this area."¹⁷³ This legislation is practical to the extent that it essentially requires a semi-formal inquiry into whether amending the EFTA's present liability framework is necessary and in the best interest of society.

Aside from the Bankruptcy Reform Act of 1999, other legislation has recently been introduced into the House of Representatives. This legislation is intended to specifically amend the EFTA's liability framework governing unauthorized EFTs.¹⁷⁴ On February 2, 1999, House Representative Thomas M. Barrett introduced the Consumer Debit Card Protection Act.¹⁷⁵ This bill, similar to § 208 under the September version of the Bankruptcy Reform Act of 1998, will amend the EFTA's liability framework so that a consumer cannot be held liable in excess of \$50 for an unauthorized EFT initiated with a card that failed to necessitate a unique identifier.¹⁷⁶ Additionally, the bill will prohibit the imposition of fees charged to a consumer's account for insufficient funds resulting from an unauthorized offline debit card transaction.¹⁷⁷

If enacted, amendments pursuant to § 5 of the Consumer Debit Card Protection Act will create a liability framework for offline debit cards similar to the liability framework applicable to credit cards under the TILA.¹⁷⁸ Moreover, the Consumer Debit Card Protection Act fails to impose any time limit upon which a consumer must claim an unauthorized EFT in order to enjoy the \$50 liability limit. Apparently, the characteristic that justifies discriminating between plastic debit devices is that use may or may not be dependent upon a unique identifier or, in other words, some debit cards require only a signature for identification.¹⁷⁹

172. *Id.* § 113(b)(2).

173. *Id.* § 113(b)(3). If the Bankruptcy Reform Act of 1999 is enacted with provisions identical to the current provisions under § 113, the Board of Governors of the Federal Reserve System will have 2 years from the date of enactment to publically report its findings. *Id.* § 113(c).

174. H.R. 445, 106th Cong. (1999). As of the end of August, 1999, this bill had only two co-sponsors.

175. *Id.*

176. *Id.* § 5(a)(1)(C).

177. *Id.* § 8.

178. Compare TILA § 133(a)(1) (limiting cardholder liability to \$50, contingent upon unauthorized use occurring prior to the card issuer receiving notice of a lost or stolen card and the card issuer complying with its affirmative notice requirements), with H.R. 445, § 5(a)(1)(C) (limiting consumer liability to \$50 for unauthorized EFT initiated with card not necessitating a unique identifier, contingent upon the proper issuance of such card and the unauthorized EFT occurring prior to the card issuer receiving notice of a lost or stolen card).

179. Section 2 under H.R. 445 is entitled "Congressional Findings". Such findings

VII. DISCUSSION

A. FAILING TO LIMIT TIME TO REPORT UNAUTHORIZED CREDIT CARD USE

Is it reasonable for a credit card issuer to absorb all liability in excess of \$50 when a cardholder reports an unauthorized use after sixty days from when the unauthorized use was first reflected on the cardholder's periodic statement? The answer Congress provided was yes,¹⁸⁰ yet the rationale behind that answer may lack merit. Evidenced by Senate testimony, Congress has justified placing the risk of loss on the card issuer because the card issuer is generally in a better financial position to absorb the loss.¹⁸¹ As a result, any loss a card issuer incurs is treated as a cost of doing business, and ultimately, this cost is passed to consumers who use the card issuer's products and services.¹⁸²

The problem with the above rationale is twofold. First, a cardholder, not a card issuer, is in the best position to prevent future unauthorized uses by notifying the card issuer of an unauthorized use that has been reflected on a periodic statement.¹⁸³ Moreover, a merchant who accepts credit cards is also

include: "According to industry analysts, as many as 1,300,000 new debit cards which can be used like credit cards are issued each month." *Id.* § 2(2). "If current trends continue, debit cards that can be used like credit cards will soon rival the popularity of credit cards and some banking experts predict that more than 2/3 of the households in the United States will have such a card by the year 2000." *Id.* § 2(3).

180. See TILA § 133(a) (limiting cardholder liability to \$50 for unauthorized use is not contingent upon providing the card issuer with timely notice).

181. Matthews, *supra* note 33, at 251. Imposing the loss that results from unauthorized use on the card issuer because the card issuer is in a better position to bear the loss is consistent with the loss spreading principle. See Mark E. Budnitz, *The Consequences of Bulk in Our Banking Diet: Bulk Filing of Checks and the Bank's Duty of Ordinary Care Under the 1990 Revision to the Uniform Commercial Code When it Honors Forged Checks*, 63 TEMP. L. REV. 729, 745 (1990).

182. See Matthews, *supra* note 33 at 251-52 (asserting that unauthorized use costs absorbed by a card issuer can be treated as part of operating costs). The loss spreading principle is one consideration in developing efficient payment law. Cooter, *supra* note 1, at 71. This principle assigns "liability for a loss to the party that can achieve risk neutrality at the lowest cost. In general, the party that can achieve risk neutrality at the lowest cost is the one that has greater economic resources and is in a position to spread the loss most effectively." *Id.*

183. Under the loss reduction principle, liability should fall upon the person who can reduce losses at the lowest cost. Budnitz, *supra* note 181, at 746. One of the elements of this principle is precaution. *Id.* A cardholder, given thirty days to review a periodic statement and to report a reflection of an unauthorized use is in the best position to take precautions against future unauthorized use because the cardholder knows whether they made a reflected purchase better than the card issuer. See generally *id.* (remarking that a customer of a bank, many times, can take precautions at the lowest cost, concerning future forged checks, by simply reviewing

in a better position to prevent unauthorized use than the card issuer. Simply requiring a merchant to verify signatures and proper photo identification when feasible,¹⁸⁴ similar to when a check is offered as payment, will provide a strong disincentive to those who intend to perpetrate an unauthorized use and will serve as front line prevention against an unauthorized use. Second, limiting a cardholder's liability to \$50 for a claim of unauthorized use made more than sixty days after the charge first appeared on the statement encourages irresponsible account maintenance¹⁸⁵ and generally places an undue burden on card issuers regarding the ability to properly investigate the claim.¹⁸⁶

To help promote responsible account maintenance, Congress could impose a time frame outside of which a cardholder will be estopped from asserting an unauthorized use and thus lose the protection of the \$50 liability

past paid checks because a customer knows her signature better than her bank). The loss reduction principle is more complex than the loss spreading principle because it "assigns liability for the more complex purpose of affecting human behavior." Cooter, *supra* note 1, at 73. The loss reduction principle contains four elements of operation: precaution, innovation, responsiveness, and learning. *Id.*

184. Because photo identification and signatures are not mandated by bank card bylaws or the federal government, credit cards can be accepted absent any element of human contact. One example is at gas stations. Credit cards can be used to purchase gasoline by merely inserting a valid credit card into the appropriate slot built into the pump. In fact, with technology rapidly advancing, the physical act of inserting a credit card into the gas pump may soon be obviated.

185. Drafting laws that encourage precaution in handling payment instruments raise complex issues:

If liability falls upon only one party, how can the liability rules motivate other parties to take precaution as well? This phenomenon is an example of the 'paradox of compensation,' which afflicts no-fault rules in the areas of law. Holding one party strictly liable for a loss erodes the other party's incentive to take precaution and to refrain from any action that would increase the loss. Economic analysis suggests that fault-based liability rules are a solution to this paradox. Any fault rule, including simple negligence, negligence with a contributory negligence defense, and comparative negligence, will motivate one party to satisfy the legal standard of fault in order to avoid liability, while inducing the other party to take precaution because it must bear any residual responsibility for the loss.

Cooter, *supra* note 1, at 74.

186. When a cardholder claims an unauthorized use, a card issuer may investigate, in part, by obtaining the respective sales slip, or receipt of purchase, and then by comparing the signature on the sales slip to the cardholder's signature on their credit card application. See Official Staff Commentary to Reg. Z, *supra* note 46, § 226.12(b)-3(iv) (comparing the signature on credit slip for the purchase to a signature of cardholder on record is one factor that makes an investigation reasonable). However, a merchant's bank is only required under industry by-laws to store sales slips for a limited time and thus, if the cardholder's claim is made after this time, then the card issuer will be unable to obtain a copy of the sales slip which usually evidences the unauthorized use.

cap. One solution may be to limit the time frame to six months following the date the periodic statement reflecting the unauthorized use was mailed. This would ameliorate the burden placed on the card issuer when an unauthorized use is claimed at a much later date, and at a time which may prove unfeasible for the card issuer to attain the sales slips necessary to conduct a reasonable investigation. However, the TILA must balance such equities with an amended framework that provides for adequate consumer protection and encourages responsible account maintenance. This balance could be attained by setting a maximum liability cap of \$500,¹⁸⁷ applicable to unauthorized use claims reported after six months following the date the periodic statement reflecting the unauthorized use was mailed.¹⁸⁸ A \$500 liability limit would encourage cardholders to review their periodic statements, thereby encouraging responsible account maintenance and making fraud more readily detectable. At the same time, a \$500 cap would adequately protect consumers from absolute liability, regardless of the time an unauthorized use was reported, and it would recognize practical obstacles involved in conducting a reasonable investigation more than six months after the periodic statement reflecting an unauthorized use was mailed.

Failing to impose a time frame to report an unauthorized EFT is also not reasonable as applied to a transaction initiated with an offline debit card. To help support this proposition, the nature and functional differences of a credit card transaction must be examined generally and compared to other traditional methods of payment.

1. Nature of Payment with Credit Card

When a consumer obtains a credit card, a contract between the consumer and the card issuer is entered.¹⁸⁹ This contract is governed generally under state law and is subject to applicable federal laws such as the TILA and Reg.

187. Using liability as an incentive toward precaution on behalf of the consumer will have little effect unless the consumer's behavior responds to the imposition. Cooter, *supra* note 1, at 75. The element of learning now becomes essential for the loss reduction principle to operate. *See id.* "Over time, people tend to learn about liability laws, and their level of responsiveness will usually increase as they realize the need to conform their behavior to the laws' demands and understand the means for doing so." *Id.*

188. Under the loss reduction principle, the element of innovation "modifies the effect of the precaution element." *Id.* at 76. With regard to credit card companies, the implementation of fraud-prevention technology is largely driven by the law's assignment of liability. *See id.* at 76, 77 (stating that the development of technological mechanisms to prevent fraud have been financed by interested financial institutions). Therefore, "[p]ayment rules that assign liability to financial institutions . . . act as an incentive for the continued development of antifraud innovations." *Id.* at 77.

189. Matthews, *supra* note 33, at 237-38.

Z.¹⁹⁰ The product, or credit card, may vary according to the terms of the contract. The brand of card also may vary. For instance, the card brand could be Visa, MasterCard, Discover, American Express, or any other card provider.¹⁹¹ Essential services a card provider extends include providing a regulated bankcard network for processing transactions and clearing¹⁹² funds between the merchant's bank and the card issuer's bank.¹⁹³ Furthermore, all persons who issue or accept particular brands of credit cards are subject to contractual regulations issued by the respective card provider.¹⁹⁴ In accordance with applicable federal laws, these regulations govern the rights of a card issuer, merchant, and card provider with respect to matters involving a credit card.¹⁹⁵ It is also important to understand that card providers are not in the business of extending credit. It is revenue from member institutions in the form of annual fees, interchange fees,¹⁹⁶ and other service-oriented fees that allows card providers to operate.¹⁹⁷

When a credit card is used at a merchant location, few safeguards protect against unauthorized use.¹⁹⁸ Merchants are in business to profit and thus, there is a natural incentive to accept any legal form of payment, taking into consideration the risk of nonpayment. A merchant who accepts a valid credit card in person and who obtains a signed sales slip assumes very little risk of nonpayment, even when the person using the credit card is not authorized to

190. See generally *id.* at 238.

191. See *id.* at 233 (noting Visa, MasterCard, American Express, Discover, and Diners Club as some of the larger credit card providers). In contrast, examples of card issuers are Citibank or MBNA America.

192. In this context, the term "clearing" refers to "the process of exchanging financial transaction details between an acquirer and an issuer to facilitate posting of a cardholder's account and reconciliation of a customer's settlement position." BUSINESS RESOURCES: FOR MERCHANTS (visited Apr. 6, 1999) <<http://www.mastercard.com/business/merchant/bankglos.html>>.

193. See Matthews, *supra* note 33, at 240 (stating that the terms of these services are contained within the association agreement).

194. *Id.*

195. *Id.*

196. An interchange fee is charged every time a transaction is processed through a Visa or MasterCard network. See *id.*

197. Member institutions pay various service fees to the provider of a bankcard system. See generally *id.*

198. Current technology that has been implemented by Visa to help combat credit card fraud includes card activation programs, address verification services for telephone transactions, and Visa's Cardholder Risk Identification Service (CRIS). Visa's CRIS employs artificial intelligence to identify purchasing patterns that their system flags as suspect or possible fraud. HOTEL ONLINE PRESS RELEASE, *Visa Reports Card Fraud Drops to Record Low; Anti-Fraud Programs Produce Dramatic Results* (visited Apr. 5, 1999) <http://www.hotel-online.com/Neo/News/PressReleases1998/VisaReducesFraud_Feb1998.html>.

use it.¹⁹⁹ Put simply, merchants are generally not in the business of detecting fraud and thus no chargeback right exists solely because the use was unauthorized. A chargeback regulation based solely on the occurrence of an unauthorized use would essentially re-allocate liability from the card issuer to the merchant. Therefore, a card issuer usually absorbs the cost of an unauthorized use under industry chargeback regulations and the TILA.²⁰⁰

In most cases, it is equitable to place the cost of an unauthorized use on the card issuer since the card issuer is the proprietor of a product that can easily be used to legally bind a consumer to large amounts of debt, only limited by successful fraud-prevention controls and the consumer's credit line. It seems inequitable, however, to hold a card issuer fully liable for amounts incurred after a cardholder has had a reasonable amount of time to learn that the credit card has been used to make unauthorized purchases. No other commonly accepted method of payment in America offers a consumer such liberal protection against unauthorized use as does payment with a credit card under the TILA. For example, it would be difficult to structure a convincing argument that the federal government should enact consumer protection legislation that limits a consumer's liability for the unauthorized use of cash. Legislation as such would promote negligence, provide little societal benefit, and place an unimaginable burden upon the Federal Reserve System.²⁰¹

2. *Nature of Payment with Check*

A consumer who uses a check as a method of payment is not entitled to the same extent of liability protection offered to a credit card holder.²⁰² Generally speaking, a "bank may refuse to reimburse you for a forged check if it believes you were negligent, . . . [which may include] failing to safeguard your checks, filling them out in a way that would be easy to alter, or not notifying the bank about a loss in a timely manner."²⁰³

199. Although merchants are required to review the signature on the credit card with the signature on the sales slip, merchants are not susceptible to a chargeback merely because a signature is forged on the sales draft.

200. TILA § 133(a), 15 U.S.C. § 1643(a) (1994).

201. In the United States, the Federal Reserve System functions as the central bank and monetary authority. WILLIAM A. McEACHERN, *ECONOMICS: A CONTEMPORARY INTRODUCTION* 292 (3d ed. 1994). This authority entails the power to issue bank notes. *Id.*

202. See U.C.C. § 3-406 (1998) (failing to exercise ordinary care that substantially contributes to the making of a forged signature on an instrument bars one from asserting the forgery against a person who pays the instrument in good faith). See also U.C.C. § 4-406(c) (1998) (stating that a customer, whose bank makes available a statement of account, must exercise reasonable promptness in examining the statement to determine whether any payment was unauthorized because a purported signature by or on behalf of customer was unauthorized).

203. Mark Mellon, FDIC attorney, cited in FDIC CONSUMER NEWS, *Know Your*

As one plausible justification for this different treatment, a check-payment is accepted, processed and handled in very different ways than when a credit card is used as a method of payment.²⁰⁴ When a check is accepted by a merchant it is eventually deposited into the merchant's bank.²⁰⁵ This bank, the depository institution, then sends the check through the appropriate channels to collect on it.²⁰⁶ The check is eventually presented for payment to the bank upon which the check was drawn.²⁰⁷ The paying bank settles for the check if it fails to timely return the check.²⁰⁸ As a general rule, a paying bank that accepts a check that contains a forged drawer's signature is liable for the amount of the check.²⁰⁹ However, if the paying bank can prove the drawer of the check was negligent, and this negligence substantially contributed to the

(Liability) Limits (on file with author).

204. Negotiable instruments and the check collection process are largely governed by Article 3 and Article 4, respectively, of the U.C.C. See also Regulation J, 12 C.F.R. pt. 210 (1998) (governing the collection of checks and other cash and noncash items and the handling of returned checks by Federal Reserve Banks); Regulation CC, 12 C.F.R. pt. 229 (1998) (governing the availability of funds and other aspects of the check collection process).

205. A *depository bank* means "the first bank to receive an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter." U.C.C. § 4-105(2) (1998). Whereas a *payor bank* means "a bank that is the drawee of a draft." *Id.* § 4-105(3).

206. See generally *id.* § 4-202 (1998) (stating the basic responsibilities of a collecting bank).

207. See generally *id.* § 4-204 (1998) (providing general standards regarding sending or presenting a check to a payor bank for collection).

208. Under the U.C.C., a payor bank must return a check or send notice of dishonor before it has made final payment on the item and before the expiration of its midnight deadline. *Id.* § 4-301(a) (1998). See *Essex Constr. Corp. v. Industrial Bank of Wash.*, 913 F. Supp. 416, 419 (D. Md. 1995) (holding that a payor bank must decide to pay or return a check by midnight of the day it receives it for collection, and failure to do so is final payment). The "midnight deadline", with respect to a bank, is defined as "midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later." U.C.C. § 4-104(a)(10) (1998). See *Go-Tane Serv. Stations, Inc. v. Sharp*, 397 N.E.2d 249 (Ill. App. Ct. 1979) (concluding that midnight deadline runs from receipt of an item at a bank's computer center). Also note, if a payor bank returns or dishonors a check prior to its midnight deadline, then the depository bank becomes subject to a midnight deadline to charge-back the payee or its customer for an amount equal to that paid or posted on the dishonored check. See *Lufthansa German Airlines v. Bank of Am., N.T.S.A.*, 478 F. Supp. 1195 (N.D. Cal. 1979) (determining that midnight deadline for depository bank to charge-back customer runs from the time depository bank learns facts of dishonor).

209. See U.C.C. § 3-417(a) (1998) (providing no warranty to the drawee making payment that the signature on the check is authorized without the drawee having knowledge that the signature of the drawer of the check is unauthorized). It is a well-settled rule of law that "the drawee of a draft takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized." *Id.* § 3-417, cmt. 3 (citing *Price v. Neal*, 3 Burr. 1354 (1762)).

making of the forged signature, then the drawer or customer is liable for the loss.²¹⁰ Although the drawer of a check is not liable for a forged check that is paid when her conduct did not substantially contribute to the making of a forged signature, a drawer of a check will bear the loss of subsequent forged checks when the drawer fails to report a forgery upon receiving the check that first contained a forged signature and the accompanying statement.²¹¹

Checks, unlike credit cards, usually are accepted by merchants after the consumer presents proper identification. This is because the risk that the merchant may not receive payment is greater when a check is used as a method of payment. For instance, a practical risk merchants face is the risk that the drawer's account has funds insufficient to pay the par value of the check. If a merchant accepts a check that is timely returned for insufficient funds, then the merchant absorbs the loss.²¹²

As a merchant takes into consideration the practical risk of accepting a bad check, consumers also make practical considerations when paying with a check. Unlike credit cards, there is no extension of credit involved.²¹³ A check generally represents nothing more than a promise to pay a certain amount that is available upon demand.²¹⁴ Since checks are a method of payment using available and entitled funds and credit cards function as a method of deferring payment by using funds belonging to a creditor, using a check as a method of payment is likely to naturally induce more responsibility in respect to account maintenance by the consumer.

As an additional consideration, checks are typically recorded in the consumer's register. Recording check-initiated transactions provides a consumer with a simple way to track the checking account balance. On the other hand, credit card transactions leave the consumer with a copy of the sales slip, which provides the consumer with little assistance unless these slips

210. U.C.C. § 3-406 (1998).

211. U.C.C. § 4-406(c) (1998). Regardless of whether a customer or payor bank is negligent, a customer who fails to report an unauthorized signature on a check within one year after the customer received a statement reflecting the signature is barred from asserting against the bank the unauthorized signature. *Id.* § 4-406(f).

212. *Id.* § 4-301 (1998) (expressing that payment on a check may generally be revoked if the check is returned to the sender prior to midnight on the banking day after the banking day on which the check is received). If the drawer's account, on which the check is payable, contains insufficient funds to cover the face value of the check, the payor bank may return the check when done prior to its midnight deadline. *See generally id.*

213. *See* U.C.C. § 3-104(f) (1998) (stating that a check is "a draft, other than a documentary draft, payable on demand and drawn on a bank").

214. *Id.* One important characteristic of a negotiable instrument is that it is an "unconditional promise or order to pay a fixed amount of money." *Id.* § 3-104(a). "The most common type of demand deposit is the checking account." ERIC N. COMPTON, *PRINCIPLES OF BANKING* 7 (2d ed. 1986). Funds held in demand deposits can be withdrawn at any time. *Id.*

are recorded or kept. Therefore, a consumer who falls victim to check fraud may be able to determine such activity faster because the consumer's check-initiated transactions are recorded in the consumer's check register. In respect to consumer liability for falling victim to check fraud, this difference may help justify the consumer's obligation to maintain a U.C.C. standard of care when using paper checks as a method of payment.

Consumers also may have additional notification from their financial institutions when checks are used in an unauthorized manner. For instance, when a check is not honored for insufficient funds it will be returned by the drawee bank and a non-sufficient funds fee will generally be assessed to the consumer's account. Notification that a check has bounced and that a fee has been charged will be mailed promptly to the consumer. When a credit card is used to initiate an unauthorized transaction, a consumer will not receive notification that the credit line is reached unless fraud-prevention technology flags the account as suspect or the consumer reports the unauthorized use. Prompt notification that a check has bounced provides additional justification for imposing a duty upon consumers to report an unauthorized check-initiated transaction.

Whether a check bounces or a credit line is spent from unauthorized use, the consumer's purchasing power has been depleted. It is likely, however, that the average consumer's available credit line over exceeds his average available checking account balance. The risk to the consumer therefore increases if a credit card is used in an unauthorized fashion. Since the risk of being bound to large amounts of debt is greater than the risk of losing a checking account balance, state law may also justifiably provide less liability protection to a consumer by imposing a duty to report the first forged check the consumer has notification of, as contrasted to the failure to impose a similar duty under the TILA's liability provisions concerning unauthorized credit card use.

3. *Nature of Payment with Debit Card*

A debit card holds characteristics of both credit cards and checks.²¹⁵ An obvious similarity between debit and credit cards is that they both are access devices to financial accounts in the form of a plastic card. The process, or method of payment, however, may operate quite differently.²¹⁶ As already

215. See generally *Debit Cards: New Twists and Risks*, BANK RATE MONITOR, Sept. 5, 1997 (noting that offline debit cards draw funds directly from checking accounts like checks, yet are used like credit cards because a sales slip is signed and fund withdrawal is not immediate).

216. See *id.*

mentioned, there are two types of debit cards, online and offline, and both types process transactions in very different ways. An online debit card requires a PIN prior to use and will initiate an EFT immediately.²¹⁷ On the other hand, an offline debit card is processed, in some respects, similar to a credit card, yet the method of payment is similar to a check.²¹⁸

Similar to a credit card, when an offline debit card is used a signature on the sales slip is required.²¹⁹ This sales slip is evidence that the merchant is owed an amount of money equal to the amount of the purchase.²²⁰ Also like the credit card process, this transaction moves electronically through a network, depending on the brand of the card or network provider, such as one provided by Visa or MasterCard. Similar to using a check as a method of payment, the network provider then clears the funds, similar to the role of a clearinghouse in the check collection process.²²¹ Final payment, or the time when the consumer's demand account is debited, may occur two to three days after the transaction was initiated, which is also similar to the time it may take to collect final payment on a check.²²²

The key characteristic legally distinguishing an offline debit card transaction from a paper check transaction is that the transfer-of-funds process is initiated at an electronic POS terminal, and therefore, the EFTA governs the transaction.²²³ This characteristic alone, however, provides little support for different treatment regarding liability allocation. Functional similarities between the debit card transaction and check transaction provide better support for maintaining different liability allocation frameworks for unauthorized debit and credit card use. Aside from whether it is a paper check being used to initiate payment or an electronic impulse, it is the same financial institution that holds the consumer's checking or debit account, the nature of the account remains a demand deposit, the same notifications are provided if the account is overdrawn and consumers are likely to record debit card transactions in the same manner checks are recorded.

217. THE BETTER BUSINESS BUREAU, *Tips On . . . Using Debit Cards* (visited Dec. 28, 1998) <<http://www.bbb.org/library/debitcard.html>>; see also Balto, *supra* note 9, at 1098.

218. Balto, *supra* note 9, at 1098.

219. *Id.*

220. See Matthews, *supra* note 33, at 243 (commenting that a sales slip is evidence of a merchant's right to payment from the card issuer and of a credit card holder's obligation to pay the card issuer).

221. See generally Balto, *supra* note 9, at 1094.

222. See *id.* at 1098; see also *Debit Cards: New Twists and Risks*, BANK RATE MONITOR, Sept. 5, 1997.

223. See generally EFTA at § 903(6), 15 U.S.C. § 1693a(6) (1994).

B. ADDITIONAL INDUSTRY CONSIDERATIONS

1. *Industry Benefits and Safeguards*

If an offline debit card functions more like a check, should Congress amend the liability provisions of the EFTA with respect to unauthorized EFTs merely because the access device looks like a credit card and is accepted without a unique identifier? Based in part on the consumer protection policies already initiated by Visa and MasterCard,²²⁴ the answer to this question is in the negative. Visa and MasterCard claim to have reduced the possible liability of a consumer who uses their brands of offline debit cards because they want to protect the consumer, however, there may be more practical reasons that explain why these policies were implemented. To begin, it is not Visa or MasterCard that must absorb the cost of this liability, rather it is the card issuing member institution that absorbs this cost. Another practical reason Visa and MasterCard implemented policies that reduce a consumer's liability more than the EFTA provides is because, in effect, this seemingly consumer-oriented policy can be diligently advertised to the consumer²²⁵ and serves as an incentive to utilize Visa and MasterCard's network by obtaining and using their offline debit brand cards.²²⁶ As long as the market remains lucrative, consumer-oriented policies remain in full effect, and fraud-prevention measures keep fraud minimal, legislative intervention is not necessary.

The industry or network providers have kept the market lucrative in two ways: the promotion of offline debit cards and the imposition of an interchange fee per transaction. As a motivating pecuniary benefit resulting from more consumers obtaining offline debit cards, Visa and MasterCard receive

224. See *Understanding Credit and Debit*, CARDHOLDER SERVICES: MASTERCARD UNIVERSITY (visited Apr. 6, 1999) <http://www.mastercard.com/consumer/mcu/credit_b5pg6.html> (stating that liability resulting from a MasterMoney debit card transaction is generally capped between \$0-\$50 when use is unauthorized). Visa also has generally capped consumer liability between \$0-\$50 for unauthorized use of a Visa Check (debit) Card. See also Balto, *supra* note 9, at 1104-05 (describing the self-regulatory efforts of Visa and MasterCard). This is similar to the TILA liability limit regarding credit cards. See TILA § 133(a)(1)(B) (limiting maximum liability to \$50 for an unauthorized use).

225. A consumer unfamiliar with the EFTA's liability framework may not realize that, generally, as long as a lost or stolen debit card is reported within two days of when the consumer learned of the loss or theft, the maximum dollar amount a consumer can be held liable for an unauthorized use is \$50. See EFTA § 909(a), 15 U.S.C. § 1693g (1994).

226. Visa has begun to promote consumer education awareness programs about debit card use and its policies on liability. See *Visa Expands Debit Card Consumer Education With National Consumers League*, PR NEWswire, July 27, 1998. "Visa's survey showed that nearly 60 percent of cardholders who had not heard of Visa's \$0-liability policy said they felt even more secure about using their card once the policy was explained." *Id.*

interchange revenue every time an offline debit card is processed through their networks.²²⁷ This interchange amount is similar to the amount charged to process a credit card transaction.²²⁸ Moreover, since Visa and MasterCard have developed their businesses around the credit card transaction, and in compliance with the TILA and Reg. Z, and since a similar interchange amount is charged for both credit card transactions and offline debit card transactions, implementing debit card liability allocation policies similar to those applicable to credit cards may help justify the application of a similar interchange fee for processing debit card transactions.²²⁹ Due to the increasing demand of the offline debit card and the potential loss of credit card users, it is certainly advantageous for Visa and MasterCard to gain debit card network users and to receive the same interchange fee as when a credit card is processed.

A current problem with the Visa and MasterCard interchange price structures, which could result in fewer merchants accepting debit cards, is that processing expenses, similar to those involved with credit cards, do not exist for offline debit card transactions.²³⁰ Interchange fees for offline debit card transactions can "cost [as much as] 14 times more than the most expensive on-line debit transaction."²³¹ Taking another perspective, the Acting Assistant

227. Ralph E. Spurgin, *It's Got to Stop: Retailers Protest Debit Card Tying*, CREDIT WORLD, May-June 1998, at 18; *see also* Balto, *supra* note 9, at 1096.

228. Spurgin, *supra* note 227, at 18; *see also* Balto, *supra* note 9, at 1098.

229. *See generally Debit Follows In Credit's Corporate Card Footsteps*, DEBIT CARD NEWS, April 30, 1997 (stating that "a growing number of off-line [debit] card issuers [are] already generating large revenues by leveraging the payments foundation created for credit card transactions . . .").

230. Spurgin, *supra* note 227, at 18. With respect to a credit card transaction, certain expenses justify the amount of the interchange fee. *See id.* These expenses include, "financing the receivables, collections and bad debt, stationery, postage, and other expenses such as credit bureau reports and those involving the new accounts and customer service operation." *Id.* With respect to debit cards,

[T]here is no financing expense. The transaction amount is taken from the customer's checking account. There is little or no bad debt, and there certainly is no reason the bad debt should be any greater than what banks experience with normal checking accounts. There are no unique stationery and postage expenses, because debit card transactions are posted to the checking account statement, which is mailed to the consumer in any case. There are no credit bureau reports needed. An infrastructure, which needed to be established for credit card activity, was not necessary for the debit activity because a checking account infrastructure already existed. Simply put: The costs for debit cards are much lower than the costs for credit cards; yet, the price being charged is similar.

Id.

231. *Id.* *See also Raising the Debit Card Stakes*, WWD, May 28, 1997, at 5. NYCE, an online debit card network provider and competitor to offline debit card providers, charges

Director of the Office of Policy and Evaluation of the Federal Trade Commission's Bureau of Competition has commented that the offline debit card fee structure "creates perverse incentives to favor the more costly system."²³² This issue is further discussed below.

2. General Considerations

In amending the EFTA relating to consumer liability, Congress may be responding to a problem that does not exist.²³³ Senator Bennett, Chairman of the Senate Banking Committee's Subcommittee on Financial Services and Technology, appeared to justify capping a consumer's liability at \$50 for unauthorized debit card use when he stated: "[i]t is a good first step in attempting to reduce some of the outrageous costs of consumer [debit card] fraud."²³⁴ According to MasterCard, however, "fraud losses on MasterMoney [debit] cards have remained extremely low."²³⁵ In fact, "[o]f the hundreds of millions of MasterCard transactions that took place in 1996, only two one-hundredths of one percent (.02%) were fraudulent."²³⁶ Moreover, in 1996 financial institutions lost over eight times as much money from fraudulent credit card use as compared to offline debit card fraud.²³⁷ MasterCard claims that a "key reason that MasterMoney fraud numbers are so low is that our member financial institutions do a tremendous job of protecting themselves

only 7.5 cents on a \$100 purchase, and MAC, another online provider, charges only 6.5 cents. *Id.*

232. Balto, *supra* note 9, at 1099.

233. "In an operating market, private agreements between parties will generally produce economically efficient results without the need for legal intervention." Cooter, *supra* note 1, at 68.

Intervention becomes necessary, however, when the market fails to produce these efficient results on its own. Rules that are designed to achieve economic efficiency in payment law, therefore, should enforce agreements between private parties when no market failure has occurred. When market failures exist, legal rules can improve upon private agreements if they are designed with the goal of minimizing costs in mind.

Id. (footnote omitted).

234. Sen. Bob Bennett, *Bennett Promotes Bill to Protect Victims of Debit Card Fraud*, Sen. Bennett-Press Release, Sept. 23, 1997 (on file with author).

235. CARDTRAK ONLINE, *MasterMoney Liability Reduced*, July 31, 1997, citing Irene Katen, Vice President of Business Management, U.S. Deposit Access, MasterCard International.

236. *Id.* During 1997, Visa and MasterCard officials claimed that "roughly .01 percent of all debit card transactions were fraudulent" *Debit Fraud Detection In Credit-Bureau Style*, BANK TECH. NEWS, Mar. 1998.

237. *The Fast-Growing Debit Market Gets New Tools To Show Fraud*, DEBIT CARD NEWS, July 31, 1997.

and their cardholders.”²³⁸ Possibly an additional explanation is that consumers are generally more responsible in maintaining debit card accounts than in maintaining credit card accounts because debit cards “draw directly on customer deposits in checking or savings accounts.”²³⁹ And thus, the risk of losing available money has a different affect on one’s attitude toward protecting against such risk, as compared to protecting against the risk of being bound to debt.

When offline debit card use increases, not only does Visa and MasterCard’s revenue increase, but so does the revenue of the financial institution that issues the debit card.²⁴⁰ These revenues result from interchange fees that are received every time a transaction is processed through the network of an offline debit card provider.²⁴¹ For example, for a \$100 purchase, made with a MasterMoney offline debit card, MasterCard charges an interchange fee of \$1.32.²⁴² A small portion of this revenue is received by the financial institution that issued the debit card.²⁴³ At best, this revenue equals the financial institution’s expenses for providing an offline debit card product.

As a consequence of accepting offline debit cards, the merchant who accepts an offline debit card bears the cost of the interchange fee.²⁴⁴ As a result, a class action lawsuit, with plaintiffs such as Wal-mart, The Limited, Sears, Safeway, Circuit City, the National Retail Federation and the International Mass Retailers Association, has been brought against Visa and MasterCard alleging a violation of antitrust law by enforcing an illegal tying arrangement.²⁴⁵ The tying arrangement allegedly forces merchants to accept offline debit cards as a condition to being able to accept credit cards.²⁴⁶ Because the average interchange cost for merchants to process offline debit card transactions is much higher than a merchant’s cost to process online debit

238. CARDTRAK ONLINE, *MasterMoney Liability Reduced*, July 31, 1997.

239. See *Debit Cards: New Twists and Risks*, BANK RATE MONITOR, Sept. 5, 1997.

240. See generally Spurgin, *supra* note 227, at 18.

241. See generally *id.*; see also Balto, *supra* note 9, at 1096.

242. Spurgin, *supra* note 227, at 18.

243. See generally *id.*

244. *Id.* “Many retailers only make a few cents on the dollar after all expenses are paid. It’s not surprising then that they don’t want to give one of those few cents to Visa for replacing a paper check with a plastic one.” *Id.*

245. *Id.* at 17. The lawsuit was filed in the U.S. District Court for the Eastern District of New York on October 25, 1996. *Id.* at 18. Retailers claim to be paying hundreds of millions of dollars in excessive interchange fees for accepting Visa and MasterCard brand offline debit cards. *Id.* If a settlement agreement is not reached, trial is scheduled to begin in Spring 1999. *Id.* at 21.

246. *Id.* at 18.

card transactions and checks, merchants that do not want to lose their ability to accept credit cards claim that they have little choice but to accept offline debit cards.²⁴⁷ Most importantly, with respect to damages, merchants claim that interchange fees charged for debit card transactions, similar in amount to those charged for credit card transactions, are not justified because offline debit card transactions do not involve expenses similar to credit card transactions.²⁴⁸ These interchange fees are alleged to have already resulted in billions of dollars of damages.²⁴⁹ Depending upon the outcome of this litigation, if merchants are forced to accept offline debit cards and pay billions of dollars in interchange fees, then this cost could ultimately be passed to consumers through increased prices, notwithstanding a consumer's method of payment.

CONCLUSION

Acknowledging that debit card fraud is relatively low, the critical question is whether the EFTA's existing liability protection against unauthorized EFTs is more beneficial to society than if amended. Without empirical evidence, this is a difficult question to answer. At the time of writing this comment, applicable provisions under the Bankruptcy Reform Act of 1999 appeared to provide the best solution because this legislation would simply require an examination of whether the EFTA's current liability framework provides consumers with adequate protection against unauthorized debit card use.

If, on the other hand, if the EFTA is amended to limit a consumer's liability to only \$50 irrespective of when the consumer reports an unauthorized offline debit card transaction, then regardless of industry policies, consumers may respond in a detrimental fashion by avoiding responsible account maintenance and precautionary measures. Though the cost incurred by consumers acting in this fashion could be absorbed by a financial institution and then passed to all customers, the nominal amount distributed should be considered as an aggregate value and balanced against protecting consumers who negligently maintain debit card accounts. This consideration, along with many others in the intricate world of payment law, must be

247. *Id.* "The suit relates to four points: 1) the price is unfair; 2) the price is exorbitant; 3) most importantly, debit acceptance is tied to credit acceptance; and 4) this forced acceptance results in billions of dollars in damages." *Id.*

248. *See id.*

249. *Id.* at 19.

assessed and reflected in any future amendments to the EFTA's liability framework.

By passing legislation to amend the EFTA – in effect changing its present liability framework to resemble that under the TILA – Congress will provide no additional protection to responsible consumers who use offline debit cards because the industry has already initiated liability allocation measures in accordance with equity and reasonable consumer behavior regarding debit card use, and thus, adequate safeguards against unauthorized use are already in place. So long as industry standards remain sensitive to legitimate consumer protection issues and the debit card market's profitability remains sufficiently contingent upon providing consumers with reasonable safety-oriented incentives to use offline debit cards as a payment method, federal intervention is unnecessary. Therefore, the debit card should be promoted by the federal government only to the extent that protecting the consumer is truly justified and any enacted legislation should be in the best interest of society as a whole.

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