THE TRIPARTITE CREDIT CARD TRANSACTION[1]

I INTRODUCTION

In the United States the use of credit cards is staggering. It was estimated[2] in 1970 that there are approximately 200 million credit cards, the average family having 6.1 cards. However, in New Zealand it is a novelty. While the tripartite card is common the tripartite plan is only just being introduced[3] but is likely to catch on quickly bringing with it certain inherent problems.

This discussion will begin with a presentation of the historical development of the credit card, followed by an explanation of the basic mechanics of the tripartite plan. Next, the plan will be examined in the light of two recognised commercial transactions to identify its legal nature. Attention will then be directed to some of the problems of the credit card transaction: the cardholder's responsibility to pay for unauthorised purchases, and the applicability of fiscal and economic control legislation. Finally, some general conclusions will be made.

The discussion will closely analyse the American position and will attempt to make predictions in the appropriate places as to whether their practice and approach will be followed in New Zealand.

II HISTORY OF THE CREDIT CARD[4]

The precursor of the modern credit card was the credit coin.[5] As early as 1915 merchants in the United States, in an attempt to stimulate sales, began issuing these coins to be used by their customers in making credit purchases.

During the 1920's the issuing of credit cards, which had replaced credit coins became an independent industry. The customer was allowed

1. This article will not be concerned with the bipartite credit card which is a simpler arrangement whereby a retailer issues credit cards to enable his customers by production of the card to obtain goods and be billed for them later.
2. "We must curb the dangers of the Credit Card" — Senator W. Proxmire: Science and Mechanics; June 1970.
3. It was reported in "The Sunday Times" March 1971 that of the all-purpose credit card firms Diners' Club is the only one established in New Zealand. It has 2,000 card holding members and 700 accredited outlets. The only other tripartite plans are those operated by the rental car companies — Mutual and Avis. Bank credit cards are at present being looked into by New Zealand banks.
4. See "Sales: Credit Card holders' Liability for Unauthorised Use", L. Weber (1967) 20 Oklahoma L. R. 219; "Credit Cards — a Survey of the Bank Card Revolution" — N. Savikas and F. Shandling (1967) 16 De Paul L. R. 389.
5. The difference between the credit card and the credit coin is primarily one of physical appearance. Whereas the credit card is a wallet-sized piece of plastic or stiff paper imprinted with a minimum of the holder's name and address, the credit coin is a small piece of metal with the merchant's name and the holder's account number engraved on it.

to purchase goods from merchants who were authorised by the issuing merchant to honour the credit card. This arrangement was launched by the petroleum industry. An oil company's card could be used to buy goods from any of its own retail outlets or those of its independent contractors. Later it became common for oil companies to make reciprocal agreements whereby each company agreed to honour cards issued by the other and it therefore became possible for a cardholder to make nation-wide use of his card at service stations. Hotel chains, telephone companies, etc., quickly followed the lead of the oil companies.

No further developments were made until 1951 when the first all-purpose plan was established by the Diners' Club. Unlike previous firms which issued credit cards, Diners sells no goods. It performs credit and collection services for the merchant members of the plan, and makes it possible for card-holding members to purchase goods at an increasing number and variety of merchants without having to enter into a direct credit relationship with any of them. Diners' Club had no competition until 1958 when the American Express Company and Carte Blanche initiated their own plans. All three are now world-wide and cater primarily for the needs of businessmen.

Early in 1960 the banks entered the credit card field offering the all-purpose[6] plan to the "average" family. They provided the next break-through in 1966 when the Midwest Bank Card System was established. Here several banks operating in a contiguous geographic area issue a common card and operate a central clearing house. Card-holders are in a position to utilise their cards, issued by any one of the banks, in transactions with any merchant having a relationship with any member bank of the system. Several other such systems have been established in America and the next likely step is a relationship between all of them.

III MECHANICS OF THE CREDIT CARD PLAN

Credit card plans involve one issuer[7] and many merchants and holders. The issuer is the credit guarantor of the plan, soliciting both merchants and holders. The issuer distributes credit cards either upon application or, until recently, by sending them unsolicited through the mail.[8]

6. At present in California an experiment is taking place between a bank and several county tax-collectors featuring the use of credit cards as a means of paying personal and real property taxes.
7. Some plans involve a fourth party. The functions of the issuer in the tripartite plan being divided between an issuer who promotes the plan and collects holder fees, and a bank which serves as a central agency for the billing and collecting of holder accounts.
8. This practice is now prohibited by Pub. L. No. 91-508, Title V §132, and by the Federal Trade Commission regulations issued pursuant to that Act in Banks and Banking, Truth in Lending, Federal Reserve Press Release, Jan. 20 1971, §226.13(b) which came into force on January 25 1971. Therefore any problems arising out of the practice will not be discussed.

The holder is entitled to purchase goods or services on credit from any retailer who has become a merchant member of the plan.[9] For this privilege the holder may have to pay an annual fee,[10] but under many plans the cards are issued free of charge. The holder also contracts[11] to reimburse the issuer for all credit extended on the basis of the card.[12] Usually at the end of each month the issuer totals all the holder's purchases and sends him a statement of his account. The holder has the option of paying the face amount of the bill within a specified period or paying by a deferred payment schedule. Under the latter 10%-20% of the bill is paid within a specified period. The remainder is paid in monthly instalments subject to a service charge which is computed as one and one-half percent of the previous month's balance, less all appropriate credits. Under most plans the holder is given a maximum amount of credit and at any given time the credit available to him is dependent upon the amount owing to the issuer.[13]

Every merchant enters into a common form contract with the issuer which describes their rights and duties. The merchant is obliged to "assign" or "endorse" to the issuer all "sales drafts" or "accounts" which represent sales made to the holder, and in return receives settlement for these sales. The issuer assumes the credit risk, handles the billing and collection procedures and investigates the credit rating of card applicants. For these services the issuer discounts the sales drafts at an agreed rate.[14] Under some plans the merchant must also pay a membership fee of up to $25.00 and a monthly rental of $1.00 for each sales draft imprinter necessary to operate the plan.

Therefore the holder has instant purchasing power, the merchant is able to obtain instant payment and the issuer makes a substantial profit.

IV LEGAL NATURE OF THE CREDIT CARD

There appears to have been no attempt to formulate a comprehensive legal definition of the exact nature of the tripartite plan. However, many writers have likened it to some existing legal categories.

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9. Such merchants are identifiable by their prominent display of the issuer's emblem. Issuers also distribute to their cardholders a list of the names and locations of all their merchant members. In addition some companies list all merchant members in every large city in the yellow pages of the telephone book.
10. In the United States this fee is only $5 or $6, but to join the Diners' Club plan in New Zealand costs $10.
11. The terms of the contract are contained either on the reverse side of the card or in the accompanying literature.
12. As to the liability of the holder for purchases made by a thief or imposter see Part V.
13. Policing of this limit is usually solely a matter for the issuer. However, some issuers stamp their cards with a sum in excess of which no single purchase can be made without first obtaining the issuer's authority.
14. The rates range from nil to 10% depending upon the nature of the retail establishment, its volume of sales, etc.

It is now proposed to observe the workings of the credit card transaction against the background of two other transactions so as to help explain the economic realities and legal problems of credit card plans.

(a) *The Travellers' Letter of Credit*[15]

The travellers' letter of credit enables persons to raise funds when travelling abroad without having to carry money with them. To accomplish this three parties are required — the issuing banker, the correspondent banker[16] and traveller or customer.

The traveller initiates the transaction by asking his banker to arrange credit for him while he is away from home. Thus the first contract is between the issuing banker and the traveller, and is contained in a letter addressed to the correspondent bankers in the locations the traveller expects to visit. The letter authorises the correspondents to pay the traveller sums up to the amount indicated in the letter. To avoid fraud the traveller is also usually provided with a letter of indication which bears his own signature authenticated by the issuing banker. When the traveller wants cash he presents the two letters to the correspondent who will require him to sign a draft for the amount and will compare the signature with that on the letter of indication. As he receives payments, the various sums are endorsed in the letter.

The contract between the issuing banker and the correspondent bankers is embodied in the travellers' letter of credit, which in effect states that if the correspondent makes payments to the traveller then the issuing banker promises to reimburse the correspondent for those advances. The letter usually takes the form of a promise to honour drafts presented to the issuing banker, and when the correspondent acts on this promise the contract is formed.

The primary purpose of the credit card and the travellers' letter of credit is the same in that both accomplish a substitution of the credit of a financially responsible person for the personal credit of another. Moreover the cardholder is in contractual privity with the card-issuer, as is the traveller under a travellers' letter of credit with the issuing banker. However, there are differences between the two transactions. While the travellers' letter of credit itself is the contract between the issuing banker and the correspondent, the credit card does not perform this function but represents the agreement between the card-issuer and the card-holder. Furthermore, the credit card does

15. The travellers' letter of credit originated in the thirteenth century and was popular until the beginning of the present century. However, with the increase in travelling, travellers' letters of credit became unsuitable, mainly because they were not flexible enough and this led to the development of travellers' cheques. For further analysis see "Law of Banking" — Lord Chorley (1967) 5 ed. Pitman; "Travellers' cheques and the Law" — E. P. Ellinger (1969) 19 Uni. Toronto L. J. 137.

16. The issuer and the correspondent while usually bankers may also be well-known institutions or trading firms.

not in itself entitle the cardholder to obtain goods on the credit of the issuer as would a travellers' letter of credit. Before the cardholder may use the card there must exist an antecedent agreement between the card-issuer and the merchant; thus the credit card serves more as an identification card. But in the travellers' letter of credit the contract between the issuing banker and the correspondent is embodied in the letter itself, and is created when the correspondent acts on the issuing banker's promise to reimburse by sending drafts to him.

(b) *The Factoring of Accounts Receivable*[17]

A factor purchases[18] at a discount the accounts receivable of his seller client for immediate cash, without recourse to the client should the buyer default on his payments. In addition to assuming the credit risk, the factor relieves the seller of the credit checking and book-keeping; notifies the buyer of the assignment; and makes collections of the accounts. Here it is the seller who initiates things.

The factor resembles the credit card issuer with regard to the services the issuer performs for the merchant members of the plan. Indeed in *Uni-Serv Corp.* v. *Frede*[19] Rosenburg J. said the issuer "is in practical effect a 'factor' for its retail store participants." But the similarity is somewhat illusory because the factor normally contracts to purchase *all* the sellers' accounts whereas the card-issuer purchases only those that represent credit card purchases.

The main difficulty in an analogy between the factoring of accounts receivable and the credit card plan is that the factor has no contractual privity with the buyer, nor indeed any relationship prior to the contract for sale, whereas the issuer has a direct contractual relationship with the cardholder, established before the contract of sale.

(c) *The Credit Card*

Under the travellers' letter of credit the traveller's promise to make payments for purchases directly to the issuing banker creates an obligation owing *directly* from the traveller to the issuing banker. In the factoring of accounts however, the buyer's promise merely indicates that he will make payments to the factor only after the right to enforce the obligation has been *assigned* to the factor by the seller.

Any attempt to form a legal pattern of the credit card transaction must therefore ask whether the card issuer derives his right to receive payment from the cardholder, either from the holder or the merchant — i.e., the question is whether the issuer, in a position similar to that of the factor stands as an assignee of the claim against the holder for

17. For further analysis see "The Export Trade" — C. Schmitthof (1969) 5 ed. Stevens.
18. While many issuers, like the factor, pay immediate cash for the accounts of the merchant, under some plans the merchant must often wait up to two months before receiving payment from the issuer. In such circumstances the comparison between the factor and the issuer wears thin.
19. 50 Misc. (2d.) 823; 272 N.Y.S. (2d.) 478, 480.

the purchase price, or whether as in the letter of credit situation, the card holder's promise to pay the issuer is interpreted as directly creating the issuer's right to collect.

The choice between these two possible interpretations (the direct obligation theory and the assignment theory) is not purely academic. For example the availability to the cardholder of defences and counter-claims in an action by the issuer, may be affected by the adoption of one theory instead of the other.[20]

The fallacy of the assignment theory is that it focuses upon the sale and treats it as giving rise to an account between seller and buyer which is assigned to a third party. This overlooks the fact that before the sale two contracts have been entered into, one between issuer and holder, and another between issuer and merchant. Since the merchant promises to transmit all sales slips to the issuer and the issuer promises to pay the merchant their face value, less discount, and since the cardholder promises to make payments directly to the issuer, it appears that the merchant parts with the goods, not in reliance upon the buyer's but upon the issuer's promise to pay for them. The issuer in turn makes payments to the merchant in reliance upon the holder's obligation of reimbursement.

Although the assignment theory is supported by language in issuer-merchant contracts, which refer to an undertaking by the merchant to assign, endorse or sell sale drafts representing credit purchases, it would seem there is no assignment at all. At no point in the transaction does the cardholder expressly promise to make payments to the merchant, nor do the contracts between the three parties contemplate such payments. If there is any assignment at all, it is only an assignment or transmittal of a document, i.e., the sales draft, that is necessary for the practical operation of the plan. The sales draft merely informs the issuer that an obligation has arisen in his favour from the holder and that the issuer is obliged to pay the merchant.

The courts however, have not been consistent in indicating which theory is preferred. In *Gulf Refining Co.* v. *Williams Roofing Co.*[21] the Court stated that in regard to the sales drafts the merchants were assignors and the issuer their assignee. In *Union Oil Co.* v. *Lull*[22] the Court quoting extensively from *Williams Roofing Co.* also talked in terms of assignment without recognising the possibility of the direct obligation theory. However, *U.S.* v. *Golden*[23] seemed to assume the existence of a direct obligation owing from the holder to the issuer.

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20. Under the direct obligation theory the cardholder will be unable to raise against the issuer any defence which would have been available against the merchant, whether or not this claim arises from the sale. However, under the assignment theory, the issuer (assignee) obtains no better right than was held by the merchant (assignor) and therefore, any defence arising out of the sale itself will be available against the issuer.
21. 208 Ark. 362; 186 5 W. (2d) 790.
22. 220 Ore. 412, 349 P. (2d) 243.
23. 166 F. supp 799.

In *Diners' Club* v. *United*[24] the merchant-issuer contract was couched in terms of assignment and the Court found that there had been an actual assignment of the merchant's claim to the issuer. However, the Court indicated that it would have reached the same decision in the absence of assignment. The Court thereby gave weight to the direct obligation theory, and stated that even where the holder's obligation to pay the issuer is direct, it should be construed as conditional upon the merchant's fulfilment of his obligations under the contract of sale.[25]

It is therefore submitted that the nature of the credit card transaction is closely analagous to that of the travellers' letter of credit. Thus the direct obligation theory which stems from it as construed in the *Diners' Club* case should be used to govern the rights and duties of the parties in resolving for example disputes as to liability for unauthorised use.

V THE CARDHOLDER'S LIABILITY FOR UNAUTHORISED PURCHASES

The question of the cardholder's liability for unauthorised[26] purchases most frequently arises when a credit card is lost or stolen and the issuer brings suit against him to recover the amount of purchases made by an imposter.[27] The practice in this area has been either to make express provision for risk allocation in the holder-issuer contract, or to make no such provision and allow the question of liability for unauthorised purchases to be determined by the courts or the legislature.

(a) *Judicial Intervention Where There is no Risk Allocation Clause*

The early American cases are of more than historical interest. Although they involve two-party situations, liability clauses were not present and therefore not only do they represent judicial guides for deciding a modern tripartite plan imposter case where there is no risk

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24. Civil No. A 10872, app. Dep't Cal., August 6, 1964 (unreported).
25. Such a construction will overcome the problem refered to in footnote 20 and the accompanying text. The holder under the direct obligation as under the assignment theory, will be able to raise as a defence against the issuer any defect arising out of the contract of sale.
26. The preliminary question of whether in fact there has been an unauthorised use may often arise. In three cases the holder's card was used by a party who had a special relationship to him, which was sufficient to authorise use of the card, and to make the holder responsible for that party's purchases:
    (i) *Sinclair Refining Co.* v. *Consolidated Van & Storage Co.* 192 F. supp 87 — employee.
    (ii) *Kane* v. *Standard Oil* 33 S.E. (2d) 913 — employee.
    (iii) *Neiman-Marcus Co.* v. *Viser* 40 SO 2d 762 — estranged wife.
27. This situation should be distinguished from that where the holder himself exceeds his authorised credit limit, but it should be noted that in either situation persons making unauthorised use of a credit card may be subject to criminal liability. However, discussion of these matters is outside the scope of this article.

allocation clause, but they also set the pattern for latter cases where risk allocation clauses appeared. Here there are three views:

In the first of these cases *Wanamaker* v. *Megary*[28] the Court invoked the doctrine that as between two innocent parties he who makes the loss possible should bear it. The holder by her negligence in keeping the coin in an insecure place had made the imposter's purchases possible and she was therefore held liable.[29] Under this theory the holder is strictly liable.

However in *Lit Bros* v. *Haines*[30] the Court rejected the *Wanamaker* decision and ruled that in the absence of an express contract a coin-holder is not liable for purchases made by an imposter. This broad rule was also stated in *Jones Store Co.* v. *Kelly*[31] and advanced in the more recent cases of *Thomas* v. *Central Charge Serv. Inc.*[32] and *Raynor* v. *Affiliated Credit Bureau Inc.*[33] Under this theory the issuer always bears the loss.

The third view arose from *Gulf Refining Co.* v. *Plotnick*,[34] a three party case, which held there is an implied obligation on the part of each party to exercise due care — the holder in using the card and the issuer in honouring it. Therefore the Court resorted to weighing the negligence of the parties. On the facts the holder was held liable because his negligence in handling the card and in failing to report theft of the card, exceeded any negligence of the merchant in accepting the card from the thief. The Court added that in the absence of any negligence on the holder's part the issuer would have to bear the risk because there was no risk allocation clause in the contract. This same reasoning was used to reach the opposite result in *Humble Oil & Refining Co.* v. *Waters*.[35] Under this view liability is determined by the concept of relative fault, otherwise there is issuer liability.

In weighing the merits of the three views, the strict holder liability of *Wanamaker*[36] is inequitable because it makes the holder virtually an insurer. The second view expressed in *Lit Bros* works an undue hardship upon the issuer who must absorb the risk regardless of the

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28. 24 Pa. Dist. 778.
29. The court also advanced the theory that a credit card is similar to a negotiable instrument payable to bearer. This theory has been systematically rejected or ignored in subsequent cases. Especially in *Lit Bros* v. *Haines* 98 N.J.L. 658 where it was held that a credit card is merely a means of identification of the particular holder.
30. 98 N.J.L. 658.
31. 225 Mo. App. 833; 36 S.W. 2d 681.
32. 212 A (2d) 533.
33. 455 P (2d) 859.
34. 24 Pa. D. & C. 147.
35. 159 50. (2d) 408.
36. It is submitted our Courts would reject this approach for a similar view expounded by Ashurst J. in *Lickbarrow* v. *Mason* 2 Term. Rep. 63, 70; 100 E.R. 35, 39 has subsequently been criticised and cannot now be regarded as good law. See e.g. *Farquaharson Bros.* v. *King* [1902] A.C. 325, 342; *Central Newbury Car Auction Ltd.* v. *Unity Finance Ltd.* [1957] 1 Q.B. 371, 388-389.

holder's negligence. The third view of *Plotnick* is the most equitable because it considers the negligence of the parties. Since the benefits of the credit card accrue to both parties, the risk should also be apportioned.

However, the position is not clear and despite the fairness of the *Plotnick* view there seems to be a tendency not to hold the cardholder liable unless he specifically contracted to bear the loss.[37] But the problem is not significant since it is extremely unlikely that any modern credit card plan would be established without providing for risk allocation.

(b) *Judicial Intervention where there is a Risk Allocation Clause*

As the tripartite plan began to evolve the issuer became divorced from the increasing volume of credit sales and it became more difficult for him to prevent directly purchases through the use of lost or stolen credit cards. This factor, together with the conflicting line of cases, prompted issuers to begin inserting risk allocation clauses. Initially the clauses attempted to shift the entire risk by making the cardholder liable for all purchases until the card was surrendered.

Magnolia Petroleum Co. v. *McMillan*[38] appears to be the first reported case where the holder contractually undertook to be responsible for all purchases prior to surrender of the card, and here the court held the holder bound by the provision.

A modified version of the contractual provision in the *Magnolia* case appears in *Gulf Refining Co.* v. *Williams Roofing Co.*[21] Here the holder assumed full responsibility for all cards obtained on credit by any person presenting the card. But in addition the holder typed the words "Good for Trucks Only" on the card. An imposter obtained the card and made several purchases. In an action by the issuer to recover for these payments the Court held that the holder's unilateral act in typing the words "Good for Trucks Only" across the face of the card, thereby restricted his liability to those kind of purchases only. Moreover the Court held the holder's agreement to assume full responsibility was in fact a guarantee of payment to anyone extending credit in good faith upon the strength of the card, and that the holder-guarantor could not be held liable beyond the strict terms of his contract. On the facts the holder was not liable because credit was not extended in good faith; the imposter used a car and not a truck, and there was also evidence of collusion between the imposter and the merchant's employees.

Fearing judicial hostility to liability for all purchase clauses, issuers changed to the now common provision which makes the holder liable

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37. The three most recent cases: *Humble Oil & Refinining Co.* v. *Waters* 159 SO (2d) 408; *Thomas* v. *Central Charge Serv. Inc.* 212 A. (2d) 533; and *Raynor* v. *Affiliated Credit Bureau Inc.* 455 P. (2d) 859 have not held the holder liable.
38. 168 S.W. 2d 881.

for all purchases until either, the card is surrendered, or until the issuer receives written notice of the loss or theft of the card. But the Courts have employed two theories in interpreting these clauses.

Under the first theory expounded in *Texaco Inc.* v. *Goldstein*[39] the contractual provision is decisive in defining liability. The holder owes a direct contractual obligation to the issuer to pay for all purchases made prior to notification of loss or theft of the card, irrespective of any questions of negligence. The terms of the 'liability til notice' clause constitute an original undertaking in which the holder makes any use of the card his own responsibility. The Court said[40] they so held because:

> With the increasing use of the credit card and its growing importance to the economy, the imposition of a high duty of care upon the major oil companies would result in an impairment of an important segment of our economic structure . . . Unless actual notice of loss is given to a company it can have no way of knowing of such loss and to require some 30,000 dealers to suspect the loss of any particular card and use diligence against its abuse is not within the requirements of the issuer of the credit card.

This view was followed in *Mobil Oil Corp.* v. *R. J. Evans Glove Co.*[41] and in *Uni-Serv Corp* v. *Vitiello.*[42] In the latter case the Court in addition suggested the holder's liability should be limited to the credit limit imposed on him by the issuer.

The second theory also binds the holder to the terms of the credit contract, but regardless of the holder's own negligence the issuer can recover only if he and the merchant exercised due care in honouring the credit card.[43] Moreover the burden of proving such due care is on the issuer. This theory which has its embryonic beginnings in the *Williams Roofing Co.* case was formulated in *Union Oil Co.* v. *Lull,*[22] Here the 'liability til notice' clause made the holder a guarantor of all purchases. The Court pointed out that the guarantee was essentially gratuitous since the holder had little or no control over the conduct

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39. 34 Misc. (2d) 751; 229 N.Y.S. (2d) 51.
40. Ibid. at 755; 229 N.Y.S. (2d) at 55.
41. 60 Misc. (2d) 314; 303 N.Y.S. 2d 103.
42. 53 Misc. (2d) 396; 278 N.Y.S. (2d) 969. The holder, although orally notifying the issuer immediately was held liable for all purchases by the thief until the issuer received written notice of loss of the card. Compare *Read* v. *Gulf Oil Co.* 114 Ga. app. 21; 150 S.E. (2d) 319 where the holder gave notice by phone and was told not to worry. A few days later she confirmed the notice by mail. However, she owned two Gulf credit cards and in the letter gave notice to cancel the wrong one. Gulf claimed it had not been effectively notified of the loss. Without mentioning the problem the court gave judgment for the holder. These different views raise the question of the nature of the notice that must be given.
43. The most obvious example of negligence on the part of a merchant would be his honouring an expired card when the expiration date is printed on the face of the card. The issuer would be negligent where for example he allowed an unusual buying pattern to continue.

of others and, in any transaction which may create indemnity liability, the person indemnified (the issuer) has the duty of exercising reasonable care to protect the person giving the indemnity (the holder).[44] On the facts the issuer had not proved the exercise of reasonable care since the residence of the holder listed on the credit card was in a different state from that shown on the license plate of the purchaser's car.

This approach was subsequently approved in *Diners' Club Inc.* v. *United.*[24] However, the issuer's action against the holder to recover the price of purchases made by a thief of the card was dismissed on another point.[45]

A further refinement was made to the second theory in *Allied Stores Inc.* v. *Funderburke*[46] which held that a 'liability til notice' clause is inapplicable where the holder is unaware the credit card is lost or stolen. This was founded on the rule that there can be no liability without fault. The mere fact that a thief had acquired the holder's card did not show any negligence on her part, but on the facts the issuer had contributed to the loss because a large number of purchases in excess of the credit limit were permitted to occur. However, the Court was careful to limit its holding to the bipartite factual setting of the case. Moreover it is a strained interpretation of the notice clause and therefore it is very doubtful whether it applies to the tripartite plan.

A choice between the two theories really involves deciding whether the contract should be literally or liberally interpreted. The first theory is more in accordance with the intention of the issuer; however, no emphasis is placed on the actions of the parties. A merchant could sell to a known thief for a share of the take. Moreover, since under the first theory neither the issuer nor the merchant is liable until notice, unquestioned acceptance of the card by the merchant is encouraged. While this promotes the purpose of the card in making it similar to cash, it is doubtful whether the rule needs to be so strict.

The second theory, which it is submitted should be preferred, tends to encourage more diligence by the merchant in preventing improper purchases. Where the issuer has some direct control over the seller,

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44. In reaching this conclusion the court drew an analogy with the bank passbook cases, where the bank must exercise reasonable care in making inquiries into the authority of the withdrawer even though the depositor has agreed that the bank would not be liable for fraudulent use of the passbook.
45. The issuer-holder contract provided that the holder was to pay the issuer for any charges incurred with the holder's card. The issuer-merchant contract however, provided that the issuer undertook to purchase all valid charges. The charges accepted by the merchant from the thief were not valid charges. Therefore when the issuer purchased the charges which were the basis of the suit, it made the payments voluntarily to promote its own goodwill among merchants. The court said such a voluntarily payment is not damage, and therefore there was nothing to base the cause of action on.
46. 277 N.Y.S. (2d) 8.

he can exercise this control to assure the merchant's diligence. But even where the issuer has no actual control, as where the merchant is an independent contractor, he can still expect a higher standard of performance through proper indemnity clauses in the merchant-issuer contract. However, the requirement under the second theory that the issuer prove due care on the part of the merchant has been criticised in that it will usually result in the issuer losing the case. This is based on the fact that it will often be impossible for the merchant to recall all his actions, even if due care was in fact used, and also on the fact that costs in locating the necessary witnesses and taking depositions will often be prohibitive. Granting that this rule may often be harsh on the issuer, it would be even harsher to put this burden of proof on the holder. The holder is not present when the charges are incurred and unlike the issuer, it would be impossible in most instances for him to prove that due care was not used. Therefore although the second theory will no doubt cause issuers to require their merchants to impose same checks in transacting credit sales this inconvenience stems from the fact that the issuer is dependent upon a broad base of creditor payments and should expect to absorb the risk of non-payment as a part of his business. Moreover a further factor in favour of the second theory is the court's reluctance to uphold agreements where the bargaining power of the party on whom the risk is placed is small compared to that of the exculpated party — in credit card arrangements, the applicant's choice is limited, he can either take or refuse the card.

However, the second theory is not entirely free from trouble. No Court has considered a case where both the merchant and the holder have been negligent, or where both the holder and the issuer have been without fault. Under the second theory in the case of dual negligence the issuer would bear the loss since he would be unable to prove reasonable care by himself or the merchant. In the other situation where no party has been negligent the contractual liability clause should be given full effect and the holder held liable.

(c) *Statutory Intervention*

Legislative action was first taken in 1962 by the New York State legislature when it passed s. 512 of the New York General Business Law which provides:

> A provision to impose liability on an obligor . . . for use of a credit card after its loss or theft is effective only if it is conspicuously written or printed in a size at least equal to eight point bold type . . . and then only until written notice of the loss or theft is given to the issuer.[47]

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47. N.B. in New Zealand under Part II 4 of the First Schedule of the Door to Door Sales Act 1967, notice of the right to cancel a credit agreement not entered into at the vendor's trade premises, must accompany every such agreement in capital letters at least one-eighth of an inch in height.

It is intended to protect the holder against the unknown assumption of liability of making ineffective the fine print "liability til notice" provision on many cards. In the *Texaco* case the Court stated[48] that by this enactment "the legislature acknowledged the validity of liability till notice clauses" and that they govern the position. But the fact that the legislature has validated these provisions does not also imply that the legislature has destroyed any defences which the holder may have arising out of acts in the credit sale. This finds support in the *Allied Stores* case where the Court, noting that the wording of the notice clause was in accord with the statute, did not draw any inference from it as to who bore the risk. It held that on this point the statute was ambiguous and thereby, at least in tripartite situations, modified the effectiveness of the statute that the *Texaco* decision gave it.

In 1967 Illinois introduced legislation[49] limiting the cardholder's liability under any scheme to $75. This statute was based on the experience of the American Express Co. which in 1965 limited their cardholder's liability to a maximum of $100.

A similar law was introduced at the federal level in 1971[50] providing that

(i) That the maximum for which a holder may be held responsible for unauthorised purchases by another person using the card is $50, but only if the holder has notice of this potential liability and only if he has been provided with a self-addressed free-stamped notice which can be returned to the issuer.

(ii) Notwithstanding the above, once the holder takes reasonable steps to give the issuer notice that a card has been lost or stolen no further charges can be made against the account. In other words the holder is discharged of liability when the first of these events occurs.

(iii) The issuer must provide on all new and old credit cards adequate notice of the cardholder's potential liability.

(iv) The card issuer must provide a method whereby the user of the card can be identified as the person authorised to use it, such as by signature, photograph, or fingerprint on the credit card or by electronic or mechanical confirmation.

(d) *Other Intervention*

In an attempt to spread their own risk holders resorted to insurance. Indeed some insurance companies wrote in as a standard part of a houseowner's policy, a clause covering credit card liability. This soon led to a few issuers in the late 1960's financing equivalent insurance for the holder through periodic charges paid by the holder.

48. 34 Misc. (2d) at 756; 229 N.Y.S. (2d) at 56.
49. Ill. Ann. Stat. Ch. 121 1/2 382 (Smith-Hurd Supp. 1967).
50. See. Pub. L. No. 91-508, Title V §132 and the Federal Trade Commission Regulations made pursuant to that Act. Banks and Banking, Truth in Lending, Federal Reserve Press Release, Jan. 20, 1971 226.13(a) — 226.13(h).

(e) *Conclusions*

It is clear the recent Federal Amendment considers the problem of unauthorised use from the standpoint of the holder, placing a major proportion of the burden on the issuer. Thus the conflict between the two theories referred to above is less significant. However, there may be instances where a holder, having had unauthorised purchases run up on his card, may wish to contest the issuer's demand for payment of the first $50. If the action gets to court and one or more of the parties has been negligent then a choice between the two theories again becomes relevant. But considering that the past practice of issuers, has been to avoid litigation for fear of bad publicity, it is highly unlikely that they will now resort to the judicial solution when the maximum which they would be seeking to recover is $50.[51] Surely the economic reality of such a situation would be that the issuer would threaten to withdraw the credit card or lower the holder's credit limit and by use of such procedures settle the account.

Although the purpose of dividing the risk is partly to induce each party to exercise reasonable care to prevent losses, some writers[52] doubt whether the risk allocation mechanism is realistic. Are there other ways of allocating the risk?

The recent American legislation in requiring the issuer to provide stricter identification procedures recognises that where there is loss it is largely caused by the issuer's business decision to use a certain form of card which contains little identification of the holder and which permits transfer of the card to relatives and friends. Moreover with the holder bearing the major portion of liability there was no incentive for the issuer to improve identification procedures. However now that the issuer carries the main burden of the loss[53] the incentive is there. Cards should be individualised and not transferable; realistic forms of identification could be imposed on the card, e.g. voice prints. Such innovations are technically possible and the cost factor could be overcome.

The logical outcome of this extreme view is that the issuer should voluntarily assume liability for all losses. The adherents to this view would attempt to justify it on the ground that the issuer can best minimize the loss and most effectively spread the cost, for it is the issuer who controls the plan.

However, it is the writer's opinion that because the holder has

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51. The average unauthorised user incurs charges amounting to $150 when he uses a lost or stolen oil company card; the charges amounting to $300 when he uses one of the all-purpose credit cards — see "A Legal-Empirical Study of the Unauthorised Use of Credit Cards" — D. Murray (1967) 21 Uni. of Miami L. R. 811.
52. See e.g. "Credit Cards — Distributing Fraud Losses" (1968) 77 Yale L.J. 1418.
53. Murray, supra, estimates that approximately $20 million is lost in the United States through the illegal use of credit cards.

little or no bargaining power, legislative intervention imposing a liability limit of $50 produces a very satisfactory result and is as far as the law should go. The issuer as prime-mover and controller of the plan bears the vast burden of the risk but the holder, because he has control of the card, bears only the initial risk. The possibility of a $50 liability is sufficient to promote care on the part of the holder when using the card. Therefore this apportionment is fair for the plan benefits all parties.

(f) *How Should New Zealand Resolve the Problem?*

In New Zealand the introduction of the tripartite credit card plan is recent and therefore operates only on a small scale.[3] However, the issuers are run by subsidiaries of the large American credit card companies which have the knowledge and experience of several years' operation elsewhere. Consequently all tripartite credit card plans established or likely to be established in New Zealand will provide for risk allocation by inclusion of "liability til notice" clauses. How would such a clause be construed if an unauthorised use dispute came before a New Zealand Court?

A comparison with the English decisions on unauthorised use of open letters of credit may be the starting point for our courts. Here the cases[54] indicate that if a draft drawn under a letter of credit is forged by a thief of the letter, the issuing banker is entitled to refuse payment because his undertaking is to pay a valid draft. However, if the issuing banker pays a forged draft he cannot claim reimbursement from the customer, for he has not acted in accordance with the terms of his mandate. Therefore the issuing banker or his correspondents bear the loss where there is unauthorised use of an open letter of credit.

Although these cases are old they nevertheless indicate that our courts in a contractual situation will tend to take a conceptual approach, and would under a credit card arrangement be inclined to hold the contractual provision decisive of liability — i.e., take the *Texaco Inc.* v. *Goldstein*[39] approach. The holder would therefore be obliged to pay for all unauthorised purchases made prior to notification of loss or theft of the card. Unfortunately our courts are not as bold as the American courts and probably would not be prepared to resort to the application of tortious principles as was done in the *Union Oil* line[22] of cases.

Thus because the courts may not be willing to give protection where American experience has shown it is needed,[55] other forms of intervention would be more satisfactory. Issuer financed cardholder insurance is a possibility. However, with the tripartite credit card plan still

54. The only reported decisions are: *Orr & Barber* v. *Union Bank of Scotland* (1854) 1 Macqueen 513 (H.L.); *British Linen Co.* v. *Caledonian Insurance Co.* (1861) 4 Macqueen 105 (H.L.)
55. See e.g. "My $10,000 Credit Card Binge" — Life Oct. 26, 1959 p. 53, where the escapade of a 19-year-old boy is told. He purchased almost $10,000 worth of goods and services on a stolen all-purpose credit card.

developing in New Zealand, there is likely to be considerable competition amongst credit card companies and they will not want to discourage potential members by imposing high membership fees. It is therefore submitted that while credit card problems are few and while we are in a position to gain from the American experience, legislation should be passed in New Zealand similar to the recent American legislation placing a restriction on the cardholder's maximum liability.

VI ECONOMIC AND FISCAL CONTROLS OF THE CREDIT CARD

In New Zealand the principal controls would be the Moneylenders Act 1908 and the Hire Purchase and Credit Sales Stabilization Regulations 1957.[56]

(a) *The Moneylenders Act 1908*

Under this Act there are two considerations:

(i) is the transaction a "loan"?

(ii) is the creditor a "moneylender"?

In dealings between the issuer and the merchant, the merchant sends all the drafts of sales made to the holder to the issuer, who buys them at a discount. Although there is an element of credit involved it is more akin to a trade discount. And since it is clear from the decision of *Chow Yong Hong* v. *Chung Fah Rubber Manufacturing*[57] that the buying of bills at a discount does not constitute a loan of money to the vendor of the bills, the merchant-issuer relationship does not fall within the scope of the Moneylenders Act.

However do the dealings between the holder and the issuer amount to a lending transaction? The Courts have on several occasions held that cash order trading amounts to the lending of money.[58] For example in *Golberg* v. *Tait*[59] Stanton J. held that notwithstanding that the money could only be used for a particular and agreed purpose, or that none of the money reached the hands of the borrower himself, there was nevertheless a loan because the cash order trader agrees to lend his customer a definite sum of money and the customer agrees to "repay" this amount plus interest. Under similar circumstances in the credit card transaction the holder obtains short term credit[60] and

56. There may be other controls. For example it is possible that the Reserve Bank Overdraft Regulations may prevent banks from issuing credit cards. However, this question is not discussed here.
57. [1962] A.C. 209.
58. *Goldberg* v. *Tait* [1950] N.Z.L.R. 976; *Allchurch* v. *Popular Cash Order Co. Ltd.* [1929] S.A.S.R. 212; *Cash Order Purchases Ltd.* v. *Brady* [1952] N.Z.L.R. 898.
59. [1950] N.Z.L.R. 976, 989.
60. It is believed that most people carry credit cards because they want to avoid carrying large amounts of cash, rather than because they desire to purchase goods on time payment plan.

the issuer is repaid with interest. It is therefore submitted that in dealings between the holder and the issuer there is a lending transaction.[61] But is the issuer a 'moneylender'?

Section 2 of the Act provides:

"Moneylender" includes every person whose business is that of moneylending but does not include:

(d) Any person bona fide carrying on . . . any business in the course of which and for the purpose whereof he lends money at a rate of interest (including any payment or deduction by way of premium, fine or foregift) not exceeding ten per annum.

In *Premor Ltd.* v. *Shaw Bros.*[62] it was held in respect of paragraph (d) that for the loan to be "in the course of" the lender's principal business it must be associated with a transaction of that business; and, to be "for the purposes of" the principal business, it must have been done with the object of promoting that business.

We must therefore distinguish between two situations. One where the issuer's sole business is to engage in credit card transactions (e.g. the all-purpose cards of the Diners' Club) and the other where the issuer engages in credit card transactions in order to promote and stimulate the sales of his main business (e.g. the cards of an Oil Company valid at its retail outlets). In the former it is submitted the issuer is a "lender" whether or not interest, service charges and annual fees amount to more than 10%. However, in the latter the issuer is only a "lender" if such charges amount to more than 10% per annum.[63] But if the issuer's credit card transactions have developed to such an extent as to amount to an operation independent of his principal business,[64] then he is a "lender" irrespective of the rate of interest he charges.

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61. Indeed the Uniform Commercial Credit Code in the United States considers the tripartite credit card transaction to be a loan.
    Section 3. 106 provides:
    Loan includes . . .
    (3) the creation of debt, pursuant to a lender credit card or similar arrangement.
62. [1964] 2 All E.R. 583.
63. If the American practice is followed whereby the holder is permitted to settle his account by paying a 10%-20% deposit and paying the remaining amount in instalments subject to a 1½% charge on the outstanding balance of each month, then it is certain that the 10% per annum limit, representing the true rate of interest, will be exceeded.
64. For example the oil companies in America primarily operate credit card plans for the purpose of promoting the sales in the particular transactions of their dealers and independent contractors, so that their credit card businesses are operations independent of their principal businesses. Similarly because in New Zealand under the Motor Spirits Distribution Act 1953 it is illegal for oil companies to own retail outlets, any credit card plan operated by them would amount to an independent business. Therefore it is submitted they would not fall within the scope of s. 2(d) of the Moneylenders Act, and would in respect of their credit card business be money lenders.

(b) *The Hire Purchase and Credit Sales Stabilization Regulations 1957*

To be within the scope of these regulations the transaction between the parties would have to be either a "loan" or a "credit sale".

(i) *Loan:*

Regulation 2 defines loan as including:

Any advance or discount, or any money paid for or on account of or on behalf of, or at the request of any person.

However under reg. 6(1) "Loans" are subject to the regulations only if (amongst other things):

(b) made on the security of goods which have been or are to be purchased by the borrower.

The arrangement between the merchant and the issuer, although not a moneylending transaction under the Moneylenders Act, falls within the definition of "loan" in reg. 2 since the issuer discounts sales drafts endorsed to him by the merchant, but reg. 6(1)(b) is not satisfied because the discounting is not arranged on the security of any goods but rather on the basis of the holder's contractual obligation to reimburse the issuer.

The dealings between the holder and the issuer are also within reg. 2 since the issuer advances money to the merchant on behalf of the holder. But here also the issuer does not pay the merchant on behalf of the holder on security of the goods, but rather on the holder's contractual obligation to reimburse him.

Therefore neither the holder-issuer, nor the merchant-issuer relationship comes within the scope of "loans".

(ii) *Credit Sales:*

Regulation 2 defines a credit sale as "an agreement for the sale of goods under which the whole or part of the purchase price is payable by instalments other than such an agreement that provides for the instalments to be spread over a period of less than nine months."

The regulation clearly does not apply between merchant and issuer for there is no agreement between them in relation to the sale of goods. Theirs is merely a discounting agreement. Nor does the regulation apply prima facie between the holder and the issuer for they do not enter into an agreement for the sale of goods. The agreement for the sale of goods is between the holder and the merchant but even this is not a credit agreement and no obligations are created between the holder and the merchant. However, if the assignment teheory[65] is prefered to the direct obligation theory then it might be possible to argue that there is credit sale agreement between the holder and the issuer arising from the assignment of rights by the merchant to the issuer. Even granting this

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65. See Part III (c) above.

unlikely possibility, the regulations will only apply if the payments are agreed to be spread over a period of more than nine months.[66]

(c) *Conclusions*

While the tripartite credit card transaction may come within the scope of the Moneylenders Act it is not covered by the Regulations except in the highly unlikely possibility mentioned immediately above. It is therefore submitted that a more positive form of economic control is necessary. The Regulations are anti-inflationary devices designed to control the amount of credit available in the country. Credit cards are certainly a means of extending credit. Although the tripartite plan is only just being introduced, it is likely to become widespread, therefore now is the time to extend the regulations to include tripartite credit card plans.

VII CONCLUSIONS

Some authorities believe that the American credit card society is a transitional state away from the cash and cheque society into a chequeless society.

What is envisaged ultimately is a major technological change in the payments mechanism. The system will hinge around a single national identification card used in conjunction with computers. Your salary would be paid to the computer and credited to your account. Your rent, mortgage or purchase payments etc. would be paid out by the computer and debited against your account. A similar payments procedure, the Giro system is already operating to a limited extent in some European countries.

But there are dangers in such a society. Its advent must be accompanied by safeguards to protect privacy and to prevent abuse of the credit and other information collected and of the massive economic power held by those in control.

L. M. P. FIRN

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66. It should be noted that the regulations would cover a bipartite credit card arrangement, where the holder is permitted to pay for the goods by instalments over a period of nine months or longer.